Mezzanine Funding

2015

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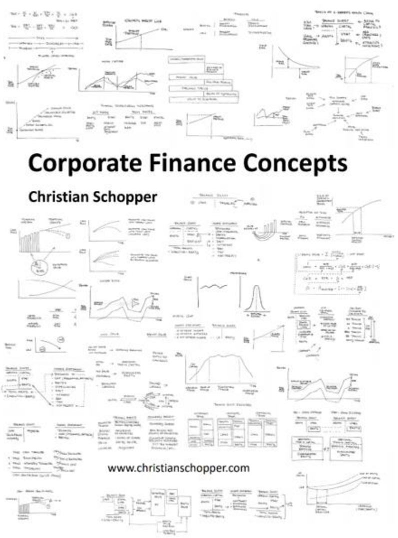

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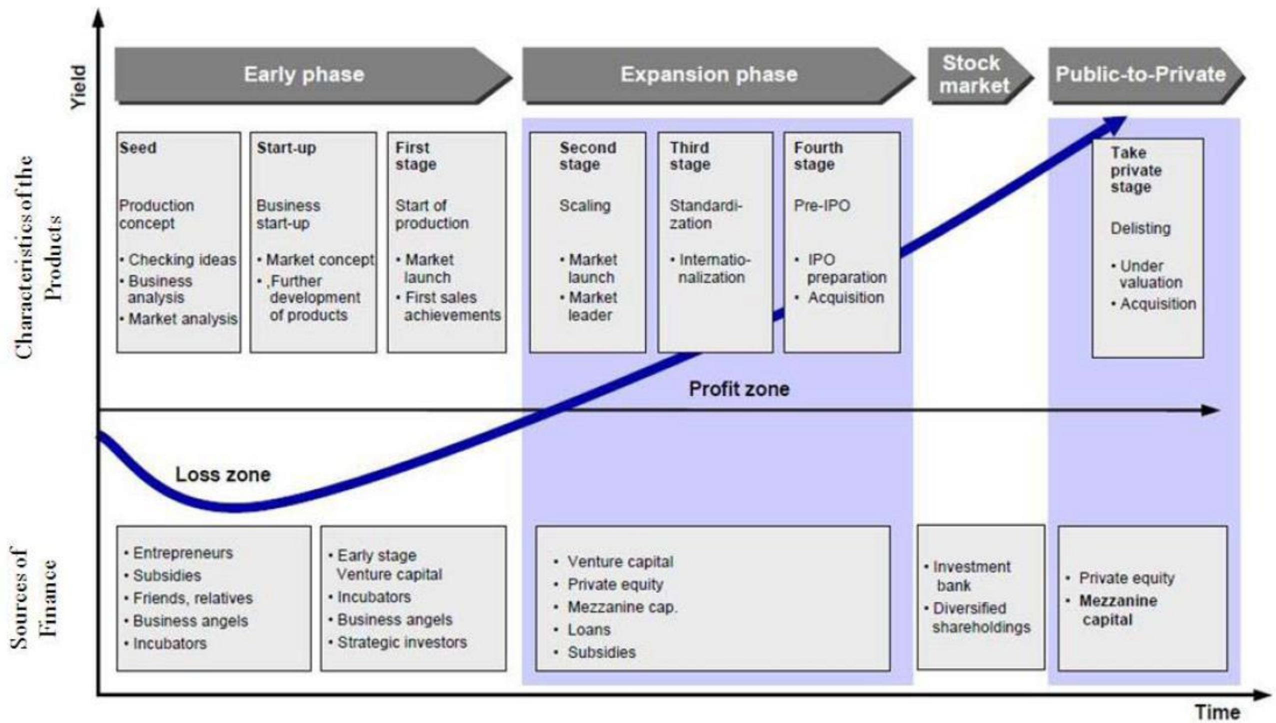
Financing Tools and the Life Cycle of the Firm



Alternative Financing Techniques

Low Risk/ Return	Low Risk/ Return	Medium Risk/ Return	High Low Risk/ Return
Asset-Based Finance	**Alternative Debt**	**"Hybrid" Instruments**	**Equity Instruments**
• Factoring • Leasing • Purchase Order Finance • Warehouse Receipts	• Corporate Bonds • Securitised Debt	• Subordinated Loans/Bonds • Silent Participations • Participating Loans • Profit Participation Rights • Convertible Bonds • Bonds with Warrants • Mezzanine Finance	• Private Equity • Venture Capital • Business Angels • Specialised Platforms for Public Listing of SMEs • Equity Derivatives

Hybrid Instruments

A common feature of hybrid techniques and equity is that the investor accepts more risk and expects a higher return than with the other techniques

Some of the most commonly used hybrid instruments are:

- Subordinated debt (loans or bonds)
  - The lender agrees that senior or secured creditors will be fully paid before any interest or principal is paid
- Equity-related debt (convertible debt or bonds with warrants)
  - The investor receives (in addition to interest) a payment linked to the share price of the company in which the investment is made
  - The difference between a convertible bond and a bond with warrants is that, in the latter case, the warrants (subscription rights) are separate from the bond and can therefore be traded separately
- Profit or earnings participation mechanisms
  - The investor is compensated by a share of future earnings of the company, subject to the risk that earnings may not reach the required threshold

Private Instruments for Mezzanine Finance

- ***The private mezzanine instruments* are: subordinated loans, participating loans and "silent" participations**

- A mezzanine facility typically includes several financing instruments (tranches) of varying degrees of risk and return
  - The exact mix of instruments in a specific facility can be tailored to suit the risk/reward preferences of the issuer and the investors

- A simple mezzanine facility contains
  - One or more categories of subordinated debt and / or …
  - … a tranche in which the investor receives a "success fee," i.e. a share of the firm's earnings or profits and/or …
  - … an equity-related tranche in which an investor receives a payment whose value is contingent upon a rise in the value of the company, usually reflected in the company's share price, often called the "equity kicker"

Private Instruments for Mezzanine Finance (cont´d)

Subordinated debt (junior debt)

- Unsecured loans with lender's ranking behind that of providers of senior debt
- Payment under all conditions, subject only that senior debt holders must be paid in full before any payment is made to subordinated debt holders
- Principal is usually repaid in "bullet" form, i.e. at the end of the loan
- In some cases, payment in kind (PIK)
  - Both interest and principal are paid at the loan's maturity
  - Generally carries a higher interest rate than one where interest is paid throughout the course of the loan

Sales or turnover participation rights

- Payment based upon the performance of the company, in terms of revenue, turnover, or earnings
- Can also take the form of PIK
- Profit-sharing loan
  - Remuneration (interest) may vary
- Participating loan
  - "Capital repayment" may vary
- Additionally, fixed interest payments can be included in the contract
- On the other hand, participating loans do not share losses
  - In the event of bankruptcy, providers of participating loans share in the results of the liquidation in the same way as other loan creditors.

Private Instruments for Mezzanine Finance (cont´d)

Profit participation rights

- Equity investments that entitle the holder to rights over the company's assets …
  - e.g. participation in profits or in the surplus on liquidation, subscription for new stock
- … but not to the right to be consulted on business decisions
  - The owner of the profit participation right is not a shareholder of the company and is not entitled to ownership rights
  - This means that he has no voting right in the company's shareholders' meeting and no right to attend these meetings
- Profit participation rights are not defined by law and can therefore to a large extent be negotiated and designed to suit the parties
  - Can be designed to resemble borrowed capital by contractually agreeing on minimum interest payments which are independent of the company's profits
  - Profit participation rights can also resemble equity capital if they grant the right to participate in the company's profits and/or liquidation proceeds

Private Instruments for Mezzanine Finance (cont´d)

"Silent" participation

- Closer in legal form to an equity investment than subordinated or participating loans
- Equity stake in a company, but without assuming any liability to the company's creditors
- Affects only the company's internal affairs and is not apparent to outside observers
- Participation in profits or losses, involvement in the company's management, supervision and information rights can be structured flexibly
- Silent investor participates in losses
  - However, it is possible to remove this feature partially or completely

Equity "kickers"

- Compensated by receiving a payment that reflects the increased value of the company enabled by mezzanine finance
- The most common are warrants which give the holder the right to purchase a specific number of shares at a predetermined price
  - The value of the warrant is the difference between the price at which a share of the company can be purchased by exercising the warrant (the strike price) and the market price
  - In cases where no such basis for pricing the equity interest is available, the value of the equity warrant is determined using a valuation technique specified in the contract

Public Instruments for Mezzanine Finance

- Convertible bonds
- Option bonds
- Preferred stocks

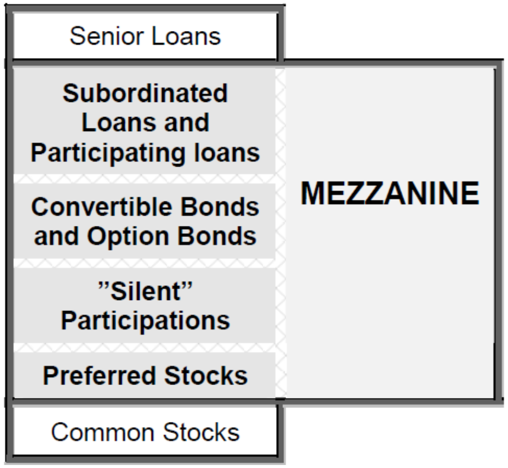
- Character of yield
  - Fixed income bonds
  - Floating rate bonds
  - Profit bonds
  - Bonds with a zero coupon
- Method of redemption
  - Single-payment bonds
  - Bonds payable in instalments
  - Convertible bonds
  - Callable bonds
- Guarantee
  - Guaranteed bonds
  - Debentures (unsecured)
- Country and currency
- Form
- Secondary tradability and other rights

Mezzanine Finance vs Other Financing Techniques

	Senior Debt
Typical structure	Revolving Debt
Investment Horizon	Short Term
Risk Tolerance	Low
Return Expectation	< 10 %
Current Coupon	Floating Rate
Hidden Costs	Personal Guarantees
Customization Ability	Rigid Standards
Seniority/Security	Senior Lien
Equity Dilution	None

	Private Equity
Typical structure	Preferred Stock
Investment Horizon	Long Term
Risk Tolerance	High
Return Expectation	35 %++
Current Coupon	n/a
Hidden Costs	Loss of Control
Customization Ability	Flexible Standards
Seniority/Security	Unsecured
Equity Dilution	High

	Mezzanine
Typical structure	Debt with Warrants
Investment Horizon	Long Term
Risk Tolerance	Medium
Return Expectation	18 – 25 %
Current Coupon	Fixed Rate
Hidden Costs	None
Customization Ability	Flexible Standards
Seniority/Security	Junior Lien
Equity Dilution	Low



Mezzanine Finance vs Other Financing Techniques (cont´d)

	Senior debt	Mezzanine	Equity
Economic perspective	Debt	Equity	Equity
Legal perspective	Debt	Debt	Equity
Ranking	Senior	Contractually subordinated	Junior
Taxation	Debt interest deductible	Debt interest deductible	Tax on capital
Covenants	Comprehensive restrictions	Tracks senior, but looser	None
Security	Yes -1st ranking	Yes -2nd ranking	No
Investor's involvement in management	No direct involvement	Moderate involvement; board seats	Direct involvement
Purpose	Contractually specified	Not specified	Not specified
Term	4-5 years	5-10 years	Open ended
Interest Costs	Cost of funds + 255-350 basis points	150-300 basis points above senior	None
Repayment	Amortizing from cash flow	Bullet* upon exit or at maturity	None
Warrants	None	Almost always	None
Total Expected Return	5-13%	13-25%	>25%

* The payment for the principal is not made over the life of the loan, but rather as a lump-sum payment at exit or maturity

Mezzanine Finance vs Other Financing Techniques (cont´d)

	Senior	Stretch	Mezzanine	Equity
Security	Secured	Partial	Subordinated	none
Ranking	Senior	First on Assets	Second	Third
Covenants	Tight	Tight	Flexible	none
Term	Demand	Term	Term/Patient	Patient
Coupon	Coupon-Floating	Coupon-Fixed	Coupon-Fixed	Dividend
Rate	Prime	Prime Adjusted	Risk Adjusted	Market Adjusted
Equity Kicker	none	Success Fee	Warrants	Shares
Prepayment Penalties	Yes	Yes	Fixed Period	No
Recovery (%)	High	Medium	Low	Low
Liquidity	High	Medium	Low	Right of Sale/ Shotgun

Moody´s: Guidance on Notching for Subordination

Guidance on Notching for Subordination

	Security Class	Number of Notches ("+" greater than; "-" less than)	Reference Rating
If Sr. Unsecured or Corporate Family Rating is Ba2 or higher	Secured Bonds	+1	Sr. Unsecured
	Sr. Unsecured	0	Sr. Unsecured
	Sr. Subordinated	-1	Sr. Unsecured
	Subordinated	-1	Sr. Unsecured
	Jr. Subordinated	-1	Sr. Unsecured
	Preferred stock	-2	Sr. Unsecured

	Security Class	Number of Notches ("+" greater than; "-" less than)	Reference Rating
If Sr. Unsecured or Corporate Family Rating is Ba3 or lower	Secured Bonds	+1	CFR or Sr. Unsecured
	Sr. Unsecured	0	CFR or Sr. Unsecured
	Sr. Subordinated	-2	CFR or Sr. Unsecured
	Subordinated	-2	CFR or Sr. Unsecured
	Jr. Subordinated	-2 or -3*	CFR or Sr. Unsecured
	Preferred stock	-3 or -4#	CFR or Sr. Unsecured

**Junior subordinated debt is rated 2 notches below senior unsecured (or the corporate family rating), unless a company has a substantial amount of senior subordinated or ordinary subordinated debt outstanding; then it is rated 3 notches below the senior implied rating.*
#Preferred is rated one notch below the lowest rating assigned to any type of subordinated debt.

Typical Mezzanine Covenants

Key negative covenants in mezzanine debt may include limitations on:

- Incurrence of debt (limit on indebtedness)
- Restricted payments
- Liens (security interest granted over an item of property)
- Change of control transactions
- Asset sales
- Affiliate transactions

Affirmative covenants may include those relating to:

- Financial reporting
- Maintenance of insurance

Types of Firms Suitable for Mezzanine Finance

Mezzanine finance can use firms with following characteristics

- Operationally and financially stable
- Sustainable and consistent business model
- Positive operating cash flow
- Strong management;
- Insufficient senior financing
- Insufficient collateral
- High leverage
- (Not a) Turnaround situation

- (Young) High-growth companies
- Established companies with emerging growth opportunities
- Companies undergoing transitions and restructuring
- Strengthening of capital structures
- Leveraged Buy-Outs (LBOs)

Excursion: Hybrid Capital for Financial Institutions

Hybrid instruments for banks usually include the following characteristics:

- they are *unsecured, deeply subordinated* and generally the most junior instrument in the issuer's capital structure (like preferred securities);
- they are *available to participate in losses* without the bank being obliged to cease trading (unlike conventional subordinated debt);
- they are *fully paid-up (unlike callable capital)*;
- they do not have any *voting rights and thus is non-dilutive to existing shareholders (unlike common shares)*;
- they are *perpetual* but may be called at the initiative of the issuer after a minimum period (say 5 years) with prior consent of the supervisory authority when replaced with same or better quality capital or when the capital position is not weakened as a result of such action
- although the capital instrument may carry an obligation to pay interest, *it could allow service obligations to be deferred (cumulative) or cancelled (noncumulative)* where the profitability of the bank would not support payment

Excursion: Hybrid Capital for Financial Institutions (cont´d)

The Basel Accord, or Basel I, sets criteria for measuring capital adequacy

- Tier 1 capital includes:
  - Common stock
  - Non-cumulative perpetual preferred stock
  - Disclosed reserves
  - Minority interests in the equity accounts of consolidated subsidiaries.
- Tier 2 capital includes:
  - Undisclosed reserves
  - Asset revaluation reserves
  - General provisions/loan loss reserves
  - **Hybrid (debt/equity) capital instruments** (like mandatory convertible debt and cumulative perpetual preferred stock)
  - Term subordinated debt
  - Intermediate term preferred stock

The Basel III framework emphasises …

- … that Tier 1 capital must help a bank remain a going concern
  - Must be subordinated to depositor and general creditor
    - including subordinated creditor claims
  - Cannot be secured or guaranteed
  - Must be perpetual with no incentives to redeem
  - Must have fully discretionary non-cumulative dividends
  - Must be capable of principal loss absorption (including a mandatory conversion to common shares or principal writedown at a pre-specified trigger point)
  - Cannot hinder recapitalisation
  - Instruments that do not qualify as Tier 1 may still constitute Tier 2 capital if
    - Having a minimum original maturity of at least five years with no incentive to redeem
    - Being callable only by the issuer after a minimum of five years with prior supervisory approval

Excursion: Hybrid Capital for Financial Institutions (cont´d)

Ratings considerations

- 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
- Historically, rating agencies viewed hybrids favourably, because hybrids were believed to have some of the loss-absorbing features associated with common equity securities
  - … whereby the analysis of the hybrid security is separate and distinct from the rating agency analysis of the issuer's overall credit rating
- In 2005, Moody's published its "Tool Kit" relating to its methodology for analysing hybrid securities featured a continuum of five baskets, from the A basket, which is 0% equity and 100% debt, to the E basket, which is 100% equity and 0% debt
- During the financial crisis, a revision was implemented considering the following:
  - Does the hybrid absorb losses for a "going concern"?
  - Does the hybrid absorb losses for a "gone concern"?
  - Is the loss absorbing hybrid there when needed?
- As a general matter, hybrids that absorb losses for a going concern are generally eligible for D basket classification, …
- … while hybrids that absorb losses for a gone concern, depending on maturity, are generally eligible for a C basket classification

Excursion: Contingent Capital for Financial Institutions

CONTINGENT CAPITAL SECURITIES: SOME EXAMPLES

	Citigroup T-DECSSM	Lloyds ECN	Rabobank SCN	Rabobank 8.375% perpetual non-cumulative capital securities	Rabobank 8.40% perpetual non-cumulative capital securities	Bank of Cyprus convertible enhanced capital securities	Credit Suisse Tier 1 buffer capital notes	Credit Suisse Tier 2 buffer capital notes	Synovus tMEDSSM
Structure	A prepaid stock purchase contract allowing the holder the right to purchase a certain number of shares of the company's common stock, deliverable in 3 years, plus a subordinated amortising note issued by company, with a scheduled final instalment paid in 3 years.	Enhanced capital notes.	Senior contingent notes.	Capital securities.	Capital securities.	Capital securities.	Tier 1 buffer capital notes.	Tier 2 buffer capital notes.	Tangible equity units, or tMEDS, each composed of a prepaid stock purchase contract and a junior subordinated amortising note due 15 May 2013 issued by Synovus, which has an initial principal amount of US$5.098197 per amortising note and a scheduled final instalment payment date of 15 May 2013.
Securities offered	Single offering of T-DECS units or option to create a T-DECS unit if the holder already possesses a separate purchase contract and a separate amortising note.	Enhanced capital notes (in exchange for existing securities, including capital securities, notes and preference shares).	Senior contingent notes.	Perpetual non-cumulative capital securities.	Perpetual non-cumulative capital securities.	Convertible enhanced capital securities.	Tier 1 buffer capital notes (issued by Credit Suisse Group AG for cash or in exchange for US$3.5 billion of 11% and CHF2.5 billion of 10% Tier 1 capital notes issued in 2008).	Tier 2 buffer capital notes issued by Credit Suisse Group (Guernsey) I Limited and irrevocably guaranteed on a subordinated basis by Credit Suisse Group AG.	Single offering of tMEDS units.
Offering format	Registered.	Bearer or registered.	Bearer or registered.	Bearer or registered.	Bearer or registered.	Registered.	Bearer or registered.	Bearer or registered.	Registered.
All-in coupon	Rate on amortising notes.	Fixed premium between 1.5% to 2.5% above the interest rate or dividend rate of the existing securities.	Fixed rate of 6.875%.	Initial rate of 8.375% up to (but excluding) the first reset date (26 July 2016); after this, reset every five years based on the US Treasury benchmark rate plus 6.425%.	Initial rate of 8.40% up to (but excluding) the first reset date (29 June 2017); after this reset every five years based on the US Treasury benchmark rate plus 7.49%.	Fixed rate of 6.50% for the first 10 interest payment periods (until 30 June 2016); after this reset every six months to 6 month LIBOR plus 3%.	Initial rate of US$ 9.5% or CHF 9.0%, as applicable, up to (but excluding) October 2013, which is the first call date of the Tier 1 capital notes; after this reset every five years.	Initial rate of US$ 7.875% up to (but excluding) August 2016; after this reset every five years based on the mid market US dollar swap rate LIBOR basis, having a five year maturity plus 5.22%.	Rate on junior subordinated amortising notes.
Future coupon adjustment exposure	N/A.	N/A.	N/A.	N/A.	N/A.	N/A.	N/A.	N/A.	N/A.
Term	3 years for purchase contract; 3 years for amortising note.	10, 12 or 15 years (depending on optional redemption terms of existing securities).	10 years.	Perpetual.	Perpetual.	Perpetual.	Perpetual.	30 years.	3 years for prepaid stock purchase contract; 3 years for junior subordinated amortising notes.

Excursion: Contingent Capital for Financial Institutions (cont´d)

CONTINGENT CAPITAL SECURITIES: SOME EXAMPLES

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Call/redemption	Purchase contracts may be settled early at the option of the holder prior to the mandatory settlement date at the minimum settlement rate, subject to adjustment, or at the fundamental change early settlement rate in connection with a "fundamental change" (a person or group becoming a beneficial owner of more than 50% of the company's common stock or a consolidation or merger or sale of all or substantially all of the company's assets). Purchase contracts also may be settled early at the company's option at the maximum settlement rate, unless the closing price of the common stock exceeds 130% of a threshold appreciation price for a certain period of time, in which case the minimum settlement rate is used. Amortising notes are redeemable at the option of the holder if the company elects to settle purchase contracts early.	Early redemption only at the issuer's option and only on a change in tax or regulatory treatment.	Automatic and permanent write-down of original principal amount to 25% of par and automatic redemption of write-down amount plus accrued and unpaid interest one business day after the second of two observation dates about 23 business days apart on which the equity capital ratio (equity capital divided by risk weighted assets of the Rabobank Group) falls below 7%; however, the occurrence of an event of default will temporarily delay the write-down. Issuer also has 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. No holder put.	Loss absorption is triggered if either: ▪ Equity capital ratio (equity capital divided by risk weighted assets) falls or remains below 8%. ▪ The issuer or the Dutch Central Bank believes that there has been such a significant reduction in the issuer's retained earnings or similar reserves causing a significant deterioration in the issuer's financial and regulatory solvency position that the equity capital ratio will fall below 8% in the near term. If loss absorption is triggered, the issuer will cancel any accrued but unpaid interest and write-down the prevailing principal amount of the capital securities. Issuer may redeem the capital securities, in whole but not in part, on or after 26 July 2016, but must redeem the capital securities on the first interest payment date on or after 26 January 2041 if certain conditions are met. Issuer may redeem the capital securities, in whole but not in part, before 26 July 2016 on the occurrence of a specified tax or capital event. No holder put.	Loss absorption is triggered in the same circumstances as those for Rabobank 8.375% perpetual non-cumulative capital securities. If loss absorption is triggered, the issuer will cancel any accrued but unpaid interest and write-down the prevailing principal amount of the capital securities. Issuer may redeem the capital securities, in whole but not in part, on or after 29 June 2017, but must redeem the capital securities on the first interest payment date on or after 29 December 2041 if certain conditions are met. Issuer may redeem the capital securities, in whole but not in part, before 29 June 2017 on the occurrence of a specified tax or capital event. No holder put.	Early redemption at the issuer's option, in whole but not in part, on or after 30 June 2016, subject to the prior approval of the Central Bank of Cyprus and provided that the convertible enhanced capital securities will be replaced by Tier 1 capital of equal or better quality.	Early redemption only at the issuer's option five years from the purchase or exchange (that is, no earlier than 2018) and in certain other circumstances with the approval of the Swiss Financial Market Supervisory Authority (FINMA).	Early redemption only at the issuer's option either: ▪ On the first optional redemption date or on any interest payment date after this, in whole or in part. ▪ On a change in tax or regulatory treatment or change in control, in whole, but not in part.	Prepaid stock purchase contracts may be settled early at the option of the holder before the mandatory settlement date at a specified settlement rate, subject to adjustment, or at the fundamental change early settlement rate in connection with a "fundamental change". Issuer does not have the option to settle early the prepaid stock purchase contracts. Amortising notes are not redeemable at the option of the holder.

Excursion: Contingent Capital for Financial Institutions (cont´d)

CONTINGENT CAPITAL SECURITIES: SOME EXAMPLES

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Status/ subordination	Amortising notes are subordinate and junior to all senior indebtedness and pari passu with all junior subordinated indebtedness.	Direct, unsecured and subordinated obligations and rank at least pari passu with all other subordinated obligations, junior to all unsubordinated obligations and senior to all undated/ perpetual obligations and all share capital.	Unsecured and senior to all subordinated capital of the issuer, but rank junior to all unsubordinated obligations.	With respect to payment obligations, the capital securities and coupons constitute direct, unsecured and subordinated obligations and rank pari passu and without any preference among themselves. With respect to payment obligations in the event of a bankruptcy, moratorium or dissolution of the issuer, the capital securities and coupons are: ▪ Subordinate and junior to indebtedness of the issuer. ▪ Pari passu with the issuer's obligations under the guarantees and contingent guarantees in relation to certain non-cumulative guaranteed trust preferred securities and related preferred securities and the most senior ranking preferred equity securities or preferred or preference shares of the issuer. ▪ Senior to the issuer's obligations under the certain depositary receipt certificates and any other instruments ranking pari passu with the depositary receipt certificates and any other instruments ranking pari passu with these.	Payment obligations are the same as those for Rabobank 8.375% perpetual non-cumulative capital securities.	Direct, unsecured and subordinated securities of the issuer and rank pari passu without any preference among themselves. Rights and claims of holders of convertible enhanced capital securities: ▪ Are subordinated to the claims of creditors of the issuer who are: ▫ depositors or other unsubordinated creditors of the issuer; ▫ subordinated creditors, except those creditors whose claims rank or are expressed to rank pari passu with the claims of holders of convertible enhanced capital securities; and ▫ holders of subordinated bonds of the issuer. ▪ Rank pari passu with the rights and claims of holders of other junior capital subordinated issues qualifying as Tier 1 capital including but not limited to issues of capital securities and convertible capital securities. ▪ Have priority over the ordinary shareholders of the issuer.	Direct, unsecured and subordinated obligations of the issuer and rank pari passu and without any preference among themselves.	Direct, unsecured and subordinated obligations of the issuer and rank pari passu and without any preference among themselves.	The amortising notes are junior subordinated obligations. They rank junior both in liquidation and right of payment to all senior indebtedness, and rank equally with all unsecured and junior subordinated indebtedness, other than junior subordinated indebtedness that is designated as junior to the amortising notes.
Optional deferral of payments	Yes, but no later than maturity date. Settlement of purchase contracts not deferrable.	No.	No.	Interest payments are at the issuer's discretion (not cumulative).	Interest payments are at the issuer's discretion (not cumulative).	Interest payments are at the issuer's discretion (not cumulative), but mandatory cancellation of payments on breach of applicable minimum solvency requirements or insufficient distributable items; if interest payments are cancelled, then no dividend payment or any other payment (redemption or purchase) will be made on ordinary share capital or other discretionary Tier 1 securities of the issuer, unless or until interest payments resume, subject to certain exceptions.	Interest payments are at the issuer's discretion (not cumulative).	No.	Yes, but no later than two years after the maturity date. Settlement of prepaid stock purchase contracts not deferrable.
Retirement of trust preferred	N/A.	N/A.	N/A.	N/A.	N/A.	N/A.	N/A.	N/A.	N/A.
Dividend payment	N/A.	Yes, if converted into ordinary shares and dividend declared.	N/A.	N/A.	N/A.	Yes, if converted into ordinary shares and dividend declared.	Yes, if converted into ordinary shares and dividend declared.	Yes, if converted into ordinary shares and dividend declared.	N/A.
Mandatory dividend deferral	N/A.	No.	N/A.	N/A.	N/A.	No.	No.	No.	N/A.

Excursion: Contingent Capital for Financial Institutions (cont´d)

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Conversion rights	None of the component securities are convertible.	Automatically converted into ordinary shares if core Tier 1 ratio falls below 5%.	Not convertible.	Not convertible. However, on the occurrence of a capital event or Basel III capital event (that is, the Dutch Central Bank notifies the issuer in writing that the capital securities may no longer be treated as Tier 1 capital due to non-compliance with Dutch solvency rules as amended to implement Basel III), the issuer may substitute or vary the terms of the capital securities so that they remain regulatory compliant securities.	Not convertible. however, upon the occurrence of a capital event or Basel III capital event, the issuer may substitute or vary the terms of the capital securities so that they remain regulatory compliant securities.	Automatically converted into ordinary shares on a "contingency event" or a "viability event". A contingency event occurs if the issuer gives notice that either: ▪ Before the Basel III adoption date, its core Tier 1 ratio is below 5% or, on or after the Basel III adoption date, its common equity Tier 1 ratio is below the minimum threshold as it will be determined. ▪ On or after the Basel III adoption date, the Central Bank of Cyprus determines that the issuer is in non-compliance with any required regulatory capital adequacy ratio thresholds specified in the applicable banking regulations. A viability event occurs if: ▪ The Central Bank of Cyprus determines that the conversion of Convertible Enhanced Capital Securities (together with other non-viability instruments that pursuant to their terms or by other operation of law, are capable of being converted into equity) is required to improve the capital adequacy and financial position of the issuer to prevent insolvency; or ▪ The Central Bank of Cyprus determines that the issuer requires extraordinary public sector support to prevent it from becoming insolvent, bankrupt or unable to pay a material amount of its debts; or. ▪ Other similar circumstances occur. Convertible at the option of the holder if a public offer for the issuer's shares or any other change of control event occurs on any date from the issue date of convertible enhanced capital securities for a period of 60 calendar days at a certain specified change of control conversion price.	Automatically converted into ordinary shares if either: ▪ Credit Suisse's reported Basel III common equity Tier 1 ratio falls below 7%. ▪ FINMA determines that Credit Suisse requires public sector support to prevent it from becoming insolvent, bankrupt or unable to pay a material amount of its debts, or other similar circumstances.	Automatically converted into ordinary shares if either: ▪ Credit Suisse's reported Basel III common equity Tier 1 ratio falls below 7%. ▪ FINMA determines that Credit Suisse requires public sector support to prevent it from becoming insolvent, bankrupt or unable to pay a material amount of its debts, or other similar circumstances. In addition, on the occurrence of a capital event or a tax event, the issuer may substitute or vary the terms of the Tier 2 buffer capital notes so that they remain regulatory compliant securities.	None of the component securities are convertible.
Preemptive rights	No.	No.	No.	No.	No.	No.	No.	No.	No.
Dividend stopper	N/A.	No.	No.	No.	No.	No.	No.	No.	N/A.

CorpFinCE
Corporate Finance Central Europe

Excursion: Contingent Capital for Financial Institutions (cont´d)

CONTINGENT CAPITAL SECURITIES: SOME EXAMPLES

	Citigroup T-DECSSM	Lloyds ECN	Rabobank SCN	Rabobank 8.375% perpetual non-cumulative capital securities	Rabobank 8.40% perpetual non-cumulative capital securities	Bank of Cyprus convertible enhanced capital securities	Credit Suisse Tier 1 buffer capital notes	Credit Suisse Tier 2 buffer capital notes	Synovus tMEDSSM
Voting rights	Yes, for underlying common stock.	Prior to conversion, only at meetings of enhanced capital note holders; on conversion, voting rights for ordinary shares.	No.	No.	No.	Voting rights for ordinary shares only on conversion.	Voting rights for ordinary shares only on conversion.	Voting rights for ordinary shares only on conversion.	Yes, for underlying common stock.
Board rights	No.	No.	No.	No.	No.	No.	No.	No.	No.
Mandatory stock sale	Yes, at 3 year mark (purchase contract settlement).	No.	No.	No.	No.	No.	No.	No.	Yes, at 3 year mark (prepaid stock purchase contract settlement date).
Amount of stock issued	Number of shares of common stock to be purchased under the terms of the purchase contract (at a settlement rate, subject to adjustment, dependent on the applicable market value of the common stock).	Amount of enhanced capital notes divided by the applicable conversion price.	N/A.	N/A.	N/A.	Amount of convertible enhanced capital securities divided by the applicable conversion price.	Amount of Tier 1 buffer capital notes divided by the applicable conversion price.	Amount of Tier 2 buffer capital notes divided by the applicable conversion price.	Number of shares of common stock to be purchased under the terms of the prepaid stock purchase contract (at a settlement rate, subject to adjustment, dependent on the applicable market value of the common stock).
Early exercise by holder	Holder may elect to settle purchase contract early, in whole or in part.	N/A.	N/A.	N/A.	N/A.	N/A.	N/A.	N/A.	Holder may elect to settle the prepaid stock purchase contract early, in whole or in part.
Optional acceleration of put/forward	No.	N/A.	N/A.	N/A.	N/A.	N/A.	N/A.	N/A.	No.
Automatic acceleration of put/forward	No.	N/A.	N/A.	N/A.	N/A.	N/A.	N/A.	N/A.	No.
Fed capital treatment in US*	Tier 1, up to 25%.	Tier 2 hybrid debt for enhanced capital notes; core Tier 1 capital for ordinary shares.	Tier 2 hybrid debt for senior contingent notes.	Tier 1, up to 25%.	Tier 1, up to 25%.	Tier 1, up to 25%.	Tier 1, up to 25%.	Tier 2 hybrid debt for Tier 2 buffer capital notes; core Tier 1 capital for ordinary shares.	Tier 1, up to 25%.
EU capital treatment	See below**.	Lower Tier 2 regulatory capital; core Tier 1 capital if converted into ordinary shares.	Not used by the issuer as regulatory capital.	See below**.	See below**.	See below**.	See below**.	See below**.	See below**.

Excursion: Contingent Capital for Financial Institutions (cont´d)

CONTINGENT CAPITAL SECURITIES: SOME EXAMPLES

	Citigroup T-DECSSM	Lloyds ECN	Rabobank SCN	Rabobank 8.375% perpetual non-cumulative capital securities	Rabobank 8.40% perpetual non-cumulative capital securities	Bank of Cyprus convertible enhanced capital securities	Credit Suisse Tier 1 buffer capital notes	Credit Suisse Tier 2 buffer capital notes	Synovus tMEDSSM
Replacement capital covenant/ negative pledge	No.	No.	No. However, there is a negative pledge that so long as any senior contingent notes remain outstanding, the issuer undertakes not to secure any of its other indebtedness, whether present or future, which is both: ▪ Represented by bonds, notes or other securities which have an initial maturity exceeding 2 years and which are for the time being, or are intended to be, quoted, listed, ordinarily dealt in or traded on any stock exchange or over-the-counter or other similar securities market. ▪ Not domestic indebtedness (indebtedness of the issuer which is denominated or payable (at the option of any party) in Euro unless 50% or more of this in aggregate principal amount is initially offered or sold outside The Netherlands).	No.	No.	No.	No.	No.	No.
Tax treatment (issuer)	T-DECS treated as units consisting of two separate financial instruments: an amortising note (treated as a debt instrument bearing original issued discount (OID) for US tax purposes) and a purchase contract (treated as a prepaid forward contract on common stock for US tax purposes). OID on an amortising note is tax-deductible. No gain or loss on settlement of a purchase contract. No deduction for dividends on underlying common stock.	UK: treated as convertible debt for UK tax purposes. US: under current law, enhanced capital notes would be treated as convertible equity and payment on enhanced capital notes likely would be treated as dividends for US tax purposes.	The Netherlands: treated as debt for Dutch tax purposes; interest on senior contingent notes is tax deductible. US: unclear if and/or what portion is treated as debt or equity or another instrument for US tax purposes.	The Netherlands: treated as debt for Dutch tax purposes; interest on capital securities is tax deductible. US: under current law, the capital securities likely would be treated as equity and payment on the capital securities likely would be treated as dividends for US tax purposes.	The Netherlands: treated as debt for Dutch tax purposes; interest on capital securities is tax deductible. US: under current law, the capital securities likely would be treated as equity and payment on the capital securities likely would be treated as dividends for US tax purposes.	Cyprus: to be determined. US: under current law, convertible enhanced capital securities would be treated as convertible equity and payment on convertible enhanced capital securities likely would be treated as dividends for US tax purposes.	Switzerland: to be determined. US: under current law, Tier 1 buffer capital notes would be treated as convertible equity and payment on Tier 1 buffer capital notes likely would be treated as dividends for US tax purposes.	Switzerland: to be determined. US: unclear if and/or what portion is treated as debt or equity or another instrument for US tax purposes.	tMEDS treated as units consisting of two separate financial instruments: a junior subordinated amortising note (treated as a debt instrument bearing OID for US tax purposes); and a prepaid stock purchase contract (treated as a prepaid forward contract on common stock for US tax purposes). OID on a junior subordinated amortising note is tax-deductible. No gain or loss on settlement of a prepaid stock purchase contract. No deduction for dividends on underlying common stock.

Excursion: Contingent Capital for Financial Institutions (cont´d)

CONTINGENT CAPITAL SECURITIES: SOME EXAMPLES

	Citigroup T-DECSSM	Lloyds ECN	Rabobank SCN	Rabobank 8.375% perpetual non-cumulative capital securities	Rabobank 8.40% perpetual non-cumulative capital securities	Bank of Cyprus convertible enhanced capital securities	Credit Suisse Tier 1 buffer capital notes	Credit Suisse Tier 2 buffer capital notes	Synovus tMEDSSM
Tax treatment (holders)	Generally no withholding tax on payments made in respect of an amortising note. No gain or loss on settlement of a purchase contract. 30% withholding tax on dividends on underlying common stock; reduced rate if tax treaty applies; sovereigns may benefit from statutory exemption.	UK: both issuers (LBG Capital No 1 plc and LBG Capital No 2 plc) are incorporated in England; no UK withholding tax on interest payments on enhanced capital notes while listed on a recognised stock exchange; some enhanced capital notes may be deemed “deeply discounted securities” the disposal of which (including transfer, redemption or conversion) could be taxed as income. US: if US issuer then: ▪ 30% withholding tax on payments on enhanced capital notes. ▪ Reduced rate if tax treaty applies. ▪ Sovereigns may benefit from statutory exemption. Payments to US corporates generally eligible for the dividends received deduction (DRD); payments to US individuals generally eligible as qualified dividend income (QDI). No gain or loss on conversion. If foreign issuer: ▪ No US withholding tax on payments. ▪ Payments to US corporates not eligible for the DRD. ▪ Payments to US individuals generally eligible as QDI if issuer is a qualified issuer. ▪ No gain or loss on conversion.	The Netherlands: generally no withholding tax on interest. US: unclear if and/or what portion is treated as debt or equity or another instrument for US tax purposes.	The Netherlands: generally no withholding tax on interest. US: if US issuer: ▪ 30% withholding tax on payments on the capital securities; reduced rate if tax treaty applies; sovereigns may benefit from statutory exemption. ▪ Payments to US corporates generally eligible for the DRD; payments to US individuals generally eligible as QDI. If foreign issuer: ▪ No US withholding tax on payments. ▪ Payments to US corporates not eligible for the DRD; payments to US individuals generally eligible as QDI if issuer is a qualified issuer.	Same as for Rabobank 8.375% perpetual non-cumulative capital securities.	Cyprus: generally no withholding tax on interest. US: if US issuer: ▪ 30% withholding tax on payments on convertible enhanced capital securities; reduced rate if tax treaty applies; sovereigns may benefit from statutory exemption. ▪ Payments to US corporates generally eligible for the DRD; payments to US individuals generally eligible as QDI. No gain or loss on conversion. If foreign issuer: ▪ No US withholding tax on payments. ▪ Payments to US corporates not eligible for the DRD; payments to US individuals generally eligible as QDI if issuer is a qualified issuer.	Switzerland: generally no withholding tax on interest. US: if US issuer: ▪ 30% withholding tax on payments on Tier 1 buffer capital notes; reduced rate if tax treaty applies; sovereigns may benefit from statutory exemption. ▪ Payments to US corporates generally eligible for the DRD; payments to US individuals generally eligible as QDI. No gain or loss on conversion. If foreign issuer: ▪ No US withholding tax on payments. ▪ Payments to US corporates not eligible for the DRD; payments to US individuals generally eligible as QDI if issuer is a qualified issuer. ▪ No gain or loss on conversion.	Switzerland: generally no withholding tax on interest. US: unclear if and/or what portion is treated as debt or equity or another instrument for US tax purposes.	Generally no withholding tax on payments made in respect of a junior subordinated amortising note. No gain or loss on settlement of a prepaid stock purchase contract. 30% withholding tax on dividends on underlying common stock; reduced rate if tax treaty applies; sovereigns may benefit from statutory exemption.
Moody's treatment	Basket C or Basket D.	Ba2 if guaranteed by Lloyds TSB Bank; Ba3 if guaranteed by Lloyds Banking Group.	N/A.	N/A.	N/A.	N/A.	N/A.	N/A.	Basket C or Basket D.
S&P treatment	100% up to 33% of adjusted common equity (ACE).	BB if guaranteed by Lloyds TSB Bank; BB- if guaranteed by Lloyds Banking Group.	N/A.	N/A.	N/A.	N/A.	N/A.	N/A.	100% up to 33% of ACE.
Balance sheet	Equity as to purchase contract; debt as to amortising notes.	Debt as to enhanced capital notes; equity as to ordinary shares.	Debt.	Equity.	Equity.	Debt as to convertible enhanced capital securities; equity as to ordinary shares.	Debt as to Tier 1 buffer capital notes; equity as to ordinary shares.	Debt as to Tier 2 buffer capital notes; equity as to ordinary shares.	Equity as to prepaid stock purchase contract; debt as to junior subordinated amortising notes.

Excursion: Contingent Capital for Financial Institutions (cont´d)

CONTINGENT CAPITAL SECURITIES: SOME EXAMPLES

	Citigroup T-DECSSM	Lloyds ECN	Rabobank SCN	Rabobank 8.375% perpetual non-cumulative capital securities	Rabobank 8.40% perpetual non-cumulative capital securities	Bank of Cyprus convertible enhanced capital securities	Credit Suisse Tier 1 buffer capital notes	Credit Suisse Tier 2 buffer capital notes	Synovus tMEDSSM
Dilution	Yes.	Not unless/until converted.	No.	Yes.	Yes.	Not unless/until converted.	Not unless/until converted.	Not unless/until converted.	Yes.
Stock price effect	Difficult to assess.	Not discernable.	Not discernable.	Not discernable.	Not discernable.	Not discernable.	Not discernable.	Not discernable.	Difficult to assess.
Anti-dilution adjustments	Yes. Adjustments for increases in cash dividends; dividends or distributions in common stock or other property; issuance of stock pur-chase rights; certain self tenders; or subdivisions, splits or combinations.	Yes. Ajustments to conversion price for a consolidation, reclassification or subdivi-sion of the ordinary shares, capitalisation of profits, capital distributions or cash dividends, rights issues or grant of other subscription rights or other adjustment which affects the ordinary shares.	None.	None.	None.	Yes. Adjustments to conversion price for a consolidation, reclas-sification or subdivision of the ordinary shares, capitalisation of profits, capital distributions or cash dividends, rights issues or other adjustment which affects the ordinary shares.	Yes. Adjustments to conversion price for a consolidation, reclas-sification or subdivision of the ordinary shares, capitalisation of profits, capital distributions or cash dividends, rights issues or grant of other subscription rights or other adjustment which affects the ordinary shares.	Yes. Adjustments to conversion price for a consolidation, reclas-sification or subdivision of the ordinary shares, capitalisation of profits, capital distributions or cash dividends, rights issues or grant of other subscription rights or other adjustment which affects the ordinary shares.	Yes. Adjustments for increases in cash dividends; dividends or distributions in common stock or other property; issuance of stock purchase rights; certain self tenders; or subdivisions, splits or combinations.
Other covenants	Normal and customary market-driven.	Normal and customary market-driven.	Normal and customary market-driven.	Normal and customary market-driven.	Normal and customary market-driven.	Normal and customary market-driven.	Normal and customary market-driven.	Normal and customary market-driven.	Normal and customary market-driven.
Listing	Listed.	Listed.	Listed.	Listed.	Listed.	Listed.	Listed.	Listed.	Listed.
Investor profile	Institutional; Tier 1 buyers.	Institutional.	Institutional.	Institutional; Tier 1 buyers.	Institutional; Tier 1 buyers.	Institutional.	Institutional.	Institutional.	Institutional; Tier 1 buyers.
Potential stock price impact on announcement	Negative.	N/A.	N/A.	N/A.	N/A.	N/A.	N/A.	N/A.	Negative.
Established product	No.	No.	No.	No.	No.	No.	No.	No.	No.

Excursion: Contingent Capital for Financial Institutions (cont´d)

CONTINGENT CAPITAL SECURITIES: SOME EXAMPLES

	Citigroup T-DECSSM	Lloyds ECN	Rabobank SCN	Rabobank 8.375% perpetual non-cumulative capital securities	Rabobank 8.40% perpetual non-cumulative capital securities	Bank of Cyprus convertible enhanced capital securities	Credit Suisse Tier 1 buffer capital notes	Credit Suisse Tier 2 buffer capital notes	Synovus tMEDSSM
Advantages (summary)	▪ No near-term rollover risk/refinancing exposure about deterioration. ▪ Appeals to hybrid/Tier 1 investors. ▪ Inventors retain downside exposure. ▪ Payments partially tax deductible. ▪ Favourable rating agency equity treatment. ▪ Payment deferral. ▪ Provides same level of safety and soundness as a mandatory convert in stress scenario.	▪ Not dilutive. ▪ Little to no stock price impact. ▪ Appeals to hybrid investors.	▪ Not dilutive. ▪ Little to no stock price impact. ▪ Appeals to hybrid investors.	▪ Not dilutive. ▪ Little to no stock price impact. ▪ Appeals to hybrid/Tier 1 investors. ▪ Favourable rating agency equity treatment. ▪ Payment deferral.	▪ Not dilutive. ▪ Little to no stock price impact. ▪ Appeals to hybrid/ Tier 1 investors. ▪ Favourable rating agency equity treatment. ▪ Payment deferral.	▪ Not dilutive. ▪ Little to no stock price impact. ▪ Appeals to hybrid/Tier 1 investors. ▪ Favourable rating agency equity treatment. ▪ Payment deferral.	▪ Not dilutive. ▪ Little to no stock price impact. ▪ Appeals to hybrid/Tier 1 investors. ▪ Favourable rating agency equity treatment. ▪ Payment deferral.	▪ Not dilutive. ▪ Little to no stock price impact. ▪ Appeals to hybrid investors.	▪ No near-term rollover risk/ refinancing exposure about deterioration. ▪ Appeals to hybrid/ Tier 1 investors. ▪ Inventors retain downside exposure. ▪ Payments partially tax deductible. ▪ Favourable rating agency equity treatment. ▪ Payment deferral. ▪ Provides same level of safety and soundness as a mandatory convert in stress scenario.
Disadvantages (summary)	▪ Dilutive. ▪ Negative stock price impact. ▪ Less permanent than other alternatives.	▪ Possible dilution if core Tier 1 ratio falls below 5%. ▪ Only receives lower Tier 2 regulatory capital treatment. ▪ Unclear whether such an instrument issued after 12 September 2010 would qualify for Tier 2 treatment after Basel III comes into effect; if not, then such instruments issued on or before 12 September 2010 will be progressively "de-recognised" between 2013 and 2022. ▪ Negative perception in the market.	▪ Unclear whether such an instrument issued after 12 September 2010 would qualify for Tier 2 treatment after Basel III comes into effect; if not, then such instruments issued on or before 12 September 2010 will be progressively "de-recognised" between 2013 and 2022. ▪ Negative perception in the market. ▪ Less permanent than stock alternatives.	▪ Less permanent than stock alternatives. ▪ Limited Tier 1 capacity with Fed.	▪ Less permanent than stock alternatives. ▪ Limited Tier 1 capacity with Fed.	▪ Possible dilution if core Tier 1 ratio falls below 5%. ▪ Limited Tier 1 capacity with Fed.	▪ Possible dilution if core Tier 1 ratio falls below 7%. ▪ Limited Tier 1 capacity with Fed.	▪ Possible dilution if core Tier 1 ratio falls below 7%. ▪ Only receives lower Tier 2 regulatory capital treatment. ▪ Unclear whether such an instrument issued after 12 September 2010 would qualify for Tier 2 treatment after Basel III comes into effect; if not, then such instruments issued on or before 12 September 2010 will be progressively "de-recognised" between 2013 and 2022.	▪ Dilutive. ▪ Negative stock price impact. ▪ Less permanent than other alternatives.

Contact

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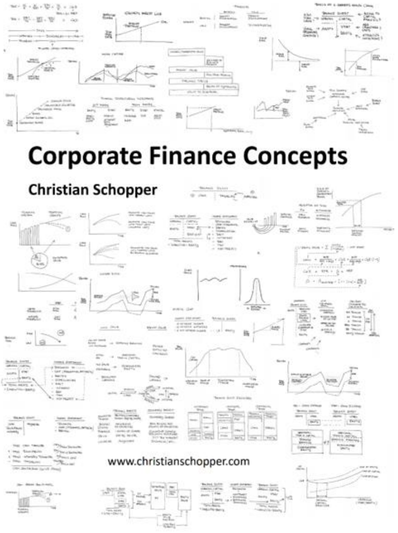

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