Financial Institutions Ratings
Bank Capital Instruments

Scope
Ratings

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Scope's ratings on bank capital securities

We are pleased to present our updated compendium of detailed individual analytical reports on specific bank capital securities (Additional Tier 1 and Tier 2). This publication includes new research on capital securities issued by Nordic banks in addition to updated reports on securities rated previously. Scope has rated over 60 securities issued by 15 European banks in nine countries over the last 10 months. Our coverage of bank capital securities continues to mirror the significant activity in the market.

As of end-May 2015, there were over 30 new issues of bank capital securities with explicit triggers compared to nearly 60 for all of 2014. Issues were primarily in USD (one-third) and EUR (one quarter) with the remainder in NOK, SEK, CHF and GBP. New issuers included Swiss cantonal, Dutch and Nordic banks.

Overview of rating methodology for bank capital securities

The ratings and analyses are based on Scope's rating methodology for bank capital instruments published in September 2014. Last month, Scope published an updated version of the bank capital securities methodology, with a call for comments. Both of these documents can be downloaded from www.scoperatings.com.

Scope considers the issuance of capital instruments by banks and the terms and conditions of these securities as being driven essentially by their role in strengthening capital positions, providing a viable private-sector alternative for recapitalisation. Consequently, both Additional Tier 1 (AT1) and Tier 2 (T2) securities are subject to principal loss absorption risks. In addition, AT1 securities are exposed to coupon cancellation risks.

Scope's approach to rating AT1 securities starts with the inherent principal loss absorption and coupon cancellation risks that investors face when investing in the securities. The minimum notching down from the Issuer Credit-Strength Rating (ICSR) is four notches, reflecting these securities' deeply subordinated status in the priority of claims as well as investors' exposure to inherent coupon cancellation risks.

When rating specific AT1 securities, there may be security-specific and/or issuer-specific factors that result in increased coupon cancellation and/or principal loss absorption risks, warranting further notching down beyond the minimum four notches. These factors include the trigger level, the distance to trigger and combined buffer requirement (CBR), the issuer's liability and capital structure, as well as specific regulatory requirements or guidelines.

For T2 securities, the rating approach acknowledges their more senior status in the priority of claims compared to AT1 securities and the absence of inherent coupon cancellation risks. However, T2 securities are considered capital instruments in a bail-in scenario and can also absorb losses in the case of early regulatory intervention – a risk which investors in regular subordinated and senior debt are not exposed to. Accordingly, when rating T2 securities, Scope assigns at least two notches down from the issuer's ICSR (per the updated rating methodology which is under call for comments). For the time being, we continue to rate Swiss banks' T2 securities at least one notch below the relevant ICSR as Swiss regulators are currently reviewing their capital framework with further details expected by end-2015.

Rating drivers

As shown in Table 1, the ratings for AT1 securities range from BB to BBB- while ratings for T2 securities range from BBB to A-. In instances where we have notched down more than the standard notching, this was because of relatively higher triggers (e.g. HSBC, Swedbank), the existence of multiple triggers (e.g. Santander), potential earnings volatility (e.g. Barclays, Deutsche) or a relatively narrow gap to capital requirements (e.g. DNB Bank, Nordea).

Table 1: Summary of rated AT1 and T2 bank securities

Issuer	Capital ranking	Trigger	Type of loss absorption	ICSR	Standard notching	Additional notching	Rating on capital instrument
KBC Group	AT1	5.125%	Temporary writedown	A-	4	0	BB+
KBC Bank	T2	7%	Permanent writedown	A-	2	0	BBB
Danske Bank	AT1	7% (both group and parent)	Temporary writedown	A-	4	1	BB
Credit Agricole	AT1	7% (CA Group) or 5.125% (CASA)	Temporary writedown	A	4	1	BB+
Credit Agricole	T2	7%	Permanent writedown	A	2	0	BBB+
Societe Generale	AT1	5.125%	Temporary writedown	A	4	0	BBB-
Deutsche	AT1	5.125%	Temporary writedown	A-	4	1	BB
DNB Bank	AT1	5.125% (Bank, Bank Group, Group)	Writedown	A+	4	1	BBB-
BBVA	AT1	5.125% (both group and parent)	Full conversion	A	4	1	BB+
Santander	AT1	5.125% (both group and parent)	Full conversion	A+	4	1	BBB-
Nordea	AT1	5.125% Bank, 8% Group	Temporary writedown	A+	4	1	BBB-
Swedbank	AT1	5.125% Bank, 8% Group	Full conversion	A-	4	1	BB
Credit Suisse AG	T2	5% (CET1+Higher Trigger)	Permanent writedown	A	1	0	A-
Credit Suisse GAG	AT1	7%	Full conversion	A	4	1	BB+
Credit Suisse GAG	AT1	5.125% (CET1+Higher Trigger)	Full conversion	A	4	0	BBB-
Credit Suisse GAG	T2	7%	Permanent writedown	A	1	2	BBB
UBS AG	T2	5% (CET1+Higher Trigger)	Permanent writedown	A	1	0	A-
UBS GAG	AT1	5.125% (CET1+Higher Trigger)	Permanent writedown	A	4	0	BBB-
UBS GAG	AT1	7% (CET1 + Higher Trigger)	Permanent writedown	A	4	0	BBB-
Barclays plc	AT1	7% fully-loaded	Full conversion	A	4	2	BB
Barclays Bank	T2	7.0%	Permanent writedown	A	2	0	BBB+
HSBC Holdings	AT1	7% fully-loaded	Full conversion	AA-	4	1	BBB
Lloyds Banking Group	AT1	7% fully-loaded	Full conversion	A	4	1	BB+

Source: Scope Ratings

Key takeaways from the AT1 rating analysis

1. Differences in structures

The differences in the structures of bank capital securities are often driven by regulatory preferences. For example, in the UK, banks have issued securities with relatively higher triggers (at 7%) and on a fully-loaded rather than transitional basis. The Prudential Regulatory Authority (PRA) has questioned whether lower triggers are adequate and the largest banks must already meet minimum CET1 targets of 7% on a fully-loaded basis. As another example, the two largest Swiss banks were amongst the earliest issuers of capital securities after FINMA required them to bolster their capital positions with contingent convertible securities. With Switzerland not subject to CRD IV, the AT1 securities issued by Swiss banks do not contain explicit CBRs or the explicit concept of a maximum distributable amount (MDA).

2. Gap to trigger levels generally comfortable and expected to remain so

For the rated securities (both AT1 and T2), the current gaps to triggers (between CET1 capital and trigger level) appear reassuring, ranging from over 3% to nearly 15%. The range is wide but there is a clustering around the 6% to 7% level. Looking ahead to 2019, we do not anticipate this overall assessment to change – although for some issuers the gap is expected to decline while for others it should increase as management capital targets are achieved.

3. Gap to CBRs are more difficult to assess

For the rated AT1 securities, the current range of gaps to CBRs (between CET1 capital and CBR) is also wide, ranging from less than 1% to nearly 12%. Excluding outliers, there is a clustering around the 4% to 5% level, a bit lower than the gap to trigger levels. For outliers, primarily Swiss and Nordic banks, this is often driven by the more stringent and specific requirements of national regulators in these countries.

Looking ahead to 2019, the gaps to CBRs are expected to be at more modest levels, potentially ranging from around 1% to 5%. We caution that these figures are based on current known capital requirements and publicly announced capital targets. Previously, a potential gap to CBR of around 1% was relatively uncommon, but now we note that this seems to be less the case.

We further highlight that there are issuers whose potential additional capital requirements relating to systemic and countercyclical buffers which comprise the CBR remain unknown. This is particularly relevant as distribution restrictions related to CBRs go into force in 2016. In light of the still subdued state of many economies within Europe, we would not expect significant countercyclical buffers in the near future. However, in stronger economies such as the Nordics and Hong Kong, countercyclical buffer rates have been set at 1% for Sweden and Norway and 2.5% in Hong Kong[1]. Over the next few months, we expect national regulators to provide further clarity on systemic requirements – especially for issuers who have not been classified by the FSB as being global systemically important banks. To date, only a few countries have decided on systemic risk buffers, including the Netherlands, Denmark, Norway and Sweden.

In addition to unknown systemic and countercyclical buffers comprising CBRs, there remains uncertainty about Pillar 2 requirements: how much they are, where they sit in the capital stack, and how a breach may impact the payment of AT1 coupons. For the relatively small number of banks that have publicly disclosed Pillar 2 requirements (primarily UK banks), these range from less than 1% to 6%. In other cases, disclosures about capital requirements from the ECB allow some estimation of Pillar 2 requirements.

We further note that irrespective of the gap to CBR, issuers must first have sufficient available distributable items to make coupon payments on AT1 securities. Over the last year, we have seen a significant improvement in the disclosure of this information.

Further regulatory clarity

As investors are aware, capital instruments (both AT1 and T2) may be written-down or converted when the issuer has reached the point of non-viability (PONV), and before any other resolution action is taken. One can conclude that capital instruments may be written down or converted when the issuer requires early regulatory intervention. As these determinations are subject to regulatory discretion, the EBA's recently published guidelines concerning triggers for the use of early intervention are informative. The guidelines apply from January 2016 and aim to promote consistent action by regulatory authorities.

Early intervention is normally expected to remedy an institution's deteriorating condition, precluding the need for more severe action – such as the removal of senior management, the write-down or conversion of capital instruments and resolution tools. Triggers for determining whether to apply early intervention measures are based on outcomes of the supervisory review and evaluation process (SREP), as well as significant events that indicate early intervention is required. These include major operational risk events such as rogue trading and significant fines; significant deterioration in the amount of eligible liabilities and own funds held for meeting the minimum requirements for owns funds and eligible liabilities (MREL); and the unexpected loss of senior management.

The EBA emphasises that there are no quantitative thresholds for determining when early intervention measures should be used. Further, the triggers do not oblige relevant authorities to apply early intervention measures automatically nor do the guidelines prevent relevant authorities from using early intervention if the triggers are not met.

[1] Relevant for European banks with credit exposures in these countries. The countercyclical buffer is institution-specific based on credit exposures.

Looking ahead

The universe of bank capital securities has developed sufficiently so that it offers investors a range of different risk profiles and returns. We expect further issuance as capital requirements – particularly MREL and TLAC – are finalised. There are still issuers who have not issued and others who have not reached the limit of 1.5% of RWAs. Meanwhile, we could see more T2 securities due to their lower cost.

We are also likely to see more standardisation in the terms and conditions of new issues. In May 2015, the EBA published a report based on its review of 15 AT1 securities issued between August 2013 and November 2014. The report focused on areas where the EBA believes it necessary to revise the wording of some existing clauses for future issues or where the EBA would recommend avoiding the use of some clauses (e.g. partial rather than full regulatory calls, contingent clauses, write-down or conversion linked to prior loss absorbing instruments). Furthermore, by year-end, the EBA aims to publish standard terms and conditions which banks can opt to use. To address concerns in instances where banks have issued with different trigger levels, or have issued both AT1 and T2 securities with triggers, the EBA urges issuers to provide further clarity about the potential interaction between securities.

Scope Ratings will continue assigning ratings to CRD IV compliant capital securities as they are issued by the financial institutions it rates. In addition, monitoring of existing ratings is ongoing. We reiterate our view that ratings on AT1 securities are more likely to be subject to change due to the dynamic nature of capital requirements and the mandatory restrictions placed on coupon payments when specific capital requirements are not met.

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Security Rating	
Outlook	Stable
8% USD 1bn contingent capital securities	BBB

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The ratings have not been solicited by the issuer; the analysis is based solely on public information.

Rating rationale

We assign a rating of BBB to KBC Bank's 8% USD 1bn contingent capital securities based on the following:

- Issuer Credit-Strength Rating (ICSR): A-, Stable outlook
- Minimum notch down from the ICSR: 1
- Additional notch: 1 due to existence of a relatively high 7% trigger for permanent write-down

In May 2015, Scope updated its methodology for rating capital instruments (currently as a call for comments). In the revised methodology we indicate a minimum of two notches for T2 from the ICSR level. In a bail-in scenario, T2 securities are considered capital instruments and rank below non-T2 subordinated debt and senior debt. As well, T2 securities may be converted or written down during early regulatory intervention (a step ahead of resolution), which is not the case with non-T2 subordinated debt. This translates into T2 being rated lower than non-T2 subordinated debt for EU banks.

We note that under the Bank Recovery and Resolution Directive (BRRD), T2 capital instruments should be written-down or converted when the issuer has reached the point-of-non-viability (PONV). While the security has a 7% trigger, we take the view that the PONV may be below or above this level. Therefore, the minimum of two notches for KBC's T2 securities in our opinion sufficiently captures the potential principal loss absorption risks.

ICSR

The ICSR of A- for KBC Group NV is driven by its focused and solid franchise as a leading bancassurer in Belgium and the Czech Republic as well as the meaningful progress made in recovering from the financial crisis. The Irish operations remain the exception and continue to drag on the Group's performance. Solvency has improved to solid levels even excluding the benefit of EUR 2bn in remaining state aid while the Group's liquidity position remains sound. KBC intends to repay the state by end-2017, instead of end-2020 as earlier agreed with the European Commission.

The ICSR of A- also applies to KBC Bank NV, the issuer of these securities. The Group remains committed to its integrated bank and insurance strategy. As of year-end 2014, banking assets accounted for about 85% of group assets with insurance assets accounting for the remainder.

Summary terms

Issuer	KBC Bank NV
Issue Date	January 2013
Amount	USD 1bn
Coupon	• 8% fixed until call date, reset thereafter • Payable semi-annually in arrears
Format	Contingent capital securities due 25 January 2023, callable 25 January 2018
ISIN	BE6248510610
Capital Treatment	Tier 2
Principal Loss Absorption	• Upon trigger event, the full principal amount of the securities will automatically be written down to zero and there will be no payment of accrued interest • Subject to determination by the regulator, all or part of the principal amount of the securities, including accrued interest, may be written off or converted into common equity or otherwise be applied to absorb losses
Trigger for Principal Loss Absorption	Consolidated group CET1 < 7% on transitional basis

Source: Prospectus, Scope Ratings

Key risk: principal loss absorption

The principal amount of the security will be permanently written down when KBC Group's consolidated CET1 ratio breaches the 7% trigger (on a transitional basis). The CET1 ratio which will be used to determine whether the trigger has been breached will take into account KBC Group's insurance business through the computation of RWAs, rather than through deductions (i.e. the Danish compromise). In addition, the securities may also be subject to write-down or conversion subject to determination by the regulator.

Distance to trigger

As of 31 March 2015, KBC Group's transitional CET1 ratio under the Danish compromise was 14.7%, compared to the trigger level of 7% on a transitional basis in the security. Therefore, the distance to trigger was over 7% or EUR 7bn (based on transitional CET1 capital of EUR 13.2bn and RWAs of EUR 90bn).

Table 1: Distance to trigger

	2014	2015	2016	2017	2018	2019
Trigger level	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%
KBC Group's CET1 / target[1]	14.4%	14.7%	≥10.5% target fully-loaded			
Gap (%)	7.4%	7.7%				≥3.5%
Gap (EUR bn)		7.0				

1) Figures for 2015 are as of 31 March 2015. Based on RWAs of EUR 90bn.

Source: Company data, Scope Ratings

On a fully-loaded basis, KBC Group's CET1 ratio was 14.7% under the Danish compromise which is above the Group's target of at least 10.5% on a fully-loaded basis. Over the next few years, we expect KBC's CET1 capital position to decline towards the 10.5% target as excess capital will be used to repay state aid and pay dividends to shareholders. The gap to trigger, however, is expected to remain comfortably above the trigger level.

Other outstanding capital instruments

Within the Group, we note that KBC Group NV issued EUR 1.4bn in AT1 securities while the above T2 securities were issued by KBC Bank NV. There is some uncertainty about how the two securities would be treated when the Group is under financial stress and needs additional capital:

- The trigger on the T2 security of 7% is higher than the trigger on the AT1 security of 5.125%. Both triggers are based on the consolidated CET1 ratio of the Group.
- However, the AT1 security is issued by KBC Group NV, a holding company, while the T2 security is issued by the operating company KBC Bank NV. Therefore, the AT1 security is structurally subordinated.

For the purposes of rating these T2 securities, we have not distinguished that the issuer is KBC Bank NV rather than KBC Group NV. As mentioned above, the ICSR of A- for KBC Group NV also applies to KBC Bank NV. Per our bank rating methodology, we do not automatically differentiate between the holding company and operating bank when assigning ratings.

In May 2015, the EBA issued guidelines stating that it would be appropriate for issuers to specify the interaction between the loss absorption of AT1 and T2 instruments to provide clarity for investors. We would welcome such clarification.

Security Rating	
Outlook	Stable
5.625% EUR 1.4bn undated deeply subordinated Additional Tier 1 fixed rate resettable callable securities	BB+

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The ratings have not been solicited by the issuer; the analysis is based solely on public information.

Rating rationale

We assign a rating of BB+ to KBC Group's EUR 1.4bn 5.625% undated deeply subordinated Additional Tier 1 fixed rate resettable callable securities based on the following:

- Issuer Credit Strength Rating (ICSR): A-, Stable outlook
- Minimum notches down from the ICSR: 4
- Additional notches: 0

Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in September 2014 for more details about the minimum notching for AT1 securities. At this time, we have not identified any additional factors which would warrant further notching from the ICSR other than the minimum four.

ICSR

The ICSR of A- for KBC Group NV is driven by its focused and solid franchise as a leading bancassurer in Belgium and the Czech Republic as well as the meaningful progress made in recovering from the financial crisis. The Irish operations remain the exception and continue to drag on the Group's performance. Solvency has improved to solid levels even excluding the benefit of EUR 2bn in remaining state aid while the Group's liquidity position remains sound. KBC intends to repay the state by end-2017, instead of end-2020 as earlier agreed with the European Commission.

Summary terms

Issuer	KBC Group NV
Issue Date	March 2014
Amount	EUR 1.4bn
Coupon	• 5.625% fixed until first call date, reset every 5 years thereafter • If any, payable quarterly in arrears
Format	Undated deeply subordinated Additional Tier 1 fixed rate resettable callable securities. Callable March 2019 and on each coupon payment date thereafter
ISIN	BE0002463389
Capital Treatment	Additional Tier 1
Coupon Cancellation	• Fully discretionary • Mandatory cancellation upon insufficient Distributable Items or if payments exceed the Maximum Distributable Amount
Principal Loss Absorption	• Upon trigger breach • Upon point of non-viability • At the issuer's discretion, the principal amount of the notes may be written up to a maximum of its original principal amount, on a pro rata basis with similar loss absorbing securities, if the issuer reports positive Consolidated Net Income and the Maximum Distributable Amount is not exceeded
Trigger for Principal Loss Absorption	Consolidated CET1 < 5.125% (transitional basis)

Source: Prospectus, Scope Ratings

Key risk: coupon cancellation

Coupon payments on the security are fully discretionary and are subject to distribution restrictions. Management, nevertheless, has stated that it intends to prioritize coupons on AT1 securities over other discretionary distributions and to respect the hierarchy of capital instruments when making discretionary coupons.

As well, coupons are mandatorily cancelled if there are insufficient distributable items or if payments exceed the Maximum Distributable Amount (as computed in accordance with Article 141 of CRD4-CRR). The amount of available distributable items as of year-end 2014 for the issuer, KBC Group NV, was approximately EUR 4.3bn, comprised of EUR 3.2bn in retained earnings and EUR 1.1bn in reserves.

KBC currently has one outstanding CRD 4 compliant AT1 security totalling EUR 1.4bn (the above issue). In 2014, KBC made EUR 39m in distributions related to these securities from after-tax profit of EUR 1.8bn.

Combined buffer requirement

Restrictions on discretionary distributions apply when CET1 capital falls below the level of the combined buffer, defined as the total of the capital conservation buffer, the countercyclical buffer and systemic risk buffers as applicable. These restrictions become effective from 1 January 2016 and are based on transitional CET1 requirements.

At this time, we know that KBC Group will be subject to the 2.5% capital conservation buffer, to be phased-in from 2016. The systemic and countercyclical buffer requirements are unknown. Currently, KBC's CET1 capital is well above the minimum required and there is no combined buffer requirement (CBR). When the capital conservation buffer begins phasing-in from 2016, the Group's CET1 capital is expected to remain comfortably above the required CET1 level associated with distribution restrictions. In the future, however, KBC may be subject to systemic and countercyclical buffers – particularly systemic buffers due to the Group's importance in its domestic market.

We also note that in mid-March 2015 KBC received a new capital requirement from the ECB. The Group must maintain a 10.5% minimum fully-loaded CET1 ratio (including latent gains on available-for-sale securities and under the Danish compromise). Therefore, while there is presently no CBR, it is possible that the ECB could restrict the payment of coupons on AT1 securities if KBC's CET1 ratio were to be below 10.5%. This is currently not a concern as the Group's fully-loaded CET1 ratio was 14.7% as of 31 March 2015. Management has indicated that the ECB will be reviewing this requirement and that 10.5% may not be the required minimum in the future.

While management's stated CET1 target is at least 10.5%, we take comfort from the higher levels that are actually maintained. Excluding the remaining EUR 2bn in state aid and the associated EUR 1bn penalty, the fully-loaded CET1 ratio is estimated to be 11.7% which is still firmly above the 10.5% minimum.

Table 1: Expected CET1 requirements

	2014	2015	2016	2017	2018	2019
Combined buffer:						
- Capital conservation			0.625%	1.25%	1.875%	2.5%
- Systemic[1]						
- Countercyclical[2]						
ECB specific requirement add-on[3]		6.0%	5.375%	4.75%	4.125%	3.5%
Minimum CET1	4.0%	4.5%	4.5%	4.5%	4.5%	4.5%
Required CET1 associated with distribution restrictions	**4.0%**	**10.5%**	**10.5%**	**10.5%**	**10.5%**	**10.5%**
KBC Group's CET1 / target[4]	14.4%	14.7%	≥10.5% target fully-loaded			
Gap (%)	10.4%	4.2%				
Gap (EUR bn)		3.8				

1) If applicable, may range from 0-5%.
2) If applicable, may range from 0-2.5%. Would normally be phased-in between 2016 and 2019.
3) Based on 10.5% minimum fully-loaded requirement from the ECB.
4) Figures for 2015 are as of 31 March 2015. Based on RWAs of EUR 90bn.
Source: Company data, Scope Ratings

Key risk: principal loss absorption

Under the terms of the securities, the principal amount of the security will be written down when KBC Group's consolidated CET1 ratio breaches the 5.125% trigger. The CET1 ratio used to determine whether the trigger has been breached will take into account KBC Group's insurance business through the computation of RWAs, rather than through deductions (i.e. the Danish compromise).

There will be concurrent pro rata write-down of the securities and write-down or conversion into equity of any similar loss absorbing instruments to restore the issuer's CET1 ratio to at least 5.125%. Similar loss absorbing instruments are defined as instruments qualifying as AT1 capital with terms for write-down or conversion when the consolidated CET1 ratio falls below 5.125%.

Further, when the 5.125% trigger has been breached and if required by regulations and/or the regulator, the write-down may follow or happen concurrently with the write-down or conversion of the outstanding principal amount of any prior loss absorbing instruments. Prior loss absorbing instruments are defined as instruments where the principal amount may be written down or converted if the consolidated CET1 ratio falls below a level that is higher than 5.125%.

In all cases, however, the principal amount of the securities cannot be written down below 1%. In addition, the securities may also be subject to write-down when the relevant resolution authority, in its discretion, determines that the issuer has reached the point of non-viability.

At KBC's discretion, the principal amount of the notes may be written up to a maximum of its original principal amount, on a pro rata basis with similar loss absorbing securities, if KBC reports positive Consolidated Net Income and the Maximum Distributable Amount is not exceeded.

Distance to trigger

As of 31 March 2015, KBC Group's transitional CET1 ratio under the Danish compromise was 14.7%. Therefore, the distance to the trigger of 5.125% was 9.6% or EUR 8.7bn (based on transitional CET1 capital of EUR 13.2bn and RWAs of EUR 90bn).

On a fully-loaded basis, KBC Group's CET1 ratio was 14.9% under the Danish compromise. KBC Group targets a 10.5% minimum CET1 ratio on a fully-loaded basis. Over the next few years, we expect KBC's CET1 capital position to decline towards the 10.5% target as excess capital will be used to repay state aid and pay dividends to shareholders. The gap to trigger, however, is expected to remain comfortably above the trigger level.

Table 2: Distance to trigger

	2014	2015	2016	2017	2018	2019
Trigger level	5.125%	5.125%	5.125%	5.125%	5.125%	5.125%
KBC Group's CET1 / target[1]	14.4%	14.7%	≥10.5% target fully-loaded			
Gap (%)	9.275%	9.575%	≥5.375%	≥5.375%	≥5.375%	≥5.375%
Gap (EUR bn)		8.7				

1) Figures for 2015 are as of 31 March 2015. Based on RWAs of EUR 90bn.

Source: Company data, Scope Ratings

Other outstanding capital instruments

Within the Group, we note that KBC Bank NV has issued USD 1bn in Tier 2 securities, maturing in January 2023. Under the terms of the Tier 2 securities, when KBC Group's consolidated CET1 ratio breaches the 7% trigger (on a transitional basis), the principal amount of the security will be permanently written down. In addition, the Tier 2 securities may also be subject to write-down or conversion subject to determination by the regulator.

As the 7% trigger on the Tier 2 security is higher than the 5.125% trigger on the above AT1 security, theoretically in a stress scenario, the Tier 2 security would be triggered first and provide a buffer for the AT1 security. However, there is some uncertainty as to what would actually happen as the AT1 security has been issued by the holding company, KBC Group NV, and is structurally subordinated.

In May 2015, the EBA issued guidelines stating that it would be appropriate for issuers to specify the interaction between the loss absorption of AT1 and T2 instruments to provide clarity for investors. We would welcome such clarification.

Security Ratings	
Outlook	Stable
5.75% EUR 750m Perpetual Non-Cumulative Resettable Additional Tier 1 Capital Notes	BB
5.875% EUR 750m Perpetual Non-Cumulative Resettable Additional Tier 1 Capital Notes	BB

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The ratings have not been solicited by the issuer; the analysis is based solely on public information.

Rating rationale

We assign a rating of BB to the 5.75% EUR 750m and 5.875% EUR 750m Perpetual Non-Cumulative Resettable Additional Tier 1 Capital Notes (Notes) issued by Danske Bank A/S based on the following:

- Issuer Credit Strength Rating (ICSR): A-, Stable outlook
- Minimum notches down from the ICSR: 4
- Additional notches: 1

Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in September 2014 for more details about the minimum notching for AT1 securities. The additional notch for these Notes reflects the following:

- Absolute level of the trigger is relatively high at 7%
- Existence of two triggers for write-down – when the CET1 ratio of Danske Bank A/S and/or Danske Bank Group falls below 7%

ICSR

The ICSR of A- for Danske Bank is underpinned by the Group's strong franchise as a universal bank in its domestic market. The financial crisis and the slow pace of economic recovery in Denmark have negatively impacted the Group's performance but there appears to be an encouraging turnaround. Non-core activities in Ireland and the Baltics as well as conduit exposures are being wound down or divested. Capital levels have improved and are now reassuring. Meanwhile, the relatively high dependence on market funding remains a potential risk.

Summary terms

Issuer	Danske Bank A/S
Issue Date	12 March 2014
Amount	EUR 750m
Coupon	• 5.75% fixed until first call date, reset every 6 years thereafter • If any, payable in arrears semi-annually
Format	Perpetual non-cumulative resettable additional Tier 1 capital notes, callable 6 April 2020 and on any interest payment date thereafter
ISIN	XS1044578273
Issue Date	18 February 2015
Amount	EUR 750m
Coupon	• 5.875% fixed until first call date, reset every 7 years thereafter • If any, payable in arrears semi-annually
Format	Perpetual non-cumulative resettable additional Tier 1 capital notes, callable 6 April 2022 and on any interest payment date thereafter
ISIN	XS1190987427
Capital Treatment	Additional Tier 1
Coupon Cancellation Features	• Fully discretionary • Mandatory to the extent ▪ there are insufficient distributable items to pay the coupon on the security; ▪ the combined buffer requirement is not met and if coupons were paid, the amount of such payments would exceed the Maximum Distributable Amount; or ▪ the relevant regulator requires such coupons to be cancelled
Principal Loss Absorption Features	• Upon trigger breach • At the issuer's discretion, the principal amount may be written up to a maximum of the original principal amount, on a pro rata basis with Parity Trigger Loss Absorbing Instruments, up to the reinstatement limit • Statutory loss absorption at point of non-viability
Trigger for Principal Loss Absorption	• Danske Bank A/S CET1 ratio < 7% and/or • Danske Bank Group CET1 ratio < 7%

Source: Prospectus, Scope Ratings

Key risk: coupon cancellation

Coupon payments on the Notes are fully discretionary and are subject to distribution restrictions. Coupons are mandatorily cancelled if the issuer has insufficient distributable items, the combined buffer requirement (CBR) is not met and coupon payments would exceed the Maximum Distributable Amount (MDA) or the regulator requires that coupon payments be restricted. Further, coupons may be cancelled even if shareholders continue to receive dividends and/or holders of Existing Hybrid Tier 1 Capital Notes continue to receive interest payments.

While the available distributable items figure has not been disclosed, we note that Dankse Bank A/S, the issuer, had DKK 107bn (EUR 13.7bn) in retained earnings as of 31 March 2015. The annual coupons on the two Notes amount to less than EUR 100m. There are no other AT1 securities outstanding other than the Notes but there are approximately EUR 1bn in Existing Hybrid Tier 1 Capital Notes outstanding, with estimated annual coupons of less than EUR 100m. At this time, we do not foresee problems meeting coupon payments from available distributable items.

Combined buffer requirement

In line with CRD 4, mandatory restrictions on distributions begin to apply from 2016 if the CET1 ratio of Danske falls below the CBR, defined as the total of the capital conservation buffer, the countercyclical buffer and the systemic risk buffer. In 2019, Danske's CBR is currently expected to consist of a 2.5% capital conservation buffer, a 3.0% systemic risk buffer and a 0.2% countercyclical capital buffer for exposures in Norway and Sweden. In May 2015, the Swedish FSA proposed raising the countercyclical buffer to 1.5% in June 2016, from the 1% which is effective from September 2015. If approved, we estimate that this would increase Danske's countercyclical buffer by another 0.05% to 0.25% in 2016.

The systemic risk buffer is phased-in from 2015 to 2019 while the capital conservation buffer is phased-in from 2016 to 2019. The countercyclical buffer is in place from 2015. Including the minimum 4.5%, the required CET1 ratio in order to avoid distribution restrictions is expected to be 10.2% in 2019.

Table 1: Estimated CET1 requirements

	2014	2015	2016	2017	2018	2019
Combined buffer:						
- Capital conservation			0.625%	1.25%	1.875%	2.5%
- Systemic		0.6%	1.2%	1.8%	2.4%	3.0%
- Countercyclical		0.2%	0.2%	0.2%	0.2%	0.2%
Minimum CET1	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%
Required CET1 associated with distribution restrictions	**4.5%**	**5.3%**	**6.5%**	**7.75%**	**8.975%**	**10.2%**
Danske Bank Group's CET1 / target	15.1%	14.1%	around 14% target			
Gap (%)	10.6%	8.8%	approx. 7.5%	approx. 6.25%	approx. 5%	approx. 3.8%
Gap (DKK bn)		79				

1) Countercyclical buffer for exposures in Norway and Sweden is subject to change - has been held constant for illustration purposes.

2) Figures for 2015 are as of 31 March 2015. Based on risk exposure amount of DKK 896bn.

Source: Company data, Scope Ratings

The Group's CET1 ratio is currently comfortably above requirements. As various capital buffers are phased-in from 2015, the gap between Danske's CET1 ratio and requirements is expected to decline but to remain solidly above the required level. While Danske's stated minimum CET1 ratio target is 13%, management has said that a CET1 ratio around 14% would be appropriate. Further, Danske has said that it intends to manage its CET1 ratio to provide a prudent cushion to its CBR in order to mitigate the risk of distribution restrictions under CRD 4.

In addition, we note that Danish banks are required to disclose their solvency need on a quarterly basis. As of 31 March 2015, Danske is subject to a solvency need of 10.6% which is comprised of the Pillar 1 requirement of 8% and a Pillar 2 requirement of 2.6%. In line with CRD 4, the Pillar 1 requirement includes a minimum of 4.5% in CET1 capital (included in Table 1 above). For Pillar 2 requirements, Danish banks can use capital instruments that automatically convert or are written down if an adequately high trigger is breached (considered to be at least 7%). Danske's two Notes have been issued with 7% triggers to be recognised in relation to Pillar 2 requirements.

Under CRD 4, the Pillar 2 requirement is not relevant for MDA purposes. Further, the prospectus for the Notes does not explicitly refer to Danske's solvency need. However, it is our view that a breach of the solvency need of 10.6% (or 11% plus with current CBR requirements included) would be a consideration for the regulator when deciding whether coupons on the Notes should be cancelled. As of 31 March 2015, the solvency need for Danske was 11.2% (including CBR) while the total capital ratio was 18.4%.

Key risk: principal loss absorption

The issuer of the Notes is Danske Bank A/S, the parent company of the Danske Bank Group. Under the terms of the Notes, the principal amount of the Notes will be written down when the CET1 ratio of Danske Bank A/S and/or Danske Bank Group's breaches the 7.0% trigger (on a transitional basis). The amount of the write-down will be the lower of (i) the amount necessary to restore the CET1 ratio of Danske Bank A/S and/or Danske Group to at least 7%, taking into account the amount of CET1 capital generated by Higher Trigger Loss Absorbing Instruments (if any) and the pro-rata write-down or conversion into equity of Parity Trigger Loss Absorbing Instruments and (ii) the amount that would reduce the principal amount of the Notes to EUR 0.01.

Parity Trigger Loss Absorbing Instruments are defined as obligations or capital instruments with a 7% trigger which qualify as AT1 capital and any other obligations or capital instruments with a 7% trigger which are meant to absorb losses on a pro-rata basis with the Notes. The outstanding Hybrid Tier 1 Capital Notes mentioned above are not considered Parity Trigger Loss Absorbing Instruments.

Higher Trigger Loss Absorbing Instruments are defined as obligations or capital instruments which include a principal loss absorption mechanism and are capable of generating CET1 capital, with a trigger above 7%. There are currently no Higher Trigger Loss Absorbing Instruments outstanding.

Furthermore, the Notes are subject to the provisions of the Bank Recovery and Resolution Directive (BRRD) which empowers relevant authorities to permanently write-down or convert into equity AT1 capital instruments such as the Notes in the course of resolution or before, at the point of non-viability. Here, we believe that Danske's solvency need of 10.6% would provide regulators with an indicator for determining the point of non-viability.

At the issuer's discretion, the principal amount of the Notes may be written up to a maximum of the original principal amount on a pro-rata basis with all other Parity Trigger Loss Absorbing Instruments, with similar reinstatement provisions.

Distance to trigger

At 1Q 2015, Danske Group's transitional CET1 ratio was 14.1%, compared to the 7% trigger level in the securities. Therefore, the distance to trigger is 7.1% or DKK 64bn based on a risk exposure amount of DKK 896bn. On a fully-loaded basis, Danske estimates its CET1 ratio to be about 13.1%. The Group's capital position as of 1Q 2015 incorporates the impact of DKK 5bn in announced share buybacks for 2015. We expect the Group's CET1 capital ratio to remain comfortably above the trigger level in light of its stated targets. Meanwhile, the transitional CET1 ratio of Danske Bank A/S was 17.4% as of 31 March 2015 also well above the 7.0% trigger.

Table 2: Distance to trigger

	2014	2015	2016	2017	2018	2019
Trigger level	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%
Danske Bank Group's CET1 ratio	15.1%	14.1%	around 14% target			
Danske Bank Group's Gap (%)	8.1%	7.1%	approx. 7%	approx. 7%	approx. 7%	approx. 7%
Danske Bank Group's Gap (DKK bn)		64				
Danske Bank A/S CET1 ratio	19.1%	17.4%				

1) Figures for 2015 are as of 31 March 2015. Based on risk exposure amount of DKK 896bn.

Source: Company data, Scope Ratings

Security Ratings	
Outlook	Positive
7.875% USD 1.75bn undated deeply subordinated additional Tier 1 fixed rate resettable notes	BB+
6.5% EUR 1.0bn undated deeply subordinated additional Tier 1 fixed rate resettable notes	BB+
7.5% GBP 0.5bn undated deeply subordinated additional Tier 1 fixed rate resettable notes	BB+
6.625% USD 1.25bn undated deeply subordinated additional Tier 1 fixed rate resettable notes	BB+

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The ratings have not been solicited by the issuer; the analysis is based solely on public information.

Rating rationale

Scope is upgrading the rating of Credit Agricole S.A (CASA)'s 7.875% USD 1.75bn, 6.5% EUR 1.0bn, 7.5% GBP 0.5bn and 6.625% USD 1.25bn undated deeply subordinated additional Tier 1 fixed rates resettable notes to BB+ from BB, based on the following:

- Issuer Credit-Strength Rating (ICSR): A, Positive outlook
- Minimum notches down from the ICSR: 4
- Additional notch: 1

Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in September 2014 for more details about the minimum notching for AT1 securities.

For the avoidance of doubt, Crédit Agricole Group (CA Group) refers to the accounting combination of Crédit Agricole SA (CASA) consolidated and 75% of the regional banks of Crédit Agricole; CASA parent means the parent company Crédit Agricole SA; CASA consolidated means CASA parent plus its subsidiaries (and CASA's 25% stake in the regional banks).

The upgrade reflects the fact that at the Ordinary General Meeting of Shareholders dated 20 May 2015, the shareholders of CASA have decided to transfer EUR 10.658bn of issue premium to a reserve item, therefore considerably increasing the amount of available distributable items (ADIs) that are available to pay the coupons on the AT1 securities. On our estimates, the ADIs of CASA at year-end 2014 represented close to EUR 15bn post shareholders' meeting (versus 2013 estimates - excluding issue premiums - of EUR 1.2bn), therefore removing the necessity to allocate a supplementary notch to the risk of potential coupon payment cancellation.

Therefore, the remaining additional notch for these securities reflects the following:

- These particular AT1 notes issued by CASA present a complex structure which needs to be properly understood by investors. For example, the legal issuer is CASA, listed entity and central body of CA Group, but the issue lists two different CET1 ratio triggers (5.125% and 7%) applicable to two different scopes of the group (CASA consolidated and the CA Group as a whole, respectively). As mentioned in the "Risk Factors" section of the prospectus, "the inclusion of two […] triggers […] may make the likelihood of [such a trigger breach…] more difficult to analyse than is the case for similar notes with single-level triggers". In this context, analytically we note two aspects. First, the minimum capital requirements of CASA and CA Group stand at a higher level than the contractual trigger (7% and 8% respectively, versus triggers of 5.125% and 7% respectively). Second, the role of CASA as Central Body in the context of the French Monetary and Financial Code is required to take all necessary measures to ensure that each and all of the Crédit Agricole Network members and its affiliated members maintain satisfactory liquidity and solvency, making it very unlikely for CASA to ever get to its trigger before the group does, at least until the group reaches its minimum capital requirement of 8%.

- Provided it is not cancelled by the issuer, coupon payment exclusively depends on the distributable items of CASA parent (and not CA Group) but assuming a Combined Buffer Requirement (CBR) breach, the Maximum Distributable Amount (MDA) is determined by reference to both CASA consolidated and CA Group's MDA, therefore adding to the complexity.

- As we expect CA Group to announce a change of corporate structure at some point in future, we believe that there is a possibility for the terms of the AT1 notes to be materially amended.

ICSR

The ICSR of A assigned by Scope to Crédit Agricole SA is based on CA Group's credit fundamentals and support. This rating reflects the benefits of CA Group's de-risking and return to its domestic retail roots, while leveraging on its size and expertise in savings products businesses (asset management and insurance). The ICSR also reflects the difficulty related to the status of the Central Body Crédit Agricole SA, which is at the same time network head and listed holding company. As a result, the communication channels between the regional banks and CASA were tested during the European crisis in our opinion.
Our positive outlook reflects Scope Rating's view of the possible change in relationship between CASA and the regional banks which, if clear and properly executed, could materially improve the governance of the group.

Summary terms

Issuer	Crédit Agricole SA
Issue Date	23 January 2014
Amount	USD 1.75bn
Coupon	• 7.875% fixed until first call date, and every year which falls five, or a multiple of five, years after that • If any, payable quarterly in arrears
Format	Undated deeply subordinated additional Tier 1 fixed rate resettable notes
ISIN	US225313AD75 (Rule 144A)/ USF22797RT78 (Regulation S)
Issue Date	8 April 2014
Amount	EUR 1.0bn
Coupon	• 6.5% fixed until first call date, and every date which falls five, or a multiple of five, years after that • If any, payable quarterly in arrears
Format	Undated deeply subordinated additional Tier 1 fixed rate resettable notes
ISIN	XS1055037177
Issue Date	8 April 2014
Amount	GBP 0.5bn
Coupon	• 7.5% fixed until first call date, and every date which falls five, or a multiple of five, years after that • If any, payable quarterly in arrears
Format	Undated deeply subordinated additional Tier 1 fixed rate resettable notes
ISIN	XS1055037920

Issue Date	18 September 2014
Amount	USD 1.25bn
Coupon	• 6.625% fixed until first call date, and every year which falls five, or a multiple of five, years after that • If any, payable quarterly in arrears
Format	Undated deeply subordinated additional Tier 1 fixed rate resettable notes
ISIN	US225313AE58 (Rule 144A)/ USF22797YK86 (Regulation S)
Capital Treatment	Tier 1
Coupon Cancellation	• Fully discretionary • Mandatory, based on the regulator's assessment of CASA's financial and solvency situation; • Or if there are not enough Distributable Items at CASA parent to pay all Tier 1-related coupons; • Or, in case of a breach of the CBR, if the coupon payment would cause the lower of the MDA of CASA consolidated or CA Group to be exceeded.
Principal Loss Absorption	• Despite the Issuer being Crédit Agricole SA, the trigger refers to capital metrics of both CASA and CA Group. • If a "capital ratio event" occurs, the principal amount of each note will be irrevocably reduced by the "relevant write-down amount" – i.e. the amount by which either the capital ratio event would be cured; or, if not enough to cure the capital ratio event, the amount necessary to reduce the principal amount of the note to one cent. • A "capital ratio event" will be deemed to have occurred if (1) CASA consolidated's CET1 ratio falls or remains below 5.125%; or (2) CA Group's CET1 ratio falls or remains below 7%. • A written-down note can be written back up if a positive net income from CASA consolidated is recorded. The issuer may then, at its full discretion and subject to the MDA not being exceeded, increase the principal of the note on a prorata basis with similar notes and up to a maximum of the original principal amount. • While it is possible that a contingent write-down will have occurred by the time the issuer reaches the Point of Non Viability (PONV), there may be cases in which the PONV occurs before the CET1 ratio of CASA consolidated or of CA Group falls below the relevant trigger. As a result, bail-in measures may provide for additional circumstances, beyond those contemplated in the T&Cs, in which the notes might be written down (or converted to equity at a time when the issuer's share price is likely to be significantly depressed).
Trigger for Principal Loss Absorption	CET1 of CA Group < 7% **or** CET1 of CASA consolidated <5.125% (transitional basis)

Source: Prospectuses, Scope Ratings

Key risk: coupon cancellation

Coupon payments on the security are fully discretionary and are subject to distribution restrictions.

In the interest of clarity, it should be mentioned here that CASA can only pay coupons provided that there are enough distributable items at the level of CASA parent. Distributable items are defined by CRR (Art.4, 1., (128)) as "the amount of the profits at the end of the last financial year plus any profits brought forward and reserves available for that purpose before distributions to holders of own funds instruments less any losses brought forward, profits which are non-distributable pursuant to provisions in legislation or the institution's by-laws and sums placed to non-distributable reserves in accordance with applicable national law or the statuses of the institution, those losses and reserves being determined on the basis of the individual accounts of the institution and not on the basis of the consolidated accounts".

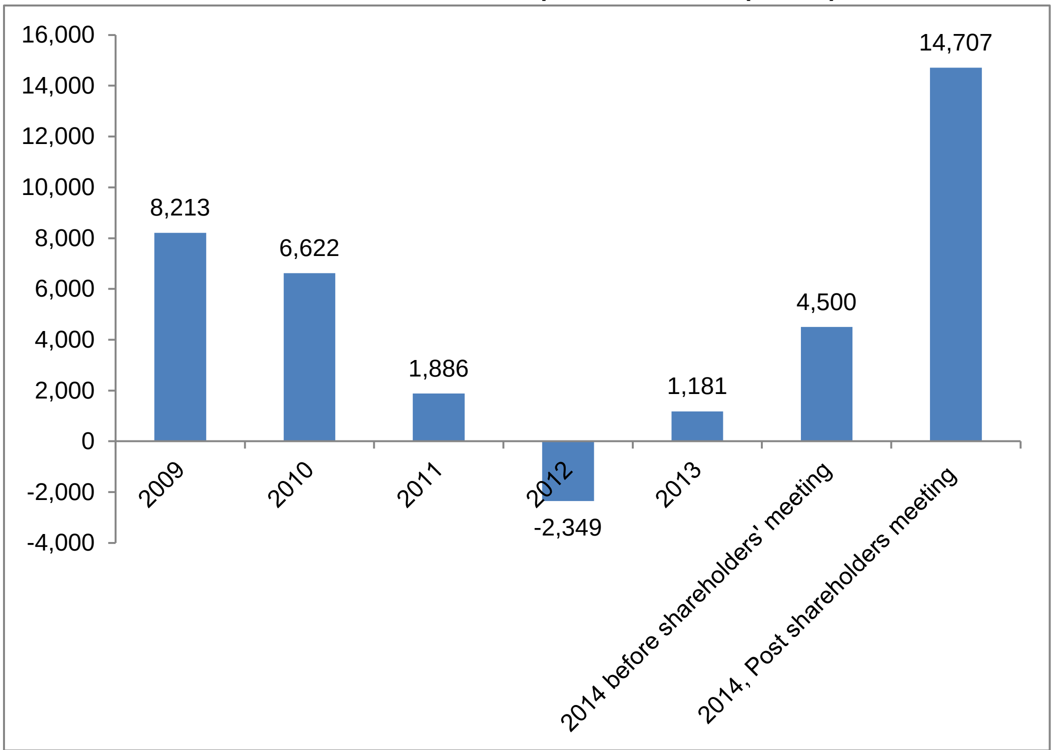
On the basis of the above paragraph, we consider that share capital, share premium, revaluation adjustments, regulated provisions and investment subsidies should be excluded from the "Distributable Items".

In the 2014 Pillar III report of Crédit Agricole SA, the company indicated estimated distributable items of EUR 25.8bn (EUR 22.8bn as of 31 December 2013), of which EUR 21.3bn of share premium (EUR 22.4bn in 2013). We believe that as per the CRR article quoted above, share premium should be excluded from the calculation of distributable items. Crédit Agricole does not say otherwise when it subsequently states in the "risk factors" section of the T&C that "in order for share premium to be included in the issuer's distributable items, the issuer's ordinary shareholders meeting must adopt a resolution to relocate the share premium to a reserve account". We believe it would be very difficult for such a resolution to be submitted if it took place in the problematic context of AT1 coupon cancellation.

At the Ordinary General Meeting of Shareholders dated 20 May 2015, the shareholders of CASA decided to transfer EUR 10.658bn of issue premium to a reserve item, therefore considerably increasing the amount of available distributable items (ADIs) that are available to pay the coupons on the AT1 securities. On our estimates, the ADIs of CASA now represent around EUR 14.7bn (versus 2014 estimates of EUR 4.5bn – excluding share premiums), therefore removing the necessity to allocate a supplementary notch to the risk of potential coupon payment cancellation. These estimated ADIs of EUR 14.7bn represent the sum of the former ADIs that we estimated at EUR 4.5bn at YE 2014 plus the EUR 10.658bn transfer of issue premium to reserves, minus estimated dividend paid of EUR 450m (representing the full dividend payment of 901m, but weighted for a 50% payment in scrip – reducing the cash component to be deducted from earnings.

On the back of the 6th resolution of the 20 May 2015 Ordinary General Meeting of CASA Shareholders (which was approved by 99.9% of the voters), we estimate the ADIs of CASA parent to stand at around EUR 14.7bn. Our own estimates for the 2009-2014 distributable items of CASA parent appear in the following chart.

Chart 1: Estimated Distributable Items – CASA parent 2009-2014 (EUR m)



Source: Scope estimates, company data

As can be seen in the above chart, the amount of distributable items of CASA parent has been quite volatile over the years, initially shrinking as the bank was absorbing the impact of the financial crisis and of the Euro crisis. However, we note that the distributable items have been rebuilding quite quickly, as the business mix of CASA has become less risky and as the earnings stream of the company has become more stable. The EUR 10.658bn transfer decided by the Ordinary Shareholder Meeting of

20 May 2015 removes a lot of our concerns on the quantity of ADIs available to pay the AT1 coupons, therefore underpinning our rating upgrade to BB+ from BB.

Combined buffer requirement

For the first time, both Crédit Agricole SA and Crédit Agricole Group have disclosed their minimum regulatory capital requirements in their 2014 Pillar 3 reports. This makes the analysis of the Combined Buffer Requirement (CBR) easier than at the time the notes were issued.

In the context of these notes, a valid question to ask is which CBR would be considered, since the notes feature two triggers for two different scopes. The Terms and Conditions (T&Cs) offer no guidance on this. Intuitively, if the T&Cs do consider two possible MDAs, then logically we should calculate two possible CBR breaches (one for CASA consolidated, one for CA Group). However, CA Group is the only entity among the two that includes the G-SIFI requirement of 1%. So as to be comprehensive, we will look into two different CBRs, with one (CA Group) higher than the other (CASA consolidated) as it will include the G-SIFI buffer of 1%.

The conclusions appear on Table 1 below.

Table 1: Combined buffer requirements CA Group and CASA consolidated

	2014	2015	2016	2017	2018	2019
CA Group						
Combined buffer:						
- Capital conservation			0.63%	1.25%	1.88%	2.50%
- Systemic			0.25%	0.50%	0.75%	1.00%
- Countercyclical[1]	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Minimum CET1	4.00%	4.50%	4.50%	4.50%	4.50%	4.50%
Required CET1 associated with distribution restrictions			**5.38%**	**6.25%**	**7.13%**	**8.00%**
CA Group's CET1	12.8% as of FY 2014 (transitional)	12.8% as of Q12 2015 (transitional)	Target 14% (fully-loaded)			
Gap (%)	8.8%	8.3%				
Gap (EUR)	43.6bn	42.6bn				
CASA consolidated						
Combined buffer:						
- Capital conservation			0.63%	1.25%	1.88%	2.50%
- Countercyclical[1]	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Minimum CET1	4.00%	4.50%	4.50%	4.50%	4.50%	4.50%
Required CET1 associated with distribution restrictions			**5.13%**	**5.75%**	**6.38%**	**7.00%**
CASA consolidated's CET1	10.4% as of FY 2014 (transitional)	10.2% as of Q1 2015 (transitional)	Target >10.5% (fully-loaded)			
Gap (%)	6.4%	5.7%				
Gap (EUR)	18.8bn	17.7bn				

1) No countercyclical buffer defined by French regulator yet

Source: Company data, Scope Ratings

CA Group plans a 2016 fully-loaded CET1 ratio of 14% by YE 2016, while CASA consolidated's CET1 target for the same year stands at >10.5%. For the purpose of the CBR analysis, we will assume that 14% and >10.5% will also be the 2019 CET1 targets for CA Group and CASA respectively.

As demonstrated in Table 1, the probability of either CA Group or CASA consolidated calculating their MDA in the context of the coupon payment of the notes is very remote. Indeed, the buffer to a CBR breach seems ample. Sticking to the 2016 estimated CET1 and RWA targets of CA Group and CASA consolidated, the gap to our 2019 estimated CBR would stand at around EUR 11bn for CASA consolidated, and around EUR 30bn for CA Group.

These buffers, combined with the fast rebuild of the ADIs at CASA parent, explain why we upgraded the securities from BB to BB+. Indeed, we have shown in the section above that the amount of available distributable items (excluding share premiums) has been multiplied by more than three following the transfer to reserves of EUR 10.658bn of issue premium, while the minimum capital requirements of the bank are officially disclosed and show that a CBR breach looks very unlikely.

To be sure, there is still some remaining uncertainty with regards to the ADIs at CASA parent level. Indeed, the ICSR of Credit Agricole benefits from a positive outlook stemming from the forthcoming restructuring of the group. However, the bulk of the restructuring should be done at the level of CASA parent. And CASA parent, bar receiving dividends from its various subsidiaries - Amundi, CACIB, Credit Lyonnais, Predica, the regional banks, is also the central body of the group (for more details on the role of CASA as central organisation please refer to our Issuer Report on Credit Agricole Group).

In the course of the various press reports about Credit Agricole's restructuring, it is regularly mentioned that CASA parent could drop its central organisation functions. If this happens, such an event could have a material impact on the ADIs of CASA parent. However, we believe that with the transfer of EUR 10.658bn from the issue premium to a reserve account, this risk has been materially reduced, therefore justifying our rating upgrade from BB to BB+ on the securities.

Finally on coupon cancellation, we note that the risks factors of both the 6.5% EUR 1.0bn notes and the 7.5% GBP 0.5bn notes make clear the fact that the issuer may cancel interest payments on one series of AT1 issues without cancelling interest payments on the other. This risk is nonetheless considerably reduced by the fact that the coupons of the four securities are all aligned on the same payment dates.

Key risk: principal loss absorption

The analysis of the notes' loss absorption risk is made more complex by the fact that investors have to consider two triggers. The notes will be temporarily written down if:

- Credit Agricole Group's CET1 ratio falls or remains below 7%;
- or CASA consolidated's CET1 ratio falls or remains below 5.125%.

Overall, the trigger analysis depends to a large extent as to which entity is likely to reach its own trigger first.

Table 1 on the previous page shows that the 2019 minimum capital requirements of CA Group and CASA consolidated stand at 8% and 7% respectively (on a fully-phased basis).

Therefore, it could be argued that the two contractual triggers appearing in the Terms & Conditions of the note are unlikely to ever get breached as the minimum capital requirements of CA Group and CASA are 8% and 7% respectively (versus AT1 triggers of 7% and 5.125% respectively).

Having said that, it seems intuitive to think that CASA should theoretically reach its minimum capital requirement of 7% (or its contractual trigger of 5.125%) ahead of CA Group as CASA only consolidates 25% of the highly cash-generative regional banks. However, the status of CASA as central body of Credit Agricole (as defined in article l511-31 of the French Monetary and Financial Code) makes the occurrence of a capital problem at CASA level very unlikely.

Indeed, according to article l511-31: « central bodies are required to look after the cohesiveness of their network, and to secure the proper functioning of their affiliated companies. To that end, **they take all necessary measures**, in particular to guarantee the liquidity and the solvency of every affiliated company as well as of the network as a whole ».

In effect, this means that were losses to seriously hit its capital base, CASA would have the legal requirement to "take all necessary measures" to protect its own solvency (and therefore the solvency of the network as a whole). Scope Ratings understands that CASA has a wide range of powers throughout the group in order to protect CASA's capital base.

This legal requirement would enable the group to absorb losses up to the point where CA Group reaches its own minimum capital requirement of 8%, at which point there is a possibility for the AT1 notes to be triggered.

Based on the above details we can differentiate three layers of priorities:

1. The legal obligation of CASA to take all necessary measures to protect the components of the networks, including itself ;
2. The minimum capital requirement, requiring minimum CET1 ratios of 7% and 8% for CASA and CA Group, respectively;
3. The contractual triggers of the note at 5.125% and 7% for CASA and CA Group, respectively.

We note that the legal obligations of CASA under the French Monetary and Financial Code legally address the potential capital shortfalls of CASA up until the CA Group's CET1 reaches 8% or less. In our opinion this may create a degree of uncertainty regarding the lower triggers stipulated by the T&Cs.

Distance to trigger

Despite the conclusions of the above analysis, which suggest that the distances to contractual triggers as a risk parameter may be less central, we show in Tables 3 and 4 our calculation regarding the distances to minimum CET1 of 5.125% for CASA and 7% for CA Group.

Table 3: Distance to trigger – CASA consolidated

	2014	2015	2016	2017	2018
Trigger level	5.125%	5.125%	5.125%	5.125%	5.125%
CET1	10.4%	10.2% as of Q1 2015	>10.5% target		
Gap (%)	5.275%	5.075%	>5.375%		
Gap (EUR)	15.5bn	15.8bn	16.9bn		

Source: Company data, Scope Ratings

Table 4: Distance to trigger – CA Group

	2014	2015	2016	2017	2018
Trigger level	7.0%	7.0%	7.0%	7.0%	7.0%
CET1	13.10%	13.0% as of Q1 2015	14.0% target		
Gap (%)	6.1%	6.0%	7.0%		
Gap (EUR)	30.2bn	30.8bn	38.5bn		

Source: Company data, Scope Ratings

Security Ratings	
Outlook	Positive
8.125% USD 1.0bn Contingent Capital Subordinated Fixed Rate Resettable Notes due 2033	BBB+

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The ratings have not been solicited by the issuer; the analysis is based solely on public information.

Rating rationale

We have assigned a rating of BBB+ to Crédit Agricole SA's high-trigger Tier 2 8.125% USD 1.0bn Contingent Capital Subordinated Fixed Rate Resettable Notes due 2033 issued in September 2013. The rating is based on the following considerations:

- Issuer Credit-Strength Rating (ICSR): A, Stable outlook
- Minimum notch down from the ICSR: 1
- Additional notches: 1

As detailed in Scope's *Bank Capital Instruments Rating Methodology* published in September 2014, the minimum notching for Tier 2 securities is one notch from the ICSR. In May 2015, Scope updated its methodology for rating capital instruments (currently as a call for comments). In the revised methodology, we are proposing to change the minimum notching to two notches from one. In a bail-in scenario, Scope believes that Tier 2 securities are considered capital instruments and rank below non-Tier 2 subordinated debt and senior debt. As well, Scope points out that Tier 2 securities could be converted or written down during early regulatory intervention (a step ahead of resolution), which would not be the case with non-Tier 2 subordinated debt. This would translate into Tier 2 being rated lower than non-Tier 2 subordinated debt for EU banks.

When the methodology is finalised, we do not intend to change the rating on the current Tier 2 security of Crédit Agricole SA. We note that under the Bank Recovery and Resolution Directive (BRRD), Tier 2 capital instruments should be written-down or converted when the issuer has reached the point-of-non-viability (PONV). While the security has a 7% trigger, we take the view that the PONV may be below or above this level. Therefore, the current two notches in our view sufficiently capture the potential principal loss absorption risks.

- The trigger level of the securities stands at a high level of 7% CET1 ratio. This high trigger is to some extent offset by (1) the fact that the trigger CET1 ratio is measured at the level of Crédit Agricole Group (CA Group) (and not the lesser capitalised Crédit Agricole SA (CASA)); (2) the fact that the long-term CET1 ratio target of CA Group stands at a high 14%, at the higher end of French and international peers; and (3) the fact that the distance versus trigger is based on the reported phased-in CET1 ratio of Crédit Agricole Group (and not the fully-loaded ratio).
- The mutualist structure of the bank leads to a situation whereby the trigger attached to the notes is measured against the metrics of Crédit Agricole Group, not the issuer's, adding a measure of complexity to the Terms & Conditions (T&C) of the notes. We note that the prospectus of the notes mentions the issuer's organizational structure as a risk factor, in particular the fact that even if CASA is Central Body of CA Group, it does not have voting control over the decisions of the regional banks. The prospectus also refers to potential conflicts of interest between the regional banks and CASA.

ICSR

The ICSR of A assigned by Scope to Crédit Agricole SA is based on CA Group's credit fundamentals and support. This rating reflects the benefits of CA Group's de-risking and return to its domestic retail roots, while leveraging on its size and expertise in savings products businesses (asset management and insurance). The ICSR also reflects the difficulty related to the status of the Central Body Crédit Agricole SA, which is at the same time network head and listed holding company. As a result, the communication channels between the regional banks and CASA were tested during the European crisis.

Our positive outlook reflects the possible change in relationship between CASA and the regional banks which, if clear and properly executed, could materially improve the governance of the group.

Summary terms

Issuer	Crédit Agricole SA
Issue Date	19 September 2013
Amount	USD 1.0bn
Coupon	• 8.125% per annum • payable semi-annually in arrear
Format	Contingent Capital Subordinated Fixed Rate Resettable Notes due 2033
ISIN	US225313AC92 (Rule 144A)/ USF22797QT87 (Regulation S)
Capital Treatment	Tier 2
Principal Loss Absorption	• Despite the Issuer being Crédit Agricole SA, the trigger refers to capital metrics of Crédit Agricole Group. • If a trigger event occurs, a contingent write-down will occur and the full principal amount of each note will automatically be written down to zero and the Notes will be cancelled. • A trigger event will be deemed to have occurred if CA Group's CET1 capital ratio falls below 7%. • While it is possible that a contingent write-down will have occurred by the time the issuer reaches the Point of Non Viability (PONV), there may be cases in which the PONV occurs before the CET1 ratio of CA Group falls below the trigger event threshold. As a result, bail-in measures may provide for additional circumstances, beyond those contemplated in the T&Cs, in which the notes might be written down.
Trigger for Principal Loss Absorption	CET1 ratio of CA Group <7% (transitional)

Source: Prospectuses, Scope Ratings

Key risk: principal loss absorption

The Notes are permanently written-down to zero when the trigger level is breached. The trigger level is breached when CA Group's CET1 ratio is less than 7% on a transitional basis.

Further, the risk factors of the prospectus make clear the fact that the PONV of the group may be higher than the trigger level of 7% (as explained in the "Summary terms"). While there is no explicit reference to the point of non-viability, the security is clearly subject to write-down and/or conversion risks.

Distance to trigger

CA Group is targeting a fully-loaded CET1 ratio target of 14% by YE 2016, a materially higher target than most other French and international peers. As CA Group is a mutualist bank with share ownership not giving right to the NAV of the company, dividend distribution tends to be materially lower than peers and therefore, capital formation faster.

It is therefore possible that by 1 January 2019, the CET1 ratio of CA Group will be materially higher than the already elevated level of 14% (as CA Group's fully-loaded CET1 ratio stood at 13% already as of 31.03.2015). However, we will assume that the 2016 CET1 target of CA Group will also be the target standing by 2019.

In the meantime, we note that the distance to the trigger of 7% should be calculated on the back of the "transitional" CET1 ratio of CA Group. As per the Q1 2015 results presentation of Crédit Agricole, the "transitional" CET1 target of CA Group is actually lower than the fully-phased one (12.8% versus 13.0%). As shown in Table 1, the distance to trigger should increase as CA Group meets its CET1 targets. By YE 2016, the distance to trigger (versus CA Group's transitional CET1 target of 14.5%) should stand at close to EUR 40bn.

Table 1: Distance to trigger

	2014	2015	2016	2017	2018
Trigger level	7.0%	7.0%	7.0%	7.0%	7.0%
CET1	13.10%	12.8% as of Q1 2015	14.0% target		
Gap (%)	6.1%	5.8%	7.0%		
Gap (EUR)	30.2bn	29.8bn	38.5bn		

Source: Company data, Scope Ratings

Security Ratings	
Outlook	Stable
8.25% USD 1.25bn undated deeply subordinated resettable interest rates notes	BBB-
7.875% USD 1.75bn undated deeply subordinated resettable interest rates notes	BBB-
6.75% EUR 1bn undated deeply subordinated resettable interest rates notes	BBB-
6% USD 1.5bn undated deeply subordinated resettable interest rates notes	BBB-

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The ratings have not been solicited by the issuer; the analysis is based solely on public information.

Rating rationale

We assign a rating of BBB- to Société Générale (SocGen)'s 8.25% USD 1.25bn, 7.875% USD 1.75bn, 6.75% EUR 1bn and 6% USD 1.5bn undated deeply subordinated resettable interest rates notes based on the following:

- Issuer Credit-Strength Rating (ICSR): A, Stable outlook
- Minimum notches down from the ICSR: 4
- Additional notches: 0

Please refer to Scope's Bank Capital Instruments Rating Methodology published in September 2014 for more details about the minimum notching for AT1 securities.

Scope does not attribute additional notches on top of the minimum four notches down from the ICSR. This is due to our belief that Société Générale S.A (the group's parent company) has enough maximum distributable amounts to secure the coupon payments on all four AT1 securities issued, and ample Combined Buffer Requirement (CBR) at this time.

Moreover, the distance to trigger is expected to remain very high, even on a fully-phased basis (i.e. by 2019).

ICSR

The ICSR of A is driven by SocGen's considerable efforts undertaken by the bank to comply with the Basel 3 capital regulations, considering that SocGen's pre-crisis capitalization levels had been lower than peers. It also reflects the strong retail franchises of SocGen both in France and in Central & Eastern Europe (CEE), and its solid position in the global equity derivatives business. However, the rating also incorporates what we perceive as a dent in the bank's revenue base resulting from the recent deleveraging.

Summary terms

Issuer	Société Générale SA
Issue Date	6 September 2013
Amount	USD 1.25bn
Coupon	• 8.25% fixed until first call date, reset every 5 (or multiple of 5) years thereafter • If any, payable semi-annually in arrears
Format	Undated deeply subordinated resettable interest rates notes
ISIN	XS0867614595
Issue Date	18 December 2013
Amount	USD 1.75bn
Coupon	• 7.875% fixed until first call date, reset every 5 (or multiple of five) years thereafter • If any, payable semi-annually in arrears
Format	Undated deeply subordinated resettable interest rates notes
ISIN	USF8586CRW49 (Unrestricted notes) / US83367TBF57 (Restricted Notes)
Issue Date	7 April 2014
Amount	EUR 1.0bn
Coupon	• 6.75% fixed until first call date, reset every 5 (or multiple of five) years thereafter • If any, payable semi-annually in arrears
Format	Undated deeply subordinated resettable interest rates notes
ISIN	XS0867620725
Issue Date	25 June 2014
Amount	USD 1.5bn
Coupon	• 6% fixed until first call date, reset every 5 (or multiple of five) years thereafter • If any, payable semi-annually in arrears
Format	Undated deeply subordinated resettable interest rates notes
ISIN	USF8586CXG25 (unrestricted notes) / US83367TBH14 (restricted Notes)
Capital Treatment	Additional Tier 1

Coupon Cancellation	• Fully discretionary • Mandatory if payment coupon on all own funds instruments (a) would exceed the Distributable Items of the issuer; or (b) would cause the Maximum Distributable Amount (MDA) then applicable to the issuer to be exceeded.
Principal Loss Absorption	• If Group CET1 ratio falls below the trigger, the issuer needs to reduce the current principal amount of each note by the relevant write-down amount, either (1) in a sufficient proportion to bring the CET1 ratio above the trigger; or (2) if (1) is insufficient to bring the CET1 ratio above the trigger level, then by an amount necessary to reduce the current principal amount of the note to one cent. • If a positive consolidated net income is recorded at any time ("return to financial health") then the issuer may at its full discretion and subject to the MDA, increase the current principal amount of each note up to a maximum of the original principal amount on a pro-rata basis with the other notes. • Resolution authorities may reduce the principal amount of the notes to zero on a permanent basis at the point of non-viability (PONV) defined as (1) the institution failing or likely to fail; (2) there is no reasonable prospect that a private action would prevent the failure and (3) a resolution action is necessary in the public interest (.
Trigger for Principal Loss Absorption	CET1 <5.125% on a transitional basis

Source: Prospectuses, Scope Ratings

We note that the terms of the USD 1.5bn, 6% notes differ slightly in explaining the PONV, updating the prospectus with a detailed section on the governmental supervision and the regulation of Société Générale, in particular the resolution framework in France and the French banking reforms of 26 July 2013 and 20 February 2014. The prospectus points out that "the PONV is deemed to be reached when banks, currently or in the near future, (i) no longer comply with regulatory capital requirements; (ii) are not able to make payments that are, or will be, imminently due or (iii) require extraordinary public financial support. Conversion ratios and transfer prices are determined by the ACPR[2] on the basis of a "fair and realistic" assessment. The ACPR must use its powers "in a proportionate manner" to achieve the following objectives: (i) to preserve financial stability; (ii) to ensure the continuity of banking activities, services and transactions of financial institutions, the failure of which would have systemic implications for the French economy; (iii) to protect deposits; and (iv) to avoid, or limit to the fullest extent possible, any public bail-out. The deposit guarantee fund may also intervene as a resolution fund. The French resolution framework will need to be adapted as part of the implementation in France of the European framework for bank recovery and resolution, in particular to extend the French bail-in tool to eligible liabilities such as senior debt. It should be noted that the ACPRs powers will be superseded by a European resolution authority starting 1 January 2016, and that thus authority will act in close cooperation with the national authority".

The Terms and Conditions (T&Cs) of the USD 1.5bn, 6% notes also include a more restrictive language on the reduction, repurchase, call or redemption of the notes.

[2] The French Prudential Supervisory and Resolution Authority (Autorité de contrôle prudentiel et de résolution).

Key risk: coupon cancellation

Coupon payments on the security are fully discretionary and are subject to distribution restrictions.

Combined buffer requirement

The CRD4-CRR restrictions on discretionary distributions are applicable from January 1, 2016 and are based on transitional CET1 requirements. Table 1 sums up the estimated gap with this buffer between now and 2019. Unsurprisingly, the gap narrows significantly as the CBR becomes more stringent. As of YE 2014, SocGen's transitional CET1 ratio stood at 10.91%, leaving a buffer of 6.91% or close to EUR 25bn compared to the then-minimum requirement of 4%, on our estimates. We expect this CBR to fall to 2% of fully-loaded RWAs by 2019.

Table 1: Combined buffer requirement

	2014	2015	2016	2017	2018	2019
Combined buffer:						
- Capital conservation			0.625%	1.25%	1.875%	2.5%
- Systemic			0.25%	0.50%	0.75%	1.00%
- Countercyclical[1]	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Minimum CET1	4.0%	4.5%	4.5%	4.5%	4.5%	4.5%
Required CET1 associated with distribution restrictions			5.375%	6.25%	7.125%	8.0%
Societe Generale's CET1	10.91% as of YE 2014 (transitional)					10.0% target fully-loaded
Gap (%)	6.9%					2.0%
Gap (EUR)						

1) No countercyclical buffer defined by French regulator yet.

Source: Company data, Scope Ratings

While we have some degree of comfort with regards to the CBR, the level of distributable items remains extremely difficult to assess. We note that to be able to pay a coupon on the notes, SocGen must report (1) distributable items determined on the basis of its individual accounts (and not on the basis of its consolidated accounts); and (2) maximum distributable amounts (MDA) "calculated in accordance with CRD4/CRR". We note that the MDA is only calculated a bank fails to meet its CBR.

Consequently, the most important determinant of coupon cancellation (bar the CBR) remains the "distributable items". Looking at Note 17 page 491 of SocGen's 2014 registration document (itself referring to the parent company accounts of the group), we believe that the amount corresponding to "Reserves, unappropriated retained earnings" is the closest equivalent to the definition of distributable items given in the T&Cs of the different AT1 notes, i.e.: "[…] profits of the issuer at the end of the financial year immediately preceding the interest payment date plus any profits brought forward and reserves available for that purpose before distributions to holders of the issuer's own funds instruments less any losses brought forward, profits which are non-distributable pursuant to [issuer by laws or French legislation] and sums placed to non-distributable reserves…".

On that basis, we believe that the amount of "distributable items" stood at EUR 12.0bn at YE 2014, leaving ample room for coupon payment.

Key risk: principal loss absorption

There is a temporary write-down when the trigger level is breached. The trigger level is breached when SocGen's CET1 ratio is less than 5.125% on a transitional basis. If at any point after the breach SocGen reports a profit, then the bank can increase the principal amount of each note at its full discretion and under the constraint of MDA.

In addition, if the PONV is reached (see above), then the notes can be written down to one cent.

Distance to trigger

SocGen is targeting a long-term 10% fully-loaded CET1 ratio. As of FY 2014 (and Q1 2015), SocGen's fully-loaded CET1 ratio was 10.1%, and its transitional CET1 ratio stood at 10.9%, to be compared with the 5.125% trigger. Therefore, the distance to trigger at the end of YE 2014 was 5.785% or around EUR 20.5bn. As shown in Table 2, the distance to trigger should decrease, as SocGen's CET 1 shifts to fully-loaded.

However, we believe that the trigger point is low enough for SocGen to secure ample capital buffer to trigger.

We note that SocGen's CET1 ratio target is dependent on RWA growth and dividend payment and that alteration on these two variables could lead to a swift and material increase in the CET1 ratio.

Table 2: Distance to trigger

	2014	2015	2016	2017	2018	2019
Trigger level	5.125%	5.125%	5.125%	5.125%	5.125%	5.125%
CET1	10.91% as of FY 2014 (transitional)					10.0% target fully-loaded
Gap (%)	5.785%					4.875%
Gap (EUR bn)	20.5					

Source: Company data, Scope Ratings

Security Ratings	
Outlook	Positive
6% EUR 1.75bn undated additional Tier 1 notes temporary write-down on 5.125% trigger	BB
6.25% USD 1.25bn undated additional Tier 1 notes temporary write-down on 5.125% trigger	BB
7.125% GBP 0.65bn undated additional Tier 1 notes temporary write down on 5.125% trigger	BB
7.50% USD 1.5bn undated additional Tier 1 notes temporary write down on 5.125% trigger	BB

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The ratings have not been solicited by the issuer; the analysis is based solely on public information.

Rating rationale

We assign a rating of BB to Deutsche Bank's four undated non-cumulative fixed to reset rates additional Tier 1 notes issued in May and November 2014. The rated securities are the 6% EUR 1.75bn, the 6.25% USD 1.25bn, the 7.125% GBP 0.65bn and the 7.5% USD 1.5bn additional Tier 1 notes respectively. The rating is based on the following considerations:

- Issuer Credit Strength Rating (ICSR): A-, stable outlook
- Minimum notches down from the ICSR: 4
- Additional notch: 1

Please refer to Scope's *Bank Capital Instruments Rating Methodology* published on September 2014 for more details about the minimum notching for AT1 securities. The additional notches for these securities reflects the following:

- On 20 February 2015, the ECB notified Deutsche Bank that it was required to maintain a CET 1 ratio of at least 10% (on a phased-in basis) at all times. This means that by 2019, Deutsche's CET1 requirement could stand at a minimum of 10% (on a fully-phased basis), 1% higher than our previous CET1 requirement estimate of 9%. This could therefore put more pressure on Deutsche's ability to meet its CBR requirement as a result. We nonetheless note that Deutsche's CET1 target was raised from 10% to 11% recently, therefore neutralising the new CET1 requirement.
- This negative factor is compounded by the fact that Available Distributable Items (ADIs) do not strike us as very elevated versus peers, and potentially more volatile;
- At the same time, we note that the absolute level of the trigger (5.125%) is relatively low and the applicable CET1 ratio is the currently defined (i.e. transitional) ratio at group level. Consequently the distance to trigger is currently very favourable, underpinning no further notching for principal loss absorption risk.

ICSR

The ICSR of A- reflects the somewhat challenged business model of Deutsche Bank at a time when increased capital constraints and regulatory overhaul make it very costly for a "global universal bank" to operate as efficiently as before the crisis. The recent presentation of the new strategic plan "Strategy 2020" has led the bank to announce the deconsolidation of Postbank. This in turn drove our decision to remove Deutsche Bank's Positive Outlook, as until now we considered the acquisition of Postbank between 2008 and 2010 as a positive rating driver that contributed to the bank's earnings stability and to the strength of its market presence in Germany. To offset this factor, Scope recognises the cross-cycle resilience of the investment bank's revenue streams despite challenging operating conditions, and welcomes the long-term Tier leverage ratio target of at least 5% in the medium term, even if execution risks are attached to this objective, in our view..

Summary terms

Issuer	Deutsche Bank AG
Issue Date	27 May 2014
Amount	EUR 1.75bn
Coupon	• 6% fixed until first call date, reset every 5 years thereafter • If any, payable annually
Format	Undated non-cumulative additional Tier 1 notes, callable 30 April 2022 and every five years thereafter
ISIN	DE000DB7XHP3
Amount	USD 1.25bn
Coupon	• 6.25% fixed until first call date, reset every 5 years thereafter • If any, payable annually
Format	Undated non-cumulative additional Tier 1 notes, callable 30 April 2020 and every five years thereafter
ISIN	XS1071551474
Amount	GBP 0.65bn
Coupon	• 7.125% fixed until first call date, reset every 5 years thereafter • If any, payable annually
Format	Undated non-cumulative additional Tier 1 notes, callable 30 April 2026 and every five years thereafter
ISIN	XS1071551391
Issue Date	19 November 2014
Amount	USD 1.5bn
Coupon	• 7.5% fixed until first call date, reset every 5 years thereafter • If any, payable annually
Format	Undated non-cumulative additional Tier 1 notes, callable 30 April 2025 and every five years thereafter
ISIN	US251525AN16
Capital Treatment	Tier 1

Coupon Cancellation	• Fully discretionary • No interest payment will accrue if (i) coupons on all Tier 1 instruments exceed the Available Distributable Items or if (ii) the competent supervisory authority orders that all or parts of the relevant payment of interest be cancelled, or another prohibition of distribution is imposed by law or an authority; • If the nominal amount is subject to a write-down due to the issuer's CET1 ratio falling below 5.125%, the interest payment will be calculated on the basis of the reduced nominal amount and thus not accrue in full.
Principal Loss Absorption	• Upon the occurrence of a trigger event, the nominal amount of each of the notes will be reduced by the amount of the relevant statutorily write-down. • The nominal amount can be written up to the extent that an annual profit is recorded and the write-up will not give rise to or increase an annual loss. • The write-up is at the discretion of the issuer. • The notes may be written down (without prospect of a potential write-up) or converted on the occurrence of a non-viability event or if the issuer becomes subject to resolution.
Trigger for Principal Loss Absorption	CET1 < 5.125% transitional basis

Source: Prospectuses, Scope Ratings

We note that versus the three AT1s issued in May 2014, the language used in the November 2014 supplementary prospectus is materially more severe (even if the T&Cs are essentially the same). For example, we note that all through the risk section and even in the section relative to the description of the notes, potential holders are repeatedly warned that they:

- are bound to consent to the imposition of any resolution measures;
- will be paid interest only to the extent it is not cancelled or deemed cancelled;
- are bound to recognize that a write-down is not an event of default.

Again, we stress that the terms themselves have not changed versus May, but it seems that the publication of the Bank Recovery and Resolution Directive (BRRD) on May 15, 2014 has led Deutsche to segregate investor risk in a more systematic way than before. We also note that the base prospectus of the November 2014 issue specifies that the notes must not be sold to retail clients.

Key risk: coupon cancellation

Coupon payments on the security are fully discretionary and are subject to distribution restrictions.

Combined buffer requirement

The CRD4-CRR restrictions on discretionary distributions are applicable from January 1, 2016 and are based on transitional CET1 requirements. At this time, we know that Deutsche will be subject to the 2.5% capital conservation buffer and a 2% buffer for being a global systemically important bank. As of June 2015, the institution-specific countercyclical capital buffer rate for Deutsche Bank has not been established yet.

More importantly, Deutsche reports that "on 20 February 2015, the ECB notified us that we are required to maintain a CET 1 ratio of at least 10% (on a phased-in basis) at all times".

This means that versus our previous estimates, the estimated required CET1 associated with distribution restrictions has in our view, gone up by one percentage point (from 9% to 10%) by 2019 – if we assume that the ECB requirement remains valid even on a fully-phased basis until then.

Table 1: Combined buffer requirement

	2014	2015	2016	2017	2018	2019
Combined buffer:						
- Capital conservation			0.625%	1.25%	1.875%	2.500%
- Systemic[1]			0.5%	1.0%	2.0%	2.0%
- ECB specific requirement add-on[2]		5.5%	4.4%	3.2%	1.6%	1.0%
- Countercyclical[3]			0.0%	0.0%	0.0%	0.0%
Minimum CET1	4.0%	4.5%	4.5%	4.5%	4.5%	4.5%
Required CET1 associated with distribution restrictions	**4.0%**	**10.0%**	**10.0%**	**10.0%**	**10.0%**	**10.0%**
Deutsche's CET1 (transitional)	15.0%	13.8% as of Q1 2015				Target of "approximately 11%"
Gap (%)	11.0%	3.8%				1.0%
Gap (EUR)	43.6bn	16.4bn				

1) Transitional requirement for being a GSIB.
2) On 20 February 2015, the ECB notified Deutsche Bank that it was required to maintain a CET1 ratio of at least 10% (on a phased-in basis) at all times
3) As of June 2015, countercyclical capital buffer rate was not established yet. May range from 0% to 2.5%
Source: CRD4-CRR, Company data, Scope Ratings

We note that since Deutsche's new CET1 ratio target (as per "Strategy 2020") stands at "approximately 11%, the gap to CET1 requirement is bound to be limited to a mere 1% (from 2019 onwards and ona fully-phased basis). On the back of Q1 2015 RWAs, the gap would represent around EUR 4.3bn, but we expect this amount to be less as Deutsche Bank's net deleveraging in the context of Strategy 2020 should have an impact on RWAs (we estimate a RWA reduction of about EUR 75bn by 2019). We nonetheless point out that the expected gap to 2019 CET1 requirement does not change: last year, Deutsche's long-term CET1 target was 10%, for a requirement of 9%. This year, the target stands at 11%, for a requirement of 10%.

However, the ability for Deutsche to pay coupons on its AT1 notes will depend on its ability to generate enough Available Distributable Items (ADIs). Deutsche's ADIs over the last four years are summarized in Table 2.

Table 2: Available Distributable Items (ADIs) Deutsche Bank AG Parent company 2011-2014, EUR m

	2014	2013	2012	2011
Distributable profit	1,169	920	792	852
Other revenue reserves after net income attribution	6,332	6,111	6,114	5,434
= Total gross dividend potential	7,501	7,031	6,906	6,286
Minus non-distributable reserves	-5,483	-5,064	-6,115	-5,453
= Available distributable items	2,018	1,967	791	833
+ Aggregate amount of interest expenses relating to T1 instruments	852	756	791	753
Total amount available to cover interest payments on T1 instruments (ADIs)	**2,870**	**2,723**	**1,582**	**1,586**

Source: Company data, Scope Ratings

The ADIs have been so far superior to the annual distributable profits of the company for the simple reason that past retained earnings are included in their calculation. However, non-distributable reserves (such as issue premiums) are also not included, which means that even if the ADIs can amply cover the AT1s coupons payments at this point, we cannot exclude that potential large settlement fines on litigations could easily eradicate the ADIs on one given year and put pressure on coupon payments. We estimate that the combined annual coupons on the four notes would amount to a maximum of about EUR 350m until the first call date. Added to EUR 750m to be paid on other Tier 1 securities (not taking into account maturities and calls) , we believe that the current ADIs needed to pay all the coupons on Deutsche's AT1s would be around a maximum of around EUR 1.5bn. In other words, based on the three year average NDIs, Deutsche has the means to pay the AT1 coupon, but does not have a significant margin of manoeuvre.

Key risk: principal loss absorption

There is a write-down affected pro-rata with all other Additional Tier 1 instruments when a trigger event occurs. The trigger event occurs if Deutsche's CET1 ratio falls below 5.125%. Upon the occurrence of a trigger event, a write-down shall be affected pro rata with all other Additional Tier 1 instruments. For such purpose, the total amount of the write downs to be allocated pro rata shall be equal to the amount required to restore fully the CET1 ratio of the issuer to 5.125%. However, the write-down cannot exceed the nominal amounts of the AT1s at the time of the trigger event.

We note that written-downs AT1s can be written up at the discretion of the issuer. The nominal amount can only be written up to the extent that an annual profit is recorded and the write-up will not give rise to or increase an annual loss. Write-ups of AT1 notes do not have priority over dividend payments on ordinary shares. Also, it is likely that any write-down due to a regulatory bail-in cannot be written up.

In addition, the notes may be written down (without prospect of a potential write-up) or converted into Deutsche Bank's shares on the occurrence of a non-viability event (more explicitly stated in the T&Cs related to the May 2014 notes) or if the issuer is subject to resolution. The holders would have no claim against the issuer in such a case and there would be no obligation of the issuer to make payments under the Notes.

Distance to trigger

The Basel 3 CET1 capital against which the 5.125% trigger is measured is the transitional CET1 ratio of Deutsche Bank, ahead of its "fully-phased", "phased out", "fully loaded" or "fully applied" application in 2019 (all these terms are used with a varying degree by the different banks and all of them mean the same thing). The transitional definition is less conservative than the "fully loaded" definition and helps explain the very significant distance to trigger between the CET1 ratio of the bank and the 5.125% trigger in Q1 2015 (as per Table 3 below). We would expect this gap to narrow between 2015 and 2019, as the progressive de-recognition of "old style" capital instruments and the increasing weight of Basel 3-specific capital deductions gather momentum and lead to likely lower levels of CET1 ahead of 2019, the first year where all the Basel 3 CET1 definitions will be fully applied.

Table 3 shows that as of Q1 2015, Deutsche's transitional CET1 ratio was 13.8%, compared to the 5.125% trigger level. Therefore, the distance to trigger at the end of Q1 2015 was 8.675% or around EUR 37.5bn. If we were to use Deutsche's fully-loaded medium-term CET1 target of "approximately 11%" and compare it with an estimated fully loaded Basel 3 RWAs post-Strategy 2020 (as per our calculation above) , the distance to trigger would still be around EUR 20bn. As mentioned above, we believe that the distance to trigger should decrease (due to a lower reported CET1 ratio reflecting the passage to fully-phased Basel 3). We also note that the bank could face significant litigation fines in future, which could also contribute to reduce the CET1 capital of the bank. However, the capital cushion of the bank (potentially strengthened by the bank's objective to raise its Tier 1 leverage ratio to 5% of more) provides a solid protection, in our view – even if there is a possibility that the Regulator could consider a viability event above the 5.125% trigger level.

Table 3: Distance to trigger

	2014	2015	2016	2017	2018	2019
Trigger level	5.125%	5.125%	5.125%	5.125%	5.125%	5.125%
CET1 (transitional, fully phased in 2019)	15%	13.8% as of Q1 2015				Target of "approximately 11%"
Gap (%)	9.875%	8.675%				5.875%
Gap (EUR)	39.2bn	37.5bn				

Source: Company data, Scope Ratings

Security Ratings	
Outlook	Stable
5.75% USD 750m Fixed Rate Reset Perpetual Additional Tier 1 Capital Notes	BBB-

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This rating was not solicited by the issuer; the analysis is based solely on public information.

Rating rationale

We assign a rating of BBB- to DNB Bank's 5.75% USD 750m Fixed Rate Reset Perpetual Additional Tier 1 Capital Notes issued on 26 March 2015. The instruments feature a 5.125% trigger for principal write-down. The rating is based on the following considerations:

- Issuer Credit Strength Rating (ICSR): A+, Stable outlook
- Minimum notches down from the ICSR: 4
- Additional notches: 1

Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in September 2014 for more details about the minimum notching for AT1 securities. There is no additional notching for these securities.

DNB maintains a solid capital position driven by its strong earnings capabilities as well as comparatively high regulatory capital requirements. Management's target of a minimum 14% CET1 ratio means that the distance to trigger on the Notes is ample. However, the gap to the combined buffer requirement is relatively narrow and this accounts for the additional notch off the ICSR. This is mitigated somewhat by DNB's track record of profitability, the commitment to achieving the minimum 14% CET1 target as well as intentions to maintain a minimum 1% management buffer above requirements.

ICSR

The ICSR of A+ for DNB Bank is based on the strength of the DNB Group (DNB ASA). DNB's rating is driven by its strong franchise as the leading financial services provider in a relatively concentrated and economically robust market. This enables the Group to generate resilient earnings and to maintain a solid capital positon. Concerns would materialize if the Norwegian economy were to significantly deteriorate or access to capital markets funding were disrupted. While still reliant on market funding, DNB's funding profile has improved with the use of covered bonds.

The government's 34% ownership stake in the Group is not a driver for DNB's rating. The Group is financially sound and in line with our rating methodology we do not notch up the ICSR of A+ based on the expectation of state support in the event the bank goes into distress. Further, a sale of the government's stake would not in and of itself lead to a rating change.

Summary terms

Issuer	DNB Bank ASA
Issue Date	26 March 2015
Amount	USD 750m
Coupon	• 5.75% fixed annual coupon until first call date (26 March 2020) • Thereafter reset every five years at 5y Mid Swap + 407.5bps • If any, payable in arrears annually
Format	• Fixed Rate Reset Perpetual Additional Tier 1 Capital Notes • Redeemable upon occurrence of Withholding Tax Event, Tax Event or Capital Event, subject to regulatory approval • Redeemable by the issuer on first call date and on every Interest Payment Date thereafter, subject to regulatory approval.
ISIN	XS1207306652
Capital Treatment	Additional Tier 1
Coupon cancellation Features	• Fully discretionary. • Mandatory in case of: (i) trigger event (ii) insufficient distributable items (iii) if payment exceeds the Maximum Distributable Amount (MDA) upon a breach of the Combined Buffer Requirement • Norwegian FSA has discretion to cancel coupon payments
Principal Loss Absorption Features	• Upon trigger event the principal amount of the Notes will be written down • At the issuer's discretion, the principal amount of the Notes may be written up subject to the Maximum Write-Up Amount and to the MDA, pro-rata with any written down AT1 instruments • Subject to write-down under the Norwegian Bank Security Act • If the Bank Recovery and Resolution Directive (BRRD) is adopted in Norway then subject to general bail-in tool and write-down or conversion at the point of non-viability
Trigger for Principal Loss Absorption	• DNB Bank CET1 ratio < 5.125%or • DNB Bank Group CET1 ratio < 5.125% or • DNB Group CET1 ratio < 5.125%

Source: Prospectus, Scope Ratings

Key risk: coupon cancellation

Coupon payments on the Notes are fully discretionary and are subject to distribution restrictions. Coupons are mandatorily cancelled if the issuer has insufficient distributable items, the combined buffer requirement (CBR) is not met and coupon payments would exceed the Maximum Distributable Amount (MDA) or the regulator requires that coupon payments be cancelled. In addition, if the trigger has been breached, all accrued interest will be cancelled.

We do not expect distributable items to be a limiting factor for DNB in regards to coupon payments. While the available distributable items figure has not been disclosed, we note that DNB Bank ASA, the issuer, had equity of NOK 93bn at 31 March 2015 (excluding share capital and premium) and view this to be a good proxy. Coupon payments on the Notes are estimated to be less than NOK 400m per annum.

Combined Buffer Requirement

Upon a breach of the CBR, a MDA would be determined and coupons on the Notes would be limited. The CBR for DNB is comprised of the following:

- Capital conservation buffer of 2.5%,
- Systemic risk buffer of 3%,
- Countercyclical buffer of 1% in 2015 and 1.5% in 2016 and
- Systemically important institution buffer of 1% in 2015, which will rise to 2% in 2016.

Combined with the minimum Pillar 1 CET1 capital requirement of 4.5%, this means that DNB must maintain a CET1 ratio of at least 12% in 2015 and 13.5% in 2016 in order to avoid restrictions on paying coupons on the Notes. Given the comparatively high capital requirements, the gap to the CBR is expected to remain relatively narrow although DNB intends to keep a minimum 1% management buffer above the CBR. The Group has indicated that the purpose of the management buffer should be to absorb potential volatility such as an increase in countercyclical buffer requirements or volatility related to exchange rates. The CET1 ratio target is a minimum of 14% by end-2016. DNB's track record in generating earnings and capital gives us a constructive view on its ability to maintain coupon payments.

We highlight that the Norwegian regulator has frontloaded capital requirements which are being phased-in under CRD 4. At the same time, Norges Bank has communicated that the countercyclical buffer can be reduced in the event of an economic downturn or large bank losses. The countercyclical buffer rate is determined on a quarterly basis (currently 1%).

Table 1: Estimated CET1 requirements

	2014	2015	2016
Combined buffer:			
- Capital conservation	2.5%	2.5%	2.5%
- Systemic	3.0%	3.0%	3.0%
- SIFI		1.0%	2.0%
- Countercyclical		1.0%	1.5%
Minimum CET1	4.5%	4.5%	4.5%
Required CET1 associated with distribution restrictions	**10.0%**	**12.0%**	**13.5%**
DNB Group's CET1 ratio / target	12.7%	12.7%	> 14% target
Gap (%)	2.7%	0.7%	>0.5%
Gap (NOK bn)		8.1	
DNB Bank CET1 ratio	13.2%	13.1%	
DNB Bank Group CET1 ratio	12.5%	12.5%	

1) Gap in NOK based on 1Q 2015 CET1 ratio and RWAs of NOK 1.2bn.

Source: Company data, Scope Ratings

Key risk: principal loss absorption

The mechanism for loss absorption is principal write-down. The 5.125% trigger applies to the issuer (DNB Bank ASA), the banking group (DNB Bank Group) and the parent (DNB Group). The write-down amount will be the lower of (a) the amount necessary to restore the CET1 ratio of the Bank, the Bank Group and the Group to 5.125% taking into account the write-down or conversion into equity of any Prior Loss Absorbing Instruments and/or Parity Loss Absorbing Instruments and (b) the amount necessary to reduce the principal amount of the Notes to one cent. There are currently no Prior Loss Absorbing Instruments outstanding while there are NOK 2.15bn of Parity Loss Absorbing Instruments outstanding.

At the full discretion of the issuer, the Notes may be written-up. Reinstatement may only occur if each of the Bank, the Bank Group and Group generates a profit in any given financial year and only a specified percentage of the lowest of any such profits will be available for reinstatement. Any discretionary reinstatement will be applied concurrently and pro-rata with the write-up other written-down AT1 instruments.

Norway will not be directly bound by BRRD before it has been implemented into the EEA agreement. Consequently, the Notes are presently subject to Norwegian rules regarding loss absorption under the Bank Security Act. The Notes may be written down by the Bank's shareholders or Norwegian authorities if the Bank's net assets are less than 25% of its share capital or a substantial part of the subordinated loan capital of the Bank is lost. We do not see this as a likely event as the net assets of the Bank are NOK 128bn while share capital is NOK 18bn (as of last audited accounts, YE2014). It is more probable that a write-down of the Notes occurs because of a trigger breach rather than under the Bank Security Act. If the Notes are written down pursuant to the Bank Security Act, they cannot be reinstated.

When BRRD is implemented in Norway, the Notes would likely be subject to the general bail-in tool as well be subject to write-down or conversion at the point of non-viability before any other resolution action is taken.

DNB Bank ASA, the issuer of the Notes, is the operating bank in Norway, with DNB Bank Group also incorporating foreign banking subsidiaries and some investment holding companies. DNB Group, the parent company, consolidates DNB Bank Group and the Group's asset management and insurance activities. In accordance with Norwegian regulations, the banking, asset management and insurance activities are organised in separate limited companies under the holding company, DNB Group. DNB is highly integrated and with the majority of assets being domestic, we would not consider the Bank, the Bank Group and the Parent company to have significantly different credit profiles.

Distance to trigger

As of 31 March 2015, the distance to trigger for DNB Group stood at 7.575%, or approximately NOK 91bn. The distance to trigger for the Bank and the Bank Group were at similar comfortable levels. As the Group's regulatory capital requirements are expected to stay at relatively high levels, we do not expect this gap to materially decline. We further note that DNB's capital ratios are constrained by the Basel 1 transitional floor and do not benefit from low risk weights. As of year-end 2014, the asset risk intensity of the Group was around 40%.

Table 2: Distance to trigger

	2014	2015	2016
Trigger level	5.125%	5.125%	5.125%
DNB Group's CET1 ratio	12.7%	12.7%	> 14% target
DNB Group Gap	7.575%	7.575%	> 8.875%
DNB Bank's CET1 ratio	13.2%	13.1%	
DNB Bank Gap	8.075%	7.975%	
DNB Bank Group's CET1 ratio	12.5%	12.5%	
DNB Bank Group Gap	7.375%	7.375%	

Note: 2015 figures are as of 31 March 2015.

Source: Company data, Scope Ratings

Security Ratings	
Outlook	Stable
9% USD 1.5bn perpetual AT1 notes (2013) equity conversion on 5.125% trigger	BB+
7% EUR 1.5bn perpetual AT1 notes (2014) equity conversion on 5.125% trigger	BB+
6.75% EUR 1.5bn perpetual AT1 notes (2015) equity conversion on 5.125% trigger	BB+

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The ratings have not been solicited by the issuer; the analysis is based solely on public information.

Rating rationale

Scope assigns long ratings of BB+ to BBVA's three Additional Tier 1 notes issued in May 2013, February 2014 and February 2015. The rated securities are the 9% USD 1.5bn, the 7% EUR 1.5bn and the 6.75% EUR1.5bn additional Tier 1 notes. The ratings are based on the following considerations:

- Issuer Credit Strength Rating (ICSR): A, stable outlook
- Minimum notches down from the ICSR: 4
- Additional notches: 1

Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in September 2014 for more details about the minimum notching for AT1 securities. The additional notch for these securities reflects the following considerations:

- While the conversion triggers are low, they are based both on group and parent bank CET1 ratio (transitional), partly limiting the benefit of earnings diversification for the bank in case the domestic profit outlook deteriorates and the bank is not allowed to upstream earnings from other parts of the group.
- We do not see a need to add further notches for coupon cancellation risks. We believe BBVA has abundant distributable items and a material buffer to its CBR requirement. Uncertainty regarding the final capital requirements (and in particular the countercyclical and systemic risk buffers) remains, but we deem the 2 notches adequate and do not apply further notching for coupon cancellation risks.

ICSR

BBVA has an ICSR of A, with a stable outlook.

The rating is based to a large extent on the strength and reliability of BBVA's retail and commercial banking franchises in several countries and on the strong market positioning in its main countries of operation.

The high degree of diversification has helped BBVA deliver significant profits, despite the stressed operating environment in Spain, and enabled it to generate capital organically. The bank has withstood harsh conditions, peaking with a collapse in its domestic real estate market and significant stress to funding markets and to domestic sovereign risk in 2011 and 2012. Despite this, the bank's capital base has kept growing throughout.

While the domestic economic environment has been improving, Spain continues to weigh negatively on the group's earnings capacity due to the continued high provisions required by a high, albeit declining, NPLs stock. The recovery, if sustained, should have a positive impact on asset quality in the coming years and also improve the sustainability of public debt, which remains a concern to us. However, we underscore, we do not automatically link BBVA's rating with the credit standing of the Spanish sovereign.

Summary terms of the rated securities

Issuer	BBVA SA
Issue Date	May-13
Amount	USD 1.5bn
Coupon	- 9% to May 9, 2018, then switches to 5y midswap rate + 8.262% - Paid Quarterly
Format	• Non Step-up, non-cumulative Contingent Convertible Perpetual Preferred Tier 1 • Redeemable at the option of the bank, subject to regulator consent, in case of change in capital treatment or tax treatment; • Redeemable at the option of the bank, subject to regulator consent and to non-detriment to BBVA's solvency and financial position, from 9 May 2018.
ISIN	XS0926832907
Capital Treatment	Additional Tier 1
Issue Date	Feb-14
Amount	EUR1.5bn
Coupon	- 7% from 2014 to 2019, then switches to 5y midswap rate + 6.155% - Paid Quarterly
Format	• Non Step-up, non-cumulative Contingent Convertible Perpetual Preferred Tier 1 • Redeemable at the option of the bank, subject to regulator consent, in case of change in capital treatment or tax treatment; • Redeemable at the option of the bank, subject to regulator consent and to non-detriment to BBVA's solvency and financial position, from 19 February 2019.
ISIN	XS1033661866
Capital Treatment	Additional Tier 1
Issue Date	Feb-15
Amount	EUR1.5bn
Coupon	• 6.75% from 2015 to 2020, then switches to 5y midswap rate + 6.604% • Paid Quarterly
Format	• Non Step-up, non-cumulative Contingent Convertible Perpetual Preferred Tier • Redeemable at the option of the bank, subject to regulator consent, in case of change in capital treatment or tax treatment; • Redeemable at the option of the bank, subject to regulator consent , from 18 February 2020.
ISIN	XS1190663952
Capital Treatment	Additional Tier 1
Coupon cancellation features	Fully discretionary if the bank deems it necessary or desirable; Mandatory in case of: - insufficient Available Distributable Items; - if distributions would exceed the MDA - a distribution would cause a breach of regulatory restrictions - request from the regulator.

Principal Loss absorption features	• Upon Trigger Event • Conversion at the point of non viability • Liability Management exercises ordered by the FROB ex Law 9/2012 (implementing the 2012 Memorandum of Understanding with the Euro Group) if the bank meets the conditions for Restructuring or Resolution as defined by Law 9/2012
Triggers for Principal Loss absorption*	• CRD4 transitional CET1 Ratio (Group) < 5.125% • CRD4 transitional CET1 Ratio (BBVA SA) < 5.125%

Source: Prospectus. Scope Ratings

*Note: the original terms of the May 2013 securities included multiple triggers based on Principal Capital, EBA CT1 Capital and Tier 1 Ratio. According to BBVA, these ceased to apply following Spanish implementation of CRD4.

Key risk: coupon cancellation

Coupon payments on the security are fully discretionary and are subject to distribution restrictions.

Available Distributable Items

The concept of Available Distributable Items (ADI) is defined in the CRR (Art.4.1-128) as "the amount of the profits at the end of the last financial year plus any profits brought forward and reserves available for that purpose before distributions to holders of own funds instruments less any losses brought forward, profits which are non-distributable pursuant to provisions in legislation or the institution's by-laws and sums placed to non-distributable reserves in accordance with applicable national law or the statuses of the institution, those losses and reserves being determined on the basis of the individual accounts of the institution and not on the basis of the consolidated accounts".

In the following table we estimate BBVA's available distributable items based on public disclosures from BBVA SA's 2014 annual accounts:

Available Distributable Items	BBVA SA 2014
Total equity	36,614
(-) Common Stock	-3,024
(-) Share Premium Account	-23,992
(-) Non Distributable reserves	
Reserves of entities consolidated	0
Legal Reserve	-567
Restricted reserve for retired capital	-268
Reserves for balance revaluation	-23
(+) dividend addback	841
(+) Valuation Adjustments	-1,601
(-) Treasury Stocks	-46
(-) Other Equity instruments	-47
(-) non controlling interests	0
Estimate of Distributable Items	**7,887**
ow Profit	1,105
ow Voluntary reserves (Parent Company level)	6,784

Source: Scope Ratings Estimates, BBVA

As shown, our estimate of Available Distributable Items is EUR 7.9bn. This includes the parent company profit for 2014 (EUR 1.1bn) and Voluntary reserves at the parent company level of EUR 6.8bn. This is an ample buffer in our view, also based on our current profitability forecasts for BBVA, which are likely to add to this amount in the coming years. At this stage we do not expect lack of ADI to be a factor restraining distributions on the notes.

Combined Buffer Requirement

The CRD4-CRR restrictions on discretionary distributions are based on transitional CET1 requirements. At this time, we know that BBVA will be subject to the 2.5% capital conservation buffer and a 1% buffer for being a global systemically important bank. In future, the bank may be subject to an institution specific countercyclical buffer ex. art 160 of CRD4 as well as to higher systemic buffers ex art. 133.4 of CRD4.

Distance-to-CBR estimate	2014	2015E	2016E	2017E	2018E	2019E
Combined buffer:						
- Capital conservation			0.6%	1.3%	1.9%	2.5%
- Systemic [1]			0.3%	0.5%	0.8%	1.0%
- Countercyclical [2]	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Minimum CET1	4.0%	4.5%	4.5%	4.5%	4.5%	4.5%
Required CET1 associated with distribution restrictions	4.0%	4.5%	5.4%	6.3%	7.1%	8.0%
BBVA CET1 Ratio [3]	12.0%	11.2%	11.1%	11.2%	11.3%	11.5%
Distance-to-CBR	**8.0%**	**6.7%**	**5.8%**	**4.9%**	**4.2%**	**3.5%**

Source: Scope Ratings
1) G-SIB phased in requirement for BBVA is 1%. Higher systemic buffers may apply in the future;
2) A coutercyclical buffer of up to 2.5% may apply in the future
3) BBVA CET1 Ratio estimate assumes 3% RWA growth, 25% payout, RoRWA of c. 1% on average in the period, 70bps from CatalunyaBanc and Garanti acquisitions, and gradual convergence of CET1 transitional to fully loaded

In the short run, we see very little risk of BBVA hitting its combined buffer requirement: The latest reported CET1 ratio on a transitional basis was 12% as of year end 2014, representing a significant buffer of 8% to the current CET1 requirement of 4%. We expect the BBVA ratio to decline in the short term due to the impact from the Catalunya Banc and Garanti stake acquisitions and from the gradual transition towards fully phased CRD4. On our estimate the ratio should resume its growth from 2016, as capital formation more than offsets the phasing-in of CRD4 deductions. However, as the new capital are also phased in, the buffer is set to decline over time and we estimate that it will fall to 3.5% in 2019. This is based on our current knowledge of BBVA capital requirements, which include a minimum CET1 requirement of 4.5%, a capital conservation buffer of 2.5% and a G-SIFI surcharge of 1%. Our calculations are based on CET1 basic and CBR requirements, and assume that BBVA will make full use of its AT1 and T2 buckets over time to optimise its capital structure, as guided by the company.

Further, the group may be subject to higher requirements, including a systemic buffer of up to 5% and a countercyclical buffer of up to 2.5%. In the worst case scenario, we estimate that the CET1 requirement would go up to 14.5%. In other words, while the coupon cancellation risk is relatively low at present, it is set to increase over time due to a combination of the above elements. On the other hand, we highlight that the acquisition of Catalunya will also contribute additional earnings which are not currently included in our capital formation forecasts and that management actions could reduce the impact from the phasing in of CRD4.

Key risk: principal loss absorption

The mechanism for loss absorption is Equity conversion. The securities have 5.125% CET1 triggers, where CET1 capital is based on transitional rules. The triggers apply both to BBVA group and BBVA parent company. As of June 2014, BBVA group had a transitional CET1 ratio of 12%, while BBVA SA had a transitional CET1 ratio of 17.2%. Both ratios exclude the impact from Catalunya Banc, and Garanti.

Distance to trigger

The current distance to trigger is already a comfortable 12% for the parent bank and 6.8% for the Group. Based on our estimates of capital formation at BBVA, this distance is decline in 2015 due to the capital impact of the Catalunya Banc consolidation and Garanti stake acquisition, before increasing again in the following yeas. Our estimates are however based on the group's consolidated profitability, so in order to project the capital formation for the parent company we have to make a further assumption, namely that all profits that are not needed to finance RWA growth can be up-streamed from the subsidiaries to the parent company. As we highlight in our Issuer Rating report of BBVA, this ability may diminish at times of stress, when national authorities may move to protect domestic depositors and hence limit the fungibility of capital across the various parts of the group. While this risk is already incorporated in our ICSR of A, we believe that it is even more relevant for the purpose of AT1 ratings with a trigger based on parent company.

With respect to this risk, we note that BBVA parent company profitability relies heavily on dividends from its subsidiaries. Net profit for 2014 was EUR 1.1bn, and included EUR 2.85bn in dividend income.

Distance-to-Trigger	2014	2015E	2016E	2017E	2018E	2019E
Trigger CET1 Transitional - BBVA SA	5.125%	5.125%	5.125%	5.125%	5.125%	5.125%
Trigger CET1 Transitional - BBVA Group	5.125%	5.125%	5.125%	5.125%	5.125%	5.125%
CET1 Ratio - BBVA Group [1]	12.0%	11.2%	11.1%	11.2%	11.3%	11.5%
CET1 Ratio - BBVA SA[2]	17.2%	16.4%	16.4%	16.4%	16.5%	16.8%
Distance-to-Trigger BBVA SA	12.1%	11.3%	11.2%	11.3%	11.4%	11.6%
Distance-to-Trigger BBVA Group	**6.8%**	**6.0%**	**6.0%**	**6.1%**	**6.2%**	**6.4%**
Distance-to-Trigger BBVA Group, in Euros	**23,969**	**21,813**	**22,331**	**23,184**	**24,401**	**26,039**

Source: Scope Ratings Estimates, BBVA
1) BBVA CET1 Ratio estimate assumes 3% RWA growth, 25% payout, RoRWA of c. 1% on average in the period, 70bps from CatalunyaBanc and
2) Assumes that all profits can be upstreamed, and parent company capital ratio follows group's capital evolution

Spanish Resolution and Restructuring

Spanish Law 9/2012 implements the Spanish Memorandum of Understanding (MoU) with the Euro Group in July of 2012, when Spain received a line of credit to recapitalise financial institutions. The MoU had some bank specific conditionality, including the pre-requisite for private sector burden-sharing before resolution of non viable banks as well as restructuring and recapitalisation of viable banks. As a result, Law 9/2012 has specific provisions which call for bail-in of convertible instruments before any public sector help can be deployed. In our view this law effectively brings forward resolution and bail-in for Spanish institutions, and as such exposes the securities to additional conversion risks. However, we do not deem it necessary to add a further notch for this risk given that the buffers to trigger are significant.

Peculiarities of the 2013 9% USD1.5bn note

The 2013 9% USD1.5bn note was one of the first CRD4 compliant AT1 issues in Europe. When it was issued, CRD4 had not even been finalised. As a result, it has some specific features that in our view entail further uncertainty. These are:

- The multiple triggers at issuance. The offering circular had triggers based on CET1 Ratio, T1 ratio, EBA Core Tier 1 Ratio and Spanish Capital Principal ratio. Following implementation of CRD4, BBVA now considers that the additional triggers (T1, EBA, Capital Principal) have ceased to apply.
- The explicit non viability language. The offering circular explicitly refers to "non-viability event" on top of trigger events. The definition of non-viability event refers again to Law 9/2012 and applicable banking regulations but also to the bank not being able to pay a material part of its debts as they fall due, being unable to carry its business or be considered non viable by the National Relevant Authority.

While we do not believe these peculiarities warrant a different rating, we highlight that as a result of regulatory overkill at issuance the resulting terms are slightly more opaque than most other AT1 issues we rate, including the BBVA 2014 7% EUR 1.5bn.

Security Ratings	
Outlook	Stable
6.375% USD 1.5bn perpetual AT1 notes (May 2014) equity conversion on 5.125% trigger	BBB-
6.25% EUR 1.5bn perpetual AT1 notes (March 2014) equity conversion on 5.125% trigger	BBB-
6.25% EUR 1.5bn perpetual AT1 notes (September 2014) equity conversion on 5.125% trigger	BBB-

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This rating was not solicited by the issuer; the analysis is based solely on public information.

Rating rationale

We assign a rating of BBB- to Santander's three Additional Tier 1 notes issued in March, May and September 2014. The rated securities are the 6.375% USD 1.5bn and the two 6.25% EUR 1.5bn AT1 notes respectively. The ratings are based on the following considerations:

- Issuer Credit Strength Rating (ICSR): A, stable outlook
- Minimum notches down from the ICSR: 4
- Additional notches: 1

Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in September 2014 for more details about the minimum notching for AT1 securities. The additional notch for these securities reflects the following:

- While the conversion triggers are low, they are based both on group and parent bank CET1 ratio (transitional), partly limiting the benefit of earnings diversification for the bank in case the domestic profit outlook deteriorates and the bank is not allowed to upstream earnings from other parts of the group.
- We do not see a need to add further notches for coupon cancellation risks. While uncertainty remains regarding the final capital requirements and the level of available distributable items is relatively limited at EUR 3bn, we believe this risk is adequately captured in the 2 basic notches as per our methodology.

ICSR

Santander has an ICSR of A+, with a stable outlook.

The ratings reflect the group's improved capital position, following the EUR 7.5bn capital increase in January, an improving – albeit still relatively weak - asset quality both at group level and in Spain as well as the stronger supervisory framework in Europe which is part of the ongoing progress towards a banking union. The ratings are driven by the bank's strong diversified retail and commercial banking business model, producing a reliable and well-diversified earnings stream and generating capital at the group level. Having withstood the global financial crisis, the Spanish real estate market collapse and the euro area sovereign crisis without damage to capital, the business model of Santander has proven its resilience to shocks in our view.

Due to the group's presence in several developed and emerging markets, we believe a key challenge for Santander will remain being faced with different regulatory requirements by different authorities and ensuring that prudential and supervisory requirements are met not only at the group level, but also locally.

Summary terms – 6.25% EUR 1.5bn, March 2014

Issuer	Banco Santander S.A.
Issue Date	Mar-2014
Amount	EUR 1.5bn
Coupon	• 6.25% from 12/03/2014 to 12/03/2019 (excluded), then switches to 5y mid-swap rate + 5.41% • Paid Quarterly
Format	• Non Step-up, non-cumulative Contingent Convertible Perpetual Preferred Tier 1 • Redeemable at the option of the bank, subject to regulator consent (only after first reset date) • Redeemable at the option of the bank, subject to regulator consent, in case of change in capital treatment or tax treatment (after closing date)
ISIN	XS1043535092
Capital Treatment	Additional Tier 1
Coupon cancellation features	• Fully discretionary if the bank deems it necessary or desirable; • Mandatory in case (i) of insufficient Available Distributable Items; (ii) of request from the regulator. • Mandatory if distributions would exceed the MDA
Principal Loss absorption features	• Upon Trigger Event (CET1 for bank or group calculated as for applicable banking reg. falling below 5.125%), conversion into Equity at the higher of: a) 5 day share price average (Current Market Price), b) EUR 0.50 (Nominal Value of common shares) c) EUR 4.34 (Floor Price), subject to subsequent adjustments for capital actions • Liability Management exercises ordered by the FROB ex Law 9/2012 (implementing the 2012 Memorandum of Understanding with the Euro Group) could result in significant principal losses
Triggers for Principal Loss absorption	• CRD4 transitional CET1 Ratio (Group) < 5.125% • CRD4 transitional CET1 Ratio (Santander SA) < 5.125% • Conversion at the point of non viability (RRD) • For loss absorption due to a liability management exercise by the FROB, the bank meets the conditions for Restructuring or Resolution as defined by Law 9/2012

Source: Prospectus, Scope Ratings

Summary terms – 6.375% USD 1.5bn, May 2014

Issuer	Banco Santander S.A.
Issue Date	May-2014
Amount	USD1.5bn
Coupon	• 6.375% from 19/05/2014 to 19/05/2019 (excluded), then switches to 5y mid-swap rate + 4.788% • Paid Quarterly
Format	• Non Step-up, non-cumulative Contingent Convertible Perpetual Preferred Tier 1 • Redeemable at the option of the bank, subject to regulator consent (only after first reset date) • Redeemable at the option of the bank, subject to regulator consent, in case of change in capital treatment or tax treatment (after closing date)
ISIN	XS1066553329
Capital Treatment	Additional Tier 1
Coupon cancellation features	• Fully discretionary if the bank deems it necessary or desirable; • Mandatory in case (i) of insufficient Available Distributable Items; (ii) of request from the regulator. • Mandatory if distributions would exceed the MDA
Principal Loss absorption features	• Upon Trigger Event, conversion into Equity at the higher of: a) 5 day share price average (Current Market Price translated into USD) b) EUR 0.50 (Nominal Value of common shares translated into USD) c) USD6.556 (Floor Price), subject to subsequent adjustments for capital actions • Liability Management exercises ordered by the FROB ex Law 9/2012 (implementing the 2012 Memorandum of Understanding with the Euro Group) could result in significant principal losses
Trigger for Principal Loss absorption	• CRD4 transitional CET1 Ratio (Group) < 5.125% • CRD4 transitional CET1 Ratio (Santander SA) < 5.125% • Conversion at the point of non viability (RRD) • For loss absorption due to a liability management exercise by the FROB, the bank meets the conditions for Restructuring or Resolution as defined by Law 9/2012

Source: Prospectus, Scope Ratings

Summary terms – 6.25% EUR 1.5bn, September 2014

Issuer	Banco Santander S.A.
Issue Date	Sep-2014
Amount	EUR 1.5bn
Coupon	• 6.25% from 11/09/2014 to 11/09/2021 (excluded), then switches to 5y mid-swap rate + 5.64% • Paid Quarterly
Format	• Non Step-up, non-cumulative Contingent Convertible Perpetual Preferred Tier 1 • Redeemable at the option of the bank, subject to regulator consent (only after first reset date) • Redeemable at the option of the bank, subject to regulator consent, in case of change in capital treatment or tax treatment (after closing date)
ISIN	XS1107291541
Capital Treatment	Additional Tier 1
Coupon cancellation features	• Fully discretionary if the bank deems it necessary or desirable; • Mandatory in case (i) of insufficient Available Distributable Items; (ii) of request from the regulator. • Mandatory if distributions would exceed the MDA
Principal Loss absorption features	• Upon Trigger Event (CET1 for bank or group calculated as for applicable banking reg. falling below 5.125%), conversion into Equity at the higher of: a) 5 day share price average (Current Market Price), b) EUR 0.50 (Nominal Value of common shares) c) EUR 5.01 (Floor Price), subject to subsequent adjustments for capital actions • Liability Management exercises ordered by the FROB ex Law 9/2012 (implementing the 2012 Memorandum of Understanding with the Euro Group) could result in significant principal losses
Trigger for Principal Loss absorption	• CRD4 transitional CET1 Ratio (Group) < 5.125% • CRD4 transitional CET1 Ratio (Santander SA) < 5.125% • Conversion at the point of non viability (RRD) • For loss absorption due to a liability management exercise by the FROB, the bank meets the conditions for Restructuring or Resolution as defined by Law 9/2012

Source: Prospectus. Scope Ratings

Key risk: coupon cancellation

Coupon payments on the security are fully discretionary and are subject to distribution restrictions.

Available Distributable Items

The concept of Available Distributable Items (ADI) is defined in the CRR (Art.4.1-128) as "the amount of the profits at the end of the last financial year plus any profits brought forward and reserves available for that purpose before distributions to holders of own funds instruments less any losses brought forward, profits which are non-distributable pursuant to provisions in legislation or the institution's by-laws and sums placed to non-distributable reserves in accordance with applicable national law or the statuses of the institution, those losses and reserves being determined on the basis of the individual accounts of the institution and not on the basis of the consolidated accounts".

Based on the available disclosures, we estimate that Santander SA had distributable reserves of EUR 3bn in 2014. This amount is relatively limited, given that the bank has already issued EUR4.5bn in CRD4 compliant AT1 securities and we estimate c. EUR 260mn in AT1 coupons per year. While the group has more ample voluntary reserves in its subsidiaries (in particular in Brazil and the UK) we warn that at times of crisis the fungibility of capital across the group can diminish significantly. Given that the ADI restriction applies at parent company level, earnings diversification provides slightly less comfort to the relative thinness of Distributable Items. Looking forward, as we expect the profitability of the Spanish operations to improve, this concern is more mitigated.

Combined Buffer Requirement

The CRD4-CRR restrictions on discretionary distributions are based on transitional CET1 requirements. At this time, we know that Santander will be subject to the 2.5% capital conservation buffer and a 1% buffer for being a global systemically important bank. In the future, the bank may be subject to an institution specific countercyclical buffer ex. art 160 of CRD4 as well as to higher systemic buffers ex art. 133.4 of CRD4.

	2014	2015	2016	2017	2018	2019
Combined buffer:						
- Capital conservation			0.625%	1.250%	1.875%	2.500%
- Systemic [1]			0.25%	0.50%	0.75%	1.00%
- Countercyclical [2]	0%	0%	0%	0%	0%	0%
Minimum CET1	4.00%	4.50%	4.50%	4.50%	4.50%	4.50%
Required CET1 associated with distribution restrictions	4.00%	4.50%	5.38%	6.25%	7.13%	8.00%
SAN CET1 Ratio [3]	12.2%	11.9%	11.8%	11.8%	11.8%	11.8%
Distance-to-CBR	**8.2%**	**7.4%**	**6.5%**	**5.6%**	**4.7%**	**3.8%**

Source: Scope Ratings Estimates, Santander
1) G-SIB phased in requirement for Santander is 1%. Higher systemic buffers may apply in the future;
2) A coutercyclical buffer of up to 2.5% may apply in the future
3) 2014 figure pro-forma including EUR7.5bn capital increase in January 2015. Santander CET1 Ratio evolution assumes 4% RWA growth, 30% dividend payout, RoRWA going from 1.08% in 2014 to 1.34% in 2019, including phasing in of CRD deductions

In the short run, we see very little risk of Santander hitting its combined buffer requirement: The group CET1 ratio on a transitional basis was 12.2% as of Q4 2014, pro-forma for the January 2015 capital increase), giving AT1 investors an ample buffer of 8.2% from the CET1 requirement. Over time, this buffer is set to decline as the new CRD4 capital requirements and deductions are phased in. Based on our current knowledge, the CET1 requirement for Santander will reach at least 8% in 2019 on account of the gradual introduction of the capital conservation and G-SIFI buffer (2.5% and 1% respectively). Our projections point to a 3.8% buffer in 2019, which includes an estimate of the gradual transition to fully phased CRD4 regime. Our calculations are based on CET1 basic and CBR requirements, and assume that Santander will make full use of its AT1 and T2 buckets.

Further, the group may be subject to higher requirements, including a systemic buffer of up to 5% and a countercyclical buffer of up to 2.5%. In the worst case scenario, we estimate that the CET1 requirement would go up to 14.5%. In other words, while the coupon cancellation risk is relatively low at present, it is set to increase over time due to a combination of the above elements. Overall, we believe even in the longer run, the risk is well captured by the 2 notches we apply for coupon cancellation risk.

Key risk: principal loss absorption

The mechanism for loss absorption is Equity conversion. All securities have 5.125% CET1 triggers, where CET1 capital is based on transitional rules. The triggers apply both to Santander group and Santander parent company. As of December 2014, Santander group had a CET1 ratio of 12.2%, while Banco Santander SA had a CET1 ratio of 14.1%, both including the impact of the capital increase.

Distance to trigger

The current distance to trigger is a comfortable 9% for the parent bank and 7.1% for the Group. Based on our estimates of capital formation at Santander group, we expect the distance to trigger to slightly decline in 2015 but stabilise thereafter and remain relatively stable over time. Indeed, while profits would push up the CET1 ratio, the gradual phasing in of CRD4 CET1 deduction will cancel out that impact on the reported regulatory ratio.

When it comes to parent company capital formation, we need to make the further assumption that all profits that are not needed to finance RWA growth can be up streamed from the subsidiaries to the parent company. As we highlight in our Issuer Rating report of Santander, this ability may diminish at times of stress, when national authorities may move to protect domestic depositors and hence limit the fungibility of capital across the various parts of the group. While this risk is already incorporated in our ICSR of A+, we believe that it is even more relevant for the purpose of AT1 ratings with a trigger based on parent company solvency and hence we add a further notch down on account of this risk.

Distance-to-Trigger	2014	2015	2016	2017	2018	2019
Trigger CET1 Transitional - Banco Santander SA	5.125%	5.125%	5.125%	5.125%	5.125%	5.125%
Trigger CET1 Transitional - Santander Group	5.125%	5.125%	5.125%	5.125%	5.125%	5.125%
CET1 Ratio - Santander Group [1]	12.2%	11.9%	11.8%	11.8%	11.8%	11.8%
CET1 Ratio - Banco Santander SA [2]	14.10%	13.80%	13.70%	13.69%	13.66%	13.67%
Distance-to-Trigger Banco Santander SA	9.0%	8.7%	8.6%	8.6%	8.5%	8.5%
Distance-to-Trigger Santander Group	**7.1%**	**6.8%**	**6.7%**	**6.7%**	**6.7%**	**6.7%**
Distance-to-Trigger Santader Group, in Euros	**41,604**	**41,845**	**42,684**	**44,014**	**45,489**	**47,329**

Source: Scope Ratings Estimates, Santander

1) 2014 figure pro-forma including EUR7.5bn capital increase in January 2015. Santander CET1 Ratio evolution assumes 4% RWA growth, 30% dividend payout, RoRWA going from 1.08% in 2014 to 1.34% in 2019, including phasing in of CRD deductions.

2) Assumes all profits in excess of RWA growth can be upstreamed, and parent company capital ratio follows group's evolution.

Spanish Resolution and Restructuring

Spanish Law 9/2012 implements the Spanish Memorandum of Understanding with the Euro Group in July of 2012, when Spain received a line of credit to recapitalise financial institutions. The MoU had some bank specific conditionality, including the pre-requisite for private sector burden-sharing before resolution of non viable banks as well as restructuring and recapitalisation of viable banks. As a result, Law 9/2012 has specific provisions which call for bail-in of convertible instruments before any public sector help can be deployed. In our view this law effectively brings forward resolution and bail-in for Spanish institutions, and as such exposes the securities to additional conversion risks.

Security Ratings	
Outlook	Stable
6.125% USD 0.5bn perpetual AT1 notes (Sept 2014) temporary writedown	BBB-
5.5% USD 1 bn perpetual AT1 notes (Sept 2014) temporary writedown	BBB-
Multicurrency perpetual AT1 notes (March 2015) temporary writedown	BBB-

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This rating was not solicited by the issuer; the analysis is based solely on public information.

Rating rationale

We assign ratings of BBB- to Nordea's three Additional Tier 1 notes issued in September 2014 and March 2015. The rated securities are the 6.125% USD 0.5bn and the 5.5% USD 1bn additional Tier 1 notes issued in September 2014 as well as the multicurrency AT1 issued in March 2015. The rating is based on the following considerations:

- Issuer Credit Strength Rating (ICSR): A+, stable outlook
- Minimum notches down from the ICSR: 4
- Additional notches: 1

Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in September 2014 for more details about the minimum notching for AT1 securities. The additional notch for these securities reflects the following considerations:

- The presence of a double trigger, of which the one based on group CET1 is a high trigger of 8%
- The low average risk intensity of Nordea's balance sheet, which may cause volatility in the capital ratios.
- Despite the high CET1 ratio, limited distance to the total CET1 requirement, which in our view adds to the coupon risk.

ICSR

Nordea has an ICSR of A+, with a stable outlook.

The ratings are driven by Nordea's long track record of strong operating profitability with low levels of non-performing assets and credit losses. The ratings also reflect the group's geographic diversification, which partly shelters Nordea from isolated macro downturns in any one of the countries in which it operates.

At the same time, our forward-looking ratings acknowledge the more problematic outlook for further revenue growth, as inexpensive funding and competition have eroded asset margins for several years. Reliance on short-term wholesale funding, notably in foreign currency, exposes the bank to sudden changes in the funding environment, which at present remains favourable.

Summary terms – 6.125% USD 500mn, Sept 2014

Issuer	Nordea Bank AB
Issue Date	23/09/2014
Amount	USD 500mn
Coupon	• Paid semi-annually (23/3 and 23/9) • 6.125% from 9/2014 to 9/2024 • then: 5 year US Mid-Swap Rate + Margin (3.388%)
Format	• Perpetual Non-Call Additional Tier 1 Notes (issued under USD25bn GMTN Program) • Redeemable by the issuer on first reset date (2024) and every interest payment date thereafter, subject to regulator approval. • Redeemable at any date, subject to regulator's approval, in case of change in capital or tax treatment
ISIN	US65557CAN39 (Rule 144A) / US65557DAL55 (Regulation S)
Capital Treatment	Additional Tier 1
Coupon cancellation features	• Fully discretionary. • Mandatory in case of: (i) lack of available distributable items (ii) payment causing the Maximum Distributable Amount (MDA) to be exceeded (iii) request from the supervisory authority
Principal Loss absorption features	Temporary write-down: • upon occurrence of a trigger event, by an amount sufficient to restore the CET1 ratio(s) to the trigger level(s), or, if insufficient, write down to USD1 • by the supervisory authority at the Point of non-viability Reinstatement, if a Positive net profit at Issuer and Group level is recorded
Triggers for Principal Loss absorption	• 5.125% in relation to the CET1 Ratio of the Issuer on a solo basis and • 8% in relation to the CET1 Ratio of the Group on a consolidated basis.

Source: Prospectus. Scope Ratings

Summary terms – 5.5% USD 1bn, Sept 2014

Issuer	Nordea Bank AB
Issue Date	23/09/2014
Amount	USD 1bn
Coupon	• Paid semi-annually (23/3 and 23/9) • 5.50% from 9/2014 to 9/2019 • then: 5 year US Mid-Swap Rate + Margin (3.563%)
Format	• Perpetual Non-Call Additional Tier 1 Notes (issued under USD25bn GMTN Program) • Redeemable by the issuer on first reset date (2019) and every interest payment date thereafter, subject to regulator approval. • Redeemable at any date, subject to regulator's approval, in case of change in capital or tax treatment
ISIN	US65557CAM55 (Rule 144A) / US65557DAM39 (Regulation S)
Capital Treatment	Additional Tier 1
Coupon cancellation features	• Fully discretionary • Mandatory in case of: (i) lack of available distributable items (ii) payment causing the Maximum Distributable Amount (MDA) to be exceeded (iii) request from the supervisory authority
Principal Loss absorption features	Temporary write-down: • upon occurrence of a trigger event, by an amount sufficient to restore the CET1 ratio(s) to the trigger level(s), or, if insufficient, write down to USD1 • by the supervisory authority at the Point of non-viability Reinstatement, if a Positive net profit at Issuer and Group level is recorded
Triggers for Principal Loss absorption	• 5.125% in relation to the CET1 Ratio of the Issuer on a solo basis and • 8% in relation to the CET1 Ratio of the Group on a consolidated basis.

Source: Prospectus. Scope Ratings

Summary terms – Multicurrency, March 2015

Issuer	Nordea Bank AB
Issue Date	12/03/2015
Amount	USD 550mn / NOK 1.25bn / SEK 2.25bn
Coupon	• USD 5.25% / NOK NIBOR + 310bps / STIBOR + 310 bps ' • SEK and NOK notes are paid quarterly (12/3, 12/6, 12/9 and 12/12) whilst USD notes are paid annually on 13/09 every year. • USD notes are initially set to pay 5.25% coupons from 3/2016 to 9/2021. Then: 5 year US Mid-Swap Rate + Margin (3.244%). SEK and NOK notes are set to pay the applicable 3-month NIBOR or STIBOR + 310bps .throughout the life of the instrument.
Format	• Perpetual Non-Call Additional Tier 1 Notes (issued under USD25bn GMTN Program) • Redeemable by the issuer on first reset date (varies depending on tranche) and every interest payment date thereafter, subject to regulator approval. Redeemable at any date, subject to regulator's approval, in case of change in capital or tax treatment
ISIN	XS1202090947 / XS1202091671 / XS1202091325
Capital Treatment	Additional Tier 1
Coupon cancellation features	• Fully discretionary • Mandatory in case of: (i) lack of available distributable items (ii) payment causing the Maximum Distributable Amount (MDA) to be exceeded (iii) request from the supervisory authority
Principal Loss absorption features	Temporary write-down: • upon occurrence of a trigger event, by an amount sufficient to restore the CET1 ratio(s) to the trigger level(s), or, if insufficient, write down to USD1 • by the supervisory authority at the Point of non-viability Reinstatement, if a Positive net profit at Issuer and Group level is recorded
Triggers for Principal Loss absorption	• 5.125% in relation to the CET1 Ratio of the Issuer on a solo basis and • 8% in relation to the CET1 Ratio of the Group on a consolidated basis.

Source: Prospectus. Scope Ratings

Key risk: coupon cancellation

Coupon payments on the securities are fully discretionary and are subject to distribution restrictions.

Available Distributable Items

The concept of Available Distributable Items (ADI) is defined in the CRR (Art.4.1-128) as "the amount of the profits at the end of the last financial year plus any profits brought forward and reserves available for that purpose before distributions to holders of own funds instruments less any losses brought forward, profits which are non-distributable pursuant to provisions in legislation or the institution's by-laws and sums placed to non-distributable reserves in accordance with applicable national law or the statuses of the institution, those losses and reserves being determined on the basis of the individual accounts of the institution and not on the basis of the consolidated accounts".

We do not expect lack of distributable element to be a limiting factor in the payment of coupons for Nordea.

We estimate the available distributable reserves of Nordea based on Nordea AB unconsolidated accounts. Our calculations point to the availability of EUR 16.6bn in distributable items, including EUR 15.5bn in the form of retained earnings, which give ample comfort that AT1 coupons payments would not be restricted by the lack of available ADIs.

Combined Buffer Requirement and CET1 total requirement

The CRD4-CRR restrictions on discretionary distributions are based on transitional CET1 requirements. According to our calculations, the Combined buffer requirement of Nordea under Pillar 1 will stand at 10.2% already at the end of 2015, including:

- A minimum Pillar 1 CET1 requirement of 4.5%
- A capital conservation buffer of 2.5%
- A Pillar 1 systemic risk buffer of 3%
- A countercyclical buffer of 0.2%

On top of the Pillar 1 buffers, Nordea is subject to additional CET1 requirements under Pillar 2, which we estimate at 4.6% (based on Sept 2014 FSA memorandum and FY 2014 data - our estimate includes 1.5% own fund requirement[3], 2% systemic buffer, 1.10% for Swedish and Norwegian Mortgages). Including the Pillar 2 add-on, we estimate Nordea's CET1 minimum requirement to stand at 14.8% at the end of 2015.

At the end of 2014, Nordea had a CET1 ratio of 15.7%. This offers ample distance to the Pillar 1 Combined Buffer Requirement. However, it is only a buffer of 110 bps to its total CET1 requirement. At the May 2015 capital markets day, Nordea announced that they would aim at maintaining a management buffer of 50-150bps over the minimum requirement which, combined with the very low volatility of Nordea's earnings and capital, should protect investors from the risk of a coupon suspension. While we acknowledge that the new capital target offers more room to manoeuvre than in the past, this remains lower than most peers in Europe. Indeed, we calculate that an unforeseen loss of EUR 1.5bn (an unlikely, but still possible scenario) could bring the ratio down to the minimum requirement and potentially cause distributions to be suspended.

We also note that the Swedish FSA has not yet clarified its stance on the restrictions on distributions in case a bank breaches its Pillar 2 capital requirements, somewhat mitigating the coupon risk.

[3] A new memorandum, published by the Swedish FSA in May 2015, offers a more detailed split of the minimum own fund requirement for Pillar 2 pension risk, concentration risk and interest rate risk in the banking book. This requirement is estimated at 70bps for Nordea, with the remaining 80bps currently representing a buffer for potential additional SREP requirements.

	2014	2015E	2016E
Minimum CET1 - Pillar 1	4.5%	4.5%	4.5%
Combined buffer:			
- Capital conservation	2.5%	2.5%	2.5%
- Systemic	3.0%	3.0%	3.0%
- Countercyclical	0.0%	0.2%	0.2%
Required CET1 associated with distribution restrictions (Pillar 1)	**10.0%**	**10.2%**	**10.2%**
Pillar 2 Add-on to CET1 Requirement [1]	4.6%	4.6%	4.6%
Total CET1 requirement (Pillar 1 & Pillar 2) [2]	**14.6%**	**14.8%**	**14.8%**
Nordea CET1 Ratio	15.7%	15.7%	15.8%
Distance-to-CBR	**5.7%**	**5.5%**	**5.6%**
Distance-to-total CET1 requirement (%)	**1.1%**	**0.9%**	**1.0%**
Distance-to-total CET1 requirement (EUR bn)	**1,582**	**1,380**	**1,477**

Source: Scope Ratings

1) Estimated by Scope based on Sept 2014 memorandum and FY 2014 data. Consists of 1.5% own fund requirement, 2% systemic buffer, 1.10% for Swedish and Norwegian Mortgages)

2) So far, the SFSA has not made a decision on the distribution restriction implications of the Pillar 2 requirement

Further, the group may be subject to higher requirements, including a countercyclical buffer of up to 2.5% ex. art 160 of CRD4. As an example, the Swedish FSA has proposed on May 26, 2015 to raise the countercyclical buffer for Sweden from 1% to 1.5%, applicable from June 2016. Due to the group's diversification, this should however have a marginal impact on Nordea's requirement (10-15 bps). As an additional risk, we highlight that while Nordea's capital ratios are high, they benefit from a very low level of risk weighted asset intensity, which could be subject to revisions given regulators renewed focus on RWA harmonisation. With a limited margin to the total requirement, RWA volatility represents an additional factor of risk in terms of coupon cancellation.

Key risk: principal loss absorption

The mechanism for loss absorption is temporary write-down. The rated securities have double triggers:

- 5.125% based on Nordea AB unconsolidated
- 8% based on Nordea Group consolidated accounts

In our view, the existence of a double trigger represents a factor of risk, partly offsetting the benefits of Nordea's diversification, a key factor supporting the Issuer credit strength rating of the group.

On the other hand, we note that the low 5.125% trigger is so distant from Nordea's AB current CET1 level (21.8%) as to be almost irrelevant unless a very severe crisis was to push Nordea into deep losses in Sweden and neighbouring countries in which Nordea operates were to ring-fence subsidiaries capital – which we deem highly unlikely.

Distance to trigger

On the other hand, the 8% trigger at the group level is certainly to be considered a high trigger – even in the context of Swedish high capital requirements.

Distance-to-Trigger	2014	2015	2016
Trigger CET1 Transitional - Nordea Bank AB	5.1%	5.1%	5.1%
Trigger CET1 Transitional - Nordea Group	8.0%	8.0%	8.0%
CET1 Ratio - Nordea Group	15.7%	15.7%	15.8%
CET1 Ratio - Nordea Bank AB	21.8%		
Distance-to-Trigger Nordea Bank AB	16.7%		
Distance-to-Trigger Nordea Group	**7.7%**	**7.7%**	**7.8%**
Distance-to-Trigger Nordea Group, in Euros	**11,183**	**11,470**	**11,769**

Source: Scope Ratings Estimates, Nordea

Based on 2014 full year data, Nordea’s CET1 ratio is 7.7% higher than the trigger point and management target of 15% would imply a 7% distance-to-trigger implied target. We view this as ample, although we note the high sensitivity of Nordea’s capital ratios to changes in RWA calculation inputs. This is explicitly identified in the terms and conditions of the notes.

For example, we calculate that Nordea’s CET1 ratio calculation would drop to 10.4% if we were to apply the Basel 1 floor to RWAs, an option that the SFSA has not waived. This would only leave a 2.4% distance to trigger.

Security Ratings	
Outlook	Stable
5.5% USD 750mn perpetual Fixed rate reset AT1 Convertible notes (Feb 2015)	BB

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This rating was not solicited by the issuer; the analysis is based solely on public information.

Rating rationale

We assign a rating of BB to Swedbank's Additional Tier 1 securities issued in February 2015. The rated securities are USD denominated for a total amount of 750mn and carry a 5.5% coupon. The rating is based on the following considerations:

- Issuer Credit Strength Rating (ICSR): A-, stable outlook
- Minimum notches down from the ICSR: 4
- Additional notches: 1

Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in September 2014 for more details about the minimum notching for AT1 securities. The additional notch for these securities reflects the following considerations:

- Despite the high CET1 ratio, limited distance to the total CET1 requirement, which in our view adds to the coupon risk.
- The presence of a double trigger, of which the one based on group CET1 is a high trigger of 8%
- The very low average risk intensity of Swedbank balance sheet, which could add volatility to the capital ratios.

ICSR

Swedbank has an ICSR of A-, with a stable outlook.

The ratings are driven by Swedbank's low-risk and leading franchise in Sweden and the Baltics. The ratings also reflect the group's high level of profitability, strong capital and low levels of problem assets.

Our forward-looking ratings also acknowledge the more challenging outlook for the overheated real estate sector in Sweden that could translate in a worse asset performance in the future, the depressed interest rate environment putting pressure on margins and the reliance on wholesale funding, although part of this is made up by covered bonds, which are inherently more reliable.

Summary terms – 5.5% USD 750mn, February 2015

Issuer	Swedbank AB
Issue Date	19/02/2015
Amount	USD 750mn
Coupon	• Paid semi-annually (17/9 and 17/3) • 5.5% from 09/2015 to 03/2020 • then: 5 year US Mid-Swap Rate + Margin (3.767%)
Format	• Perpetual Non-Call Additional Tier 1 Notes • Redeemable by the issuer on first reset date (17 March 2020) and every five years thereafter, subject to regulator's approval. • Redeemable upon occurrence of Withholding Tax Event, Tax Event or Capital Event, subject to regulator's approval
ISIN	XS1190655776
Capital Treatment	Additional Tier 1
Coupon cancellation features	• Fully discretionary. • Mandatory in case of: (i) lack of available distributable items (ADI) (ii) subject to Maximum Distributable Amount (MDA) upon Combined Buffer Requirement breach (iii) request from the supervisory authority
Principal Loss absorption features	Conversion to Equity: • Upon occurrence of a trigger event, due to a CET1 breach, in the case of the Issuer of 5.125% or in the case of the Group 8.00%. • By the supervisory authority at the Point of non-viability
Triggers for Principal Loss absorption	• 5.125% in relation to the CET1 Ratio of the Issuer on a solo basis and • 8% in relation to the CET1 Ratio of the Group on a consolidated basis.

Source: Prospectus. Scope Ratings

Key risk: coupon cancellation

Coupon payments on the security are fully discretionary and are subject to distribution restrictions.

Available Distributable Items

The concept of Available Distributable Items (ADI) is defined in the CRR (Art.4.1-128) as "the amount of the profits at the end of the last financial year plus any profits brought forward and reserves available for that purpose before distributions to holders of own funds instruments less any losses brought forward, profits which are non-distributable pursuant to provisions in legislation or the institution's by-laws and sums placed to non-distributable reserves in accordance with applicable national law or the statuses of the institution, those losses and reserves being determined on the basis of the individual accounts of the institution and not on the basis of the consolidated accounts".

We do not expect lack of distributable element to be a limiting factor in the payment of coupons for Swedbank.

Swedbank's own disclosure of Available Distributable Items as of year-end 2014 come at SEK 45.1bn, out of which SEK 31.9bn are retained earnings, and SEK 13.2bn share premium reserve. Even considering only retained earnings as distributable, the position of Swedbank is very comfortable to pay annual coupons on the AT1 notes.

Combined Buffer Requirement and CET1 total requirement

However, we are more cautious with respect to potential restrictions due to the low distance to the bank's minimum CET1 requirement and the uncertainty related to the Swedish FSA' attitude towards AT1 distribution should the buffer be breached. Indeed Swedish capital requirement are stricter than in the rest of the European Union.

The CRD4-CRR restrictions on discretionary distributions are based on transitional CET1 requirements. According to our calculations, the Combined Buffer Requirement for Swedbank under Pillar 1 will stand at 10.7 % in 2015, including:

- A minimum Pillar 1 CET1 requirement of 4.5%
- A capital conservation buffer of 2.5%
- A Pillar 1 systemic risk buffer of 3%
- A countercyclical buffer of 0.7%

However, Swedish capital rules include additional buffer. On top of the Pillar 1 buffers, Swedbank is subject to additional CET1 requirements under Pillar 2 of 8.6% of RWAs, composed as follows:

- Risk Weighting floor for mortgages – requirement of 5.1% of RWAs
- Pillar 2 systemic buffer of 2%
- Other risks in Pillar 2: 1.5%

Based on these assumptions, the total CET1 requirement of Swedbank is 19.3% in 2015.

At the end of 2014, Swedbank had a CET1 ratio of 21.2%. This offers ample distance to the Pillar 1 Combined Buffer Requirement. However, it is only a buffer of 2.6% to its total CET1 requirement in 2014, which does not include the countercyclical buffer requirement. According to our estimate, and due to the high strong capital generation of Swedbank, we expect the CET1 ratio to increase to 21.7% in 2015, partly offsetting the increased requirement due to the introduction of the countercyclical buffer.. However, we note that the bank's profitability targets (ROE of 15%) allow limited flexibility to build up ample buffers above regulatory requirements and we highlight the risk of higher dividend pay-out ratios to our capital build-up forecasts. Swedbank doesn't have a formal CET1 target.

We also note that the Swedish FSA has not yet clarified its stance on the restrictions on distributions in case a bank breaches its Pillar 2 capital requirements. In our view, the decision may depend on the ultimate cause for the breach. For example, a decline in the ratio which is common to the banking sector and driven by models change addressing the low risk weighting of assets may be offset by a decline in the Pillar 2 requirements, hence not causing a limitation to distributions. On the other hand a company specific loss hitting the ratios would in our view be more likely to cause limitations.

Further, the group may be subject to higher requirements going forward, including a countercyclical buffer of up to 2.5% ex. art 160 of CRD4.

As an additional risk factor, we highlight that while Swedbank's capital ratios are high, they benefit from a very low level of risk weighted asset intensity (less than 20% in 2014) , which could be subject to revisions given regulators' renewed focus on RWA harmonisation.

	2014	2015E	2016E
Minimum CET1 - Pillar 1	4.5%	4.5%	4.5%
Combined buffer:			
- Capital conservation	2.5%	2.5%	2.5%
- Systemic (Pillar 1 component only)	3.0%	3.0%	3.0%
- Countercyclical		0.7%	0.7%
Required CET1 associated with distribution restrictions (Pillar 1)	**10.0%**	**10.7%**	**10.7%**
Pillar 2 Add-on to CET1 Requirement [1]	8.6%	8.6%	8.6%
Total CET1 requirement (Pillar 1 & Pillar 2) [2]	**18.6%**	**19.3%**	**19.3%**
Swedbank CET1 Ratio	21.2%	21.7%	22.1%
Distance-to-CBR	**11.7%**	**11.0%**	**11.0%**
Distance-to-total CET1 requirement (%)	**2.6%**	**2.4%**	**2.8%**
Distance-to-total CET1 requirement (SEK bn)	**10,872**	**10,117**	**11,862**

Source: Scope Ratings

1) Estimated by Scope based on Sept 2014 memorandum and FY 2014 data. Cosists of 1.5% own fund requirement, 2% systemic buffer, 5.1% for Swedish mortgage floors).
2) So far, the SFSA has not made a decision on the distribution restriction implications of the Pillar 2 requirement

Key risk: principal loss absorption

The mechanism for loss absorption is equity conversion. The rated securities have double triggers:

- 5.125% based on Swedbank AB parent company accounts
- 8% based on Swedbank's group consolidated accounts

In our view, the consolidated 8% trigger is the main loss-absorption feature of the rated securities. In order for the 5.125% trigger to gain relevance, the following scenarios should materialise at the same time:

- A material divergence in the profitability trends of Swedbank AB and its main subsidiaries (Swedbank Mortgage, Baltics, Asset Management companies)
- Ring-fencing of capital in the main subsidiaries of Swedbank, so that dividends cannot be upstreamed.

We deem the above unlikely: First, we note that most of the operations of the Swedbank group are in Sweden, and that the framework for cooperation in crisis situations between authorities in the Nordic region, including Baltics, is quite strong, with an established Cross Border Stability Group. Within Sweden, we note that BRRD already shelters covered bonds from resolution, which reduces the risk of Swedbank Hypotek being prohibited from upstreaming dividends. As such, we base our analysis of principal loss absorption on our consolidated estimates for capital and on the group based trigger.

Distance to trigger

Based on YE 2014, the Distance to Trigger for the rated security stood at 13.2% in 2014. We view this as ample, although we note that 8% is to be considered a high trigger – even in the context of Swedish high capital requirements and that Swedbank's risk intensity is very low (below 20% in 2014).

Distance-to-Trigger	2014	2015	2016
Trigger CET1 Transitional - Swedbank Group	8.0%	8.0%	8.0%
Trigger CET1 Transitional - Swedbank AB	5.125%	5.125%	5.125%
CET1 Ratio - Swedbank Group	21.2%	21.7%	22.1%
CET1 Ratio - Swedbank AB	20.5%		
Distance-to-Trigger - Swedbank AB	15.4%		
Distance-to-Trigger - Swedbank Group	**13.2%**	**13.7%**	**14.1%**
Distance-to-Trigger - Swedbank Group, in SEKm	**54,779**	**57,859**	**60,559**

Source: Scope Ratings Estimates, Swedbank

Credit Suisse Group and Basel 3 Capital Instruments

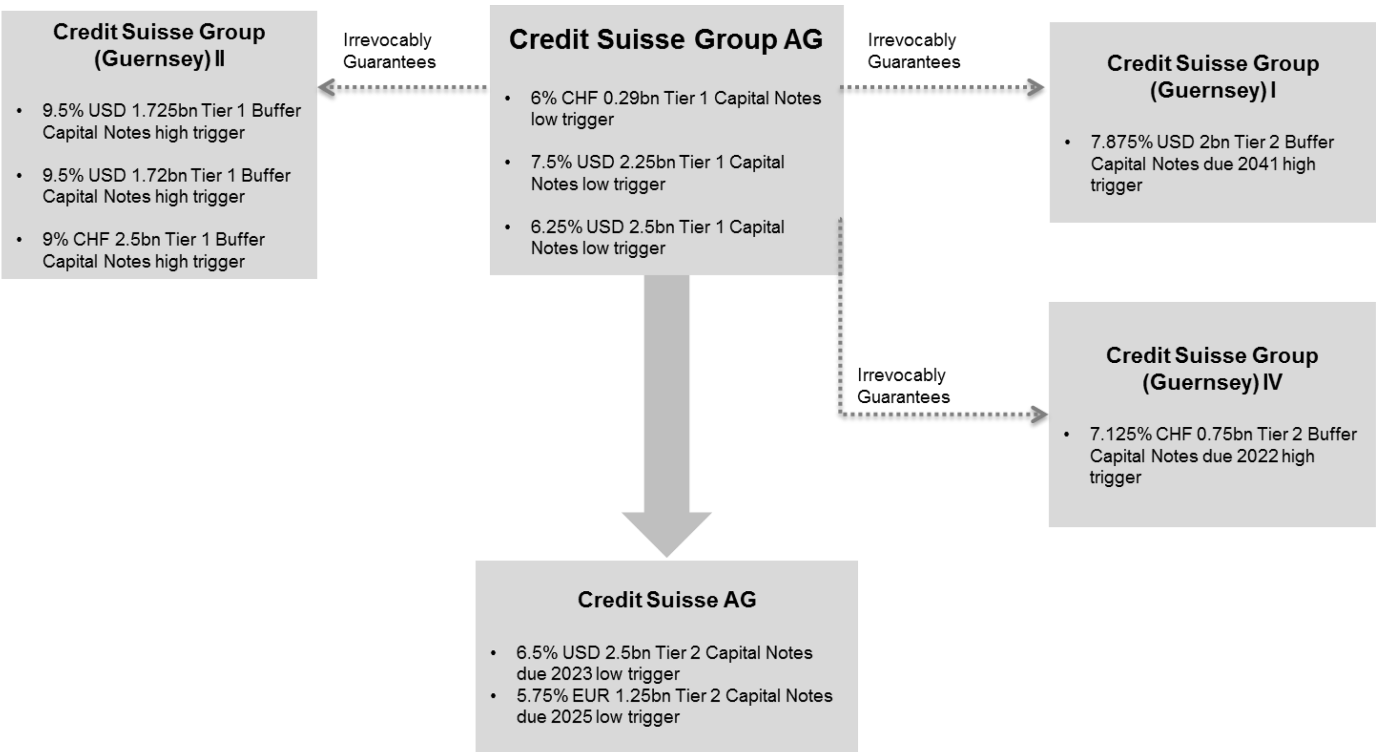
In light of the sheer quantity of Basel 3-compliant capital instruments issued by Credit Suisse Group (CSG) and its affiliates over the years (10 different issues since 2011, excluding various employee compensation schemes eligible for additional Tier 1), this short research report aims at introducing the securities as a function of their legal position within the group.

Among systemically-important Swiss banks, Credit Suisse has embraced the concept of Basel 3-compliant loss-absorbing "contingent convertible" securities very early, with its first Tier 1 and Tier 2 Buffer Capital Notes issued in February 2011.

In July 2012, Credit Suisse Group, in the context of a group-wide capital strengthening exercise, announced its decision to exchange some of its existing hybrids into newly-issued higher-trigger Tier 1 Buffer Capital Notes. Some of the exchange took place at the time of the announcement (for USD 1.725bn) while others only took place in October 2013 (for USD 1.72bn and CHF 2.5bn respectively). We note that these securities were issued by a Special Purpose Entity, Credit Suisse (Guernsey) II Ltd and that they are "irrevocably guaranteed on a subordinated basis by Credit Suisse Group AG".

Other Guernsey-based entities were used (with the same irrevocable guaranteed from Credit Suisse Group AG) to issue Higher-Trigger Tier 2 Buffer Capital Notes. The Group also used its operating bank parent Credit Suisse AG to issue Low-Trigger Tier 2 notes. The structure of CSG's Basel 3 compliant-capital instruments appears in the Chart below.

Credit Suisse Group: Structure of existing Basel 3-compliant capital instruments



Source: Scope Ratings, company data

Security Ratings		**Lead Analyst**
Outlook	Negative	Jacques-Henri Gaulard j-h.gaulard@scoperatings.com
6% CHF 0.29bn Tier 1 Capital Notes Contingent convertible securities	BBB-	**Team Leader**
7.5% USD 2.25bn Tier 1 Capital Notes Contingent convertible securities	BBB-	Sam Theodore s.theodore@scoperatings.com
6.25% USD 2.5bn Tier 1 Capital Notes Contingent convertible securities	BBB-	

The ratings have not been solicited by the issuer; the analysis is based solely on public information.

Rating rationale

On April 10, 2015 Scope downgraded the long-term ratings of Credit Suisse from A+ to A, stable outlook. This led to a downgrade to BBB- from BBB of the 6% CHF 0.29bn, 7.5% USD 2.25bn and 6.25% USD 2.5bn Tier 1 Capital Notes based on the following:

- ICSR: A, Stable outlook
- Minimum notches down from the ICSR: 4
- Additional notch: 0

Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in September 2014 for more details about the minimum notching for AT1 securities. The lack of additional notches for these securities reflects the following:

As far as coupon cancellation risk is concerned, Scope does not feel the need to add further notching as (1) CSG is not submitted to as drastic a restriction on discretionary distributions as European banks abiding by CRDIV-CRR. Moreover, Scope has identified CSG's distributable profits to be a multiple of the annual coupons payable by the bank on all its AT1 outstanding as of YE 2014; and (2) the issuer is severely restricted on its ability to pay dividend on ordinary shares if an interest payment on the Tier 1 Capital Notes is cancelled. This in our view adds some degree of protection to Tier 1 Capital Notes holders;

With regards to principal loss absorption, Scope perceives the trigger of the three securities (sum of CET1 ratio and Higher Trigger Capital ratio below 5.125%) to be extremely low, not only in absolute terms, but also with regards to the minimum capital requirements of Credit Suisse Group (CSG) under Swiss regulation. Since the trigger is below CSG's Swiss minimal requirements, we view the possibility of these notes being permanently written-down as highly theoretical (except in resolution).

ICSR

The rating of A reflects Scope's belief that Credit Suisse benefits from a focused and profitable investment banking franchise, as well as a cash-generative wealth management business, providing the bank with a stable and large earnings stream. However, Credit Suisse suffers in our opinion from capital metrics that are slightly lower than peers as well as a slightly less strong momentum than peers in the wealth management business. Considering the weight of investment banking in the bank's business mix relative to peers (more than 50% of 2014 revenues), we believe that the overall dynamics of the bank's business model could change, with more emphasis on the wealth management side of the bank. However, such changes are in our view difficult to implement: the wealth management business of Credit Suisse is somewhat smaller than the one of its major domestic peer, and material external growth opportunities in private banking are hard to come by. Resolute growth in wealth management could potentially cost the bank in terms of capital expenditures initially, while a material shrinkage of the investment bank could have a significantly negative impact on profits.

Scope has assigned similar long-term ratings of A to Credit Suisse Group AG (the holding company of Credit Suisse AG) and to Credit Suisse AG. In rating the holding company at the same level as the operating bank, Scope pointed at the highly integrated structure of the Credit Suisse Group, financially, operationally and strategically.

Summary terms

Issuer	Credit Suisse Group AG
Issue Date	4 September 2013
Amount	CHF 0.29bn
Coupon	• 6% fixed until first call date, and thereafter at a rate equal to the Mid Market Swap Rate plus 5.203% • If any, payable annually in arrear
Format	Perpetual Tier 1 contingent convertible securities, callable 4 September 2018 and every year after that.
ISIN	CH0221803791
Issue Date	11 December 2013
Amount	USD 2.25bn
Coupon	• 7.5% fixed until first call date, and thereafter at a rate equal to the Mid Market Swap Rate plus 4.598% • If any, payable semi-annually in arrear
Format	Perpetual Tier 1 contingent convertible securities, callable 11 December 2023 and every five years after that
ISIN	XS0989394589/US22546DAB29
Issue Date	18 June 2014
Amount	USD 2.5bn
Coupon	• 6.25% fixed until first call date, and thereafter at a rate equal to the Mid Market Swap Rate plus 3.455% • If any, payable semi-annually in arrear
Format	Perpetual Tier 1 contingent convertible securities, callable 18 December 2024 and every five years after that
ISIN	XS1076957700/US225436AA21
Capital Treatment	Tier 1 and low-trigger Loss-absorbing capital – Progressive Component
Coupon Cancellation	• Fully discretionary • Mandatory if there are insufficient distributable profits or if Credit Suisse is below its Swiss capital requirements as a result of such interest payment being made or if the Regulator has required the issuer not to make such interest payments.

Principal Loss Absorption	• Following the occurrence of a Contingency Event or a Viability Event, a write-down will occur and the full principal amount of the Notes will automatically and permanently be written down to zero on the write-down date. • A contingency event refers to the sum of the CET1 ratio and the Higher Trigger Capital Ratio of CSG to be below 5.125%; • A viability event refers to (1) the regulator notifying CSG that conversion or write-off of all Basel 3-compliant capital instruments is an essential requirement to prevent CSG from becoming insolvent, bankrupt, unable to pay a material part of its debt or ceasing to carry on its business; or (2) CSG has received irrevocable commitment of extraordinary support from the public sector without which CSG would have become insolvent, bankrupt, unable to pay a material part of its debts as they fall due or unable to carry on its business. • Contingency and Viability events could cease to apply to the Notes if regulation on capital and on Progressive Components changes;
Trigger for Principal Loss Absorption	CET1 + Higher-Trigger <5.125% transitional basis

Source: Prospectuses, Scope Ratings

Key risk: coupon cancellation

Coupon payments on the security are fully discretionary and are subject to distribution restrictions.

Additionally, if a coupon is cancelled, CSG shall not recommend to shareholders that any distribution of dividend in cash or in kind be paid to ordinary shares. Capital returns (such as share buy-backs) are also not possible.

Conversely, if Credit Suisse elects to pay dividends on ordinary shares corresponding to a period when the Tier 1 Capital Notes coupons were cancelled, then CSG should pay Tier 1 Capital Notes holders the aggregate amount of all pending interest which has arisen during the period.

We also note that by virtue of interest payment being non-cumulative, coupon cancellation does not constitute a default for any purpose. However, this provision contradicts the “Events of Default” section of the Terms & Conditions (T&C) whereby an event of default will occur if CSG fails to make any payment of interest in respect of the Tier 1 Capital Notes. However, the “Events of Default” section of the Terms & Conditions (T&C) specifically identifies failure “to make any payment of interest in respect of the Notes” as a default. There is probably a difference between a discretionary willingness to cancel the coupon (which is distinct from the coupon payment being prohibited by distribution restrictions) and “classical” default whereby the Issuer does not have the possibility to honour its interest payments. One cancellation is proactive (discretionary coupon cancellation on AT1 instruments) while the other is completely passive (Event of Default) but identifying the difference may be the source of some difficulty for investors.

Coupon payment: analysing the distribution restrictions

While for many banks in the rest of Europe and in the UK coupon payment is dependent upon the Capital Buffer Requirements as defined by CRD4-CRR, themselves triggering a “Maximum Distributable Amount” that is restricting coupon payment, the restrictions on Tier 1 coupon distribution seem a bit less restrictive in Switzerland. Indeed, in the case of the three securities under consideration, Credit Suisse Group is prohibited from making coupon payment in three circumstances.

- First, when CSG has an amount of distributable profits which is less than the sum of (i) the aggregate amount of such interest payment and (ii) all other payments (except redemptions) made by CSG since the last financial year on the Tier 1 BCNs and any other Tier 1 instruments – excluding any portion of such payment already accounted for in determining the distributable profits. This latter clause enables to avoid double-counting for AT1 coupons already provisioned and paid for – other European banks re-integrate these coupons in their distributable profits. We note that under the Swiss Code of Obligations, “distributable profits” refers to the aggregate of net profits carried forward and freely available reserves (other than reserves for own shares) less any amounts that must be contributed to legal reserves under applicable law. According to Credit Suisse Group’s 2014annual report 5% of the annual profits must be retained and booked as legal reserves as long as these reserves amount to less than 20% of paid-in share capital. In 2014, CSG’s reserves exceeded this 20% threshold.

We also note that the distributable profits have to be calculated on the basis of the latest annual unconsolidated financial statements of CSG immediately prior to the interest payment date.

Table 1 estimates the amount of distributable profits available for Credit Suisse to pay its AT1 coupons, based on Credit Suisse Group AG parent company accounts.

Table 1: Estimated Distributable Profits

Credit Suisse Group AG (parent company)	2012	2013	2014
Aggregate net profits carried forward	4,343	4,666	5,075
Freely available reserves	10,500	10,500	10,500
Minus contribution to legal reserves	0	0	0
Total distributable profits	**14,843**	**15,166**	**15,575**

Source: Company data, Scope Ratings

As shown in Table 1, Scope estimates that the distributable profits of Credit Suisse Group AG for 2012, 2013 and 2014 were very high at around CHF 15bn or more. This compares very favourably to the annual coupons that, on our estimates, Credit Suisse Group would have to pay on all its AT1 capital instruments (both eligible and non-eligible to Basel 3) (Table 2).

Table 2: Estimated annual coupons payable on all AT1 capital instruments outstanding (as of June 2014)

List of all AT1's (eligible and non-eligible)	Original currency outstanding (m)	in CHF m	Coupon	Total interest
5.86% USD 1.25bn	135	127	5.86%	7.464
3-month Libor+69bps USD 0.75bn	50	47	0.97%	0.460
9.5% USD 1.72bn	1,720	1,623	9.50%	154.168
9.0% CHF 2.5bn	2,500	2,500	9.00%	225.000
3.3% USD 3.028bn	3,028	2,857	3.30%	94.278
9.5% USD 1.725bn	1,725	1,628	9.50%	154.616
8.514% GBP 0.15bn	20	29	5.84%	1.707
6.0% CHF 0.29bn	290	290	6.00%	17.400
7.5% USD 2.25bn	2,250	2,123	7.50%	159.216
6-month Libor+533bps USD 0.389bn	377	356	5.74%	20.417
6-month Libor+475bps CHF 0.028bn	28	28	5.16%	1.445
6-month Libor+507bps USD 0.508bn	506	477	5.48%	26.162
6-month Libor+451bps CHF 0.059bn	59	59	4.92%	2.903
6-month Libor+575bps USD 0.376bn	376	355	6.16%	21.853
6-month Libor+485bps CHF 0.028bn	28	28	5.26%	1.473
6.25% USD 2.5bn	2,500	2,359	6.25%	147.422
Total		14,886		1,036
Reminder 2014		*14,003*		*980*

Source: Company data, Scope Ratings estimates

The second circumstance triggering coupon cancellation is when "regulatory condition is not satisfied or would not be satisfied if such interest payment were made". "Regulatory condition" means that CSG, on a consolidated basis, is and will be, after payment, in compliance with all applicable capital adequacy requirements of the National Regulations;

- Thirdly, a coupon is cancelled when the Regulator has required the Issuer not to make such interest payment.

Even if Credit Suisse is not in the strictest sense submitted, like other European banks, to Combined Buffer Requirements to be able to pay interests, the bank must nonetheless abide by the Swiss capital requirements. Systematically important banks in Switzerland benefit from an “ad hoc” supervision with individual requirements. Table 3 summarises the capital requirements for Credit Suisse.

Table 3: Swiss capital requirements of Credit Suisse Group

	2014	2015	2016	2017	2018	2019
Combined buffer:						
- Low-trigger capital instruments	1.68%	2.54%	3.04%	3.46%	3.79%	4.05%
- High-trigger capital instruments	1.75%	2.25%	2.63%	2.87%	3.00%	3.00%
- Countercyclical[1]						
Minimum CET1	6.75%	7.37%	8.12%	8.75%	9.38%	10.00%
Capital Adequacy Requirement associated with distribution restrictions	**10.18%**	**12.16%**	**13.79%**	**15.08%**	**16.17%**	**17.05%**
CSG Transitional CET1 ratio (%)	14.80%	13.7% as of Q1 2015				>11.0% target
CET1 Gap (%)	8.05%	6.33%				>1%
CET1 Gap (CHF)						

1) Up to 2.5% of CET1.

Source: Company data, Scope Ratings

Table 3 shows the three layers of capital requirement that Credit Suisse Group has to abide by. As far as the low-trigger and high-trigger components are concerned, they reflect issuing potential and, as of Q1 2014, both ratios stood above 3%, not far from the required levels by 2019.

The CET1 metrics are the most demanding but since CSG’s capital requirements are on a transitional basis until 1 January 2019, we do not expect any major problem for the bank to abide by these requirements, at least in the short-term. As of Q1 2015, the gap between Credit Suisse’s capital requirements and the bank’s transitional CET1 ratio stood at 6.3%, or above CHF 18bn. In the long-term though, if we compare the long-term CET1 targets of Credit Suisse Group with the minimum required CET1 of 10%, the gap narrows considerably to >1% or >CHF 2.5-2.6bnbn – based on the long-term RWA target of the bank. However, this gap would still represent 2.5x the coupons payable to all current AT1s outstanding. This seems all the more adequate that CSG seems to have issued the bulk of its 2019-requested high-trigger AT1s already.

Key risk: principal loss absorption

While the Terms and Conditions of the three securities under consideration are virtually the same, we note that as time went by (more than nine months have elapsed between the issuance date of the 6% CHF 0.29bn USD Tier 1 Capital Notes and of the 6.25% USD 2.5bn Tier 1 Capital Notes), the Risk Section has increased in volume, and so has the section dedicated to the CET1 and the Swiss capital ratios.

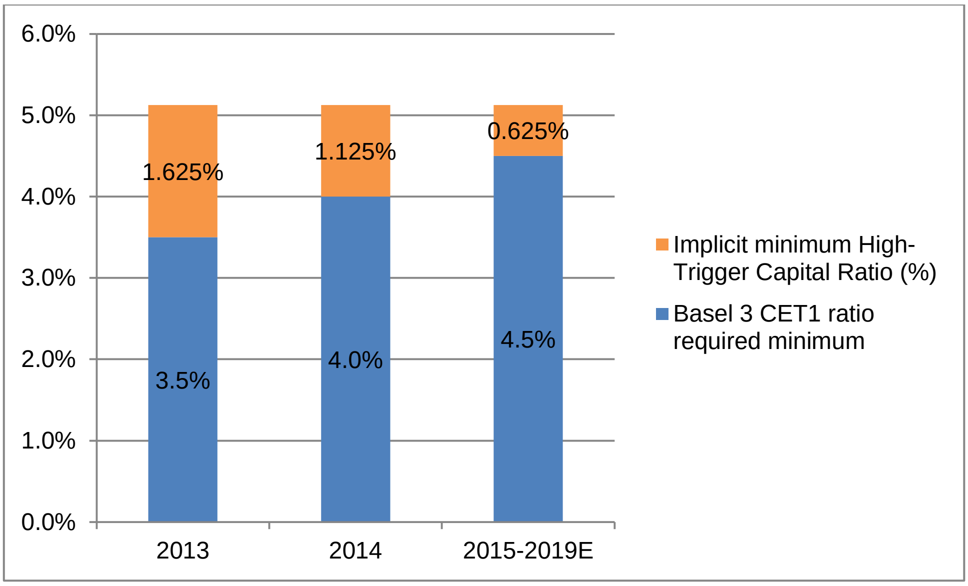
Interestingly, the increased details in the risk section always refer to capital absorption, and not coupon cancellation. In particular, the risk section in the prospectus of the 6.25% USD 2.5bn Tier 1 Capital Notes addresses directly the potential problems related to respecting the creditor’s hierarchy under resolution – which we address in detail in our report on Credit Suisse’s High-Trigger Tier 2 Buffer Capital Notes. The prospectus of the 6.25% capital notes states that “[in case of resolution proceedings] FINMA may not be required to follow any order of priority…”

Despite the more developed risk section, Scope is of the opinion that the permanent write-down risk that is attached to the 6%, 7.5% and 6.25% Tier 1 Capital Notes is of a highly theoretical nature.

The reason for this is that the trigger upon which a permanent write-down occurs is very low in two respects.

- **First, with regards to the definition of the capital metric under which the trigger is measured.** The sum of the CET1 ratio and the Higher-Trigger ratio is highly unusual. This sum must be below 5.125% for the 6% Tier 1 Capital Notes to be permanently written-down. Since Credit Suisse Group’s minimum transitional CET1 requirement under Basel 3 was 3.5% in 2013 and must be 4% in 2014 and 4.5% from 2015 onwards, this means by difference that the minimum Higher-Trigger capital ratio for CSG to remain above the trigger defined by the Terms & Conditions (T&C) of the Tier 2 Capital Notes should have been 1.625% in 2013, and should be 1.125% in 2014 and 0.625% from 2015 onwards (Chart 1).

Chart 1: Estimates of minimum transitional Basel 3 requirements for CSG's CET1 + Higher-Trigger capital ratios 2013-2019 (in %)



Source: Scope ratings, company data

Projecting ourselves from 2015 onwards (when the minimum required CET1 ratio of 4.5% is "fully-loaded"), the sum of CET1 + Higher Trigger Capital means in effect: (1) a CET1 ratio of at least 4.5% and (2) a Higher-Trigger capital ratio of at least 0.625%. This is the only minimum combination of the two metrics that is theoretically possible under Basel 3 regulation. In our view, it is highly unlikely that CSG's supervisor would let the CET1 and Higher Trigger capital ratios of the bank to fall below these levels before intervention. Therefore, we identify Credit Suisse's Group's PONV higher than these 4.5%/0.625% thresholds. As a result, bar in resolution, a trigger event for these notes is unlikely.

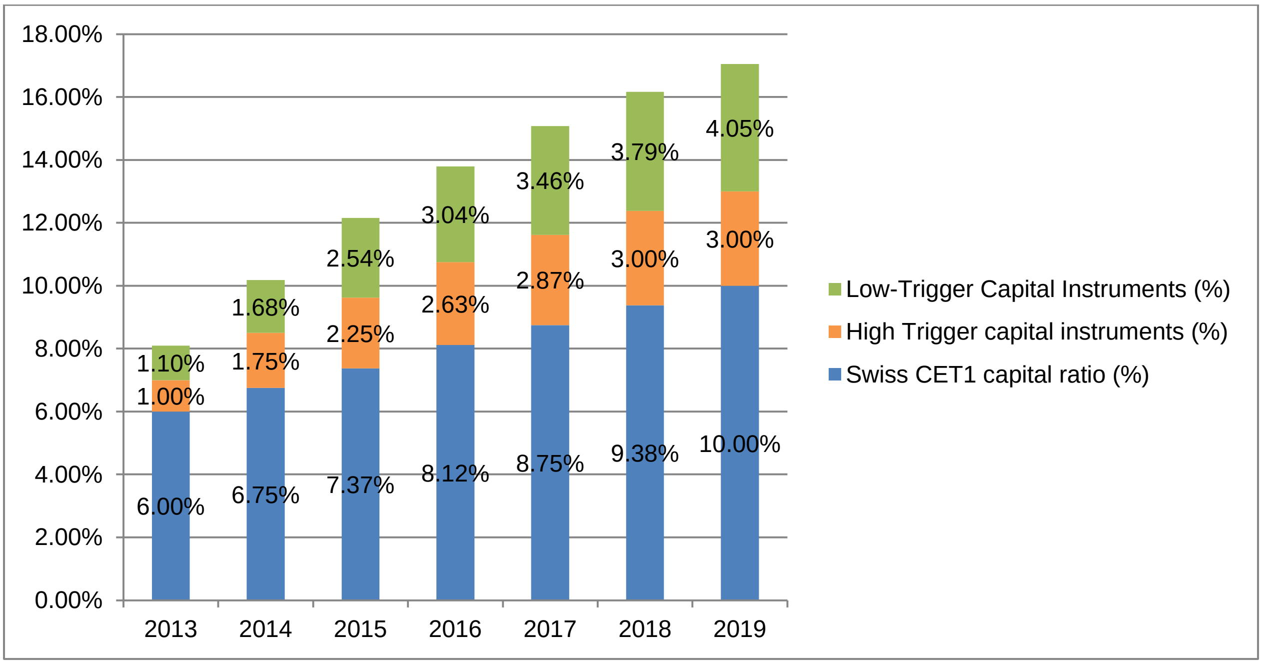
We note that a trigger combining CET1 with Higher-Trigger capital ratio is not presented as such in the sections of the Capital Adequacy Ordinance (CAO) dedicated to the Progressive Capital Component of global systemically important Swiss banks. According to Article 130-2 of the CAO, "The Progressive component must be covered by convertible capital which conversion is triggered at the latest when the CET1 ratio falls below 5%". In the case of the three securities under consideration, the conversion is triggered only when the CET1 ratio **and** the Higher Trigger Capital Ratio fall below 5%.

- **Second, with regards to the bank-specific requirements which, in our view, are applicable to these Notes**. Indeed, Swiss supervisors have a more conservative approach of the Basel 3 regulatory framework for systemically-important banks. As a result, the Swiss requirements for Core Equity Tier 1 and the High Trigger capital ratios are significantly higher than the theoretical Basel 3 requirements that was were illustrated in Chart 1. Actually, each global systemically important Swiss bank reports publicly its specific, FINMA-defined, capital requirements. The Credit-Suisse-specific requirements are illustrated on Chart 2 below.

On a transitional basis, the minimum CET1 requirement of Credit Suisse is never lower than 6.75% from 2014 onwards, while the Higher-Trigger capital ratio is never lower than 1.75%. As a result, CSG is bound, by Swiss regulation, to a transitional CET1 + Higher Trigger capital ratio of at least 8.5% in 2014, 9.62% in 2015, 10.75% in 2016, 11.62% in 2017 and 12.38% in 2018. On a fully phased-basis, the minimum level will be 13% for Credit Suisse Group in 2019.

In light of the numbers shown on Chart 2, an implicit permanent write-down CET1 ratio trigger at 4.5% looks even more highly theoretical (except in resolution).

Chart 2: Estimates of minimum transitional Swiss requirements for CSG's CET1 + Higher-Trigger capital ratios 2013-2019 (in %)



Source: Company data

However, despite the low probability of the Notes being written-down, we note that the risk section of the different prospectuses make clear that FINMA has significantly increased authority (or broad statutory powers) in case of resolution proceedings involving banks in Switzerland. This resolution authority includes, among other things, the power to cancel outstanding equity, to convert debt instruments and other liabilities of a bank into equity and to cancel such liabilities fully or partially.

We note that this prerogative of the FINMA limits itself to resolution.

Distance to trigger

Unsurprisingly considering the undemanding trigger of the Notes, we expect Credit Suisse Group's CET1 and Higher-Trigger capital ratios to remain largely above the 5.125% trigger level required by the T&C of the Notes – even when the CET1 ratio enters its "fully loaded" definition on January 1, 2019.

Table 4: Distance to Trigger

	2013	FY 2014	Q1 2015	2019
Trigger level	5.125%	5.125%	5.125%	5.125%
CET1 + Higher-Trigger Capital (%)	19.1%	17.8%	16.7%	14.0% target[1]
CET1 Gap (%)	13.98%	12.68%	11.62%	8.88%
CET1 Gap (CHF)	38.4bn	37.1bn	33.6bn	22bn based on long-term RWA targets of CSG

1) Based on the 11% long-term CET1 target ratio of Credit Suisse Group plus the 3% minimum requirement for Higher-Trigger Capital Ratio.

Source: Company data, Scope Ratings estimates

Security Ratings	
Outlook	Stable
Credit Suisse Group (Guernsey) II Limited irrevocably guaranteed on a subordinated basis by Credit Suisse Group AG	
9.5% USD 1.725bn Tier 1 Buffer Capital Notes Contingent convertible securities on 7% trigger	BB+
9.5% USD 1.72bn Tier 1 Buffer Capital Notes Contingent convertible securities on 7% trigger[4]	BB+
9% CHF 2.5bn Tier 1 Buffer Capital Notes Contingent convertible securities on 7% trigger[1]	BB+

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The ratings have not been solicited by the issuer; the analysis is based solely on public information.

Rating rationale

On April 10, 2015 Scope downgraded the long-term ratings of Credit Suisse from A+ to A, stable outlook. This led to a downgrade to BB+ from BBB- of the 9.5% USD 1.725bn, 9.5% USD 1.72bn and 9% CHF 2.5bn Tier 1 Buffer Capital Notes (BCNs) issued by Credit Suisse (Guernsey) II Limited, and irrevocably guaranteed on a subordinated basis by Credit Suisse Group AG. The rating is based on the following considerations:

- ICSR: A, Stable outlook
- Minimum notches down from the ICSR: 4
- Additional notch: 1

Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in September 2014 for more details about the minimum notching for AT1 securities. The additional notches for these securities reflect the following:

- Even if the distance to trigger is defined under transitional Basel 3 capital rules, the 7% CET1 ratio trigger of the three securities is relatively high. However we believe that the conversion risk is, at this stage, extremely remote.

Scope does not feel the need to add further notching for coupon cancellation risk as:

(1) CSG is not submitted to as drastic restrictions on discretionary distributions as European banks abiding by CRDIV-CRR. Moreover, Scope has identified CSG's distributable profits to be a multiple of the annual coupons payable by the bank on all its AT1 outstanding as of December 2014.

CSG is severely restricted on its ability to pay dividend on ordinary shares if an interest payment on the Tier 1 BCNs is cancelled. This in our view adds some degree of protection to Tier 1 BCN holders.

[4] Rating assigned based on summary Terms and Conditions and on the T&C of the USD 1.725bn 9.5% Tier 1 Buffer Capital Notes.

ICSR

The rating of A reflects Scope's belief that Credit Suisse benefits from a focused and profitable investment banking franchise, as well as a cash-generative wealth management business, providing the bank with a stable and large earnings stream. However, Credit Suisse suffers in our opinion from capital metrics that are slightly lower than peers as well as a slightly less strong momentum than peers in the wealth management business. Considering the weight of investment banking in the bank's business mix relative to peers (more than 50% of 2014 revenues), we believe that the overall dynamics of the bank's business model could change, with more emphasis on the wealth management side of the bank. However, such changes are in our view difficult to implement: the wealth management business of Credit Suisse is somewhat smaller than the one of its major domestic peer, and material external growth opportunities in private banking are hard to come by. Resolute growth in wealth management could potentially cost the bank in terms of capital expenditures initially, while a material shrinkage of the investment bank could have a significantly negative impact on profits.

Scope has assigned similar long-term ratings of A to Credit Suisse Group AG (the holding company of Credit Suisse AG) and to Credit Suisse AG. In rating the holding company at the same level as the operating bank, Scope pointed at the highly integrated structure of the Credit Suisse Group, financially, operationally and strategically.

Summary terms

Issuer	Credit Suisse Group (Guernsey) II Limited
Guarantor	Irrevocably guaranteed on a subordinated basis by Credit Suisse Group AG
Issue Date	31 July 2012
Amount	USD 1.725bn
Coupon	• 9.5% fixed until first call date, and thereafter at a rate equal to the aggregate of 6.64% and the 6-month USD Libor rate • If any, payable annually in arrear until the first interest payment date following the first call date; semi-annually in arrear after that.
Format	Perpetual Tier 1 contingent convertible securities, callable 23 October 2018 and twice a year after that.
ISIN	XS0810846617
Issue Date	23 October 2013
Amount	USD 1.72bn
Coupon	• 9.5% fixed until first call date, and thereafter at a rate equal to the aggregate of 6.64% and the 6-month USD Libor rate • If any, payable semi-annually in arrear
Format	Perpetual Tier 1 contingent convertible securities, callable 23 October 2018 and twice a year after that.
ISIN	N/A
Issue Date	23 October 2013
Amount	CHF 2.5bn
Coupon	• 9% fixed until first call date, and thereafter at a rate equal to the aggregate of 7.15% and the 6-month US CHF Libor rate • If any, payable semi-annually in arrear

Format	Perpetual Tier 1 contingent convertible securities, callable 23 October 2018 and twice a year after that.
ISIN	N/A
Capital Treatment	Tier 1 and High-Trigger Loss-absorbing capital – Buffer Component
Coupon Cancellation	• Fully discretionary • Mandatory if there are insufficient distributable profits or if Credit Suisse is below its Swiss capital requirements as a result of such interest payment being made.
Principal Loss Absorption	• Upon a contingency event or a viability event, the BCNs are mandatorily converted into ordinary shares; • A contingency event refers to the CET1 ratio of the group being below 7%; • A viability event refers to (1) the regulator notifying CSG that conversion or write-off of all Basel 3-compliant capital instruments is an essential requirement to prevent CSG from becoming insolvent, bankrupt, unable to pay a material part of its debt or ceasing to carry on its business; (2) CSG has received irrevocable commitment of extraordinary support from the public sector without which CSG would have become insolvent, bankrupt, unable to pay a material part of its debts as they fall due or unable to carry on its business; or (3) the CET1 ratio contained in any Interim Capital Report is below 5%, and as a consequence the conversion into equity or write-off of any or all Progressive Capital Instruments in issue at such time occurs or, in the determination of the Regulator, would have occurred but for the conversion of the Tier 1 BCNs and the conversion or write-off of all other Buffer Capital Instruments that, pursuant to their terms or by operations of law, are capable of being converted into equity or written off at that time.
Trigger for Principal Loss Absorption	CET1 < 7% transitional basis

Source: Prospectuses, Scope Ratings

Key risk: coupon cancellation

Coupon payments on the securities are fully discretionary and are subject to distribution restrictions.

Additionally, if a coupon is cancelled, CSG shall not recommend to shareholders that any distribution of dividend in cash or in kind be paid to ordinary shares. Capital returns (such as share buy-backs) are also not possible.

Conversely, if Credit Suisse elects to pay dividends on ordinary shares corresponding to a period when the Tier 1 BCN coupons were cancelled, then CSG should pay BCN holders the aggregate amount of all pending interest which has arisen during the period.

We note that the Risk Factors in the Information Memorandum make clear that if Credit Suisse is prohibited from making coupon payments on these particular Tier 1 BCNs, it will nonetheless not be prohibited from making distributions to holders of securities ranking pari passu with the BCNs. However, this provision is nowhere to be found in the T&C of the BCNs.

We also note that by virtue of interest payment being non-cumulative, coupon cancellation does not constitute a default for any purpose. However, this provision contradicts the "Events of Default" section of the Terms & Conditions (T&C) whereby an event of default will occur if CSG fails to make any payment of interest in respect of the Tier 1 BCNs". However, the "Events of Default" section of the Terms & Conditions (T&C) specifically identifies failure "to make any payment of interest in respect of the Tier 1 BCNs" as a default. There is probably a difference between a discretionary willingness to cancel the coupon (which is distinct from the coupon payment being prohibited by distribution restrictions) and "classical" default whereby the Issuer does not have the possibility to honour its interest payments. One cancellation is proactive (discretionary coupon cancellation on AT1 instruments) while the other is completely passive (Event of Default) but identifying the difference may be the source of some difficulty for investors.

Coupon payment: analysing the distribution restrictions

While for many banks in the rest of Europe and in the UK coupon payment is dependent upon the Capital Buffer Requirements as defined by CRD4-CRR, themselves triggering a "Maximum Distributable Amount" that is restricting coupon payment, the restrictions on Tier 1 coupon distribution seem a bit less deterring in Switzerland. Indeed, in the case of the three securities under analysis, Credit Suisse Group is prohibited from making coupon payment in two circumstances.

- First, when CSG has an amount of distributable profits which is less than the sum of (i) the aggregate amount of such interest payment and (ii) all other payments (except redemptions) made by CSG since the last financial year on the Tier 1 BCNs and any other Tier 1 instruments – excluding any portion of such payment already accounted for in determining the distributable profits. This latter clause enables to avoid double-counting for AT1 coupons already provisioned and paid for – other European banks re-integrate these coupons in their distributable profits. We note that under the Swiss Code of Obligations, "distributable profits" refers to the aggregate of net profits carried forward and freely available reserves (other than reserves for own shares) less any amounts that must be contributed to legal reserves under applicable law. According to Credit Suisse Group's 2014 annual report 5% of the annual profits must be retained and booked as legal reserves as long as these reserves amount to less than 20% of paid-in share capital. In 2014, CSG's reserves exceeded this 20% threshold. We also note that the distributable profits have to be calculated on the basis of the latest annual unconsolidated financial statements of CSG immediately prior to the interest payment date.

Table 1 estimates the amount of distributable profits available for Credit Suisse to pay its AT1 coupons, based on Credit Suisse Group AG parent company accounts.

Table 1: Estimates Distributable Profits

Credit Suisse Group AG (parent company)	2012	2013	2014
Aggregate net profits carried forward	4,343	4,666	5,075
Freely available reserves	10,500	10,500	10,500
Minus contribution to legal reserves	0	0	0
Total distributable profits	**14,843**	**15,166**	**15,575**

Source: Company data, Scope Ratings

As shown in Table 1, Scope estimates that the distributable profits of Credit Suisse Group AG for 2012, 2013 and 2014 were very high at around CHF 15bn. This compares very favourably to the annual coupons that, on our estimates, Credit Suisse Group would have to pay on all its AT1 capital instruments (both eligible and non-eligible to Basel 3) (Table 2).

Table 2: Estimated annual coupons payable on all AT1 capital instruments outstanding (as of June 2015)

List of all AT1's (eligible and non-eligible)	Original currency outstanding (m)	in CHF m	Coupon	Total interest
5.86% USD 1.25bn	135	127	5.86%	7.464
3-month Libor+69bps USD 0.75bn	50	47	0.97%	0.460
9.5% USD 1.72bn	1,720	1,623	9.50%	154.168
9.0% CHF 2.5bn	2,500	2,500	9.00%	225.000
3.3% USD 3.028bn	3,028	2,857	3.30%	94.278
9.5% USD 1.725bn	1,725	1,628	9.50%	154.616
8.514% GBP 0.15bn	20	29	5.84%	1.707
6.0% CHF 0.29bn	290	290	6.00%	17.400
7.5% USD 2.25bn	2,250	2,123	7.50%	159.216
6-month Libor+533bps USD 0.389bn	377	356	5.74%	20.417
6-month Libor+475bps CHF 0.028bn	28	28	5.16%	1.445
6-month Libor+507bps USD 0.508bn	506	477	5.48%	26.162
6-month Libor+451bps CHF 0.059bn	59	59	4.92%	2.903
6-month Libor+575bps USD 0.376bn	376	355	6.16%	21.853
6-month Libor+485bps CHF 0.028bn	28	28	5.26%	1.473
6.25% USD 2.5bn	2,500	2,359	6.25%	147.422
Total		14,886		1,036
Reminder 2014		*14,003*		*980*

Source: Company data, Scope Ratings estimates

The second circumstance triggering coupon cancellation is when “regulatory condition is not satisfied or would not be satisfied if such interest payment were made”. “Regulatory condition” means that CSG, on a consolidated basis, is and will be, after payment, in compliance with all applicable capital adequacy requirements of the National Regulations.

Even if Credit Suisse is not in the strictest sense submitted, like other European banks, to Combined Buffer Requirements to be able to pay interests, the bank must nonetheless abide by the Swiss capital requirements. Systemically important banks in Switzerland benefit from an “ad hoc” supervision with individual requirements. Table 3 summarises the capital requirements for Credit Suisse.

Table 3: Swiss capital requirements of Credit Suisse Group

	2014	2015	2016	2017	2018	2019
Combined buffer:						
- Low-trigger capital instruments	1.68%	2.54%	3.04%	3.46%	3.79%	4.05%
- High-trigger capital instruments	1.75%	2.25%	2.63%	2.87%	3.00%	3.00%
- Countercyclical[1]						
Minimum CET1	6.75%	7.37%	8.12%	8.75%	9.38%	10.00%
Capital Adequacy Requirement associated with distribution restrictions	**10.18%**	**12.16%**	**13.79%**	**15.08%**	**16.17%**	**17.05%**
CSG Transitional CET1 ratio (%)	14.80%	13.7% as of Q1 2015				>11.0% target
CET1 Gap (%)	8.05%	6.33%				>1%
CET1 Gap (CHF)						

1) Up to 2.5% of CET1.

Source: Company data, Scope Ratings

Table 3 shows the three layers of capital requirement that Credit Suisse Group has to abide by. As far as the low-trigger and high-trigger components are concerned, they reflect issuing potential and, as of Q1 2015, both ratios stood above 3% - not far from the required levels by 2019.

The CET1 metrics are the most demanding but since CSG's capital requirements are on a transitional basis until 1 January 2019, we do not expect any major problem for the bank to abide by these requirements, at least in the short-term. As of Q1 2015, the gap between Credit Suisse's capital requirements and the bank's transitional CET1 ratio stood at 6.3%, or CHF 18.2bn. In the long-term though, if we compare the long-term CET1 targets of Credit Suisse Group with the minimum required CET1 of 10%, the gap narrows considerably to >1% or >CHF 2.5-2.6bn – based on the long-term RWA target of the bank. However, this gap would still represent around 2.5x the coupons payable to all current AT1s outstanding. This seems all the more adequate that CSG seems to have issued the bulk of its 2019-requested high-trigger AT1s already.

Key risk: principal loss absorption

Despite having been issued very early on (31 July 2012) the 9.5% Tier 1 BCNs have remained eligible for loss-absorption purposes under Basel 3. This is due to the flexibility of the T&C, whereby the distance to the CET1 ratio trigger of 7% was defined first under Basel 2.5 (in 2012), then from 2013 onwards under transitional Basel 3 requirements (to become "fully-loaded" in 2019). The other two securities under analysis have been issued in 2013. This means that the T&C refer only to Basel 3 capital requirements.

Since the three securities have been issued by a special purpose vehicle (Credit Suisse Group (Guernsey) II Ltd), they are irrevocably guaranteed by Credit Suisse Group AG on a subordinated basis. Credit Suisse Group can at any time substitute for the issuing entity. Also, the T&C enable Credit Suisse to substitute all the BCNs for other compliant securities if the BCNs cease at some point to be treated as Buffer Capital under National Regulations and/or Additional Tier 1 Capital under BIS regulations.

Looking at the T&C, we note that the CET1 ratio of Credit Suisse Group can be below 7% without triggering a contingency event when the regulator is satisfied that the bank has taken enough measures to restore the capital ratio to a level above 7%.

Additionally, the risks section of the prospectus makes very clear that the occurrence of a viability event is subject to a subjective determination by the regulator or the Swiss federal government or central bank requiring Credit Suisse Group to accept support from the public sector. As a result, the regulator may require or the federal government may cause the conversion of the BCNs into ordinary shares in circumstances that are beyond the control of the issuer and Credit Suisse Group, and with which neither the Issuer nor Credit Suisse Group agrees.

Distance to trigger

Since the distance to trigger pertaining to the BCNs has historically been calculated under Basel 2.5 (in 2012- for the 9.5% 1.725bn Notes only) and then under transitional Basel 3 requirements (for the three securities from 2013 onwards), Credit Suisse Group has so far reported CET1 ratios that were largely in excess of the "threshold ratio" of 7%, as demonstrated by Table 4 below. On top of the Basel 2.5 definitions of capital being less conservative than Basel 3 definitions, we note that the transitional definition of Basel 3 is also less conservative than the "fully-phased" definition of Basel 3 to be applied on 1 January 2019.

Table 4: Past, present and future distance to trigger: 2012 Credit Suisse Tier 1 BCNs

	2011	2012	2013	FY 2014	Q1 2015	2019
Trigger level	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%
CET1[1]	10.7%	15.5%	15.7%	14.8%	13.7%	11% target
Gap (%)	3.7%	8.5%	8.7%	7.8%	6.7%	4.0%
Gap (CHF)	8.9bn	19.1bn	23.8bn	22.8bn	19.4bn	10bn based on long-term RWA targets of CSG

1) The eligible CET1 ratio for the calculation of the distance to trigger was the Basel 2.5 core Tier 1 ratio of Credit Suisse Group in 2011 and 2012, is the transitional Basel 3 CET1 ratio of Credit Suisse Group from 2013 to 2018, and will be "the fully-loaded" Basel 3 CET1 ratio from 1 January 2019 onwards.

Source: Company data, Scope Ratings estimates

Historically, the gap to the threshold CET1 ratio of 7% has indeed been very high, reaching levels close to CHF 25bn in 2013 and staying above the CHF 20bn mark in 2014 despite the CHF 1.6bn charge relative to the settlement of the US cross-border case. This is very ample but we note that the "fully loaded" long-term capital projections of Credit Suisse aim at a CET1 ratio target of 11%, materially lower than the transitional 14.8% reported at the end of 2014. We also note that on the back of the long-term RWA targets of the bank, the distance to trigger should stand at CHF 10bn by 1 January 2019, a comfortable amount but showing a significant decline versus past metrics.

Security Ratings

Outlook	Stable
Credit Suisse Group (Guernsey) I Limited irrevocably guaranteed on a subordinated basis by Credit Suisse Group AG	
7.875% USD 2bn Tier 2 Buffer Capital Notes due 2041 Contingent convertible securities on 7% trigger	BBB
Credit Suisse Group (Guernsey) IV Limited irrevocably guaranteed on a subordinated basis by Credit Suisse Group AG	
7.125% CHF 0.75bn Tier 2 Buffer Capital Notes due 2022 Contingent convertible securities on 7% trigger	BBB

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The ratings have not been solicited by the issuer; the analysis is based solely on public information.

Rating rationale

On April 10, 2015 Scope downgraded the long-term ratings of Credit Suisse from A+ to A, stable outlook. This led to a downgrade to BBB from BBB+ of the 7.875% USD 2bn Tier 2 Buffer Capital Notes due 2041 and the 7.125% CHF 0.75bn Tier 2 Buffer Capital Notes due 2022, issued by Credit Suisse Group (Guernsey) I Limited and Credit Suisse Group (Guernsey) IV Limited respectively. Both Tier 2 Buffer Capital Notes are irrevocably guaranteed on a subordinated basis by Credit Suisse Group AG. The rating is based on the following considerations:

- Issuer Credit Strength Rating (ICSR): A, negative outlook
- Minimum notch down from the ICSR: 1
- Additional notches: 2

As detailed in Scope's Bank Capital Instruments Rating Methodology published in September 2014, the minimum notching for T2 securities is one notch from the ICSR. In May 2015, Scope updated its methodology for rating capital instruments (currently as a call for comments). In the revised methodology, we are proposing to change the minimum notching to two notches from one. In a bail-in scenario, T2 securities are considered capital instruments and rank below non-T2 subordinated debt and senior debt. As well, T2 securities may be converted or written down during early regulatory intervention (a step ahead of resolution), which is not the case with non-T2 subordinated debt. This translates into T2 being rated lower than non-T2 subordinated debt for EU banks.

When the methodology is finalised, we do not intend to change the rating on the current T2 securities, as our current rating on Credit Suisse Group's high-trigger Tier 2 Buffer Capital Notes already include a gap of three notches from the ICSR, in itself enough to capture the risk of loss-absorption in a resolution scenario.

The additional two notches from the current minimum notching of one can be explained by the following:

- Even if the distance to trigger is defined under transitional Basel 3 capital rules, the 7% CET1 ratio trigger level of the BCNs due 2041 and 2022 is relatively high. However we believe that the conversion risk is, at this stage, extremely remote.

We believe that there are major ambiguities remaining with regards to the priority of claims pertaining to a high-trigger Tier 2 note versus a low-trigger AT1 instrument for a systemically important Swiss bank such as Credit Suisse. This could create problems for holders of Credit Suisse's capital instruments in the unlikely case of the bank's fundamentals deteriorating – despite FINMA's commitment to respect creditor hierarchy in case of bail-in.

ICSR

The rating of A reflects Scope's belief that Credit Suisse benefits from a focused and profitable investment banking franchise, as well as a cash-generative wealth management business, providing the bank with a stable and large earnings stream. However, Credit Suisse suffers in our opinion from capital metrics that are slightly lower than peers as well as a slightly less strong momentum than peers in the wealth management business. Considering the weight of investment banking in the bank's business mix relative to peers (more than 50% of 2014 revenues), we believe that the overall dynamics of the bank's business model could change, with more emphasis on the wealth management side of the bank. However, such changes are in our view difficult to implement: the wealth management business of Credit Suisse is somewhat smaller than the one of its major domestic peer, and material external growth opportunities in private banking are hard to come by. Resolute growth in wealth management could potentially cost the bank in terms of capital expenditures initially, while a material shrinkage of the investment bank could have a significantly negative impact on profits.

Scope has assigned similar long-term ratings of A to Credit Suisse Group AG (the holding company of Credit Suisse AG) and to Credit Suisse AG. In rating the holding company at the same level as the operating bank, Scope pointed at the highly integrated structure of the Credit Suisse Group, financially, operationally and strategically.

Summary terms

Issuer	Credit Suisse Group (Guernsey) I Limited
Guarantor	Irrevocably guaranteed on a subordinated basis by Credit Suisse Group AG
Issue Date	24 February 2011
Amount	USD 2bn
Coupon	• 7.875% fixed until first call date, reset every 5 years thereafter • payable semi-annually in arrear
Format	Tier 2 Buffer Capital Notes due 2041, callable on 24 August 2016 and twice a year after that.
ISIN	XS0595225318
Issuer	Credit Suisse Group (Guernsey) IV Limited
Guarantor	Irrevocably guaranteed on a subordinated basis by Credit Suisse Group AG
Issue Date	22 March 2012
Amount	CHF 0.75bn
Coupon	• 7.125% fixed until first call date, and thereafter at a rate equal to the Mid-Swap rate plus 6.685%. • payable annually in arrear
Format	Tier 2 Buffer Capital Notes (BCNs) due 2022, callable on 22 March 2017
ISIN	CH0181115681
Capital Treatment	Tier 2, High-trigger loss-absorbing capital – Buffer Component

Principal Loss Absorption	• Upon a contingency event or a viability event, the BCNs are mandatorily converted into ordinary shares; • A contingency event refers to the CET1 ratio of the group being below 7%; • A viability event refers to (1) an essential requirement to prevent CSG from becoming insolvent, bankrupt, unable to pay a material part of its debt or ceasing to carry on its business and (2) CSG has received irrevocable commitment of extraordinary support from the public sector without which CSG would have become insolvent, bankrupt, unable to pay a material part of its debts as they fall due or unable to carry on its business. • For the Tier 2 BCNs due 2022 only, a third viability event is added: The CET1 ratio contained in any Interim Capital Report is below 5%, and as a consequence the conversion into equity or write-off of any or all Progressive Capital Instruments in issue at such time occurs or, in the determination of the Regulator, would have occurred but for the conversion of the Tier 2 BCNs and the conversion or write-off of all other Buffer Capital Instruments that, pursuant to their terms or by operations of law, are capable of being converted into equity or written off at that time.
Trigger for Principal Loss Absorption	CET1 <7% transitional basis

Source: Prospectuses, Scope Ratings

Key risk: principal loss absorption

Despite having been issued very early on, on 24 February 2011 and on 22 March 2012 respectively, both the 7.875% Tier 2 BCNs due 2041 and the 7.125% Tier 2 BCNs due 2022 have remained eligible for loss-absorption purposes under Basel 3. This is due to the flexibility of the Terms & Conditions (T&C), whereby the distance to the CET1 ratio trigger of 7% was defined first under Basel 2.5 (in 2011 and 2012), then from 2013 onwards under transitional Basel 3 requirements (to become “fully-phased”, “phased out”, “fully loaded” or “fully applied” in 2019).

Since the securities have been issued by newly created special purpose vehicles (Credit Suisse Group (Guernsey) I Ltd and Credit Suisse Group (Guernsey) IV Limited respectively), they are irrevocably guaranteed by Credit Suisse Group AG on a subordinated basis. Credit Suisse Group can at any time substitute for the issuing entity. Also, the T&C enable Credit Suisse to substitute all the BCNs for other compliant securities if the BCNs cease at some point to be treated as Buffer Capital under National Regulations and/or Tier 2 Capital under BIS regulations.

Looking at the T&C, we note that the CET1 ratio of Credit Suisse Group can be below 7% without triggering a contingency event when the regulator is satisfied that the bank has taken enough measures to restore the capital ratio to a level above 7%.

Additionally, the risks section of both prospectuses makes very clear that the occurrence of a viability event is subject to a subjective determination by the regulator or the Swiss federal government or central bank requiring Credit Suisse Group to accept support from the public sector. As a result, the regulator may require or the federal government may cause the conversion of the BCNs into ordinary shares in circumstances that are beyond the control of the issuer and Credit Suisse Group, and with which neither the Issuer nor Credit Suisse Group agrees.

Lastly, we note that the only material difference in T&C between the 7.875% Tier 2 BCNs due 2041 and the 7.125% Tier 2 BCNs due 2022 is that the latter adds a third viability event (as per the Summary Terms above). Our understanding of this third viability event is that if the CET1 ratio of the group is below 5% at any point, and if all the progressive component capital – i.e. all the low-trigger capital instruments - have been converted as a result, then the high-trigger Tier 2 BCNs (which at that point would also include the 7.875% securities due 2041) would also be converted in equity at this point.

In other words, if a 7% trigger capital instrument has for some reason not converted before the CET1 ratio of the group fell to 5%, it should be converted for sure when this 5% trigger event occurs.

We do not view this supplementary clause as significant enough to justify differentiating the rating of the two Tier 2 BCN issues.

Distance to trigger

Since the distance to trigger pertaining to the BCNs has historically been calculated under Basel 2.5 (in 2011 and 2012) and then under transitional Basel 3 requirements, Credit Suisse Group has so far reported CET1 ratios that were largely in excess of the "threshold ratio" of 7%, as demonstrated by Table 2 below. On top of the Basel 2.5 definitions of capital being less conservative than Basel 3 definitions, we note that the transitional definition of Basel 3 is also less conservative than the "fully-phased" definition of Basel 3 to be applied on 1 January 2019.

Table 1: Past, present and future distance to trigger: 2011-2012 Credit Suisse BCNs

	2011	2012	2013	FY 2014	Q1 2015	2019
Trigger level	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%
CET1[1]	10.7%	15.5%	15.7%	14.8%	13.7%	11% target
Gap (%)	3.7%	8.5%	8.7%	7.8%	6.7%	4.0%
Gap (CHF)	8.9bn	19.1bn	23.8bn	22.8bn	19.4bn	10bn based on long-term RWA targets of CSG

1) The eligible CET1 ratio for the calculation of the distance to trigger was the Basel 2.5 core Tier 1 ratio of Credit Suisse Group in 2011 and 2012, is the transitional Basel 3 CET1 ratio of Credit Suisse Group from 2013 to 2018, and will be "the fully-loaded" Basel 3 CET1 ratio from 1 January 2019 onwards.
Source: Company data, Scope Ratings estimates

Historically, the gap to the threshold CET1 ratio of 7% has indeed been very high, reaching levels close to CHF 25bn in 2013 and 2014 despite the CHF 1.6bn charge relative to the settlement of the US cross-border case. This is very ample but we note that the "fully loaded" long-term capital projections of Credit Suisse aim at a CET1 ratio target of 11%, materially lower than the transitional 13.7% reported at the end of Q1 2015. We also note that on the back of the long-term RWA targets of the bank, the distance to trigger should stand at CHF 10bn by 1 January 2019, a comfortable amount but showing a significant decline versus past metrics (and assuming long-term RWA targets of CHF 250-260bn). Versus the transitional group shareholders' equity of CHF 44.0bn at YE 2014, the group will have to recognize, by 2019, the equivalent of CHF 15bn of deductions, including goodwill, other intangible assets and certain deferred tax assets.

We note that the leverage ratio has become the "binding constraint" for Credit Suisse's capital metrics, and that the CET1 ratio has become a "secondary driver", to quote from Credit Suisse's CFO in the course of the Q1 2015 Q&A session.

The planned reduction of the distance to trigger by 2019, as well as the mild uncertainty regarding Credit Suisse's CET1 target, are enough for Scope to add another notch differential on top of the traditional 1-notch difference between a senior unsecured debt and a Tier 2 security.

Position of high-trigger Tier 2 notes in creditor hierarchy ambiguous

The position of these Tier 2 BCNs in the priorities of claims is not straightforward considering that their trigger levels are higher than the trigger levels attached to some AT1 securities issued by Credit Suisse. If a contingency event was to happen, couldn't the Tier 2 BCN be converted ahead of lower-trigger AT1 securities, therefore reversing the usual creditor hierarchy?

The notes' T&C make very clear that the Tier 2 BCNs "constitute direct, unsecured and subordinated obligations of the issuer and rank pari passu and without any preference among themselves". The prospectus goes further by affirming that in the case of liquidation or insolvency, the Tier 2 BCNs rank junior to all senior debt holders, pari passu with subordinated bondholders, and senior to Tier 1 holders and shareholders. However, this provision is "subject to any obligations which are mandatorily preferred by law".

A look at the law brings us to an examination of the Capital Adequacy Ordinance (CAO) stipulated by the Swiss Federal Council as of 1 June 2012 (updated as of 30 June 2014).

Prima facie, like in the T&C of the prospectus, the CAO gives a clear hierarchy regarding the loss-absorption of banks' capital. Article 19, in particular explicitly ranks the losses as to be absorbed first by common equity holders, then AT1 holders; then Tier

2 holders. Article 20-3 adds that “in case of liquidation, bankruptcy or restructuring of the bank, the capital of the bank [defined as CET1 + AT1 + T2] is ranked after the unsubordinated debt of all other debt holders”.

But Article 20-4 adds that “Capital instruments with contingent conversion or write-down features […] are considered as capital instruments with their status before conversion or write-downs […] except for the convertible capital of systemically-important banks”.

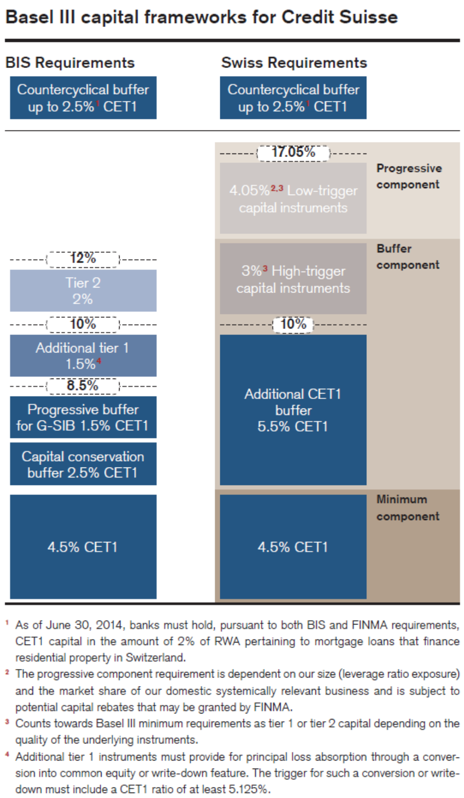
We understand this point as meaning that there could potentially be cases for convertible instruments of systematically important Swiss banks to potentially not follow the traditional creditor hierarchy. Article 20-4 then refers to Title 5 of the OAC about the “Specific provisions for systemically-important banks”. From that moment in the OAC, references to AT1s and T2s disappear completely. From Article 128 to Article 132, the CAO clearly defines the capital requirements of the two systemically-important Swiss banks by dividing them in four “blocks”: the minimum component, the buffer component, the progressive component and the countercyclical buffer.

Chart 1 below, illustrating Credit Suisse’s capital framework, shows that the group exclusively uses the language of Title 5 of the CAO and completely drops the references to AT1 and T2. Article 129 (dedicated to the Buffer Component) states that convertible capital which converts when the CET1 ratio goes below 7% can represent up to 3% of the capital buffer. Article 130 (dedicated to the Progressive Component) states that the Progressive Component must be covered by convertible capital which conversion is triggered at the latest when the CET1 ratio stands below 5%.

So there is equivalence between (1) the Buffer Component and high-trigger convertible capital; and (2) the Progressive Component and low-trigger convertible capital.

This equivalence seems, in the case of Swiss systemically important banks, more critical than the traditional CET1-AT1-T2 creditor hierarchy.

Chart 1: Capital framework for Credit Suisse

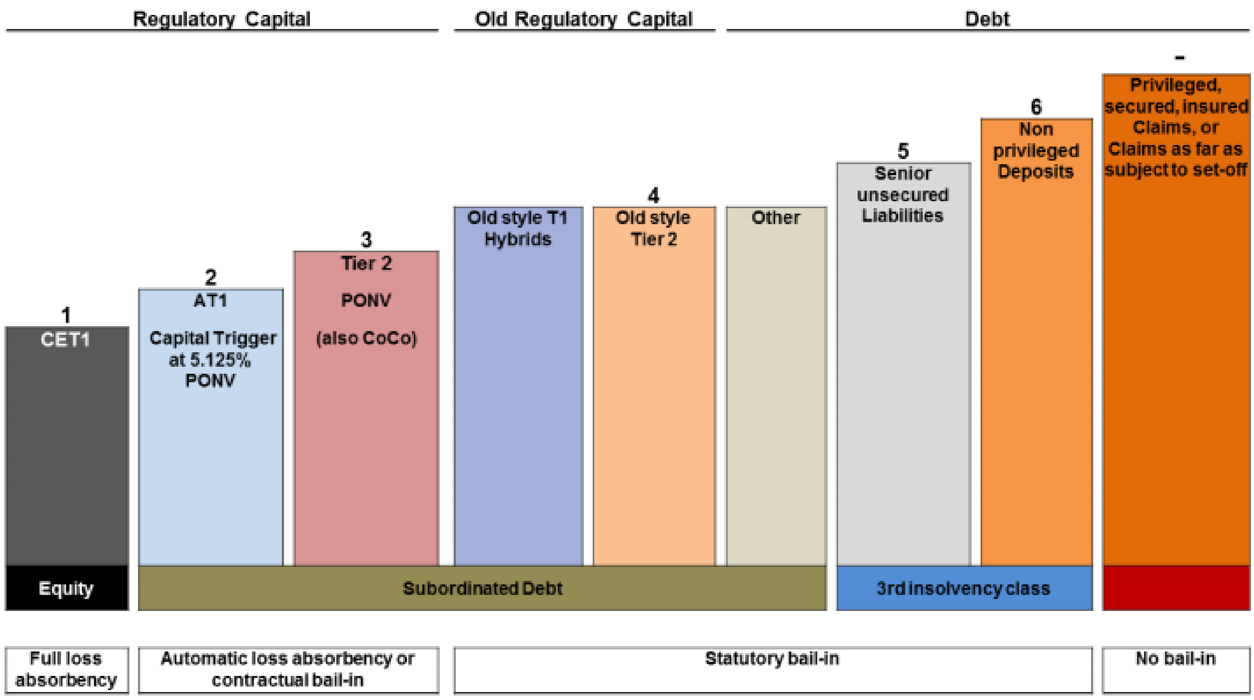


Source: Company data

The Position Paper of FINMA on the "Resolution of Global Systemically Important Banks" (dated 7 August 2013) throws a different light on the problem.

To be sure, according to the paper, observing the hierarchy of creditors while implementing a bail-in is one of three "fundamental principles" (with equal treatment of the same class of creditors and "no creditor worse off" than in liquidation). The Position Paper goes as far as to illustrate the creditor hierarchy in a chart (replicated in Chart 2 below).

Chart 2: Creditor Hierarchy in a bail-in context as illustrated by FINMA



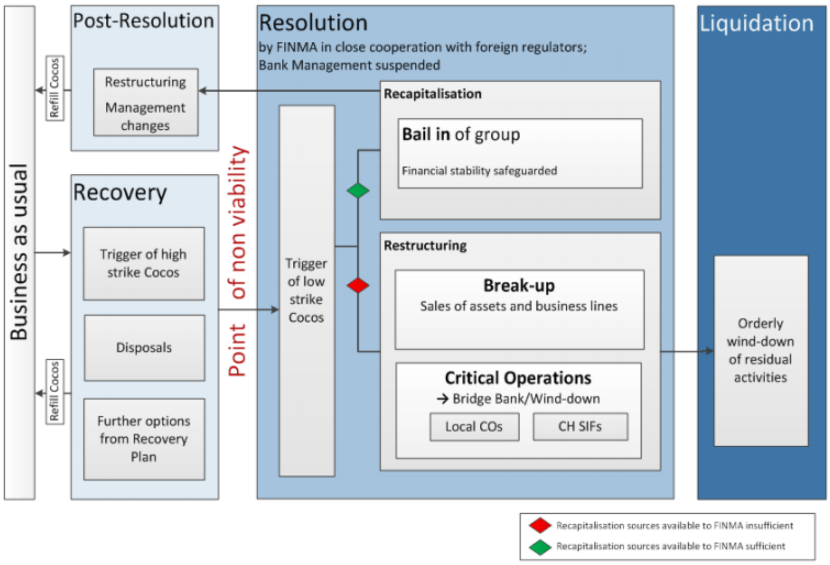
Source: FINMA – Position Paper on the Resolution Global Systemically Important Banks

However, what we believe may not be fully appreciated is the fact that FINMA has established, in the Position Paper, its own definition of the Point of Non-Viability (PONV).

According to Chart 3, the conversion/write down of the high-trigger capital instruments in the process of recovery could be enough to "repair" the bank and avert resolution. It is only when recovery has been attempted and has failed that the PONV is reached, corresponding to the conversion/write-down of low-trigger capital instruments.

In this context, it is easier to understand the respect of creditor hierarchy as shown by Chart 2. In recovery (but before resolution), high-trigger AT1s would be converted ahead of high-trigger Tier 2. In resolution, low-trigger AT1s would be converted ahead of low-trigger Tier 2.

Chart 3: FINMA's description of the different stages of a banking crisis and the decisions to be taken



Source: FINMA

However, strictly speaking there is a chance of the creditor hierarchy not being respected as, in the context of the chart above, a Tier 2 (with high-trigger, during recovery) is likely to be converted/written down ahead of an AT1 (with low-trigger, only converted in resolution).

This major ambiguity helps explain why, in our view, the Position Paper remains very flexible in its dealing with bail-in. FINMA hints at the fact that "deviation from one of the three principles will not cause the restructuring plan to fail". More specifically, the Position Paper makes clear that nothing should get in the way of FINMA trying to quickly and orderly resolve large failing institutions. Bail-in is clearly defined in this paper as "issuing compulsory instructions to convert debt into equity capital, thereby turning creditors into shareholders. There is also the option to oblige creditors to bear a share of losses via writing down their principal, requiring them to waive some of their claims. Such "bail-in" measures complement contingent convertible capital of which the Swiss systemically important banks are obliged to hold a considerable amount".

What we find interesting though is that in this paper FINMA explicitly raises the issue that its decisions may be questioned in court. We find equally interesting that FINMA's decisions (vis-à-vis "liquidation proceedings" in particular) can not be reversed. As mentioned in the position paper, "in the context of restructuring and liquidating banks, the courts have an independent function insofar as creditors can challenge FINMA's decisions both in restructuring and in liquidation proceedings. In the case of systemically important banks, this is limited to ensuring the ex-post balancing of interests, e.g. by means of compensation for a specific set of creditors; this means that FINMA's decisions cannot be reversed". This point about FINMA's decision not being reversed is underlined at least one more time in the paper.

We view this statement as an affirmation that creditors would have very limited rights in the unlikely case of the resolution of a systemically important Swiss bank. It is this limitation, associated with the ambiguous status of the traditional creditor hierarchy in case of recovery and resolution in Switzerland that make us add an additional notch of difference to the rating of Credit Suisse's Tier 2 BCNs.

Also, the we expect the legal framework of Swiss TBTF banks to evolve by the end of the year, following the recommendations of the Brunetti report. The capital requirements could change and the new rules might shed some light on the weight of creditors' hierarchy in the context of the resolution of large Swiss banks.

Financial Institutions Ratings
Crédit Suisse AG – Tier 2 rating report

Security Ratings	
Outlook	Stable
6.5% USD 2.5bn Tier 2 Capital Notes due 2023 Contingent convertible securities	A-
5.75% EUR 1.25bn Tier 2 Capital Notes due 2025 Contingent convertible securities	A-

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The ratings have not been solicited by the issuer; the analysis is based solely on public information.

Rating rationale

On April 10, 2015 Scope downgraded the long-term ratings of Credit Suisse from A+ to A, stable outlook. This led to a downgrade to A- from A of the 6.5% USD 2.5bn Tier 2 Capital Notes due 2023 and the 5.75% EUR 1.25bn Tier 2 Capital Notes due 2025, both issued by Credit Suisse AG. The rating is based on the following considerations:

- Issuer Credit Strength Rating (ICSR): A, stable
- Minimum notch down from the ICSR: 1
- Additional notches: 0

As detailed in Scope's Bank Capital Instruments Rating Methodology published in September 2014, the minimum notching for T2 securities is one notch from the ICSR. In May 2015, Scope updated its methodology for rating capital instruments (currently as a call for comments). In the revised methodology, we are proposing to change the minimum notching to two notches from one. In a bail-in scenario, T2 securities are considered capital instruments and rank below non-T2 subordinated debt and senior debt. As well, T2 securities may be converted or written down during early regulatory intervention (a step ahead of resolution), which is not the case with non-T2 subordinated debt. This translates into T2 being rated lower than non-T2 subordinated debt for EU banks.

When the methodology is finalised, we do not intend to immediately change the rating on the current T2 securities. We will wait for the new Swiss capital requirements (expected at YE 2015) to be released to do so. At this stage, Scope applies no additional notching to the two securities, beyond the 1-notch defined by the current version of our methodology.

- Scope perceives the trigger of the two securities (sum of CET1 ratio and Higher Trigger Capital ratio below 5%) to be extremely low, not only in absolute terms, but also with regards to the minimum capital requirements of Credit Suisse Group (CSG) under Swiss regulation. Since the trigger could be construed as being below CSG's Swiss minimal requirements, we view the possibility of these notes being permanently written-down as highly theoretical (except in resolution).

The fact that Credit Suisse AG, operating bank of Credit Suisse Group, has issued these capital instruments seems slightly at odds with FINMA's instructions that its favourite resolution mechanism is through a SPE (single Point of Entry). Since Credit Suisse Group AG, Holding Company of the Group, occupies that role at Credit Suisse, the fact that the operating company of the group issues loss-absorbing capital instruments can appear surprising. In any case, the combination of the low trigger, the Tier 2 status and the position below the holding company makes the instrument not materially different from a traditional subordinated debt.

ICSR

The rating of A reflects Scope's belief that Credit Suisse benefits from a focused and profitable investment banking franchise, as well as a cash-generative wealth management business, providing the bank with a stable and large earnings stream. However, Credit Suisse suffers in our opinion from capital metrics that are slightly lower than peers as well as a slightly less strong momentum than peers in the wealth management business. Considering the weight of investment banking in the bank's business mix relative to peers (more than 50% of 2014 revenues), we believe that the overall dynamics of the bank's business model could change, with more emphasis on the wealth management side of the bank. However, such changes are in our view difficult to implement: the wealth management business of Credit Suisse is somewhat smaller than the one of its major domestic peer, and material external growth opportunities in private banking are hard to come by. Resolute growth in wealth management could potentially cost the bank in terms of capital expenditures initially, while a material shrinkage of the investment bank could have a significantly negative impact on profits.

Scope has assigned similar long-term ratings of A to Credit Suisse Group AG (the holding company of Credit Suisse AG) and to Credit Suisse AG. In rating the holding company at the same level as the operating bank, Scope pointed at the highly integrated structure of the Credit Suisse Group, financially, operationally and strategically.

Summary terms

Issuer	Credit Suisse AG
Issue Date	8 August 2013
Amount	USD 2.5bn
Coupon	• 6.5% per annum • payable semi-annually in arrear
Format	Tier 2 Capital Notes due 2023
ISIN	XS0957135212/US22546DAA46
Issue Date	18 September 2013
Amount	EUR 1.25bn
Coupon	• 5.75% fixed until first call date, and thereafter at a rate equal to the Mid-Swap rate plus 4% • payable annually in arrear
Format	Tier 2 Capital Notes due 2025 callable on 18 September 2020
ISIN	XS0972523947
Capital Treatment	Tier 2 and low-trigger loss-absorbing capital – Progressive component.

Principal Loss Absorption	• Despite the Issuer being Credit Suisse AG, the trigger refers to capital metrics of Credit Suisse Group AG (CSG), and not Credit Suisse AG. • Following the occurrence of a Contingency Event or a Viability Event, a write-down will occur and the full principal amount of the Notes will automatically and permanently be written down to zero on the write-down date. • A contingency event refers to the sum of the CET1 ratio and the Higher Trigger Capital Ratio of CSG to be below 5%; • A viability event refers to (1) the regulator notifying CSG that conversion or write-off of all Basel 3-compliant capital instruments is an essential requirement to prevent CSG from becoming insolvent, bankrupt, unable to pay a material part of its debt or ceasing to carry on its business; or (2) CSG has received irrevocable commitment of extraordinary support from the public sector without which CSG would have become insolvent, bankrupt, unable to pay a material part of its debts as they fall due or unable to carry on its business. • Contingency and Viability events could cease to apply to the Notes if regulation on capital and on Progressive Components changes;
Trigger for Principal Loss Absorption	CET1 + Higher-Trigger <5% transitional basis

Source: Prospectuses, Scope Ratings

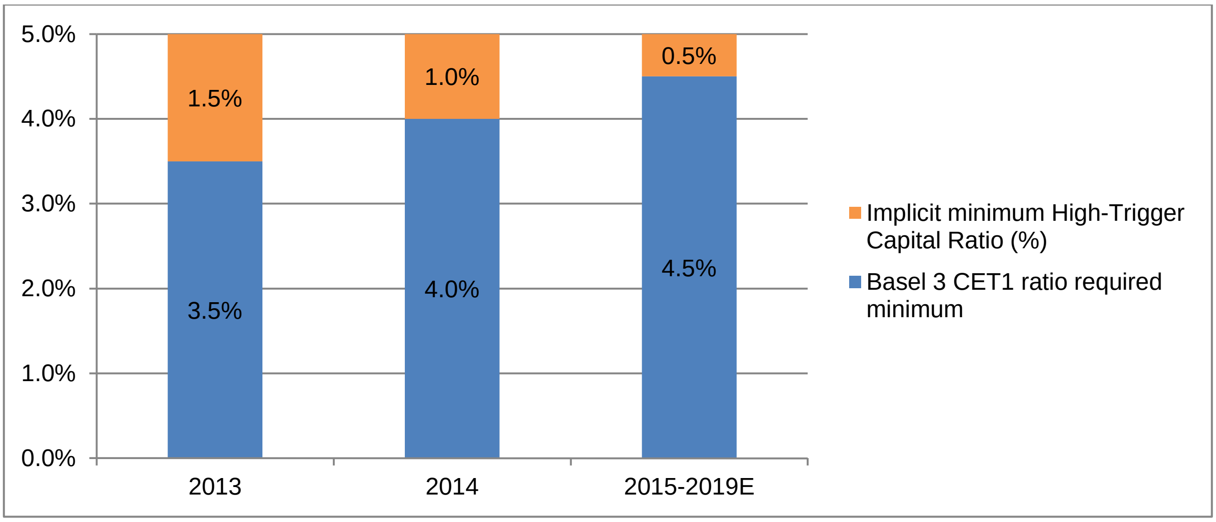
Key risk: principal loss absorption

The permanent write-down risk that is attached to the 6.5% Tier 2 Capital Notes due 2023 and the 5.75% Tier 2 Capital Notes due 2025 is, in Scope's view, of a highly theoretical nature.

The reason for this is that the trigger upon which a permanent write-down occurs is very low in two respects.

- **First, with regards to the definition of the capital metric under which the trigger is measured**. The sum of the CET1 ratio and the Higher-Trigger ratio is highly unusual. This sum must be below 5% for both securities to be permanently written-down. Since Credit Suisse's minimum transitional CET1 requirement under Basel 3 was 3.5% in 2013, 4% in 2014 and must be 4.5% from 2015 onwards, this means by difference that the minimum Higher-Trigger capital ratio for CSG to remain above the trigger defined by the Terms & Conditions (T&C) of the Tier 2 Capital Notes should have been 1.5% in 2013 and 1% in 2014, and should be 0.5% from 2015 onwards (Chart 1).

Chart 1: Estimates of minimum transitional Basel 3 requirements for CSG's CET1 + Higher-Trigger capital ratios 2013-2019 (in %)



Source: Scope ratings, company data

Projecting ourselves from 2015 onwards (when the minimum required CET1 ratio of 4.5% is "fully-loaded"), the sum of CET1 + Higher Trigger Capital means in effect: (1) a CET1 ratio of at least 4.5% and (2) a Higher-Trigger capital ratio of at least 0.5%. This is the only minimum combination of the two metrics that is theoretically possible under Basel 3 regulation. In our view, it is highly unlikely that CSG's supervisor would let the CET1 and Higher Trigger capital ratios of the bank to fall below these levels before intervention. Therefore, we identify Credit Suisse's Group's PONV higher than these 4.5%/0.5% thresholds. As a result, bar in resolution, a trigger event for these notes is unlikely.

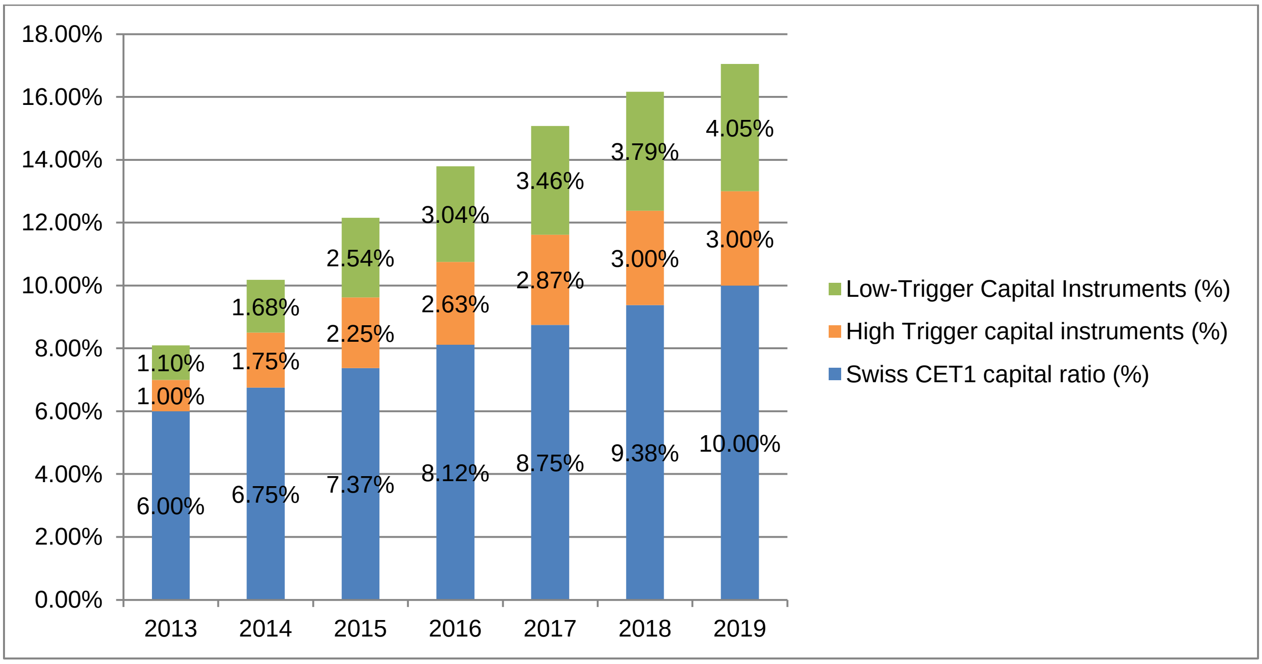
We note that a trigger combining CET1 with Higher-Trigger capital ratio is not presented as such in the sections of the Capital Adequacy Ordinance (CAO) dedicated to the Progressive Capital Component of global systemically important Swiss banks. According to Article 130-2 of the CAO, "The Progressive component must be covered by convertible capital which conversion is triggered at the latest when the CET1 ratio falls below 5%". In the case of the 6.5% and 5.75% Tier 2 Capital Notes, the conversion is triggered only when the CET1 ratio **and** the Higher Trigger Capital Ratio fall below 5%.

- **Second, with regards to the bank-specific requirements which, in our view, are applicable to these Notes**. Indeed, Swiss supervisors have a more conservative approach of the Basel 3 regulatory framework for systemically-important banks. As a result, the Swiss requirements for Core Equity Tier 1 and the High Trigger capital ratios are significantly higher than the theoretical Basel 3 requirements illustrated in Chart 1. Actually, each global systemically important Swiss bank reports publicly its specific, FINMA-defined, capital requirements. The Credit-Suisse-specific requirements are illustrated on Chart 2 below.

  On a transitional basis, the minimum CET1 ratio of Credit Suisse is never lower than 6.75% from 2014 onwards, while the Higher-Trigger capital ratio is never lower than 1.75%. As a result, CSG is bound, by Swiss regulation, to a transitional CET1 + Higher Trigger capital ratio of at least 8.5% in 2014, 9.62% in 2015, 10.75% in 2016, 11.62% in 2017 and 12.38% in 2018. On a fully phased-basis, the minimum level will be 13% for Credit Suisse Group in 2019.

  In light of the numbers shown on Chart 2, an implicit permanent write-down CET1 ratio trigger at 4.5% looks even more highly theoretical (except in resolution).

Chart 2: Estimates of minimum transitional Swiss requirements for CSG's CET1 + Higher-Trigger capital ratios 2013-2019 as of Q1 2015 (in %)



Source: Company data

However, despite the low probability of the Notes being written-down, we note that the risk section of the Information Memorandum makes clear that in case of resolution, "FINMA could require the full conversion or write-down of Credit Suisse's obligations under its contingent convertible bonds and applicable debt capital (including the Notes) before the conversion of CS's other debt into equity or a debt reduction. In such case, holders of the Notes would lose all of their investment in such notes".

We note that this prerogative of FINMA limits itself to resolution.

Except for the very low trigger attached to these Notes, we believe that the fact that they are issued at Credit Suisse AG level (and not Credit Suisse Group AG) represents a small additional protection for noteholders. The Position Paper of FINMA on the "Resolution of Global Systemically Important Banks" (dated 7 August 2013) makes very clear that, in case of resolution, the Single Point of Entry (SPE) is the favoured approach. We also believe that CSG's change in legal structure announced in November 2013 aimed at introducing Credit Suisse Group AG (or CSG) as "SPE" in a resolution context.

When introducing the new structure, CSG made very clear that bailinable debt would be issued at holding company level. This announcement was made after the 6.5% and the 5.75% Tier 2 Capital Notes were issued but it is clear that with the newly announced legal structure, these low-trigger Tier 2 capital instruments definitely look like regulatory oddities considering how far out from trigger they seem to be, were it because of (1) the issuer (Credit Suisse AG instead of Credit Suisse Group AG – even if Scope rates both entities at the same level of A with stable outlook); (2) the position of the instrument in the creditor hierarchy (Tier 2) and (3) the highly theoretical trigger attached to the instrument (5% CET1 plus Higher-Trigger Capital Ratio).

Distance to trigger

Unsurprisingly considering the undemanding trigger of the Notes, we expect Credit Suisse AG's CET1 and Higher-Trigger capital ratios to remain largely above the 5% trigger level required by the T&C of the Notes – even when the CET1 ratio enters its "fully loaded" definition on January 1, 2019.

Table 1: Distance to Trigger – Credit Suisse AG

	2013	FY 2014	Q1 2015	2019
Trigger level	5.0%	5.0%	5.0%	5.0%
CET1 + Higher-Trigger Capital (%)	17.8%	17.5%	16.6%	14.0% target[1]
Gap (%)	12.780%	12.5%	11.6%	9.0%
Gap (CHF)	33.9bn	35.5bn	32.7bn	Around CHF 23.0bn based on long-term RWA targets of CSG

1) Based on the 11% long-term CET1 target ratio of Credit Suisse Group plus the 3% minimum requirement for Higher-Trigger Capital Ratio.

Source: Company data, Scope Ratings estimates

Security Ratings (assigned 17 March 2015)	
Outlook	Stable
5.75% EUR 1bn Tier 1 Capital Notes Contingent convertible on 5.125% trigger	BBB-
7.00% USD 1.25bn Tier 1 Capital Notes Contingent convertible on 5.125% trigger	BBB-

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The ratings have not been solicited by the issuer; the analysis is based solely on public information.

Rating rationale

We have assigned a rating of BBB- to UBS Group AG (UBS)'s 5.75% EUR 1bn and 7.00% USD 1.25bn Tier 1 capital notes based on the following:

- ICSR: A, Stable outlook
- Minimum notches down from the ICSR: 4
- Additional notches: 0

Please refer to Scope's Bank Capital Instruments Rating Methodology published in September 2014 for more details about the minimum notching for AT1 securities.

Scope decided not to add any additional notch beyond the four minimum notches stipulated by the capital instruments methodology. This is due to the following:

On coupon cancellation risk, even if UBS Group AG is a new company and does not seem to have built free reserves yet, the company makes very clear in its Q4 2014 financial report that "as of the balance sheet date, UBS Group AG estimates that the amount of reserves possibly available for distribution to shareholders under Swiss corporate law was approximately CHF 36.7bn". This amount can only be reached if share premium is included in the Available Distributable Items (ADIs), and since share premium is included in the capital reserves (as per the Directive on the Establishment of Accounts (DEC-CFB) of 14 December 1994 (lastly amended on 21 December 2006) and also per Article 671-2-1[5] of the Swiss Code of Obligations), we believe it is safe to include it in UBS Group AG's ADIs as of YE 2014. Our understanding of Swiss corporate law is that share premium is not formally attached to share capital, contrary to the way it is presented in other European countries. In addition, (1) UBS is not submitted to as drastic a restriction on discretionary distributions as European banks abiding by CRD 4-CRR; and (2) the issuer is severely restricted on its ability to pay dividend on ordinary shares if an interest payment on the Tier 1 Capital Notes is cancelled. All these factors in our view add some degree of protection to Tier 1 Capital Notes holders, justifying no extra notching on coupon cancellation risk.

With regards to principal loss absorption, Scope perceives the trigger of the two securities (sum of CET1 ratio and Higher Trigger Capital ratio below 5.125%) to be extremely low, not only in absolute terms, but also with regards to the minimum capital requirements of UBS Group under Swiss regulation. Since the trigger is below UBS's Swiss minimal requirements, we view the possibility of these notes being permanently written-down as highly theoretical (except in resolution).

[5] "Even after it has reached the statutory level, any share issue proceeds in excess of the nominal value […] must be allocated to the general reserve".

ICSR

The ICSR of A with a Stable Outlook is driven by the bank's significant downsizing during the crisis and acceptable levels of underlying profitability from core franchises over the past five years. At the same time, the ratings reflect the uncertain outcome of several high-profile litigation cases as well as what we perceive as the low level of risk-weighted asset intensity of the bank – partly linked to the build-up of significant reserves of cash and highly liquid assets in the post-crisis years.

Summary terms

Issuer	UBS Group AG
Issue Date	19 February 2015
Amount	EUR 1.0bn
Coupon	• 5.75% until first call date, and thereafter at a rate equal to the Mid Market Swap Rate plus 5.287% • If any, payable annually in arrear on 19 February of each year, commencing on 19 February 2016
Format	Perpetual Tier 1 capital notes, callable 19 February 2022 and every year after that.
ISIN	CH0271428309
Issue Date	19 February 2015
Amount	USD 1.25bn
Coupon	• 7.00% fixed until first call date, and thereafter at a rate equal to the Mid Market Swap Rate plus 4.866% • If any, payable annually in arrear on 19 February of each year, commencing on 19 February 2016
Format	Perpetual Tier 1 capital notes, callable 19 February 2025 and every year after that.
ISIN	CH0271428333
Capital Treatment	Tier 1 and low-trigger Loss-absorbing capital – Progressive Component
Coupon Cancellation	• Fully discretionary • Mandatory if (1) there are insufficient distributable items or (2) if UBS Group AG is not in compliance with all applicable minimum capital adequacy requirements of the National Regulations on a consolidated basis and/or (3) the FINMA has requested the issuer not to make such interest payment.
Principal Loss Absorption	• Following the occurrence of a Trigger Event or a Viability Event, a contingent write-down will occur and the full principal amount of the Notes will automatically and permanently be written down to zero on the write-down date. • A Trigger Event refers to the sum of the CET1 ratio and the High-Trigger Capital Ratio of UBS Group to be less than 5.125%; • A Viability Event refers to (1) the FINMA has notified UBS that conversion or write-off of all Basel 3-compliant capital instruments is an essential requirement to prevent the Group Holding Company from becoming insolvent, bankrupt, unable to pay a material part of its debt or ceasing to carry on its business; or (2) the Group Holding Company has received irrevocable commitment of extraordinary support from the public sector without which the Group Holding Company would have become insolvent, bankrupt, unable to pay a material part of its debts as they fall due or unable to carry on its business.
Trigger for Principal Loss Absorption	CET1 + Higher-Trigger <5.125% transitional basis

Source: Prospectuses, Scope Ratings

Historically UBS has not issued a lot of Basel 3-compliant AT1 products as the bank decided to build up its 10% CET1 capital requirement and its 3% buffer requirement exclusively through CET1. As a result, the bank privileged low-trigger Tier 2 issues to the market, and high-trigger Tier 2 issues to employees as part of its compensation program (DCCP). UBS started only recently to issue AT1 notes from the group holding company to both employees (for 2014 compensation) and the market (in February 2015). The AT1 notes rated in this report are also part of the progressive capital component, and therefore they live in the same capital bucket as the Low-Trigger Tier 2 products (all rated A- by Scope Ratings) that the group issued between 2012 and 2014. We note that according to UBS's capital requirements as defined by Swiss regulation, low-trigger loss absorbing capital should represent 5.4% of UBS's Risk Weighted Assets (RWAs) by 2019.

Key risk: coupon cancellation

Coupon payments on the security are fully discretionary and are subject to distribution restrictions.

Additionally, if a coupon is cancelled, UBS Group shall not recommend to ordinary shareholders that any dividend or other distribution in cash or in kind be paid or made on any ordinary shares. Capital returns (such as share buy-backs) are also not possible.

We also note that by virtue of interest payment being non-cumulative, coupon cancellation or non-payment does not constitute a default for any purpose. However, this provision contradicts the "Events of Default" section of the Terms & Conditions (T&C) whereby an event of default will occur if UBS Group fails to make any payment of interest in respect of the Tier 1 Capital Notes. There is probably a difference between a discretionary willingness to cancel the coupon (which is distinct from the coupon payment being prohibited by distribution restrictions) and "classical" default whereby the Issuer does not have the possibility to honour its interest payments. One cancellation is proactive (discretionary coupon cancellation on AT1 instruments) while the other is completely passive (Event of Default) but identifying the difference may be the source of some difficulty for investors.

Moreover, the T&Cs make clear the fact that any default claim with regards to non payment (either interest of principal) would be superseded by the occurrence of a contingent write-down.

Coupon payment: analysing the distribution restrictions

While for many banks in the rest of Europe and in the UK coupon payment is dependent upon the Capital Buffer Requirements as defined by CRD4-CRR, themselves triggering a "Maximum Distributable Amount" that is restricting coupon payment, the restrictions on Tier 1 coupon distribution seem a bit less restrictive in Switzerland. Indeed, in the case of the two securities under consideration, UBS Group is prohibited from making coupon payment in three circumstances.

- First, when UBS Group AG has an amount of distributable items which is less than the sum of (i) the amount of such interest payment plus (ii) all other payments (except redemptions) made by UBS Group AG on the notes and on any parity obligations or junior obligations, plus (iii) all payments payable by UBS Group AG on any parity obligations or junior obligations, excluding any portion of such payments already accounted for in determining the amount of such distributable items. This latter clause enables to avoid double-counting for AT1 coupons already provisioned and paid for – other European banks re-integrate these coupons in their distributable profits.

- Second, when UBS Group AG is not in compliance with all applicable minimum capital adequacy requirements if the bank pays the interest on the notes;
- Third, when FINMA has required the Issuer not to make such interest payment.

We note that under the Swiss Code of Obligations, "distributable profits" refers to the aggregate of net profits carried forward and freely available reserves (other than reserves for own shares) less any amounts that must be contributed to legal reserves under applicable law.

According to the terms and conditions (T&C) of the notes, the distributable items will be calculated based on the non-consolidated audited financial statements of the Issuer in accordance with the Swiss Code of Obligations. Since The Issuer UBS Group AG was only incorporated on 10 June 2014, no Distributable Items will be available until and unless the Issuer's first set of audited financial statements is approved by the annual meeting of shareholders which is scheduled for 7 May 2015.

A quick look at UBS Group AG's parent company 2014 financial statement shows that the holding company reports total shareholders' equity of CHF 37,154m (CHF 37,942m as of Q1 2015). As per UBS's Q4 2014 financial report, "UBS Group AG estimates that the amount of reserves possibly available for distribution to shareholders under Swiss corporate law was approximately CHF 36.7bn" (this number was not updated in the Q1 2015 financial report).

However, considering that UBS Group AG is a brand new company, the bulk of these CHF 36.7bn can only be share premium. Swiss corporate law is quite clear on share premium and we found three documents that confirm the inclusion of share premium in general capital reserves, therefore validating their status as ADI.

- The Directive on the Establishment of Accounts of banks dated 14 December 1994 (and lastly modified on 21 December 2006). The directive specifically includes share premium into capital reserves.
- The Banking Ordinance of 30 April 2014 uses the classification above by separating share capital from "capital reserves" and "earnings reserves" but does not segregate share premium (which is therefore included in the "capital reserves" as per the Directive above).
- The Swiss Code of Obligations is even more explicit as Article 671-2-1 states that "Even after it has reached the statutory level, any share issue proceeds in excess of the nominal value […] must be allocated to the general reserve".

As a result of all the above, we believe that UBS Group AG has ample ADIs to support the estimated cumulative coupons to be paid on all the group's AT1 instruments issued to date (around a maximum of CHF 300m, which we believe is a very small amount to distribute overall).

Even if UBS is not in the strictest sense submitted, like other European banks, to Combined Buffer Requirements to be able to pay interests, the bank must nonetheless abide by the Swiss capital requirements. Systematically important banks in Switzerland benefit from an "ad hoc" supervision with individual requirements. Table 1 summarises the capital requirements for UBS.

Table 1: Swiss capital requirements of UBS Group

	2014	Q1 2015	2015	2016	2017	2018	2019
Combined buffer:							
- Low-trigger capital instruments	2.5%	3.4%	3.4%	4.1%	4.6%	5.1%	5.4%
- High-trigger capital instruments	1.8%	2.3%	2.3%	2.6%	2.9%	3.0%	3.0%
- Countercyclical[1]							
Minimum CET1	6.9%	7.5%	7.4%	8.1%	8.8%	9.4%	10.0%
Capital Adequacy Requirement associated with distribution restrictions	**11.2%**	**13.2%**	**13.1%**	**14.8%**	**16.3%**	**17.5%**	**18.4%**
UBS Transitional CET1 ratio (%)	19.4%	18.6%					13.0% target
CET1 Gap (%)	12.5%	11.1%					3.0%
CET1 Gap (CHF bn)	27.6bn	24.3bn					6.0bn

1) Up to 2.5% of CET1.

Source: Company data, Scope Ratings

Table 1 shows the three layers of capital requirement that UBS Group has to abide by. As far as the low-trigger and high-trigger components are concerned, they reflect issuing potential. As of Q1 2015 (and on a fully applied basis), the low-trigger capital ratio of UBS stood at 5.7%, above its 2019 requirement of 5.4%.

However, the bank still has a lot of issuing capability as far as the High-Trigger component is concerned, since the fully-applied High-Trigger capital ratio stood at 1.2% as of Q1 2015, still leaving UBS with quite a lot of leeway (estimated at around CHF 3.6bn on the basis of 2019 estimated RWAs) to abide by its 2019 capital requirements, and keeping in mind that the High-Trigger requirement is currently filled with CET1.

The CET1 metrics are the most demanding but since UBS's capital requirements are on a transitional basis until 1 January 2019, we do not expect any problem for the bank to abide by these requirements, at least in the short-term. As of YE 2014, the gap between UBS's capital requirements and the bank's transitional CET1 ratio stood at 12.5%, or close to CHF 28bn (the gap stood at CHF 24.3bn as of Q1 2015). In the long-term though, if we compare the long-term CET1 targets of UBS Group with the minimum required CET1 of 10%, the gap narrows considerably to about 3%. Based on the 2016 RWA target of CHF 200bn, the gap would still amount to a very sizeable CHF 6bn. This gap would still represent more than 20x the coupons payable to all current AT1s outstanding.

However, we re-iterate that the T&Cs (and Swiss capital regulation) do base distribution restriction on distributable items (and not on capital buffer requirement).

Key risk: principal loss absorption

The T&Cs of the two securities are very consistent with similar T&Cs published by other Swiss banks on similar products.

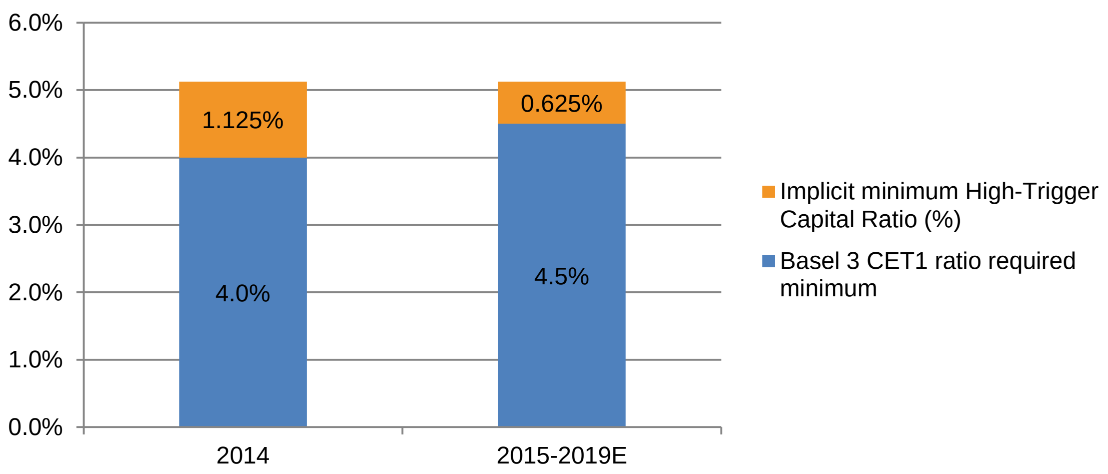
What is more surprising though is to see Swiss G-SIBs continuing to issue very low-trigger loss-absorbing capital instruments with very little chance of being triggered (except in resolution and/or determination by the FINMA that the bank has reached its "point of non-viability" – itself very likely to be above the 5.125% trigger of the two securities being reviewed).

Scope is indeed of the opinion that the permanent write-down risk that is attached to the 5.75% EUR 1bn and the 7.00% USD 1.25bn Tier 1 Capital Notes is of a highly theoretical nature.

The reason for this is that the trigger upon which a permanent write-down occurs is very low in two respects.

- **First, with regards to the definition of the capital metric under which the trigger is measured.** The sum of the CET1 ratio and the Higher-Trigger ratio is highly unusual. This sum must be below 5.125% for the 5.75% EUR 1bn and the 7.00% USD 1.25bn Tier 1 Capital Notes to be permanently written-down. Since UBS Group's minimum transitional CET1 requirement under Basel 3 was 4% in 2014 and must be 4.5% from 2015 onwards, this means by difference that the minimum Higher-Trigger capital ratio for UBS to remain above the trigger defined by the Terms & Conditions (T&C) of the Tier 1 Capital Notes should have been 1.125% in 2014 and should be 0.625% from 2015 onwards (Chart 1).

Chart 1: Estimates of minimum transitional Basel 3 requirements for UBS's CET1 + Higher-Trigger capital ratios 2013-2019 (in %)



Source: Scope ratings, company data

Projecting ourselves from 2015 onwards (when the minimum required CET1 ratio of 4.5% is "fully-loaded"), the sum of CET1 + Higher Trigger Capital means in effect: (1) a CET1 ratio of at least 4.5% and (2) a Higher-Trigger capital ratio of at least 0.625%. This is the only minimum combination of the two metrics that is theoretically possible under Basel 3 regulation. In our view, it is highly unlikely that UBS's supervisor would let the CET1 and Higher Trigger capital ratios of the bank to fall below these levels before intervention. Therefore, we identify UBS Group's Point of Non Viability (PONV) higher than these 4.5%/0.625% thresholds. As a result, bar in resolution, a trigger event for these notes is unlikely.

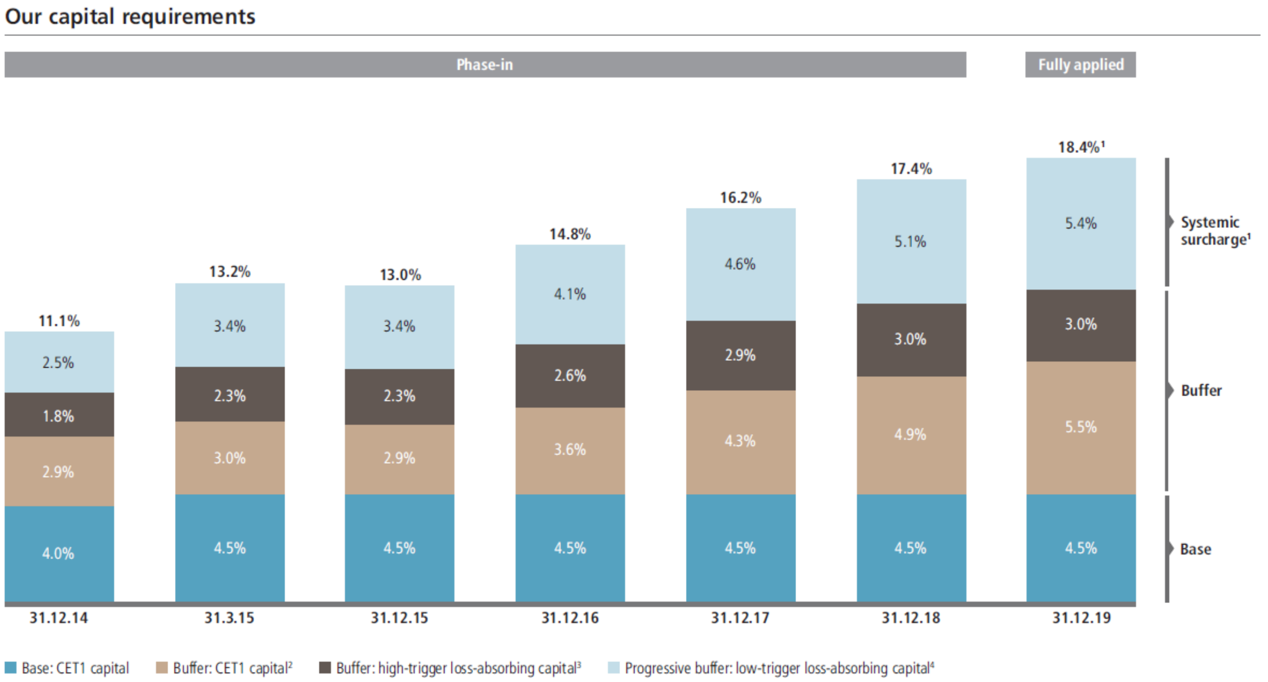
We note that a trigger combining CET1 with Higher-Trigger capital ratio is not presented as such in the sections of the Capital Adequacy Ordinance (CAO) dedicated to the Progressive Capital Component of global systemically important Swiss banks. According to Article 130-2 of the CAO, “The Progressive component must be covered by convertible capital which conversion is triggered at the latest when the CET1 ratio falls below 5%”. In the case of the two securities under consideration, the conversion is triggered only when the CET1 ratio **and** the Higher Trigger Capital Ratio fall below 5.125%.

- **Second, with regards to the bank-specific requirements which, in our view, are applicable to these Notes**. Indeed, Swiss supervisors have a more conservative approach of the Basel 3 regulatory framework for systemically-important banks. As a result, the Swiss requirements for Core Equity Tier 1 and the High Trigger capital ratios are significantly higher than the theoretical Basel 3 requirements that was were illustrated in Chart 1. Actually, each global systemically important Swiss bank reports publicly its specific, FINMA-defined, capital requirements. The UBS-specific requirements are illustrated on Chart 2 below.

  On a transitional basis, the minimum CET1 ratio requirement of UBS is never lower than 6.9% from 2014 onwards, while the Higher-Trigger capital ratio is never lower than 1.8%. As a result, UBS is bound, by Swiss regulation, to a transitional CET1 + Higher Trigger capital ratio of at least 8.7% in 2014, 9.7% in 2015, 10.7% in 2016, 11.7% in 2017 and 12.4% in 2018. On a fully phased-basis, the minimum level will be 13% for UBS Group in 2019.

  In light of the numbers shown on Chart 2, an implicit permanent write-down CET1 ratio trigger at 4.5% looks even more highly theoretical (except in resolution).

  Chart 2: Estimates of minimum transitional Swiss requirements for UBS’s CET1 + Higher-Trigger capital ratios 2013-2019 (in %)



1 The total capital ratio requirement for 2019 would be reduced to 17.5% if the progressive buffer capital requirement is reduced as expected, which would result in a proportional reduction of both requirements during the phase-in period. 2 Includes the effect of the countercyclical buffer requirement for 31 December 2014 and 31 March 2015. Capital requirements for 31 December 2015 to 2019 do not include a countercyclical buffer requirement, as potential future developments cannot be accurately predicted and may vary from period to period. 3 CET1 capital can be substituted by high-trigger loss-absorbing capital up to the stated percentage. 4 Numbers for 31 December 2015 to 2019 are based on latest information available and current supervisory guidance from FINMA. High-trigger loss-absorbing capital qualifies as progressive buffer capital until the end of 2017.

Source: Company data

However, despite the low probability of the Notes being written-down, we note that FINMA has significantly increased authority (or broad statutory powers) in case of resolution proceedings involving banks in Switzerland. This resolution authority includes, among other things, the power to cancel outstanding equity, to convert debt instruments and other liabilities of a bank into equity and to cancel such liabilities fully or partially.

We note that this prerogative of the FINMA limits itself to resolution.

Distance to trigger

Unsurprisingly considering the undemanding trigger of the Notes, we expect UBS Group's CET1 and Higher-Trigger capital ratios to remain largely above the 5.125% trigger level required by the T&C of the Notes – even when the CET1 ratio enters its "fully loaded" definition on January 1, 2019.

Table 2: Distance to Trigger – UBS Group AG

	2013	2014	Q1 2015	2019
Trigger level	5.125%	5.125%	5.125%	5.125%
CET1 + Higher-Trigger Capital (%)	18.9%	19.8%	19.8%	13.0% target[1]
Gap (%)	13.7%	14.7%	14.7%	7.9%
Gap (CHF)	31.3bn	32.5bn	32.2bn	15.8bn based on 200bn RWAs

1) Based on the 13% long-term CET1 target ratio of UBS (the 3% minimum requirement for Higher-Trigger Capital Ratio is assumed already covered by CET1 capital).

Source: Company data, Scope Ratings estimates

There is even a case to say that even if UBS's CET1 target stands at 13% by 2019, adding the higher trigger capital that has been issued to date (CHF 2,620m as of Q1 2015) would lift the 13% target to an "equivalent" CET1 + High Trigger ratio of 14.3%. This admittedly theoretical ratio would raise the 2019 gap to more than 9%, or a very sizeable CHF 18.4bn. This, in our view, amply justifies not adding an extra notch for principal absorption.

Security Ratings (assigned 17 March 2015)	
Outlook	Stable
7.125% USD 1.25bn Tier 1 Capital Notes Contingent convertible on 7.00% trigger	BBB-

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The ratings have not been solicited by the issuer; the analysis is based solely on public information.

Rating rationale

We have assigned a rating of BBB- to UBS Group AG (UBS)'s 7.125% USD 1.25bn Tier 1 Capital Notes based on the following:

- ICSR: A, Stable outlook
- Minimum notches down from the ICSR: 4
- Additional notches: 0

Please refer to Scope's Bank Capital Instruments Rating Methodology published in September 2014 for more details about the minimum notching for AT1 securities.

Scope decided not to add any additional notch beyond the four minimum notches stipulated by the capital instruments methodology. This is due to the following:

On coupon cancellation risk, even if UBS Group AG is a new company and does not seem to have built free reserves yet, the company makes very clear in its Q4 2014 financial report that "as of the balance sheet date, UBS Group AG estimates that the amount of reserves possibly available for distribution to shareholders under Swiss corporate law was approximately CHF 36.7bn". This amount can only be reached if share premium is included in the Available Distributable Items (ADIs), and since share premium is included in the capital reserves (as per the Directive on the Establishment of Accounts (DEC-CFB) of 14 December 1994 (lastly amended on 21 December 2006) and also per Article 671-2-1[6] of the Swiss Code of Obligations), we believe it is safe to include it in UBS Group AG's ADIs as of YE 2014. Our understanding of Swiss corporate law is that share premium is not formally attached to share capital, contrary to the way it is presented in other European countries. In addition, (1) UBS is not submitted to as drastic a restriction on discretionary distributions as European banks abiding by CRD 4-CRR; and (2) the issuer is severely restricted on its ability to pay dividend on ordinary shares if an interest payment on the Tier 1 Capital Notes is cancelled. All these factors in our view add some degree of protection to Tier 1 Capital Notes holders, justifying no extra notching on coupon cancellation risk.

With regards to principal loss absorption, Scope perceives the trigger of the 7.125% USD 1.25bn capital notes (sum of CET1 ratio and Higher Trigger Capital ratio below 7%) to be low in light of UBS's current level of CET1 + HT capital (19.8% as of Q1 2015, 14.9% on a fully-applied basis and 13% based on UBS's long term targets). The 7% trigger looks also quite low in light of the minimum CET1 + HT capital requirements of UBS Group under Swiss regulation (7.4% by YE 2015, 13% by 01.01.2019).

Since the trigger is below UBS's Swiss minimal requirements and also significantly below UBS's current capital levels, we view the possibility of these notes being permanently written-down as quite theoretical (except in resolution).

[6] "Even after it has reached the statutory level, any share issue proceeds in excess of the nominal value […] must be allocated to the general reserve".

ICSR

The ICSR of A with a Stable Outlook is driven by the bank's significant downsizing during the crisis and acceptable levels of underlying profitability from core franchises over the past five years. At the same time, the ratings reflect the uncertain outcome of several high-profile litigation cases as well as what we perceive as the low level of risk-weighted asset intensity of the bank – partly linked to the build-up of significant reserves of cash and highly liquid assets in the post-crisis years.

Summary terms

Issuer	UBS Group AG
Issue Date	19 February 2015
Amount	USD 1.25bn
Coupon	• 7.125% fixed until first call date, and thereafter at a rate equal to the Mid Market Swap Rate plus 5.464% • If any, payable annually in arrear on 19 February of each year, commencing on 19 February 2016
Format	Perpetual Tier 1 capital notes, callable 19 February 2020 and every year after that.
ISIN	CH0271428317
Capital Treatment	Tier 1 and High-Trigger Loss-Absorbing Capital
Coupon Cancellation	• Fully discretionary • Mandatory if (1) there are insufficient distributable items or (2) if UBS Group AG is not in compliance with all applicable minimum capital adequacy requirements of the National Regulations on a consolidated basis and/or (3) the FINMA has requested the issuer not to make such interest payment.
Principal Loss Absorption	• Following the occurrence of a Trigger Event or a Viability Event, a contingent write-down will occur and the full principal amount of the Notes will automatically and permanently be written down to zero on the write-down date. • A Trigger Event refers to the sum of the CET1 ratio and the High-Trigger Capital Ratio of UBS Group to be less than 7.00%; • A Viability Event refers to (1) the FINMA has notified UBS that conversion or write-off of all Basel 3-compliant capital instruments is an essential requirement to prevent the Group Holding Company from becoming insolvent, bankrupt, unable to pay a material part of its debt or ceasing to carry on its business; or (2) the Group Holding Company has received irrevocable commitment of extraordinary support from the public sector without which the Group Holding Company would have become insolvent, bankrupt, unable to pay a material part of its debts as they fall due or unable to carry on its business.
Trigger for Principal Loss Absorption	CET1 + Higher-Trigger <7% transitional basis

Source: Prospectuses, Scope Ratings

Historically UBS has not issued a lot of Basel 3-compliant AT1 products as the bank decided to build up its 10% CET1 capital requirement and its 3% buffer requirement exclusively through CET1. As a result, the bank privileged low-trigger Tier 2 issues to the market, and high-trigger Tier 2 issues to employees as part of its compensation program (DCCP). UBS started only recently to issue AT1 notes from the group holding company to both employees (for 2014 compensation) and the market (in February 2015). The security considered in this report is a High-Trigger capital note eligible for the High-Trigger buffer of UBS's capital requirements. We note that according to UBS's capital requirements as defined by Swiss regulation, high-trigger loss absorbing capital should represent 3% of UBS's Risk Weighted Assets (RWAs) by 2019 (to be compared with 1.2% as of Q1 2015). We also note that the High-Trigger requirement is currently fulfilled by CET1.

Key risk: coupon cancellation

Coupon payments on the security are fully discretionary and are subject to distribution restrictions.

Additionally, if a coupon is cancelled, UBS Group shall not recommend to ordinary shareholders that any dividend or other distribution in cash or in kind be paid or made on any ordinary shares. Capital returns (such as share buy-backs) are also not possible.

We also note that by virtue of interest payment being non-cumulative, coupon cancellation or non-payment does not constitute a default for any purpose. However, this provision contradicts the “Events of Default” section of the Terms & Conditions (T&C) whereby an event of default will occur if UBS Group fails to make any payment of interest in respect of the Tier 1 Capital Notes. There is probably a difference between a discretionary willingness to cancel the coupon (which is distinct from the coupon payment being prohibited by distribution restrictions) and “classical” default whereby the Issuer does not have the possibility to honour its interest payments. One cancellation is proactive (discretionary coupon cancellation on AT1 instruments) while the other is completely passive (Event of Default) but identifying the difference may be the source of some difficulty for investors.

Moreover, the T&Cs make clear the fact that any default claim with regards to non payment (either interest of principal) would be superseded by the occurrence of a contingent write-down.

Coupon payment: analysing the distribution restrictions

While for many banks in the rest of Europe and in the UK coupon payment is dependent upon the Capital Buffer Requirements as defined by CRD4-CRR, themselves triggering a “Maximum Distributable Amount” that is restricting coupon payment, the restrictions on Tier 1 coupon distribution seem a bit less restrictive in Switzerland. Indeed, in the case of the 7.125% USD 1.25bn securities, UBS Group is prohibited from making coupon payment in three circumstances.

- First, when UBS Group AG has an amount of distributable items which is less than the sum of (i) the amount of such interest payment plus (ii) all other payments (except redemptions) made by UBS Group AG on the notes and on any parity obligations or junior obligations, plus (iii) all payments payable by UBS Group AG on any parity obligations or junior obligations, excluding any portion of such payments already accounted for in determining the amount of such distributable items. This latter clause enables to avoid double-counting for AT1 coupons already provisioned and paid for – other European banks re-integrate these coupons in their distributable profits.
- Second, when UBS Group AG is not in compliance with all applicable minimum capital adequacy requirements if the bank pays the interest on the notes;
- Third, when FINMA has required the Issuer not to make such interest payment.

We note that under the Swiss Code of Obligations, “distributable profits” refers to the aggregate of net profits carried forward and freely available reserves (other than reserves for own shares) less any amounts that must be contributed to legal reserves under applicable law.

According to the terms and conditions (T&C) of the notes, the distributable items will be calculated based on the non-consolidated audited financial statements of the Issuer in accordance with the Swiss Code of Obligations. Since The Issuer UBS Group AG was only incorporated on 10 June 2014, Distributable Items were only available when the issuer’s first set of audited financial statements were approved by the annual meeting of shareholders which occurred on 7 May 2015.

A quick look at UBS Group AG’s parent company 2014 financial statement shows that the holding company reports total shareholders’ equity of CHF 37,154m (CHF 37,942m as of Q1 2015). As per UBS’s Q4 2014 financial report, “UBS Group AG estimates that the amount of reserves possibly available for distribution to shareholders under Swiss corporate law was approximately CHF 36.7bn”. This number was not updated in the Q1 2015 financial report.

However, considering that UBS Group AG is a brand new company, the bulk of these CHF 36.7bn can only be share premium. Swiss corporate law is quite clear on share premium and we found three documents that confirm the inclusion of share premium in general capital reserves, therefore validating their status as ADI.

- The Directive on the Establishment of Accounts of banks dated 14 December 1994 (and lastly modified on 21 December 2006). The directive specifically includes share premium into capital reserves.

- The Banking Ordinance of 30 April 2014 uses the classification above by separating share capital from "capital reserves" and "earnings reserves" but does not segregate share premium (which is therefore included in the "capital reserves" as per the Directive above).

- The Swiss Code of Obligations is even more explicit as Article 671-2-1 states that "Even after it has reached the statutory level, any share issue proceeds in excess of the nominal value […] must be allocated to the general reserve".

As a result of all the above, we believe that UBS Group AG has ample ADIs to support the estimated cumulative coupons to be paid on all the group's AT1 instruments issued to date (around a maximum of CHF 300m, which we believe is a very small amount to distribute overall).

Even if UBS is not in the strictest sense submitted, like other European banks, to Combined Buffer Requirements to be able to pay interests, the bank must nonetheless abide by the Swiss capital requirements. Systematically important banks in Switzerland benefit from an "ad hoc" supervision with individual requirements. Table 1 summarises the capital requirements for UBS.

Table 1: Swiss capital requirements of UBS Group

	2014	Q1 2015	2015	2016	2017	2018	2019
Combined buffer:							
- Low-trigger capital instruments	2.5%	3.4%	3.4%	4.1%	4.6%	5.1%	5.4%
- High-trigger capital instruments	1.8%	2.3%	2.3%	2.6%	2.9%	3.0%	3.0%
- Countercyclical[1]							
Minimum CET1	6.9%	7.5%	7.4%	8.1%	8.8%	9.4%	10.0%
Capital Adequacy Requirement associated with distribution restrictions	**11.2%**	**13.2%**	**13.1%**	**14.8%**	**16.3%**	**17.5%**	**18.4%**
UBS Transitional CET1 ratio (%)	19.4%	18.6%					13.0% target
CET1 Gap (%)	12.5%	11.1%					3.0%
CET1 Gap (CHF bn)	27.6bn	24.3bn					6.0bn

1) Up to 2.5% of CET1.

Source: Company data, Scope Ratings

Table 1 shows the three layers of capital requirement that UBS Group has to abide by. As far as the low-trigger and high-trigger components are concerned, they reflect issuing potential. As of Q1 2015 (and on a fully applied basis), the low-trigger capital ratio of UBS stood at 5.7%, above its 2019 requirement of 5.4%.

However, the bank still has a lot of issuing capability as far as the High-Trigger component is concerned, since the fully-applied High-Trigger capital ratio stood at 1.2% as of Q1 2015, still leaving UBS with quite a lot of leeway (estimated at around CHF 3.6bn on the basis of 2019 estimated RWAs) to abide by its 2019 capital requirements and keeping in mind that the High-Trigger requirement is currently filled in full with CET1 capital.

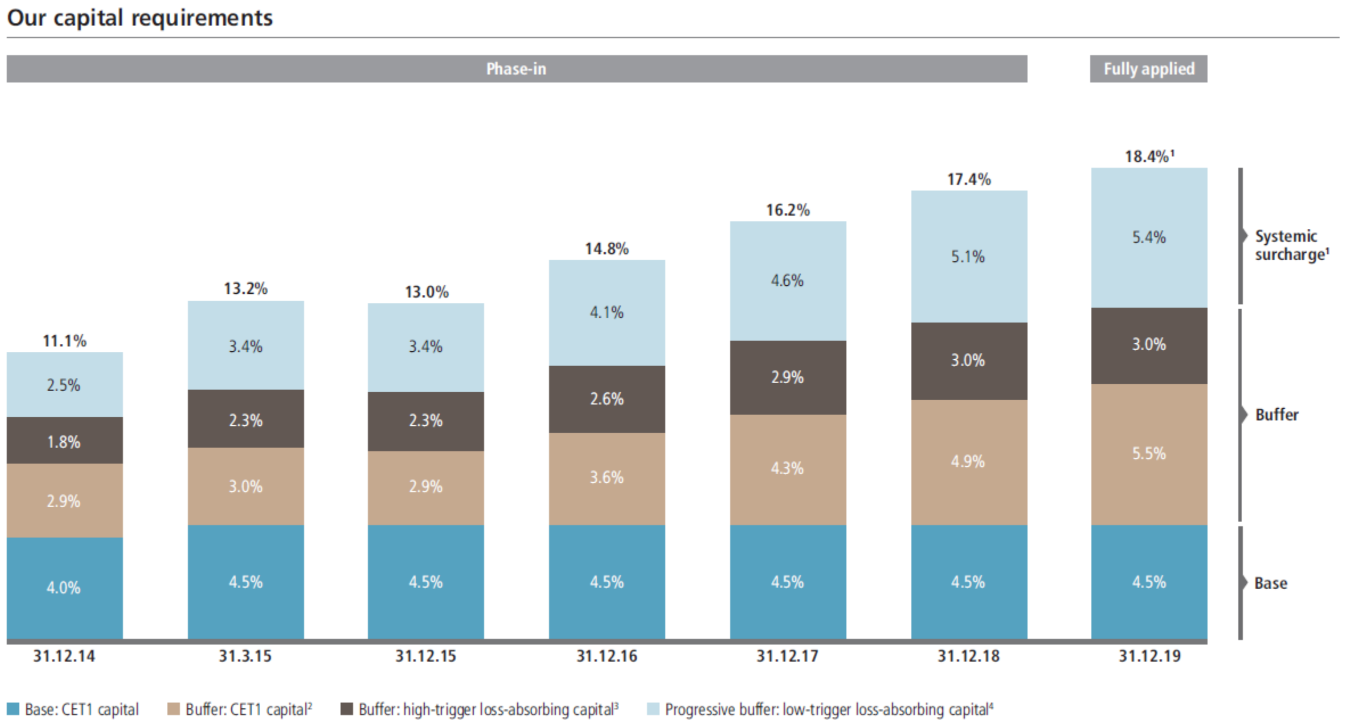
The CET1 metrics are the most demanding but since UBS's capital requirements are on a transitional basis until 1 January 2019, we do not expect any problem for the bank to abide by these requirements, at least in the short-term. As of YE 2014, the gap between UBS's capital requirements and the bank's transitional CET1 ratio stood at 12.5%, or close to CHF 28bn (the gap stood at CHF 24.3bn as of Q1 2015). In the long-term though, if we compare the long-term CET1 targets of UBS Group with the minimum required CET1 of 10%, the gap narrows considerably to about 3%. Based on the 2016 RWA target of CHF 200bn, the gap would still amount to a very sizeable CHF 6bn. This gap would still represent more than 20x the coupons payable to all current AT1s outstanding.

However, we re-iterate that the T&Cs (and Swiss capital regulation) do base distribution restriction on distributable items (and not on capital buffer requirement).

Key risk: principal loss absorption

Scope perceives the 7% trigger of the security as effectively quite low in a UBS-specific context. Swiss supervisors have a conservative approach of the Basel 3 regulatory framework for systemically-important banks. Each global systemically important Swiss bank reports publicly its specific, FINMA-defined, capital requirements. The UBS-specific requirements are illustrated on Chart 1 below. On a transitional basis, the minimum CET1 ratio requirement of UBS is never lower than 6.9% from 2014 onwards, while the Higher-Trigger capital ratio is never lower than 1.8%. As a result, UBS is bound, by Swiss regulation, to a transitional CET1 + Higher Trigger capital ratio of at least 8.7% in 2014, 9.7% in 2015, 10.7% in 2016, 11.7% in 2017 and 12.4% in 2018. On a fully phased-basis, the minimum level will be 13% for UBS Group in 2019. In light of the numbers shown on Chart 1, an implicit permanent write-down CET1 + High-Trigger capital ratio trigger at 7% looks quite theoretical (except in resolution). Indeed, UBS Group had a minimum requirement that was 1.7% higher than the trigger by YE 2014 (and 2.8% higher as of Q1 2014). The minimum requirement should be 6% higher than the trigger by 2019.

Chart 1: Estimates of minimum transitional Swiss requirements for UBS's CET1 + Higher-Trigger capital ratios 2013-2019 (in %)



1 The total capital ratio requirement for 2019 would be reduced to 17.5% if the progressive buffer capital requirement is reduced as expected, which would result in a proportional reduction of both requirements during the phase-in period. 2 Includes the effect of the countercyclical buffer requirement for 31 December 2014 and 31 March 2015. Capital requirements for 31 December 2015 to 2019 do not include a countercyclical buffer requirement, as potential future developments cannot be accurately predicted and may vary from period to period. 3 CET1 capital can be substituted by high-trigger loss-absorbing capital up to the stated percentage. 4 Numbers for 31 December 2015 to 2019 are based on latest information available and current supervisory guidance from FINMA. High-trigger loss-absorbing capital qualifies as progressive buffer capital until the end of 2017.

Source: Company data

Moreover, UBS's actual CET1 + HT capital ratio has been materially higher than the minimum requirements, as demonstrated by Table 2 below.

Distance to trigger

We expect UBS Group's CET1 and Higher-Trigger capital ratios to remain largely above the 7.00% trigger level required by the T&C of the Notes – even when the CET1 ratio enters its "fully loaded" definition on January 1, 2019.

Table 2: Distance to Trigger - UBS

	2013	2014	Q1 2015	2019
Trigger level	7.00%	7.00%	7.00%	7.00%
CET1 + Higher-Trigger Capital (%)	18.9%	19.8%	19.8%	13.0% target[1]
Gap (%)	11.872%	12.834%	12.785%	6.0%
Gap (CHF)	27.1bn	28.3bn	28.0bn	12bn based on 200bn RWAs

1) Based on the 13% long-term CET1 target ratio of UBS (the 3% minimum requirement for Higher-Trigger Capital Ratio is assumed already covered by CET1 capital).

Source: Company data, Scope Ratings estimates

There is even a case to say that even if UBS's CET1 target stands at 13% by 2019, adding the higher trigger capital that has been issued to date (CHF 2,620m as of Q1 2015) would lift the 13% target to an "equivalent" CET1 + High Trigger ratio of 14.3%. This admittedly theoretical ratio would raise the 2019 gap to more than 7%, or more than CHF 14.5bn. This, in our view, amply justifies not adding an extra notch for principal absorption.

Financial Institutions Ratings

UBS AG – Tier 2 rating report

Security Ratings	
Outlook	Stable
7.25% USD 2bn Tier 2 Subordinated Notes due 2022 Contingent convertible securities on 5% trigger	A-
7.625% USD 2bn Tier 2 Subordinated Notes due 2022 Contingent convertible securities on 5% trigger	A-
4.75% USD 1.5bn Tier 2 Subordinated Notes due 2023 Contingent convertible securities on 5% trigger	A-
4.75% EUR 2bn Tier 2 Subordinated Notes due 2026 Contingent convertible securities on 5% trigger	A-
5.125% USD 2.5bn Tier 2 Subor. Notes due 2024 Contingent convertible securities on 5% trigger	A-

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The ratings have not been solicited by the issuer; the analysis is based solely on public information.

Rating rationale

We assign a rating of A- to the five low-trigger Tier 2 Subordinated Notes issued by UBS AG in February 2012, August 2012, May 2013, February 214 and May 2014 respectively. The 7.25% and the 7.625% USD 2bn Tier 2 Subordinated Notes due 2022 have been issued by UBS AG acting through its Jersey branch and its Stamford branch respectively. All other rated Tier 2 Subordinated Notes are issued by UBS AG directly. The rating is based on the following considerations:

- Issuer Credit-Strength Rating (ICSR): A, Stable outlook
- Minimum notch down from the ICSR: 1
- Additional notches: 0

As detailed in Scope's *Bank Capital Instruments Rating Methodology* published in September 2014, the minimum notching for Tier 2 securities is one notch from the ICSR. In May 2015, Scope updated its methodology for rating capital instruments (currently as a call for comments). In the revised methodology, we are proposing to change the minimum notching to two notches from one. In a bail-in scenario, Tier 2 securities are considered capital instruments and rank below non-Tier 2 subordinated debt and senior debt.

When the methodology is finalised and when the final rules on capital requirements for the two Swiss systemic banks are published (expected YE 2015), we may have to amend our ratings on the current Tier 2 securities to take into account the higher loss-absorption risk of these securities in the context of a creditor's hierarchy that position Tier 2 securities ahead of other subordinated debt. However, in light of the financial strength of UBS Group as a whole and in light of the very low trigger attached to the securities, we expect a potentially new rating to remain firmly anchored in the investment grade range. These factors will have to be considered in the context of the issuing vehicle for these securities (UBS AG, operating company of UBS Group) and therefore further removed from resolution considerations.

Currently, the lack of additional notches for these securities reflects the following:

- Scope perceives the trigger of the five securities (sum of CET1 ratio and Higher Trigger Capital ratio below 5%) to be extremely low, not only in absolute terms, but also with regards to the minimum capital requirements of UBS Group AG (UBS) under Swiss regulation. Since the trigger could be construed as being below UBS's Swiss minimal requirements, we view the possibility of these notes being permanently written-down as highly theoretical (except in resolution).

ICSR

The ICSR of A with a Stable Outlook is driven by the bank's significant downsizing during the crisis and acceptable levels of underlying profitability from core franchises over the past five years. At the same time, the ratings reflect the uncertain outcome of several high-profile litigation cases as well as what we perceive as the low level of risk-weighted asset intensity of the bank – partly linked to the build-up of significant reserves of cash and highly liquid assets in the post-crisis years.

Summary terms

Issuer	UBS AG, acting through its Jersey branch
Issue Date	22 February 2012
Amount	USD 2bn
Coupon	• 7.25% fixed until first call date, reset once on that date • payable annually in arrear
Format	Tier 2 Subordinated Notes due 2022, callable on 22 February 2017
ISIN	XS0747231362
Issuer	UBS AG, acting through its Stamford branch
Issue Date	17 August 2012
Amount	USD 2bn
Coupon	• 7.625% fixed until maturity • payable semi-annually in arrear
Format	Tier 2 Subordinated Notes due 2022
ISIN	US90261AAB89
Issuer	UBS AG
Issue Date	22 May 2013
Amount	USD 1.5bn
Coupon	• 4.75% fixed until first call date, reset once on that date • payable annually in arrear
Format	Tier 2 Subordinated Notes due 2023, callable on 22 May 2018
ISIN	CH0214139930
Issue Date	13 February 2014
Amount	EUR 2bn

Coupon	• 4.75% fixed until first call date, reset once on that date • payable annually in arrear
Format	Tier 2 Subordinated Notes due 2026, callable on 12 February 2021
ISIN	CH0236733827
Issue Date	15 May 2014
Amount	USD 2.5bn
Coupon	• 5.125% fixed until maturity • payable annually in arrear
Format	Tier 2 Subordinated Notes due 2024
ISIN	CH0244100266
Capital Treatment	Tier 2, Low-trigger loss-absorbing capital – Progressive Capital Component
Principal Loss Absorption	• Following the occurrence of a Trigger Event or a Viability Event, the full principal amount of each note shall automatically be written down to zero, the Notes shall be cancelled and all references to the principal amount of the Notes in the Terms & Conditions shall be construed accordingly. • A trigger event shall be deemed to have occurred if the Relevant Trigger Capital Ratio (defined as the sum of the CET1 capital ratio and the High-Trigger Capital ratio) is less than the Write-down threshold (meaning 5%). • A viability event refers to (1) FINMA notifying CSG that conversion or write-down of all Basel 3-compliant capital instruments is an essential requirement to prevent UBS AG from becoming insolvent, bankrupt, unable to pay a material part of its debt or ceasing to carry on its business; or (2) UBS AG has received irrevocable commitment of extraordinary support from the public sector without which UBS AG would have become insolvent, bankrupt, unable to pay a material part of its debts as they fall due or unable to carry on its business.
Trigger for Principal Loss Absorption	CET1 + Higher Trigger CET1 <5% transitional basis

Source: Prospectuses, Scope Ratings

Key risk: principal loss absorption

Since the 7.25% and the 7.625% USD 2bn Tier 2 Subordinated Notes have both been issued before Basel 3 was applicable in Switzerland, their Terms & Conditions (T&C) contain references to Basel 2.5 capital ratios which are not applicable to the other three securities under consideration.

We also note that the 7.625% USD 2bn Tier 2 Subordinated Notes due 2022 contains certain clauses that are specific to Connecticut (as the issue is done through UBS's Stamford branches). According to these specific clauses, the note holders waive their right to any preferential treatment and preference in case of insolvency or liquidation of UBS AG and priority is given to depositors and other liability holders of the branches of UBS AG in the United States. Considering the subordinated status of the 7.625% Tier 2 subordinated note holders, we do not believe this clause to have a material impact on the credit risk of the note.

Historically UBS has not issued a lot of Basel 3-compliant AT1 products as the bank decided to build up its 10% CET1 capital requirement and its 3% buffer requirement exclusively through CET1. As a result, the bank privileged low-trigger Tier 2 issues to the market, and high-trigger Tier 2 issues to employees as part of its compensation program (DCCP). UBS started only recently to issue AT1 notes from the group holding company to both employees (for 2014 compensation) and the market (in February 2015). The February 2015 AT1 securities are rated BBB- by Scope (both high-trigger and low-trigger).

The Tier 2 instruments issued by UBS present three distinct features versus comparable Tier 2 instruments:

1. There is a dividend restriction clause in the T&C of the five notes whereby the issuer gives the holders a trigger event write-down notice provided that UBS has not paid any distribution in cash or kind on its common equity capital nor has it bought back shares one month before the notice is handed. This dividend restriction clause appears to be quite narrow.

2. Also the T&C make clear that on occurrence of a trigger event on the low-trigger Tier 2 notes, the outstanding high-trigger capital instruments should be written-down (or converted) first. This latter clause adds additional protection to Tier 2 holders, in our view.

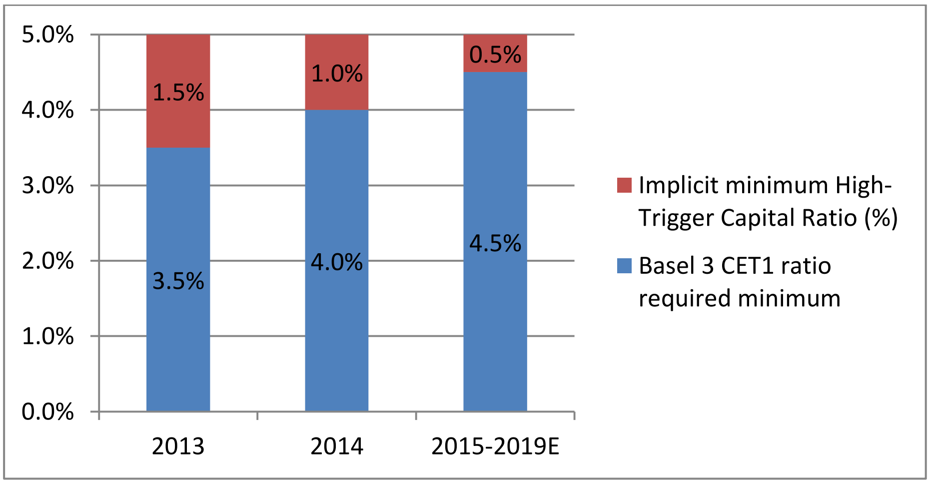
3. Lastly, the definition of the "trigger CET1 ratio" in the T&C is different from the definition of the "CET1 ratio" which can be confusing. According to the T&Cs of the five Tier 2 subordinated notes, the CET1 ratio is defined as the CET1 capital (itself defined as common equity tier 1 capital minus deductions from common equity tier 1 capital required to date) divided by Risk Weighted Assets. However, the "trigger CET1 ratio" is defined as the sum of the CET1 capital (as defined above) plus the high-trigger contingent capital. In reality, this means that the trigger event defined by the T&C of UBS's Tier 2 notes is measured against the sum of CET1 and High-trigger capital, not CET1 only.

As a result of Point 3) above, the permanent write-down risk that is attached to the five Tier 2 subordinated notes is, in Scope's view, of a highly theoretical nature.

The reason for this is that the trigger upon which a permanent write-down occurs is very low in two respects.

- **First, with regards to the definition of the capital metric under which the trigger is measured**. The sum of the CET1 ratio and the Higher-Trigger ratio is highly unusual. This sum must be below 5% for the security to be permanently written-down. Since UBS's minimum transitional CET1 requirement under Basel 3 was 3.5% in 2013 and 4% in 2014, and must be 4.5% from 2015 onwards, this means by difference that the minimum High-Trigger capital ratio for UBS to remain above the trigger defined by the T&C of the Tier 2 subordinated notes should have been 1.5% in 2013, 1% in 2014 and should be 0.5% from 2015 onwards (Chart 1).

Chart 1: Estimates of minimum transitional Basel 3 requirements for CSG's CET1 + Higher-Trigger capital ratios 2013-2019 (in %)



Source: Scope ratings, company data

Projecting ourselves from 2015 onwards (when the minimum required CET1 ratio of 4.5% is "fully-loaded"), the sum of CET1 + High Trigger Capital means in effect: (1) a CET1 ratio of at least 4.5% and (2) a Higher-Trigger capital ratio of at least 0.5%. This is the only minimum combination of the two metrics that is theoretically possible under Basel 3 regulation. In our view, it is highly unlikely that UBS's supervisor would let the CET1 and Higher Trigger capital ratios of the bank to fall below these levels before intervention. Therefore, we identify UBS's Point of Non Viability higher than these 4.5%/0.5% thresholds. As a result, bar in resolution, a trigger event for these notes is unlikely.

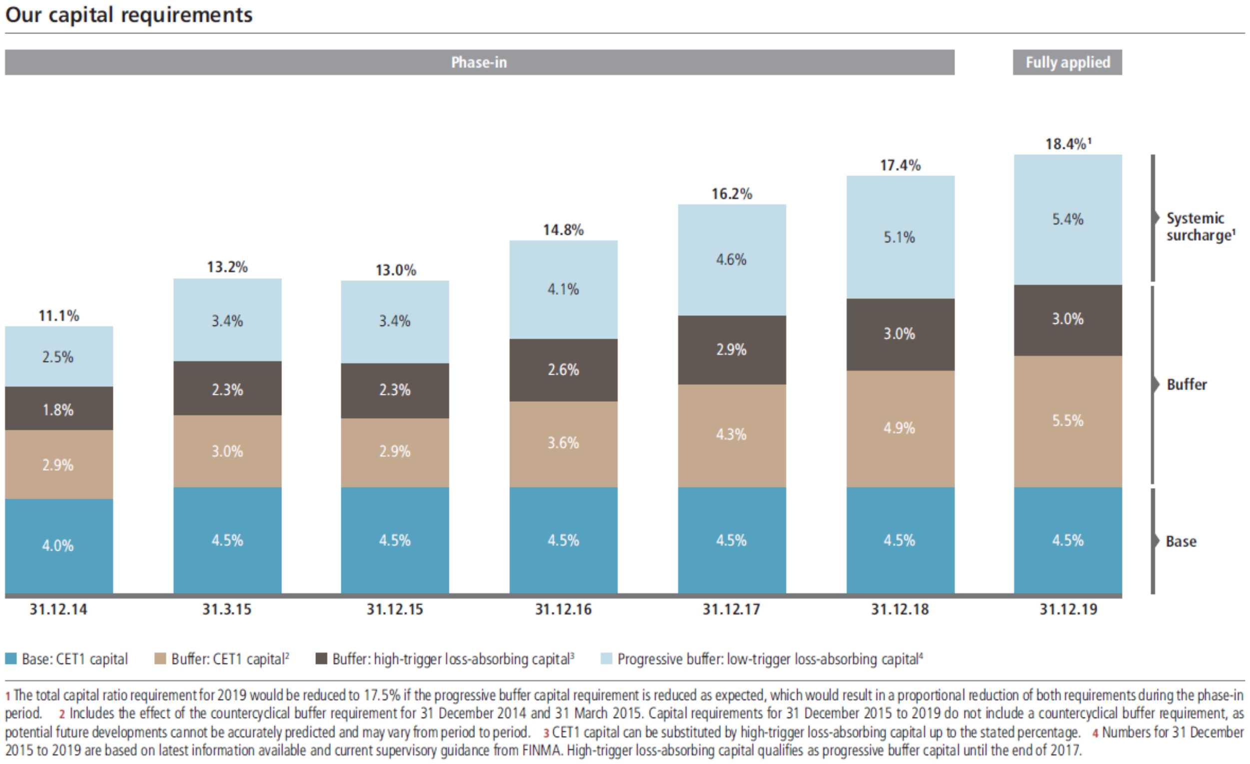
We also note that a trigger combining CET1 with High-Trigger capital ratio is not presented as such in the sections of the Capital Adequacy Ordinance (CAO) dedicated to the Progressive Capital Component of global systemically important Swiss banks. According to Article 130-2 of the CAO, "The Progressive component must be covered by convertible capital which conversion is triggered at the latest when the CET1 ratio falls below 5%". In the case of the five Tier 2 subordinated notes, the conversion is triggered only when the CET1 ratio **and** the High Trigger Capital Ratio fall below 5%.

- **Second, with regards to the bank-specific requirements which, in our view, are applicable to these Notes**. Indeed, Swiss supervisors have a more conservative approach of the Basel 3 regulatory framework for systemically-important banks. As a result, the Swiss requirements for Core Equity Tier 1 and the High Trigger capital ratios are significantly higher than the theoretical Basel 3 requirements illustrated in Chart 1. Actually, each global systemically important Swiss bank reports publicly its specific, FINMA-defined, capital requirements. The UBS-specific requirements are illustrated on Chart 2 below.

  On a transitional basis, UBS's CET1 + High Trigger Capital ratio stood at 20% as of Q1 2015 (of which 18.6% CET1). This compares extremely favourably with CET1 and High-Trigger Capital Requirements of 9.7% in 2015. On a fully phased-basis, the minimum required level of CET1 + High Trigger Capital ratio for UBS will stand at 13% in 2019.

  In light of the numbers mentioned above and of UBS's capital requirements (appearing on Chart 2), an implicit permanent write-down CET1 ratio trigger at 4.5% looks even more highly theoretical (except in resolution).

Chart 2: Estimates of minimum transitional Swiss requirements for UBS capital ratios 2014-2019 (in %)



Source: Company data

Lastly, the T&C of the five Tier 2 subordinated notes make very clear that that the occurrence of a Viability Event "may occur irrespective of whether or not a Trigger Event has occurred or whether any of the conditions to the issuance of a Trigger-Event Write-Down Notice have been met". This refers to the discretion of the regulator in its definition of the Point of Non Viability (which the FINMA seems to have somewhat defined as being between minimum CET1 ratios of 5% and 7% in its August 2013 position paper).

Distance to trigger

Unsurprisingly considering the undemanding trigger of the Notes, we expect UBS's CET1 and High-Trigger capital ratios to remain largely above the 5% trigger level required by the T&C of the Notes – even when the CET1 ratio enters its "fully loaded" definition on January 1, 2019. We note that Table 1 below looks at the distance to trigger of UBS AG (who is posting capital metrics slightly different from its parent, UBS Group AG).

Table 1: Distance to Trigger

	2013	2014	Q1 2015	2019
Trigger level	5.000%	5.000%	5.000%	5.000%
CET1 + Higher-Trigger Capital (%)	18.9%	19.9%	19.1%	13.0% target[1]
Gap (%)	13.872%	14.937%	14.058%	8.0000%
Gap (CHF)	31.7bn	33.0bn	30.8bn	16bn based on 200bn RWAs

1) Based on the 13% long-term CET1 target ratio of UBS (the 3% minimum requirement for Higher-Trigger Capital Ratio is assumed already covered by CET1 capital).

Source: Company data, Scope Ratings estimates

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Financial Institutions Ratings

Barclays Bank plc – Tier 2 rating report

Security Rating	
Outlook	Stable
7.75% USD 1bn fixed to fixed rate contingent capital notes	BBB+

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The ratings have not been solicited by the issuer; the analysis is based solely on public information.

Rating rationale

We have assigned a rating of BBB+ to Barclays Bank's 7.75% USD 1bn fixed to fixed rate contingent capital notes based on the following:

- Issuer Credit-Strength Rating (ICSR): A, Stable outlook
- Minimum notch down from the ICSR: 1
- Additional notches: 1 due to the existence of a relatively higher trigger for permanent write-down

In May 2015, Scope updated its methodology for rating capital instruments (currently with a call for comments). In the revised methodology, we indicate a minimum of two notches T2 securities from the ICSR level. In a bail-in scenario, T2 securities are considered capital instruments and rank below non-T2 subordinated debt and senior debt. As well, T2 securities may be converted or written down during early regulatory intervention (a step ahead of resolution), which is not the case with non-T2 subordinated debt. This translates into T2 being rated lower than non-T2 subordinated debt for EU banks.

We note that under the Bank Recovery and Resolution Directive (BRRD), T2 capital instruments should be written-down or converted when the issuer has reached the point-of-non-viability (PONV). While the security has a 7% trigger, we take the view that the PONV may be below or above this level. Therefore, the minimum of two notches for Barclays Bank's T2 security in our opinion sufficiently captures the potential principal loss absorption risks.

ICSR

The ICSR of A for Barclays driven by management's intentions to refocus the business profile of the Group by reducing the weight of inherently volatile investment banking activities to about one-third, from over a half. The other core businesses are Personal and Corporate Banking, Barclaycard and Africa Banking. Barclays is also executing on capital, leverage and financial targets. If successful, Barclays will be better positioned to generate more stable and sustainable earnings. Potential conduct and litigation costs remain a risk.

Summary terms

Issuer	Barclays Bank plc
Issue Date	April 2013
Amount	USD 1bn
Coupon	• 7.75% fixed until call date, reset thereafter • Payable semi-annually
Format	Fixed to fixed rate contingent capital notes due April 2023, callable April 2018
ISIN	US06739FHK03
Capital Treatment	Tier 2
Principal Loss Absorption	• Upon capital adequacy trigger event, automatic write-down of full principal amount of notes and lost of interest accrued since the last coupon payment date • Contractual acknowledgment of UK bail-in power
Trigger for Principal Loss Absorption	Consolidated group CET1 < 7% on transitional basis

Source: Prospectus, Scope Ratings

Key risk: principal loss absorption

There is permanent write-down when the trigger level is breached. The trigger level is breached when Barclays' consolidated CET1 ratio is below 7% on a transitional basis. Included in the prospectus is the specific risk that the write-down may occur even if existing preference shares and ordinary shares of Barclays plc and Barclays Bank plc remain outstanding.

In addition, investors in the security agree and consent to the exercise of any UK bail-in power by the relevant UK relevant resolution authority that may result in the cancellation of all, or a portion, of the principal amount of and/or conversion of all or a portion of the principal amount of the securities into shares or other securities. While there is no explicit reference to the point of non-viability, the security is clearly subject to write-down and/or conversion risks.

Distance to trigger

As of 31 March 2015, Barclays' CET1 ratio was 12.3% on a transitional basis, compared to the 7% transitional trigger in the security. Therefore, the distance to trigger was 5.3% or GBP 21bn (based on transitional CET1 capital of GBP 49bn and RWAs of GBP 396bn).

Table 1: Distance to trigger

	2014	2015	2016	2017	2018	2019
Trigger level	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%
Barclays' CET1 / target [1]	12.3%	12.3%				11.5% - 12% target fully-loaded
Gap (%)		5.3%				4.5% - 5.0%
Gap (GBP)		21.0				

1) Figures for 2015 are as of 31 March 2015. Based on transitional CRD 4 CET1 capital of GBP 49bn and RWAs of GBP 396bn.

Source: Company data, Scope Ratings

Barclays is targeting a 11.5% to 12% fully-loaded CET1 ratio in 2019 (1Q 2015: 10.6%), including a management buffer of up to 1.5%. This target is subject to change as capital requirements are further clarified. As shown in Table 1 above, Barclays currently maintains CET1 capital solidly above the trigger level. As the trigger is based on a transitional basis, the gap between Barclays' CET1 capital and the trigger should increase as Barclays achieves its capital targets (which are on a fully-loaded basis). In 2019, when capital requirements are fully-phased in and assuming Barclays meets its capital targets, the gap to trigger would be about the same as it is currently.

Other outstanding capital instruments

Within the Group, Barclays plc, the holding company, has issued over GBP 4bn equivalent of AT1 securities. To date, all these AT1 securities have been issued with a 7% trigger on a fully-loaded basis with conversion into equity. Meanwhile, these T2 securities have been issued by Barclays Bank plc with a 7% trigger on a transitional basis. For all securities, the trigger is based on the consolidated group CET1 ratio.

During the transition period (until 2019), if there were to be a trigger breach, we would expect the AT1 securities to be converted first as the trigger is based on a fully-loaded basis. However, after 2019, there is some uncertainty about which securities would be converted or written down first – the AT1 securities issued by the holding company or the T2 securities issued by the operating bank. Both the AT1 and T2 securities would have the same trigger at 7%. In May 2015, the EBA issued guidelines stating that it would be appropriate for issuers to specify the interaction between the loss absorption of AT1 and T2 instruments to provide clarity for investors. We would welcome such clarification.

Security Ratings	
Outlook	Stable
8.25% USD 2bn perpetual subordinated contingent convertible securities	BB
8% EUR 1bn perpetual subordinated contingent convertible securities	BB
7% GBP 698m fixed rate resetting perpetual subordinated contingent convertible securities	BB
6.5% EUR 1.1bn fixed rate resetting perpetual subordinated contingent convertible securities	BB
6.625% USD 1.2bn fixed rate resetting perpetual subordinated contingent convertible securities	BB

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The ratings have not been solicited by the issuer; the analysis is based solely on public information.

ICSR

The ICSR of A for Barclays driven by management's intentions to refocus the business profile of the Group by reducing the weight of inherently volatile investment banking activities to about one-third, from over a half. The other core businesses are Personal and Corporate Banking, Barclaycard and Africa Banking. Barclays is also executing on capital, leverage and financial targets. If successful, Barclays will be better positioned to generate more stable and sustainable earnings. Potential conduct and litigation costs remain a risk.

Rating rationale

We have assigned a rating of BB to the above noted perpetual subordinated contingent convertible securities issued by Barclays plc based on the following:

- ICSR: A, Stable outlook
- Minimum notches down from the ICSR: 4
- Additional notches: 2

Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in September 2014 for more details about the minimum notching for AT1 securities. The additional notches for these securities reflect the following:

- Absolute level of the trigger at 7% is relatively high and is on a fully-loaded basis.
- Restrictions on distributions apply at a higher level of CET1 capital as Barclays is subject to Pillar 2A capital requirements which as clarified by the UK regulator should sit below the combined buffer requirement in the capital stack.
- Barclays is in the midst of a restructuring which is subject to execution risks. Earnings stability would improve if the reliance on more volatile investment banking activities is reduced.
- Distance to trigger is currently narrower than for many other issuers.
- The UK regulator has proven to be relatively demanding and may increase capital requirements or accelerate timelines for capital requirements.

For the purposes of rating these securities, we have not distinguished that the issuer is Barclays plc rather than Barclays Bank plc. As detailed in our bank rating methodology, we do not mechanically differentiate between the holding company and the operating bank when assigning ratings.

Summary terms

Issuer	Barclays plc
Issue Date	November 2013
Amount	USD 2bn
Coupon	• 8.25% fixed until first call date, reset every 5 years thereafter • If any, payable quarterly in arrears
Format	Perpetual subordinated contingent convertible securities, callable December 2022 and every five years thereafter
ISIN	US06738EAA38
Issue Date	December 2013
Amount	EUR 1bn
Coupon	• 8% fixed until first call date, reset every 5 years thereafter • If any, payable quarterly in arrears
Format	Perpetual subordinated contingent convertible securities, callable December 2020 and every five years thereafter
ISIN	XS1002801758
Issue Date	June 2014
Amount	GBP 698m
Coupon	• 7% fixed until first call date, reset every 5 years thereafter • If any, payable quarterly in arrears
Format	Perpetual subordinated contingent convertible securities, callable 2019 and every five years thereafter
ISIN	XS1068561098
Issue Date	June 2014
Amount	EUR 1.1bn
Coupon	• 6.5% fixed until first call date, reset every 5 years thereafter • If any, payable quarterly in arrears
Format	Perpetual subordinated contingent convertible securities, callable 2019 and every five years thereafter
ISIN	XS1068574828

Summary terms – continued

Issue Date	June 2014
Amount	USD 1.2bn
Coupon	• 6.625% fixed until first call date, reset every 5 years thereafter • If any, payable quarterly in arrears
Format	Perpetual subordinated contingent convertible securities, callable 2019 and every five years thereafter
ISIN	US06738EAB11
Capital Treatment	Additional Tier 1
Coupon Cancellation	• Fully discretionary • Mandatory if there are insufficient distributable items to pay coupons on these securities, parity securities and any junior securities or the solvency condition is not satisfied in respect of such coupon payment
Principal Loss Absorption	• Full conversion into ordinary shares upon trigger breach at conversion price subject to conversion shares offer • Contractual acknowledgment of and agreement with UK bail-in power
Trigger for Principal Loss Absorption	Consolidated group CET1 < 7% on fully-loaded basis

Source: Prospectuses, Scope Ratings

Key risk: coupon cancellation

Coupon payments are fully discretionary and are subject to distribution restrictions. As the AT1 securities rank senior to ordinary shares, it is currently management's stated intention to take into account the relative ranking of the AT1 securities in the Group's capital structure when exercising its discretion to cancel coupon payments or declare ordinary share dividends. Notwithstanding coupon cancellation on the AT1 securities, Barclays may still pay dividends on ordinary or preference shares.

As well, coupons are mandatorily cancelled if there are insufficient distributable items (based on issuer accounts and not group) to pay coupons on these securities, parity securities and any junior securities. As of year-end 2014, the distributable reserves of the issuer Barclays plc was GBP 7.4bn.

Barclays currently has outstanding five issues of CRD 4 compliant AT1 securities, totalling GBP 4.3bn. In 2014, Barclays made GBP 250m in distributions related to these securities from after-tax profit of GBP 845m.

Lastly, the issuer must still be solvent immediately after making payments related to the AT1 securities. The issuer is considered solvent if it is able to pay debts owed to senior creditors as they fall due and if the value of its assets is at least equal to the value of its liabilities.

Combined buffer requirement

Restrictions on discretionary distributions apply when CET1 capital falls below the level of the combined buffer, defined as the total of the capital conservation buffer, the countercyclical buffer and systemic risk buffers as applicable. These restrictions become effective from 1 January 2016 and are based on transitional CET1 requirements.

At this time, we know that Barclays will be subject to the 2.5% capital conservation buffer and a 2% buffer for being a global systemically important bank, both to be phased-in from 2016. The countercyclical capital buffer rate for UK exposures is currently set at 0%. While not currently used by the UK regulator, sectoral capital requirements could be put in place alongside the countercyclical capital buffer in the future.

In addition to the minimum capital requirements under CRD4-CRR (CET1 plus AT1 plus T2 equal to 8%), supervisors may require additional capital (Pillar 2A) for risks not covered by CRD4 requirements. The UK's PRA has confirmed that Pillar 2A capital should sit below the combined buffer in the capital stack and cannot be counted towards meeting the combined buffer requirement (CBR). Therefore, the restrictions on distributions apply at a higher level of CET1 capital. For Barclays, the PRA has set a Pillar 2A guidance of 2.8% (previously 2.5%), of which at least 1.6% should be met with CET1 capital.

Currently, Barclays' CET1 capital is well above the minimum required and there is no CBR. Beginning in 2016, however, the various components of the CBR will start phasing-in. By 2019, based on current known requirements, Barclays will need to maintain a CET1 ratio of at least 10.6% in order to avoid distribution restrictions on its AT1 securities.

Providing some clarity for investors, Barclays has stated that it intends to maintain a management buffer of up to 1.5% above its CET1 requirements.

Table 1: Combined buffer requirement

	2014	2015	2016	2017	2018	2019
Combined buffer:						
- Capital conservation			0.625%	1.25%	1.875%	2.5%
- Systemic[1]			0.5%	1.0%	1.5%	2.0%
- Countercyclical[2]	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Pillar 2A[3]		1.6%	1.6%	1.6%	1.6%	1.6%
Minimum CET1	4.0%	4.5%	4.5%	4.5%	4.5%	4.5%
Required CET1 associated with distribution restrictions	**4.0%**	**6.1%**	**7.225%**	**8.35%**	**9.475%**	**10.6%**
Barclays' CET1 / target [4]	10.3%	10.6%	>11% target			11.5% - 12% target
Gap (%)	6.3%	4.5%	3.8%			0.9% - 1.4%
Gap (GBP bn)		17.8				

1) Phased-in requirement for being a GSIB. Barclays may be subject to other systemic buffers in the future.
2) Subject to quarterly review by the FPC. Countercyclical capital buffer rate for UK exposures currently 0%. May range from 0% to 2.5%.
3) Subject to at least annual review by the PRA.
4) Figures for 2015 are as of 31 March 2015. Based on RWAs of GBP 396bn.
Source: Company data, Scope Ratings

Key risk: principal loss absorption

Under the terms of the securities, there is full conversion into shares when the trigger level is breached. The trigger level is breached when the consolidated Barclays' CET1 ratio is less than 7% on a fully-loaded basis. We note that AT1 capital instruments issued by non-UK banks generally have a CET1 trigger based on a transitional basis. The UK regulator has decided to exercise its discretion to accelerate the introduction of certain enhanced capital requirements under CRD4. Therefore, for the purposes of these securities, Barclays will calculate its CET1 capital ratio on a fully-loaded basis, without regard to any transitional provisions. This is a more stringent basis and will lead to a CET1 ratio lower than it would be were Barclays to calculate the CET1 capital ratio applying transitional provisions.

In addition, investors in the security agree and consent to the exercise of any UK bail-in power by the relevant UK relevant resolution authority that may result in the cancellation of all, or a portion, of the principal amount of and/or conversion of all or a portion of the principal amount of the securities into shares or other securities. The UK introduced bail-in provisions in January 2015, ahead of the January 2016 deadline contained in the Bank Recovery and Resolution Directive. While there is no explicit reference to the point of non-viability, the securities are clearly subject to write-down and/or conversion risks.

Distance to trigger

Barclays is targeting a 11.5% to 12% fully-loaded CET1 ratio in 2019, including a management buffer of up to 1.5%. This target is subject to change as capital requirements are further clarified. As shown in Table 2, the distance to trigger should increase as Barclays achieves its CET1 targets and thus, the risk of principal loss absorption should decrease over time.

Table 2: Distance to trigger

	2014	2015	2016	2017	2018	2019
Trigger level	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%
Barclays' CET1 / target [1]	10.3%	10.6%	>11% target			11.5% - 12% target
Gap (%)	3.3%	3.6%	4.0%			4.5% - 5.0%
Gap (GBP bn)		14.3				

1) Figures for 2015 are as of 31 March 2015. Based on RWAs of GBP 396bn.

Source: Company data, Scope Ratings

Financial Institutions Ratings

HSBC Holdings plc – AT1 rating report

Security Ratings	
Outlook	Stable
5.625% USD 1.5bn perpetual subordinated contingent convertible securities	BBB
6.375% USD 2.25bn perpetual subordinated contingent convertible securities	BBB
5.5% EUR 1.5bn perpetual subordinated contingent convertible securities	BBB
6.375% USD 2.25bn perpetual subordinated contingent convertible securities	BBB

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The ratings have not been solicited by the issuer; the analysis is based solely on public information.

Rating rationale

We have assigned a rating of BBB to the above four issues of perpetual subordinated contingent convertible securities issued by HSBC Holdings plc based on the following:

- ICSR: AA-, Stable outlook
- Minimum notches down from the ICSR: 4
- Additional notches: 1

Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in September 2014 for more details about the minimum notching for AT1 securities. The additional notch for these securities reflects the following:

- Absolute level of the trigger is relatively high at 7% and is on a fully-loaded basis
- Restrictions on distributions apply at a higher level of CET1 capital as HSBC is subject to Pillar 2A capital requirements which as clarified by the UK regulator should sit below the combined buffer requirement in the capital stack
- The UK regulator has proven to be relatively demanding and may increase capital requirements or accelerate timelines for capital requirements

ICSR

The ICSR of AA- for HSBC is based on the Group's very diverse and unique business franchise which generates robust earnings. This capability enabled HSBC to maintain strong liquidity and capital positions during the financial crisis and will be key for successfully navigating an evolving operating environment. Nonetheless, the Group's size and complexity means that it is more vulnerable to operational, governance and internal control risks. With its broad-based focus on emerging markets, HSBC is also more exposed to potential volatility inherent in these markets.

Summary terms

Issuer	HSBC Holdings plc
Issue Date	September 2014
Amount	USD 1.5bn
Coupon	• 5.625% fixed until first call date, reset every 5 years thereafter • If any, payable in arrears semi-annually
Format	Perpetual subordinated contingent convertible securities, callable December 2020 and every five years thereafter
ISIN	US404280AS86
Issue Date	September 2014
Amount	USD 2.25bn
Coupon	• 6.375% fixed until first call date, reset every 5 years thereafter • If any, payable in arrears semi-annually
Format	Perpetual subordinated contingent convertible securities, callable December 2024 and every five years thereafter
ISIN	US404280AR04
Issue Date	September 2014
Amount	EUR 1.5bn
Coupon	• 5.25% fixed until first call date, reset every 5 years thereafter • If any, payable in arrears semi-annually
Format	Perpetual subordinated contingent convertible securities, callable 2022 and every five years thereafter
ISIN	XS1111123987
Issue Date	March 2015
Amount	USD 2.25bn
Coupon	• 6.375% fixed until first call date, reset every 5 years thereafter • If any, payable in arrears semi-annually
Format	Perpetual subordinated contingent convertible securities, callable 2025 and every five years thereafter
ISIN	US404280AT69

Summary terms – continued

Capital Treatment	Additional Tier 1
Coupon Cancellation	• Fully discretionary • Mandatory if there are insufficient distributable items to pay coupons on these securities, parity securities and any junior securities or the solvency condition is not satisfied in respect of such coupon payment
Principal Loss Absorption	• Full conversion into ordinary shares upon trigger breach at conversion price subject to conversion shares offer • Contractual acknowledgment of and agreement with UK bail-in power
Trigger for Principal Loss Absorption	Consolidated group CET1 ratio < 7% on fully-loaded basis

Key risk: coupon cancellation

Coupon payments are fully discretionary and are subject to distribution restrictions. Nevertheless, as the AT1 securities rank senior to ordinary shares, it is currently management's stated intention to take into account the relative ranking of the AT1 securities in the Group's capital structure when exercising its discretion to cancel coupon payments or declare ordinary share dividends. Management may depart from this policy at any time in its sole discretion.

As well, coupons are mandatorily cancelled if there are insufficient distributable items (based on individual accounts and not group) to pay coupons on these securities, parity securities and any junior securities. As of year-end 2014, the issuer, HSBC Holdings plc, had USD 48.9bn in reserves available for distribution.

Lastly, the issuer must be solvent immediately after making payments related to the AT1 securities. The issuer is considered solvent if it is able to pay debts owed to senior creditors as they fall due and if the value of its unconsolidated gross assets is at least equal to the value of its unconsolidated gross liabilities.

Combined buffer requirement

Restrictions on discretionary distributions apply when CET1 capital falls below the level of the combined buffer, defined as the total of the capital conservation buffer, the countercyclical buffer and systemic risk buffers as applicable. These restrictions become effective from 1 January 2016 and are based on transitional CET1 requirements.

At this time, we know that HSBC will be subject to the 2.5% capital conservation buffer and a 2.5% buffer for being a global systemically important bank, both to be phased-in from 2016. The countercyclical capital buffer rate for UK exposures is currently set at 0%. From January 2016, the countercyclical capital buffer rate for HK exposures is 0.625%, increasing in equal increments to 2.5% by January 2019. This is estimated to lead to an approximate 0.2% countercyclical buffer for the Group in 2016 which will increase to 0.8% in 2019 (Table 1). While not currently used by the UK regulator, sectoral capital requirements may be put in place alongside the countercyclical capital buffer in the future.

In addition to the minimum capital requirements under CRD4-CRR (CET1 plus AT1 plus T2 equal to 8%), supervisors may require additional capital (Pillar 2A) for risks not covered by CRD4 requirements. The UK's PRA has confirmed that Pillar 2A capital should sit below the combined buffer in the capital stack and cannot be counted towards meeting the combined buffer requirement (CBR). Therefore, the restrictions on distributions apply at a higher level of CET1 capital. For HSBC, the PRA has set a Pillar 2A guidance of 2% (previously 1.5%), of which at least 1.1% should be met with CET1 capital.

Currently, HSBC's CET1 capital is well above the minimum required and there is no CBR. Beginning in 2016, however, the various components of the CBR will start phasing-in. By 2019, based on current known requirements, HSBC will need to maintain a CET1 ratio of at least 11.4% in order to avoid distribution restrictions on its AT1 securities. In the medium term, the Group is targeting an end-point CRD 4 CET1 ratio of 12-13% and has stated that it intends to maintain a management buffer above requirements.

Table 1: Estimated CET1 requirements

	2014	2015	2016	2017	2018	2019
Combined buffer:						
- Capital conservation			0.625%	1.25%	1.875%	2.5%
- Systemic[1]			0.625%	1.25%	1.875%	2.5%
- Countercyclical[2]	0.0%	0.0%	0.2%	0.4%	0.6%	0.8%
Pillar 2A[3]		1.1%	1.1%	1.1%	1.1%	1.1%
Minimum CET1	4.0%	4.5%	4.5%	4.5%	4.5%	4.5%
Required CET1 associated with distribution restrictions	**4.0%**	**5.6%**	**7.1%**	**8.5%**	**10.0%**	**11.4%**
HSBC's CET1 / target [4]	11.1%	11.2%	12-13% target			
Gap (%)	7.1%	5.6%				0.6% - 1.6%
Gap (USD bn)		67.9				

1) Phased-in requirement for being a GSIB. HSBC may be subject to other systemic buffers in the future.

2) Subject to quarterly review by the FPC. Countercyclical capital buffer rate for UK exposures currently 0%. From January 2016, the rate for HK exposures will be 0.625% - rising to 2.5% in 2019.

3) Subject to at least annual review by the PRA.

4) Figures for 2015 are as of 31 March 2015. Based on RWAs of USD 1,212bn.

Source: Company data, Scope Ratings

Key risk: principal loss absorption

Under the terms of the securities, there is full conversion into shares when the trigger level is breached. The trigger level is breached when HSBC's consolidated CET1 ratio is less than 7% on a fully-loaded basis. We note that AT1 capital instruments issued by non-UK banks generally have a CET1 trigger based on a transitional basis. The UK regulator has decided to exercise its discretion to accelerate the introduction of certain enhanced capital requirements under CRD4. Therefore, for the purposes of these securities, HSBC will calculate its CET1 capital ratio on a fully-loaded basis, without regard to any transitional provisions. This is a more stringent basis and will lead to a CET1 ratio lower than it would be were HSBC to calculate the CET1 capital ratio applying transitional provisions.

In addition, investors in the security agree and consent to the exercise of any UK bail-in power by the relevant UK relevant resolution authority that may result in the cancellation of all, or a portion, of the principal amount of and/or conversion of all or a portion of the principal amount of the securities into shares or other securities. The UK introduced bail-in provisions in January 2015, ahead of the January 2016 deadline contained in the Bank Recovery and Resolution Directive. While there is no explicit reference to the point of non-viability, the securities are clearly subject to write-down and/or conversion risks.

Distance to trigger

As of 31 March 2015, HSBC's fully-loaded CET1 ratio was 11.2%, compared to the 7% trigger level in the securities. We expect the Group's CET1 capital to remain comfortably above the trigger level in light of its stated CET1 ratio target of 12-13%.

Table 2: Distance to trigger

	2014	2015	2016	2017	2018	2019
Trigger level	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%
HSBC's CET1 / target[1]	11.1%	11.2%	12-13% target			
Gap (%)	4.1%	4.2%	5-6%			
Gap (USD bn)		50.9				

1) Figures for 2015 are as of 31 March 2015. Based on RWAs of USD 1,212bn.

Source: Company data, Scope Ratings

Security Ratings	
Outlook	Stable
7% GBP 1.5bn fixed rate reset AT1 perpetual subordinated contingent convertible securities	BB+
7.625% GBP 1.5bn fixed rate reset AT1 perpetual subordinated contingent convertible securities	BB+
7.875% GBP 750m fixed rate reset AT1 perpetual subordinated contingent convertible securities	BB+
6.375% EUR 750m fixed rate reset AT1 perpetual subordinated contingent convertible securities	BB+
7.5% USD 1.7bn fixed rate reset AT1 perpetual subordinated contingent convertible securities	BB+

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The ratings have not been solicited by the issuer; the analysis is based solely on public information.

Rating rationale

We have assigned a rating of BB+ to the above noted AT1 perpetual subordinated contingent convertible securities issued by Lloyds Banking Group plc based on the following:

- Issuer Credit Strength Rating (ICSR): A, Stable outlook
- Minimum notches down from the ICSR: 4
- Additional notches: 1

Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in September 2014 for more details about the minimum notching for AT1 securities. The additional notch for these securities reflects the following:

- Absolute level of the trigger is relatively high at 7% and is on a fully-loaded basis
- Restrictions on distributions apply at a higher level of CET1 capital as Lloyds subject to Pillar 2A capital requirements which as clarified by the UK regulator should sit below the combined buffer requirement in the capital stack
- The UK regulator has proven to be relatively demanding and may increase capital requirements or accelerate timelines for capital requirements

ICSR

The ICSR of A is based on the strength of the Lloyds Banking Group. Lloyds enjoys a strong domestic franchise in the UK as the leading provider of current accounts, savings, personal loans, credit cards, mortgages and insurance. Over the last five years, management has made clear progress in transforming the Group into a lower risk UK-focused retail and commercial bank. Legacy issues while diminished, however, continue to depress earnings.

Summary terms

Issuer	Lloyds Banking Group plc
Issue Date	April 2014
Amount	GBP 1.5bn
Coupon	• 7% fixed until first call date, reset every 5 years thereafter • If any, payable quarterly in arrears
Format	Perpetual subordinated contingent convertible securities, callable 2019 and every five years thereafter
ISIN	XS1043550307
Amount	GBP 1.5bn
Coupon	• 7.625% fixed until first call date, reset every 5 years thereafter • If any, payable quarterly in arrears
Format	Perpetual subordinated contingent convertible securities, callable 2023 and every five years thereafter
ISIN	XS1043552188
Amount	GBP 750m
Coupon	• 7.875% fixed until first call date, reset every 5 years thereafter • If any, payable quarterly in arrears
Format	Perpetual subordinated contingent convertible securities, callable 2029 and every five years thereafter
ISIN	XS1043552261
Amount	EUR 750m
Coupon	• 7.875% fixed until first call date, reset every 5 years thereafter • If any, payable quarterly in arrears
Format	Perpetual subordinated contingent convertible securities, callable 2020 and every five years thereafter
ISIN	XS1043545059
Amount	USD 1.675bn
Coupon	• 7.5% fixed until first call date, reset every 5 years thereafter • If any, payable quarterly in arrears
Format	Perpetual subordinated contingent convertible securities, callable 2024 and every five years thereafter
ISIN and CUSIP	US539439AG42 and 539439AG4, respectively

Summary terms - continued

Capital Treatment	Additional Tier 1
Coupon Cancellation	• Fully discretionary • Mandatory if there are insufficient distributable items to pay coupons on these securities, parity securities and any junior securities • Mandatory if payments on common equity, AT1 securities and variable compensation exceed the Maximum Distributable Amount • For USD 1.675bn issue, also subject to Solvency Condition
Principal Loss Absorption	• Full conversion into ordinary shares upon trigger breach at conversion price subject to conversion shares offer • Subject to write off or conversion on the occurrence of a bail-in or if issuer becomes subject to resolution
Trigger for Principal Loss Absorption	Consolidated CET1 < 7% on fully-loaded basis

Source: Prospectuses, Scope Ratings

Key risk: coupon cancellation

Coupon payments on the AT1 securities are fully discretionary and are subject to distribution restrictions. Nevertheless, as the AT1 securities rank senior to ordinary shares, it is currently management's stated intention to take into account the relative ranking of the AT1 securities in the Group's capital structure when exercising its discretion to declare ordinary share dividends or to cancel coupon payments. Following the cancellation of any coupon payment, Lloyds is not restricted in any way from making distributions on parity or junior securities, including ordinary shares.

As well, coupons are mandatorily cancelled if there are insufficient distributable items (based on individual accounts and not consolidated) to pay coupons on these securities, parity securities and any junior securities. As of year-end 2014, the parent company Lloyds Banking Group plc had available distributable reserves of approximately GBP 8.5bn. Lloyds has stated that substantially all of the company's merger reserve of GBP 7.8bn is available for distribution under UK company law as a result of transactions undertaken to recapitalise the company in 2009.

Lloyds currently has outstanding five issues of CRD 4 compliant AT1 securities, totalling GBP 5.3bn. In 2014, Lloyds made GBP 287m in distributions related to these securities from after-tax profit of GBP 1.5bn.

In addition, for the USD 1.675bn security, the terms state that Lloyds must be solvent immediately after making payments related to the AT1 securities. Lloyds is considered solvent if it is able to pay debts owed to senior creditors as they fall due and its unconsolidated assets are at least equal to its unconsolidated liabilities.

Combined buffer requirement

Restrictions on discretionary distributions apply when CET1 capital falls below the level of the combined buffer, defined as the total of the capital conservation buffer, the countercyclical buffer and systemic risk buffers as applicable. These restrictions become effective from 1 January 2016 and are based on transitional CET1 requirements.

At this time, we know that Lloyds will be subject to the 2.5% capital conservation buffer, to be phased-in from 2016. The countercyclical capital buffer rate for UK exposures is currently set at 0%. While at present not used by the UK regulator, sectoral capital requirements could be put in place alongside the countercyclical buffer in the future. In addition, while not classified as a global systemically important bank, we would expect Lloyds to be considered systemically important in its domestic market, the UK. The Group has indicated that systemic buffers may be as high as 3%.

In addition to the minimum capital requirements under CRD4-CRR (CET1 plus AT1 plus T2 equal to 8%), supervisors may require additional capital (Pillar 2A) for risks not covered by CRD4 requirements. The UK's PRA has confirmed that Pillar 2A capital should sit below the combined buffer in the capital stack and cannot be counted towards meeting the combined buffer requirement (CBR). Therefore, the restrictions on distributions apply at a higher level of CET1 capital. For Lloyds, the PRA has set a Pillar 2A guidance 3.8%, of which at least 2.1% should be met with CET1 capital.

Currently, Lloyds' CET1 capital is well above the minimum required and there is no CBR. Beginning in 2016, the capital conservation buffer will start phasing-in but the required CET1 associated with distribution restrictions remains very manageable. In 2019, we would expect the gap to narrow as a systemic buffer is likely to be imposed. Management is currently working on the assumption that the Group will need to maintain a steady state CET1 ratio of 12%.

Table 1: Estimated CET1 requirements

	2014	2015	2016	2017	2018	2019
Combined buffer:						
- Capital conservation			0.625%	1.25%	1.875%	2.5%
- Systemic[1]						
- Countercyclical[2]	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Pillar 2A[3]		2.1%	2.1%	2.1%	2.1%	2.1%
Minimum CET1	4.0%	4.5%	4.5%	4.5%	4.5%	4.5%
Required CET1 associated with distribution restrictions	**4.0%**	**6.6%**	**7.225%**	**7.85%**	**8.475%**	**9.1%**
Lloyds' CET1	12.8%	13.4%	Assumes 12% will be required			
Gap (%)	8.8%	6.8%				
Gap (GBP bn)		15.9				

1) Not known. The Group has indicated that this may range from 0% to 3%.
2) Subject to quarterly review by the FPC. Current countercyclical buffer rate for UK exposures is 0%. May range from 0% to 2.5%.
3) Subject to at least annual review by the PRA.
4) Figures for 2015 are as of 31 March 2015. Based on RWAs of GBP 234bn.
Source: CRD4-CRR, PRA, Company data, Scope Ratings

Key risk: principal loss absorption

There is full conversion into shares when the trigger level is breached. The trigger level is breached when Lloyds' consolidated CET1 ratio is less than 7% on a fully-loaded basis. We note that AT1 capital instruments issued by non-UK banks generally have a CET1 trigger based on a transitional basis. The UK regulator has decided to exercise its discretion to accelerate the introduction of certain enhanced capital requirements under CRD4. Therefore, for the purposes of this security, Lloyds will calculate its CET1 capital ratio on a fully-loaded basis, without regard to any transitional provisions. This is a more stringent basis and will lead to a CET1 ratio lower than it would be were Lloyds to calculate the CET1 capital ratio applying transitional provisions. In addition, investors in the securities are subject to write off or conversion on the occurrence of a bail-in or if Lloyds becomes subject to resolution.

Distance to trigger

Lloyds currently assumes that it will be required to hold a fully-loaded CET1 capital ratio of 12%. As of 31 March 2015, Lloyds' fully-loaded CET1 ratio was 13.4% well above the 7% trigger level in the securities. As we expect the Group to maintain its capital position above requirements, the gap to trigger level should also remain comfortable in the future.

Table 2: Distance to trigger

	2014	2015	2016	2017	2018	2019
Trigger level	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%
Lloyds' CET1	12.8%	13.4%	Assumes 12% will be required			
Gap (%)	5.8%	6.4%				
Gap (GBP bn)		15.0				

1) Figures for 2015 are as of 31 March 2015. Based on RWAs of GBP 234bn.
Source: Company data, Scope Ratings

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