AT1 and Tier 2 Handbook: 3rd edition

Since the last update of our bank capital securities handbook a year ago, a great deal has happened in the Additional Tier 1 (AT1) realm. Amongst other things, we have seen improved disclosure on issuer capital requirements, increased market volatility and further issuance. In light of the role the securities are expected to play in strengthening capital positions and providing a viable private sector alternative for recapitalizing banks, we foresee continued growth in the asset class.

Scope's ratings on bank capital securities

This is our third compendium of detailed individual analytical reports on specific bank capital securities (AT1 and Tier 2). This publication includes new research on capital securities from inaugural issuers as well as updated reports on securities rated previously. Scope rates over 75 securities issued by 19 European banks in 11 countries (Figure 1). Our coverage of bank capital securities continues to mirror the significant activity in the market – over the last twelve months there has been over EUR 50bn in new issuance.

Overview of rating methodology for bank capital securities

The ratings and analyses are based on Scope's rating methodology for bank capital instruments which was last updated in May 2016 and which can be downloaded from www.scoperatings.com.

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 senior unsecured debt rating is four notches, reflecting these securities' deeply subordinated status in the priority of claims, their going concern loss absorbing features and investors' exposure to 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 distance to trigger and combined buffer requirement (CBR), the issuer's capital generation capabilities and liability 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 investors in subordinated debt are not exposed to. Accordingly, when rating T2 securities, Scope starts with at least two notches down from the senior unsecured debt rating.

How have the risks for investors evolved?

In contrast to 2013 when the AT1 market began to grow in earnest, one can clearly appreciate that the risks facing investors have increased. Back then, the asset class was relatively new and the market was still coming to terms with the principal loss absorption features of the securities. In hindsight, the risk that investors were going to miss a coupon or suffer from a write-down or conversion seemed rather hypothetical at the time. Now, however, some of these risks certainly appear more tangible.

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Highlights

Coupon cancellation risks come to the fore

Over the last six months or so there has been marked increase in the perception of coupon cancellation risks. While we had always understood that over time the risk of coupon cancellation should normally increase compared to the risk of principal loss absorption, we have been surprised by how quickly this has played out.

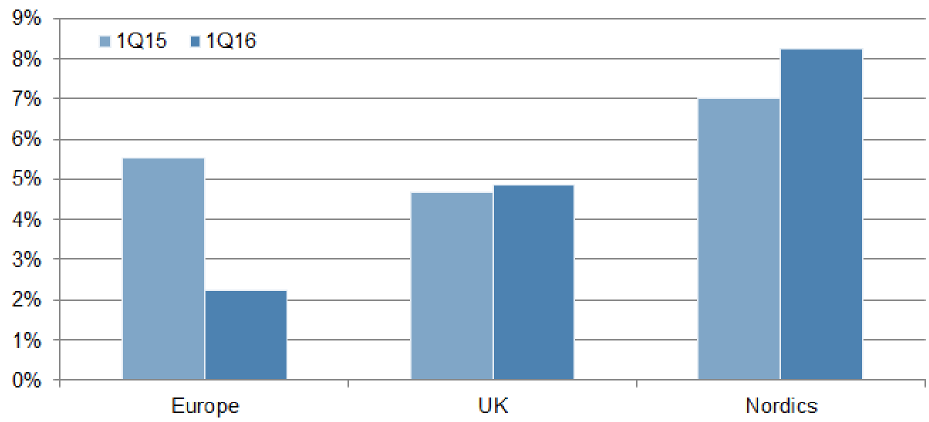
Previously, unless an issuer had limited available distributable items and/or suffered from meaningful earnings volatility, coupon cancellation risks were largely limited. Lately, however, three factors have led to increased coupon cancellation risk in general. First, various buffers comprising the combined buffer requirement (CBR) started to phase-in from January 2016. Second, amidst investor demand for greater transparency, EBA Opinion 2015/24 clarified that Pillar 2 capital requirements are considered minimum requirements which sit between Pillar 1 requirements and the CBR in the capital stack. And thirdly, European AT1 issuers disclosed their capital requirements stemming from the ECB's supervisory review and evaluation process (SREP).

For the larger European banks, disclosed SREP capital requirements for 2016 have generally equated to 9.5% to 10% of CET1 capital. Systemic and countercyclical buffers where applicable are in addition. This effectively means that banks must maintain CET1 capital levels of at least 9.5% to 10% in order to avoid breaching the CBR and incurring mandatory restrictions on distributions, including coupons on AT1 securities.

Disclosed CET1 capital requirements roughly double

With the improved disclosure on capital requirements, we see that the distances to required CET1 levels for many banks within the EU are in fact much less than they were in 2015 as disclosed CET1 capital requirements have roughly doubled. The situation for banks in the UK, Switzerland and the Nordic countries is somewhat different as regulators in these countries had communicated and frontloaded various capital requirements somewhat earlier.

Figure 1: Development in distance to required CET1 levels



Notes: Europe includes KBC, ING, BNP Paribas, Credit Agricole, Societe Generale, Deutsche Bank, Intesa, Unicredit, BBVA and Santander. UK includes Barclays, HSBC, Lloyds and RBS. Nordics includes DNB, Danske, Handelsbanken, Nordea and Swedbank.
Source: Scope Ratings

The SREP requirements for 2016 are comprised of Pillar 1 and Pillar 2 CET1 capital requirements as well as the capital conservation buffer. It is our understanding that the ECB has frontloaded the 2.5% capital conservation buffer and therefore SREP requirements overall are not expected to materially increase over the next few years. However, total CET1 capital requirements may still increase if systemic and countercyclical buffers are applicable and are phased-in. These buffers can translate into an additional 1-3% plus in CET1 capital requirements. In addition, some banks will see the phasing-in of deductions from capital.

Further, on a conference call in February the ECB communicated that going forward total Pillar 1 capital requirements would likely also be assessed in determining if there is a breach of the CBR. The Pillar 1 requirement consists of a minimum of 4.5% in CET1 capital, 6% in Tier 1 capital and 8% in total capital.

A closer look at coupon cancellation risks

Investors in AT1 capital instruments may not receive a coupon or receive only a partial distribution due to issuer discretion or a breach of the CBR. In general, Scope does not believe that financially viable issuers with sufficient, available distributable items would willingly utilise this discretion because the potential reputational damage could be very significant and materially harm future market access. Furthermore, issuers have the discretion to cut bonuses and dividends before not paying coupons on AT1 securities.

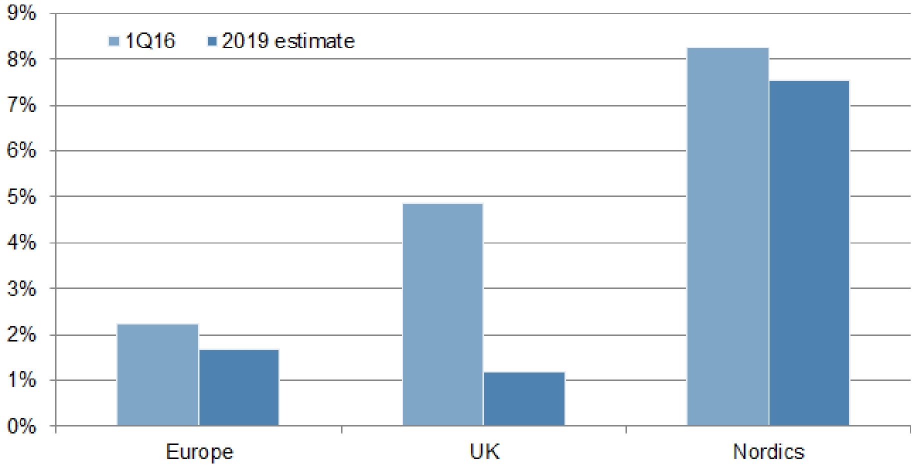
However, we believe that there may be a real risk of regulators influencing an issuer's discretion in regards to paying coupons or using their discretion under the supervisory process to restrict coupon payments. Such regulatory action occurred during the crisis and is very likely to occur again if warranted. In Scope's view, the most probable risk for AT1 investors is an issuer not making coupon payments because it does not meet the evolving CBR.

Factors preventing an issuer from meeting the CBR may include: (i) generating losses, (ii) unexpected provisions or charges related to litigation or conduct issues; (iii) a material increase in risk-weighted assets due to internal model changes or future regulatory requirements, (iv) an increase in the CBR due to changes in countercyclical capital-buffer rates or various systemic-risk buffer requirements and (v) material changes to Pillar 2 requirements.

As the banking industry moves through the transition period for implementing various capital buffers – with the final stage in 2019 – what appears as a comfortable capital position currently, may be less sufficient later on and impair a bank's capacity to pay future AT1 coupons. Looking ahead to 2019, the gap to CBRs appears to decline from current levels, with differences again amongst European, UK and Nordic issuers (Figure 2). We caution that the range is wide and that these are estimates based on currently disclosed CET1 targets, management buffers and our forecasts. Over time, issuers could refine their targets and management buffers in response to regulatory and market demands.

For investors and credit analysts, this raises the interesting issue of what would be considered a comfortable buffer. This is likely to vary depending on the issuer. For those issuers with more stable earnings and consistent organic capital generation capabilities operating under clear regulatory capital regimes, the "desired" management buffer is likely to be less. For those issuers with more volatile earnings or who are exposed to conduct and litigation fines or potentially higher capital requirements, the "desired" management buffer is likely to be larger.

Figure 2: Estimated future gaps to required CET1 levels (%)



Notes: Europe includes KBC, ING, BNP Paribas, Credit Agricole, Societe Generale, Deutsche Bank, Intesa, Unicredit, BBVA and Santander. UK includes Barclays, HSBC, Lloyds and RBS. Nordics includes DNB, Danske, Handelsbanken, Nordea and Swedbank.
Source: Scope Ratings.

Ongoing discussions may mean that banks eventually have more headroom

Since the volatility in the AT1 market seen in January and February there have been ongoing discussions about potentially relaxing requirements for European banks. In particular, Pillar 2 requirements may be separated into two components – one which is required and relevant for determining if the CBR has been breached and one which is considered guidance and not relevant for determining if the CBR has been breached. The way Pillar 2 requirements are met could also change – currently for ECB supervised banks, the Pillar 2 requirement is met with CET capital. In the future, they could also be met with AT1 and T2 capital as is the case in the UK. As well, there may be a change to the automatic limitation on AT1 coupons when the CBR has been breached and the maximum distributable amount needs to be calculated – specifically in scenarios where an issuer has made a loss for the year.

Beware of all requirements

Naturally when assessing coupon cancellation risks we focus on the CBR and at what level would a breach lead to a calculation of the maximum distributable amount (MDA). However, we believe that it is important to take a broader view due to the discretionary nature of coupons and the broad powers of regulators.

For example, in Nordic countries (Denmark, Norway and Sweden), Pillar 2 requirements are not included when determining the level of CET1 capital required to avoid restrictions on distributions. However, Pillar 2 requirements can be material and significantly increase total capital requirements. In fact, we question how comfortable both regulators and investors would be if an issuer were not meeting all of its capital requirements while technically not breaching the MDA trigger level. Besides Pillar 2 requirements, leverage ratio and MREL/TLAC requirements are also relevant.

We note that in Switzerland which is not subject to CRD IV, the securities issued by the two large Swiss banks do not include a reference to the CBR. Instead, the terms and conditions state that the issuers are prohibited from making coupon payments if they are not in compliance with all applicable minimum capital adequacy requirements. These include going and gone concern requirements – as a percentage of RWAs and leverage exposure.

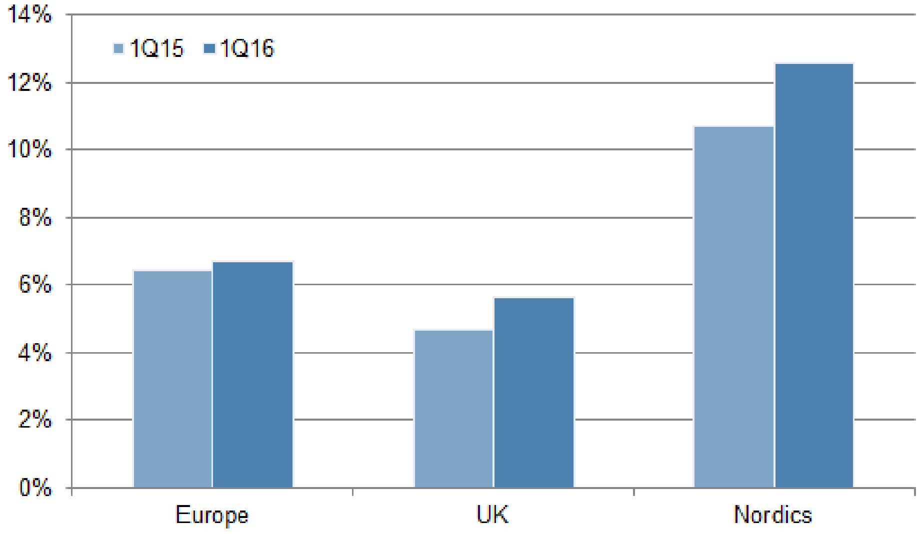
A closer look at principal loss absorption risks

Under the terms of AT1 capital instruments, write-down or conversion occurs when an issuer's CET1 ratio hits the specified trigger level or the issuer has reached the PONV (point of non-viability). Depending on the terms of the AT1 security, it may be written down on a permanent or temporary basis or be converted into equity.

Principal loss-absorption risks recede further

With the trigger levels for write-down or conversion being clearly defined and fixed and issuers building capital positions to meet higher regulatory solvency norms, this should generally mean lower write-down or conversion risks. For example, if minimum CET1 requirements are around 10%, banks are unlikely to maintain capital positions that risk breaching a high trigger of 7%, let alone a lower trigger.

Figure 3: Distance to trigger levels (%)



Notes: Europe includes KBC, ING, BNP Paribas, Credit Agricole, Societe Generale, Deutsche Bank, Intesa, Unicredit, BBVA and Santander. UK includes Barclays, HSBC, Lloyds and RBS. Nordics includes DNB, Danske, Handelsbanken, Nordea and Swedbank.
Source: Scope Ratings.

Principal loss absorption when the contractual trigger level is breached is relatively straightforward to understand. However, the PONV is less clearly defined and remains subject to interpretation. It is our understanding that AT1 securities may be written down or converted in early regulatory intervention and before resolution – when supervisors decide that action must be taken in order to remedy a bank's deteriorating condition. SREP results as well as other material events may be considered by supervisors in their decision making. A poor SREP result, substantial fines, a significant deterioration in the level of liabilities held for MREL purposes and an unexpected loss of senior management could be factors that lead to early regulatory intervention.

Figure 4: Summary of rated AT1 and T2 securities

Issuer	Capital Ranking	Trigger	Type of Loss Absorption	Senior unsecured debt rating [1]	Minimum Notching	Additional Notching	Rating on Capital Instrument
Barclays Bank	T2	7%	Permanent writedown	A	2	0	BBB+
Barclays plc	AT1	7% fully loaded	Full conversion	A	4	2	BB
BBVA	AT1	5.125% (issuer and group)	Full conversion	A	4	1	BB+
BNP Paribas	AT1	5.125%	Temporary writedown	A+	4	0	BBB
Credit Agricole	T2	7%	Permanent writedown	A+	2	0	A-
Credit Agricole	AT1	7% (CA group) or 5.125% (CASA)	Temporary writedown	A+	4	1	BBB-
Credit Suisse AG	T2	5% (CET1+ high trigger)	Permanent writedown	A	2	0	BBB+
Credit Suisse GAG	T2	7%	Full conversion	A	2	1	BBB
Credit Suisse GAG	AT1	5.125% (CET1+ high trigger)	Permanent writedown	A	4	0	BBB-
Credit Suisse GAG	AT1	7%	Full conversion	A	4	1	BB+
Danske Bank	AT1	7% (issuer and group)	Temporary writedown	A-	4	1	BB
Deutsche Bank	AT1	5.125%	Temporary writedown	A-	4	1	BB
DNB Bank	AT1	5.125% (bank, bank group, group)	Temporary writedown	A+	4	1	BBB-
HSBC Holdings	AT1	7% fully loaded	Full conversion	AA-	4	1	BBB
ING Group	AT1	7%	Full conversion	A	4	0	BBB-
Intesa	AT1	5.125% (issuer and group)	Temporary writedown	A-	4	0	BB+
KBC Bank	T2	7%	Permanent writedown	A	2	0	BBB+
KBC Group	AT1	5.125%	Temporary writedown	A	4	0	BBB-
Lloyds Banking Group	AT1	7% fully loaded	Full conversion	A	4	1	BB+
Nordea	AT1	5.125% bank, 8% group	Temporary writedown	A+	4	1	BBB-
Santander	AT1	5.125% (issuer and group)	Full conversion	A+	4	1	BBB-
Societe Generale	AT1	5.125%	Temporary writedown	A	4	0	BBB-
Svenska Handelsbanken	AT1	5.125% issuer, 8% group	Temporary writedown	A	4	1	BB+
Swedbank	AT1	5.125% bank, 8% group	Full conversion	A-	4	1	BB
UBS AG	T2	5% (CET1+ high Trigger)	Permanent writedown	A	2	0	BBB+
UBS GAG	AT1	5.125% (CET1+ high trigger)	Permanent writedown	A	4	0	BBB-
UBS GAG	AT1	7% (CET1 + high trigger)	Permanent writedown	A	4	0	BBB-

Note: 1 Senior unsecured debt rating eligible for TLAC/ MREL as applicable.
Source: Scope Ratings

KBC Bank NV – Tier 2 rating report

Security ratings

Outlook	Stable
8% USD 1bn contingent capital securities	BBB+

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 KBC Bank's 8% USD 1bn contingent capital securities based on the following:

- Senior unsecured debt rating (eligible for MREL): A, Stable Outlook
- Minimum notches down from senior unsecured debt rating: 2
- Additional notches: 0

In accordance with our recently updated rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating and no longer the issuer credit-strength rating (ICSR). Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in May 2016 for more details.

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 minimum of two notches for KBC's Tier 2 securities in our opinion sufficiently captures the potential principal loss absorption risks.

Issuer credit profile

The ICSR of A+ for KBC is underpinned by the Belgian group's solid franchise as a leading bancassurer at home and in the Czech Republic. The group has successfully put the crisis years behind them. State aid has been fully repaid ahead of schedule and the group's overall risk profile has materially declined with the disposal of legacy activities. Further, asset quality continues to steadily recover supported by improving macro conditions in Ireland. Solvency has strengthened to solid levels and the group's liquidity position remains sound.

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 2016, KBC Group's transitional CET1 ratio under the Danish compromise was 14.6%, compared to the trigger level of 7% on a transitional basis in the security. Therefore, the distance to trigger was over 7% or EUR 6.8bn (based on RWAs of EUR 89bn). In light of the group's minimum CET1 requirements (SREP plus national buffer), we expect the group to remain comfortably positioned against the trigger level.

Table 1: Distance to trigger

	2015	2016	2017	2018	2019
Trigger level	7.0%	7.0%	7.0%	7.0%	7.0%
KBC Group CET1	14.9%	14.6% (1Q16)			
Gap (%)	7.9%	7.6%			
Gap (EUR bn) [1]	6.9	6.8			

Note: 1. Based on RWAs of EUR 87bn at end-2015 and RWAs of EUR 89bn at end-March 2016.
Source: Company data, Scope Ratings

Other outstanding capital instruments

Within the group, we note that KBC Group NV has issued EUR 1.4bn in AT1 securities while the above Tier 2 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 7% trigger on the Tier 2 security is higher than the 5.125% trigger on the AT1 security, with both triggers being measured against the consolidated CET1 ratio of the group.

However, the AT1 security is issued by KBC Group NV, a holding company, while the Tier 2 security is issued by the operating company KBC Bank NV. Therefore, the AT1 security is structurally subordinated.

We further note that the Tier 2 security is callable in January 2018 and the group has said that it expects legacy Tier 2 issued by KBC Bank to disappear over time. Recent capital issuance (AT1 and Tier 2) has been at group level and this will continue in the future.

KBC Group – AT1 rating report

Security ratings

Outlook	Stable
5.625% EUR 1.4bn undated deeply subordinated Additional Tier 1 fixed rate resettable callable securities	BBB-

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 KBC Group's EUR 1.4bn 5.625% undated deeply subordinated Additional Tier 1 fixed rate resettable callable securities based on the following:

- Senior unsecured debt rating (eligible for MREL): A, Stable Outlook
- Minimum notches down from senior unsecured debt rating: 4
- Additional notches: 0

In accordance with our recently updated rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating and no longer the issuer credit-strength rating (ICSR). Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in May 2016 for more details. At this time, we have not identified any additional factors which would warrant further notching from the senior unsecured debt rating other than the minimum four.

Issuer credit profile

The ICSR of A+ for KBC is underpinned by the Belgian group's solid franchise as a leading bancassurer at home and in the Czech Republic. The group has successfully put the crisis years behind them. State aid has been fully repaid ahead of schedule and the group's overall risk profile has materially declined with the disposal of legacy activities. Further, asset quality continues to steadily recover supported by improving macro conditions in Ireland. Solvency has strengthened to solid levels and the group's liquidity position remains sound.

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 2015 for the issuer, KBC Group NV, was approximately EUR 6.4bn, comprised of EUR 5.3bn in retained earnings and EUR 1.1bn in reserves.

KBC currently has one outstanding CRD IV compliant AT1 security totalling EUR 1.4bn (the above issue). In 2015, KBC made EUR 52m in distributions related to these securities from after-tax profit of EUR 2.6bn.

Combined buffer requirement (CBR)

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 became effective from 1 January 2016 and are based on transitional CET1 requirements.

In November 2015, KBC was notified by the ECB that under the latest SREP review it must maintain a minimum CET1 capital ratio of 9.75% on a phased-in basis under the Danish compromise. In addition, the National Bank of Belgium has set capital buffers for domestic systemically important banks and KBC will be subject to a capital buffer of 1.5% to be phased-in over three years starting in 2016. Consequently, KBC is subject to a CET1 requirement of 10.25% in 2016, rising to 11.25% in 2019 assuming the SREP requirement does not change.

Management targets a minimum total capital ratio of 17%, which includes a flexible internal buffer above CET1 requirements, 1.5% in AT1 capital and a minimum of 2% in Tier 2 capital.

With the full repayment of state aid and the disposal of legacy activities completed, KBC generates solid earnings and capital organically. We expect the group to remain comfortably positioned against its capital requirements. As of end-March 2016, the group's CRD IV fully loaded CET1 ratio was 14.6%.

Table 2: Estimated CET1 requirements

	2015	2016	2017E	2018E	2019E
Combined buffer:					
- Capital Conservation		0.63%	1.25%	1.88%	2.50%
- Systemic[1]		0.50%	1.00%	1.50%	1.50%
- Countercyclical[2]		0.00%	0.00%	0.00%	0.00%
ECB SREP requirement add-on[3]	6.00%	4.62%	4.00%	3.37%	2.75%
Minimum CET1 (Pillar I)	4.50%	4.50%	4.50%	4.50%	4.50%
Required CET1 associated with distribution restrictions	**10.50%**	**10.25%**	**10.75%**	**11.25%**	**11.25%**
KBC Group CET1	14.90%	14.6% (1Q16)			
Distance to CBR (%)	4.40%	4.35%			
Distance to CBR (EUR bn) [4]	3.8	3.9			

Notes: 1. Domestic buffer of 1.5% to be phased-in between 2016 and 2019.
2. If applicable, may range from 0-2.5%.
3. Based on SREP capital requirement of 10.5% in 2015 and 9.75% for years 2016-2019.
4. Based on EUR 87bn of RWAs as of YE2015 and EUR 89bn of RWAs as of 1Q 2016.
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 2016, KBC Group's transitional CET1 ratio under the Danish compromise was 14.6%. Therefore, the distance to the trigger of 5.125% was 9.5% or EUR 8.4bn (based on RWAs of EUR 89bn). In light of the group's minimum CET1 requirements (SREP plus national buffer), we expect the group to remain comfortably positioned against the trigger level.

Table 3: Distance to trigger

	2015	2016	2017	2018	2019
Trigger level	5.125%	5.125%	5.125%	5.125%	5.125%
KBC Group CET1	14.9%	14.6% (1Q16)			
Gap (%)	9.8%	9.5%			
Gap (EUR bn) [1]	8.5	8.4			

Note: 1. Based on RWAs of EUR 87bn at end-2015 and RWAs of EUR 89bn at end-March 2016.
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 and with a call in January 2018. 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.

Danske Bank – AT1 rating report

Security ratings

Outlook	Positive
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

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:

- Senior unsecured debt (eligible for MREL): A-, Positive Outlook
- Minimum notches down from the senior unsecured debt rating: 4
- Additional notches: 1

In accordance with our recently updated rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating and no longer the issuer credit-strength rating (ICSR). Please refer to Scope's Bank Capital Instruments Rating Methodology published in May 2016 for more details.

The minimum 4 notches reflect the deeply subordinated status of AT1 capital instruments in the priority of claims, their going concern loss absorbing features and investors' exposure to coupon-cancellation risks.

The additional notch for these securities 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%

Issuer credit profile

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	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	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	Tier 1
Coupon Cancellation	• 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	• 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: Prospectuses, 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 Danske Bank A/S, the issuer, had DKK 101bn in retained earnings as of 31 December 2015. For the year 2015, payments on AT1 instruments amounted to DKK 607, while dividends were over DKK 8bn. At this time, we do not foresee problems meeting coupon payments from available distributable items.

Combined buffer requirement (CBR)

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 0.5% countercyclical capital buffer for exposures in Norway and Sweden.

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 10.5% in 2019.

Table 4: Combined buffer requirements Danske Bank group

	2015	2016E	2017E	2018E	2019E
Combined buffer:					
- Capital Conservation Buffer		0.63%	1.25%	1.88%	2.50%
- Systemic[1]	0.60%	1.20%	1.80%	2.40%	3.00%
- Countercyclical[2]	0.20%	0.50%	0.50%	0.50%	0.50%
Pillar 2 (CET1 component)	.	1.40%	1.40%	1.40%	1.40%
Minimum CET1 (Pillar I)	4.50%	4.50%	4.50%	4.50%	4.50%
Required CET1 associated with distribution restrictions	**5.30%**	**6.83%**	**8.05%**	**9.28%**	**10.50%**
Danske CET1 ratio (transitional)	16.1%	15.6%	16.3%	16.8%	>14%
Distance to CBR (%)	10.8%	8.8%	8.2%	7.6%	
Distance to CBR (DKK bn)	**90.03**	**74.97**	**71.19**	**66.67**	**-**

Source: Company data, Scope Ratings

In addition, we note that Danish banks are required to disclose their solvency need on a quarterly basis, including the Pillar 2 requirement. The latest disclosure points to a CET1 requirement under Pillar 2 of 1.4%.

In Denmark, 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 total solvency need including buffers of 11.9% would be a consideration for the regulator when deciding whether coupons on the Notes should be cancelled.

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.

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.

Distance to trigger

At Q1 2016, Danske Group's transitional CET1 ratio was 15%, compared to the 7% trigger level in the securities. Therefore, the distance to trigger is 8% or DKK 68bn based on a risk exposure amount of DKK 854bn. On a fully-loaded basis, Danske estimates its CET1 ratio to be about 14.7%. We expect the Group's CET1 capital ratio to remain comfortably above the trigger level in light of its stated target of 14%. The parent company's CET1 ratio stood at 19.5% as of year end 2015, hence the distance to trigger would be even more material when looking at the parent company solo trigger.

Table 5: Distance to trigger – Danske Bank (group)

	2015	2016 Q1	2017 E	2018 E	2019 E
Trigger level	7.0%	7.0%	7.0%	7.0%	7.0%
Danske CET1 ratio transitional/target	16.1%	15.0%			14.0%
Gap (%)	9.10%	8.0%			7.0%
Gap (DKK bn)	75.9	68.3			61.8

Source: Company data, Scope Ratings

BNP Paribas – AT1 rating report

Security ratings

Outlook	Stable
6.125% EUR 0.75bn perpetual fixed rate resettable Additional Tier 1 notes	BBB
7.375% USD 1.5bn perpetual fixed rate resettable Additional Tier 1 notes	BBB
7.625% USD 1.5bn perpetual fixed rate resettable Additional Tier 1 notes	BBB

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

Rating rationale

Scope has assigned a rating of BBB with a Stable Outlook to BNP Paribas (BNPP)'s 6.125% EUR 0.75bn and 7.375% EUR 1.5bn perpetual fixed rate resettable Additional Tier 1 notes. Scope is now also assigning an initial rating to the 7.625% USD 1.5bn perpetual fixed rate resettable AT1 notes issued in March 2016 which has similar terms and conditions to the other rated securities. The rating is based on the following considerations:

- Senior unsecured debt rating: A+, Stable Outlook
- Minimum notches down from senior unsecured debt rating: 4
- Additional notches: 0

In accordance with our recently updated rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating and no longer the issuer credit-strength rating (ICSR). The minimum four notches reflect the deeply subordinated status of AT1 capital instruments in the priority of claims, their going concern loss absorbing features and investors' exposure to coupon-cancellation risks. Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in May 2016 for more details.

While the distance to CET1 requirements is no longer as ample as before, we acknowledge the strong earning capabilities of the group through economic cycles underpinned by its balanced universal banking business model. At the same time, the group's intention to target a management buffer of 50bps above requirements is relatively low compared to other AT1 issuers. On balance, we have decided not to notch more than the minimum four notches down from the senior unsecured debt rating at this time.

We highlight that the Term and Conditions of the 6.125% and 7.625% notes mention the risks related to TLAC, in particular the relative situation of TLAC requirements vis-à-vis the bank's combined buffer requirements introduced by CRD IV. As BNPP has addressed this risk openly, we believe it is worth mentioning, even if it is too early to draw definitive conclusions on the subject.

Issuer credit profile

The Issuer Credit-Strength Rating (ICSR) of A+ for BNP Paribas reflects our view that the group, which now ranks as the euro area's largest banking group by total assets, continues to preserve reassuring, stable and predictable credit fundamentals, underpinned by a relatively well-balanced universal-bank business model. Besides being one of the dominant players in the French banking market, BNP Paribas has over the years built or acquired valuable retail and commercial bank franchises – among them on the US West Coast, Italy, and Belgium. Its wholesale and investment banking business remains substantial but the group has been able to de-risk and scale back during and after the crisis without fundamentally altering its business model.

BNP Paribas displays reassuring prudential and financial metrics. We are also confident that internal controls and risk management, including business conduct across the group, have been reinforced, especially in the aftermath of the financially painful settlement with US authorities.

Summary terms

Issuer	**BNP Paribas SA**
Issue Date	**17 June 2015**
Amount	EUR 0.75bn
Coupon	• 6.125% fixed until first call date (17 June 2022), reset on each five-year anniversary thereafter at the 5-year Mid-Swap Rate plus 5.23%. • If any, payable semi-annually in arrears on 17 June and 17 December of each year
Format	Perpetual fixed rate resettable additional Tier 1 notes under the EUR 90bn EMTN programme
ISIN	XS1247508903

Issue Date	**19 August 2015**
Amount	USD 1.5bn
Coupon	• 7.375% fixed until first call date (19 August 2025), reset every five years after the first call date at the 5-Year Mid-Swap Rate plus 5.15%. • If any, payable semi-annually in arrears on 19 February and 19 August of each year from (and including) 19 February 2016.
Format	Perpetual fixed rate resettable additional Tier 1 notes programme
ISIN	US05565AAN37 (Rule 144A)/ USF1R15XK367 (Regulation S)

Issue Date	**30 March 2016**
Amount	USD 1.5bn
Coupon	• 7.625% fixed until first call date (30 March 2021), reset on each five-year anniversary thereafter at the 5-year Mid-Swap Rate plus 6.314%. • If any, payable semi-annually in arrears on 30 March and 30 September of each year
Format	Perpetual Fixed Rate Resettable Additional Tier 1 Notes
ISIN	US05565AAQ67 (Rule 144A)/ USF1R15XK441 (Regulation S)

Capital Treatment	Additional Tier 1
Coupon Cancellation	• Fully discretionary • Mandatory (1) if the relevant regulator notifies the issuer that it has determined that the interest amount (in whole or part) should be cancelled based on its assessment of the financial and solvency situation of the issuer; or (2) if the coupon payable under the Notes, together with the interest payments or distributions to be paid on own funds items would be higher than the amount of distributable items available to the issuer or if the interest payments under the notes together with other distributions of the kind referred to in Article 141 (2) of CRD IV would cause the applicable Maximum Distributable Amount to be exceeded.
Principal Loss Absorption	• Temporary write-down - If a trigger event occurs (i.e. if at anytime the CET1 ratio of the group is below 5.125%), the issuer reduces the then prevailing outstanding amount of each note by the relevant write-down amount. Write downs can occur on more than one occasion and the principal amount of a note may never be reduced to below one cent. - If a positive group net income is recorded at any time, the issuer may at its discretion reinstate some or all of the principal amount of the notes on a pro-rata basis with all other discretionary temporary loss absorption instruments (if any) which would, following such reinstatement, constitute additional Tier 1 capital. • Permanent write-down following the exercise of the Bail-in power by the relevant resolution authority
Trigger for Principal Loss Absorption	CET1 <5.125% on a transitional basis

Source: Prospectuses, Scope Ratings

Key risk: coupon cancellation

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

We note that to be able to pay coupons on the notes, BNP Paribas must report sufficient distributable items, which are determined on the basis of its individual accounts, i.e. at the parent company level. In the Terms and Conditions of the notes dated 24 March 2016 distributable retained earnings, which the issuer considers as being equivalent to distributable items, are indicated to be EUR 23,978 million as of year-end 2015. This figure already takes into account the proposal to allocate part of the net income for the year to retained earnings (and the residual part to dividend distribution).

During the Annual General Meeting on 26 May 2016 the proposal to allocate part of net income to retained earnings was approved, resulting in retained earnings at YE2015 increasing to EUR 23.9bn from EUR 20.6bn at YE2014.

Combined buffer requirement

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

In Opinion 2015/24 dated 18 December 2015, the EBA clarified the interaction between Pillar 1 and Pillar 2 capital requirements and the CBR (see *"EBA Opinion 24/2015: Clarity added to the MDA debate"*, January 2016). The buffers sit on top of

Pillar 1 and Pillar 2 requirements and restrictions on distributions apply when CET1 capital falls below the buffers. We note the ongoing discussions about Pillar 2 needs and whether a portion should be considered guidance rather than a requirement as this would impact the level of CET1 capital that must be maintained in order to avoid restrictions on paying AT1 coupons.

Helpfully for investors, many banks disclose their capital requirements stemming from the Supervisory Review and Evaluation Process (SREP). The SREP capital requirement comprises the minimum Pillar 1 CET1 requirement, an institution-specific Pillar 2 CET1 requirement for risks not covered explicitly under CRD IV and a front-loading of the capital conservation buffer.

For 2016, BNP has a SREP requirement of 9.5% which had to be met as of 1 January 2016. As the group is a G-SIB it is subject to an additional 2% buffer imposed by the FSB, to be phased-in from 2016 over four years. The countercyclical capital buffer rate for exposures in France is currently set at 0% and will be reviewed quarterly.

As of 1Q 2016 BNP reported a transitional CET1 ratio of 11.1%, 110bps above its requirement for 2016. On a fully-loaded basis, the CET1 ratio was 11%. By 2019, we estimate that BNP will need to maintain a CET1 ratio of at least 11.5% in order to avoid distribution restrictions on AT1 coupons, assuming that SREP requirements do not change.

Management is targeting a CET1 ratio of 11.5% by mid-2017 and a CET1 ratio of 12% in 2018. Management takes the view that a 50bp buffer above end-point requirements is consistent with the group's "strong and recurring organic capital generation throughout the cycle". We acknowledge that BNP has demonstrated strong organic capital generation over the last few years which have been sufficient to absorb the impact of significant litigation charges. In December 2015, BNP announced "strategic initiatives" with regards to First Hawaiian Bank. If the Hawaiian subsidiary were sold or disposed via an IPO, BNP estimates a positive 40bps impact on its fully-loaded CET1 ratio.

Table 6: Estimated CET1 requirements

	2016 E	2017 E	2018 E	2019 E
Combined buffer:				
- Capital Conservation Buffer	0.63%	1.25%	1.88%	2.50%
- Systemic[1]	0.50%	1.00%	1.50%	2.00%
- Countercyclical[2]	0.00%	0.00%	0.00%	0.00%
ECB SREP requirement add-on[3]	4.38%	3.75%	3.13%	2.50%
Minimum CET1 (Pillar I)	4.50%	4.50%	4.50%	4.50%
Required CET1 associated with distribution restrictions	**10.00%**	**10.50%**	**11.00%**	**11.50%**
BNP CET1 ratio (transitional) / target (FL)	11.1% (1Q16)	11.50%	12%	
Distance to CBR (%)	1.10%	1.00%	1.00%	
Distance to CBR (EUR bn) [4]	6.9			

[1] Buffer for G-SII, phased-in between 2016 and 2019 [2] If applicable, may range from 0-2.5%. Would normally be phased-in between 2016 and 2019
[3] Based on SREP capital requirement of 9.5% [4] Based EUR 624bn of RWAs at end-March 2016
Source: Company data, Scope Ratings

On a separate matter, BNPP has highlighted in the "Risks relating to the notes" section of the offering documents that regulatory proposals not yet implemented could have an impact on the issuer's capacity to make distributions related to Additional Tier 1 instruments. More specifically, the Total Loss Absorbing Capacity requirement, when introduced, being a Pillar I requirement has to be met with CET1 capital in excess of the amount already used to meet buffers. This in turn may impact the issuer's ability to meet the CBR.

Key risk: principal loss absorption

The notes are subject to temporary write-down as a consequence of a breach of the trigger level. The trigger level is breached when BNPP's transitional CET1 ratio hits the 5.125% threshold. As shown in Table 2. BNPP's distance to trigger is ample, almost 600bps or EUR 37bn as of 1Q 2016.

Table 7: Distance to trigger

	2015	2016 E	2017 E	2018 E	2019 E
Trigger level	5.125%	5.125%	5.125%	5.125%	5.125%
BNP CET1 ratio / target (FL)	11%	11.1% (1Q16)	11.50%	12%	
Gap (%)	5.88%	5.98%	6.38%	6.9%	
Gap (bn EUR) [1]	37.0	37.3			

[1] Based on EUR 629bn of RWAs as of YE2015 and on EUR 624bn as of Q1 2016.
Source: Company data, Scope Ratings

Crédit Agricole SA – AT1 rating report

Security ratings

Outlook	Stable
7.875% USD 1.75bn undated deeply subordinated additional Tier 1 notes (issued Jan. 2014)	BBB-
6.5% EUR 1.0bn undated deeply subordinated additional Tier 1 notes (issued April 2014)	BBB-
7.5% GBP 0.5bn undated deeply subordinated additional Tier 1 notes (issued April 2014)	BBB-
6.625% USD 1.25bn undated deeply subordinated additional Tier 1 notes (issued Sept. 2014)	BBB-
8.125% USD 1.25bn undated deeply subordinated additional Tier 1 notes (issued Jan. 2016)	BBB-

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

Rating rationale

On 7 April 2016, Scope upgraded the ratings of the above noted undated deeply subordinated additional Tier 1 notes to BBB- from BB+, following the upgrade of Credit Agricole's issuer credit-strength rating (ICSR). Scope is now also assigning an initial rating to the 8.125% USD 1.25bn undated deeply subordinated AT1 notes issued in January 2016 which has similar terms and conditions to the other rated securities. The ratings on the securities are based on the following:

- Senior unsecured debt rating: A+, Stable Outlook
- Minimum notches down from senior unsecured debt rating: 4
- Additional notches: 1

In accordance with our recently updated rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating and no longer the issuer credit-strength rating (ICSR). Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in May 2016 for more details. The additional notch for these securities reflects the following:

- Complexity of the notes. There are two triggers – one for CASA consolidated (the issuer) at 5.125% and one for CA Group at 7%. Meanwhile, coupon payments depend exclusively on the available distributable items of CASA parent. Upon a breach of the Combined Buffer Requirement (CBR), the relevant Maximum Distributable Amount would be the lower of CASA or CA Group.
- With the Eureka transaction, CASA will no longer benefit from the contribution of the Regional Banks and the weight of asset management, insurance and corporate and investment banking activities will increase. This may lead to increased volatility in earnings and affect capital formation.

Issuer credit profile

The A+ ICSR on Crédit Agricole reflects the success of the group's de-risking and refocusing on its core businesses, mainly domestic and selected international retail, while leveraging its size and expertise in savings products (asset management and insurance). The group is well positioned to benefit from closer integration – cross-selling products and services group-wide. We note that the 2016-2020 medium-term plan continues to be underpinned by a focus on core businesses and a commitment to financial prudence.

Summary terms

Issuer	Crédit Agricole SA
Issue Date	23 January 2014
Amount	USD 1.75bn
Coupon	• 7.875% p.a. until first call date, reset every five, or a multiple of five, years after that at 5Y Mid-swap rate + 4.898% • 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% p.a. until first call date, reset every five, or a multiple of five, years after that at 5Y Mid-swap rate + 5.120% • 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% p.a. until first call date, reset every five, or a multiple of five, years after that at 5Y Mid-swap rate + 5.120% • 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% p.a. until first call date, reset every five, or a multiple of five, years after that at 5Y Mid-swap rate + 4.697% • If any, payable quarterly in arrears
Format	Undated deeply subordinated additional Tier 1 fixed rate resettable notes
ISIN	US225313AE58 (Rule 144A)/ USF22797YK86 (Regulation S)

Issue Date	19 January 2016
Amount	USD 1.25bn
Coupon	• 8.125% p.a. until first call date, reset every five, or a multiple of five, years after that at 5Y Mid-swap rate + 6.185% • If any, payable quarterly in arrears
Format	Undated deeply subordinated additional Tier 1 fixed rate resettable notes
ISIN	US225313AJ46 (Rule 144A)/ USF2R125CD54 (Regulation S)

Capital Treatment	Additional Tier 1
Coupon Cancellation	• Fully discretionary • Mandatory (i) based on the regulator's assessment of CASA's financial and solvency situation, (ii) if there are insufficient Distributable Items at CASA parent, (iii) if a distribution would cause the lower of the MDA of CASA consolidated or CA Group to be exceeded.
Principal Loss Absorption	• Temporary Write-down upon Trigger Event: reduce the current principal amount of each note (pro rata with other notes and equal Loss absorbing instruments) by the relevant write-down amount– i.e. the amount by which either the capital ratio event would be cured; or, if not enough, the amount necessary to reduce the principal amount of the note to one cent. • A write-up can occur at the Issuer discretion, after a positive net income at CASA parent is recorded, subject to the MDA limit. • Write-down or conversion at point of non-viability (PONV)
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 securities are fully discretionary and are subject to distribution restrictions.

CASA can only pay coupons provided there are enough distributable items at the level of CASA parent. As of YE2015, Crédit Agricole's distributable items (ADI) were EUR 26.7bn. This figure includes EUR 11.2bn of share premium and EUR 15.5bn of reserves, and does not take into consideration the impact of the Eureka transaction which is expected to have a positive impact.

It is noted in the "Risk Factors" of the prospectus that in order for the share premium to be included in ADI, shareholders must adopt a resolution to reallocate it to reserves. This happened in May 2015, with shareholders approving a transfer of EUR 10.7bn of issue premium to a reserve item. Hence, the level of reserves at YE2015 stands at a reassuring level of EUR 15.5bn.

Combined buffer requirement (CBR)

In Opinion 2015/24 dated 18 December 2015, the EBA clarified the interaction between Pillar 1 and Pillar 2 capital requirements and the CBR (see "EBA Opinion 24/2015: Clarity added to the MDA debate", January 2016). The buffers sit on top of Pillar 1 and Pillar 2 requirements and restrictions on distributions apply when CET1 capital falls below the buffers. These restrictions became effective from 1 January 2016 and are based on transitional CET1 requirements.

Helpfully for investors, banks have started to disclose their capital requirements stemming from the Supervisory Review and Evaluation Process (SREP). The SREP capital requirement comprises the minimum Pillar 1 CET1 requirement, an institution-specific Pillar 2 CET1 requirement for risks not covered explicitly under CRD IV and a front-loading of the capital conservation buffer.

CASA's SREP requirement for 2016 stands at 9.5% and must be met as of 30 June 2016. CA Group's SREP requirement for 2016 is also 9.5% but as the group is a G-SIB, it is subject to an additional 1% G-SIB buffer imposed by the FSB, to be phased-in from 2016 over four years. As of 1 January 2016, CA Group's minimum CET1 capital requirement was 9.75%. As CA Group's domestic risk buffer is at the same level as the G-SIB buffer, overall CET1 requirements do not change.

The countercyclical capital buffer rate for exposures in France is currently set at 0% and will be reviewed quarterly. Assuming the countercyclical buffer remains at 0% in 2019, CASA would be subject to a CET1 requirement of 9.5% in 2019, while CA Group would be subject to a CET1 requirement of 10.5%. It is our understanding that SREP capital requirements should not change materially between now and 2019 as the capital conservation buffer has been front-loaded by the ECB.

A breach of the CBR would lead to the calculation of the relevant Maximum Distributable Amount (MDA) which in the Terms & Conditions of the notes is defined as "the lower of the amount resulting from the calculation at the level of the Crédit Agricole S.A. Group or the Crédit Agricole Group". However, in the "Risk Factors" section, it states that in case of a CBR breach "it is not completely clear which Group's consolidated net income will be taken into account in determining the Maximum Distributable Amount of either Group" and hence the Relevant MDA.

As there are two possible MDAs, we assess two distances to CBR (one for CASA consolidated and one for CA Group) and consider the smaller to be more relevant. As of YE2015, CA Group was 375bs above the SREP requirement of 9.75% for 2016. And CASA was 130bps above the SREP requirement of 9.5% for 2016 (Table 1).

In its medium-term plan, management has set new fully-loaded CET1 targets. CA Group targets a fully-loaded CET1 ratio of 16% by end-2019 while CASA intends to keep a buffer of 150bps above minimum requirements over the period of the medium-term plan.

Table 8: Combined buffer requirements for CA Group and CASA consolidated

CA Group	2016 E	2017 E	2018 E	2019 E
Combined buffer:				
- Capital Conservation Buffer	0.63%	1.25%	1.88%	2.50%
- Systemic[1]	0.25%	0.50%	0.75%	1.00%
- Countercyclical[2]	0.00%	0.00%	0.00%	0.00%
ECB SREP requirement add-on[3]	4.38%	3.75%	3.13%	2.50%
Minimum CET1 (Pillar I)	4.50%	4.50%	4.50%	4.50%
Required CET1 associated with distribution restrictions	**9.75%**	**10.00%**	**10.25%**	**10.50%**
CA Group transitional CET1 / FL target	13.5% YE2015			16% FL target
Distance to CBR (%)	3.75%			5.50%
Distance to CBR (EUR bn)[4]	19			
CASA consolidated				
Combined buffer:				
- Capital Conservation Buffer	0.63%	1.25%	1.88%	2.50%
- Systemic[1]	0.00%	0.00%	0.00%	0.00%
- Countercyclical[2]	0.00%	0.00%	0.00%	0.00%
ECB SREP requirement add-on[3]	4.38%	3.75%	3.13%	2.50%
Minimum CET1 (Pillar I)	4.50%	4.50%	4.50%	4.50%
Required CET1 associated with distribution restrictions	**9.50%**	**9.50%**	**9.50%**	**9.50%**
CASA consolidated transitional CET1 / FL target		10.8% YE2015	≥11% FL target	
Distance to CBR (%)		1.3%	≥1.5%	
Distance to CBR (EUR bn)[4]	4			

Notes: 1. Buffer for G-SIB equivalent to national buffer. Phased-in between 2016 and 2019. 2. If applicable, may range from 0-2.5%. Would normally be phased-in between 2016 and 2019. 3. Based on SREP capital requirement of 9.5%. 4. Based on RWAs of EUR 509.4bn for CA Group and EUR 305.6bn for CASA as of YE2015.
Source: Company data, Scope Ratings

CA Group has an ample buffer before potentially breaching the CBR. For CASA, we note that the buffer is less. The Eureka transaction, in which CASA will transfer to SACAM Mutualisation, an entity 100% owned by the Regional Banks, its 25% stake in the Regional Banks, is expected to close in 3Q 2016. As a result, CASA Group will no longer consolidate the 25% equity interest in the Regional Banks – equivalent to around EUR 1bn in profit annually.

Post the transaction, CASA's business mix will change, with asset gathering and corporate and investment banking activities becoming larger contributors to earnings.

On an underlying pro forma basis as of YE2015, Asset Gathering would increase to 38% from 33% and Large Customers would increase to 29% from 22% while Retail Banking would account for 20% of net income group share. Consequently, the volatility of earnings may increase although we acknowledge that the group significantly de-risked its corporate and investment banking activities in 2011 and 2012. The Eureka transaction also provides a one-off boost to CASA's fully-loaded CET1 ratio of 41bps.

Key risk: principal loss absorption

Both CASA and CA Group show a considerable distance to trigger as seen below. For CASA, the potential volatility of future earnings may affect the capacity to maintain the buffer at the current level.

At the same time, we note that CASA as the Central Body of the organization must "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" (article L511-31 of the French Monetary and Financial code). This means there is a legal obligation to preserve its own capital position and the position of each entity of the network, providing some reassurance for investors.

Table 9: Distance to trigger – CA Group

	2015	2016 E	2017 E	2018 E	2019 E
Trigger level	7.0%	7.0%	7.0%	7.0%	7.0%
CA Group transitional CET1 / FL target	13.5%				16% FL target
Gap (%)	6.5%				9%
Gap (bn EUR)[1]	33				

Note: 1. Based on RWAs of EUR 509.4bn at YE2015.
Source: Company data, Scope Ratings

Table 10: Distance to trigger – CASA consolidated

	2015	2016 E	2017 E	2018 E	2019 E
Trigger level	5.125%	5.125%	5.125%	5.125%	5.125%
CASA consolidated transitional CET1 / FL target			10.8%	11% FL target	
Gap (%)			5.675%	5.875%	
Gap (bn EUR)[1]	17				

Note: 1. Based on RWAs of EUR 305.6bn at YE2015.
Source: Company data, Scope Ratings

Crédit Agricole SA – Tier 2 rating report

Security ratings

Outlook	Stable
8.125% USD 1.0bn Contingent Capital Subordinated Fixed Rate Resettable Notes due 2033	A-

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

Rating rationale

On 7 April 2016, Scope upgraded to A- from BBB+ the Tier 2 8.125% USD 1.0bn Contingent Capital Subordinated Fixed Rate Resettable Notes due 2033 issued in September 2013 by Credit Agricole SA following the upgrade of the issuer credit-strength rating (ICSR). The rating on the security is based on the following:

- Senior unsecured debt rating: A+, Stable Outlook
- Minimum notches down from senior unsecured debt rating: 2
- Additional notches: 0

In accordance with our recently updated rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating and no longer the issuer credit-strength rating (ICSR). Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in May 2016 for more details.

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 trigger for write-down if Crédit Agricole Group's CET1 ratio falls below 7%, we take the view that the PONV may be below or above this level. Therefore, in our view the current two notches sufficiently capture the potential principal loss absorption risks.

We further note that the trigger is measured at the level of Crédit Agricole Group (CA Group), which is better capitalised than Crédit Agricole SA (CASA). CA Group targets a CET1 ratio of 16% by end-2019, at the higher end of French and international peers.

Issuer credit profile

The A+ ICSR on Crédit Agricole reflects the success of the group's de-risking and refocusing on its core businesses, mainly domestic and selected international retail, while leveraging its size and expertise in savings products (asset management and insurance). The group is well positioned to benefit from closer integration – cross-selling products and services group-wide. We note that the 2016-2020 medium-term plan continues to be underpinned by a focus on core businesses and a commitment to financial prudence.

Summary terms

Issuer	Crédit Agricole SA
Issue Date	19 September 2013
Amount	USD 1.0bn
Coupon	• 8.125% per annum • Payable semi-annually in arrears
Format	Contingent Capital Subordinated Fixed Rate Resettable Notes due 2033
ISIN	US225313AC92 (Rule 144A)/ USF22797QT87 (Regulation S)

Capital Treatment	Tier 2
Principal Loss Absorption	• 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 basis)

Source: Prospectus, 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, as noted in the "risk factors" of the prospectus, the PONV of the group may be higher than the trigger level of 7%.

Distance to trigger

CA Group is targeting a fully-loaded CET1 ratio target of 16% by YE2019, a materially higher target than most other French and international peers.

We note that the distance to the trigger of 7% should be based on the transitional CET1 ratio of CA Group. As per the YE2015 results presentation, the transitional CET1 ratio of CA Group stands at 13.5%, lower than the 13.7% on a fully-loaded basis. As shown in Table 1, the distance to trigger should increase as CA Group meets its CET1 target.

Table 1: Distance to trigger

	2015	2016 E	2017 E	2018 E	2019 E
Trigger level	7.0%	7.0%	7.0%	7.0%	7.0%
CA Group transitional CET1 / FL target	13.5%				16% FL target
Gap (%)	6.5%				9.0%
Gap (bn EUR)[1]	33				

1. Based on EUR 509.4bn RWA as of YE2015. Source: Company data, Scope Ratings

Société Générale – AT1 rating report

Security ratings

Outlook	Stable
8.25% USD 1.25bn undated deeply subordinated resettable interest rate notes	BBB-
7.875% USD 1.75bn undated deeply subordinated resettable interest rate notes	BBB-
6.75% EUR 1bn undated deeply subordinated resettable interest rate notes	BBB-
6% USD 1.5bn undated deeply subordinated resettable interest rate notes	BBB-
8% USD 1.25bn undated deeply subordinated resettable interest rate notes	BBB-

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 referenced undated deeply subordinated resettable interest rate notes issued by Société Générale. The ratings are based on the following:

- Senior unsecured debt rating: A, Stable Outlook
- Minimum notches down from senior unsecured debt rating: 4
- Additional notches: 0

In accordance with our recently updated rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating and no longer the issuer credit-strength rating (ICSR). The minimum four notches reflect the deeply subordinated status of AT1 capital instruments in the priority of claims, their going concern loss absorbing features and investors' exposure to coupon-cancellation risks. Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in May 2016 for more details.

Issuer credit profile

The ICSR of A for Société Générale (SocGen) reflects the group's strong and well managed retail franchises in France and Central & Eastern Europe. The group's diversified universal banking business model contributes to earnings resilience. However, capital markets activities as well as pockets of emerging markets presence (e.g. Russia) expose the group to greater risks. The ratings also take into account the significant efforts the group has undertaken to comply with enhanced Basel III prudential metrics on capital and liquidity, considering that before the crisis SocGen was highly-levered and dependent on short-term wholesale funding.

Summary terms

Issuer	Société Générale
Issue Date	September 2013
Amount	USD 1.25bn
Coupon	• 8.25% fixed until first call date, reset every 5 (or multiple of 5) years thereafter • After first call date, rate equal to Mid Swap Rate USD 5 years plus 6.394% • If any, payable semi-annually in arrears
Format	Undated deeply subordinated resettable interest rate notes, callable November 2018 and every 5 (or multiple of 5) years thereafter
ISIN	XS0867614595

Issue Date	December 2013
Amount	USD 1.75bn
Coupon	• 7.875% fixed until first call date, reset every 5 years (or multiple of 5) years thereafter • After first call date, rate equal to Mid Swap Rate USD 5 years plus 4.979% • If any, payable semi- annually in arrears
Format	Undated deeply subordinated resettable interest rate notes, callable December 2023 and every 5 years (or multiple of 5) years thereafter
ISIN	USF8586CRW49 (Unrestricted notes) / US83367TBF57 (Restricted Notes)

Issue Date	April 2014
Amount	EUR 1.0bn
Coupon	• 6.75% fixed until first call date, reset every 5 (or multiple of 5) years thereafter • After first call date, rate equal to Mid Swap Rate USD 5 years plus 5.538% • If any, payable semi-annually in arrears
Format	Undated deeply subordinated resettable interest rates notes, callable April 2021 and every 5 (or multiple of 5) years thereafter
ISIN	XS0867620725

Issue Date	June 2014
Amount	USD 1.5bn
Coupon	• 6% fixed until first call date, reset every 5 (or multiple of 5) years thereafter • After first call date, rate equal to Mid Swap Rate USD 5 years plus 4.067% • If any, payable semi-annually in arrears
Format	Undated deeply subordinated resettable interest rates notes, callable January 2020 and every 5 (or multiple of 5) years thereafter
ISIN	USF8586CXG25 (unrestricted notes) / US83367TBH14 (restricted notes)

Issue Date	September 2015
Amount	USD 1.25bn
Coupon	• 8% fixed until first call date, reset every 5 (or multiple of 5) years thereafter • After first call date, rate equal to Mid Swap Rate USD 5 years plus 5.873% • If any, payable semi-annually in arrears
Format	Undated deeply subordinated resettable interest rates notes, callable September 2025 and every 5 (or multiple of 5) years thereafter
ISIN	US83368JFA34

Capital Treatment	Additional Tier 1
Coupon Cancellation	• Fully discretionary • Mandatory if coupon payments 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	Consolidated group CET1 <5.125% on a transitional basis

Source: Prospectuses, Scope Ratings

Key risk: coupon cancellation

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

Coupons are mandatorily cancelled if there are insufficient distributable items or if payments exceed the Maximum Distributable Amount (MDA). The MDA is only calculated when the issuer does not meet its combined buffer requirement. As of year-end 2015, we estimate that Société Générale (SocGen) had available distributable items of EUR 12.1bn. We have used the figure labelled “reserves, unappropriated earnings” found in note 6.1 of the 2015 parent company financial statements as a proxy.

SocGen currently has five outstanding CRD IV compliant AT1 securities totalling EUR 8.5bn. In 2015, SocGen made EUR 443m in distributions related to these securities from net income group share of EUR 4bn. We do not see the level of available distributable items as being a constraining factor for paying AT1 coupons.

Combined buffer requirement (CBR)

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

In Opinion 2015/24 dated 18 December 2015, the EBA clarified the interaction between Pillar 1 and Pillar 2 capital requirements and the CBR (see *“EBA Opinion 24/2015: Clarity added to the MDA debate”*, January 2016). The buffers sit on top of Pillar 1 and Pillar 2 requirements and restrictions on distributions apply when CET1 capital falls below the buffers. We note the ongoing discussions about Pillar 2 needs and whether a portion should be considered guidance rather than a requirement as this would impact the level of CET1 capital that must be maintained in order to avoid restrictions on paying AT1 coupons.

Helpfully for investors, many banks disclose their capital requirements stemming from the Supervisory Review and Evaluation Process (SREP). The SREP capital requirement comprises the minimum Pillar 1 CET1 requirement, an institution-specific Pillar 2 CET1 requirement for risks not covered explicitly under CRD IV and a front-loading of the capital conservation buffer.

For 2016, SocGen has a SREP requirement of 9.5%. In addition, as a global systemically important bank (G-SIB) SocGen is subject to a 1% buffer which is being phased-in between 2016 and 2019. It is our understanding that the group is also subject to a domestic systemically important financial institution (D-SIFI) buffer of 1%. However, the G-SIB and D-SIFI buffers are not aggregated and therefore the relevant systemic buffer is 1%. By 2019, we estimate that SocGen will need to maintain a CET1 ratio of at least 10.5% in order to avoid distribution restrictions on AT1 coupons, assuming that SREP requirements do not change.

Management aims to maintain a 100 to 150bp buffer above regulatory thresholds. The group targets a CET1 ratio above 11% by end-2016 and total capital ratio of more than 18% by end-2017 in light of future TLAC obligations. As of end-March 2016, the group’s transitional CET1 ratio was 11.5% while the fully-loaded CET1 ratio was 11.1%.

Table 11: Estimated CET1 requirements

	2016	2017E	2018E	2019E
Combined buffer:				
- Capital Conservation	0.63%	1.25%	1.88%	2.50%
- Systemic [1]	0.25%	0.50%	0.75%	1.00%
- Countercyclical [2]	0.00%	0.00%	0.00%	0.00%
ECB SREP requirement add-on [3]	4.37%	3.75%	3.12%	2.50%
Minimum CET1 (Pillar I)	4.50%	4.50%	4.50%	4.50%
Required CET1 associated with distribution restrictions	**9.75%**	**10.00%**	**10.25%**	**10.50%**
SocGen Group CET1, transitional		11.5% (1Q16)	100-150 bps buffer	
Distance to CBR (%)	1.75%			
Distance to CBR (EUR bn) [4]	6.1			

Notes: 1. G-SIB buffer of 1% to be phased-in between 2016 and 2019.
2. If applicable, may range from 0-2.5%.
3. Based on SREP capital requirement of 9.5% for years 2016-2019.
4. Based on RWAs of EUR 351bn as of 1Q 2016.
Source: Company data, Scope Ratings

Key risk: principal loss absorption

Under the terms of the notes, the principal amount of the notes will be written down when SocGen'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 the group's insurance business through the computation of RWAs, rather than through deductions (i.e. the Danish compromise). The group at its discretion may write-up the principal amount of the notes if it reports a profit and subject to the constraint of the MDA.

Distance to trigger

As of 31 March 2016, SocGen's transitional CET1 ratio under the Danish compromise was 11.5%. Therefore, the distance to the trigger of 5.125% was 6.4% or EUR 22.4bn (based on RWAs of EUR 351bn). In light of the group's minimum CET1 requirements (SREP plus G-SIB buffer) and management's intentions to maintain a 100-150bps buffer above requirements, we expect the group to remain solidly positioned against the trigger level.

Table 12: Distance to trigger

	2015	1Q 2016	2017	2018	2019
Trigger level	5.125%	5.125%	5.125%	5.125%	5.125%
SocGen Group CET1, transitional	11.4%	11.5%			
Gap (%)	6.3%	6.4%			
Gap (EUR bn) [1]	22.4	22.4			

Note: 1. Based on RWAs of EUR 87bn at end-2015 and RWAs of EUR 89bn at end-March 2016.
Source: Company data, Scope Ratings

Deutsche Bank AG – AT1 rating report

Security ratings

Outlook	Negative
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

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 additional Tier 1 notes (undated, non-cumulative, fixed to reset rates) issued in May and November 2014. The respective ratings of the above listed securities are based on the following considerations:

- Senior unsecured debt: A-, negative outlook
- Minimum notches down from the senior unsecured debt rating: 4
- Additional notches: 1

In accordance with our recently updated rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating and no longer the issuer credit-strength rating (ICSR). Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in May 2016 for more details.

The minimum of 4 notches reflect the deeply subordinated status of the notes in the debt waterfall, the risk of coupon cancellation and the low absorption features of the notes.

The additional notch for these securities reflects the following considerations:

- Deutsche Bank Available Distributable Items (ADIs) strike us as comparatively low and potentially more volatile;
- The distance to the combined buffer requirement (CBR) is in the lower end of our rated peers and the banks' capital accumulation capabilities pose some doubts, especially in light of the latest earnings performance
- The same considerations stand for the distance to trigger, although we note that the absolute level of the trigger (5.125%) is relatively low and the applicable CET1 ratio is calculated on a transitional basis. Consequently the distance to trigger is currently favourable, underpinning no further notching for principal loss absorption risk.

Issuer credit profile

The ICSR of A- reflects the satisfactory financial fundamentals of the bank, but also its challenged business model and the likely fallouts from the restructuring plan announced in 2015. Operating as a global universal bank with emphasis on wholesale and investment banking, alongside a more marginally profitable domestic retail franchise, has been weighing on the cost base. The bank's "Strategy 2020" has identified many of the intrinsic weaknesses of Deutsche's business model and fundamentals going forward. That said, we consider that the path towards business model streamlining, cost cutting, further deleveraging and capacity reduction will likely take its toll on medium term profitability. Material execution risks remain and the end-game is far from clear. Our analysis recognises the relative cross-cycle resilience of the wholesale and investment bank's revenue streams despite challenging operating conditions. Added to that are the remaining uncertainties related to potential litigation cases. These are hurdles towards unimpeded capital generation in our view.

Summary terms

Issuer	Deutsche Bank AG
Issue Date	27 May 2014
Amount	USD 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

Issue Date	27 May 2014
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

Issue Date	27 May 2014
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	21 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	Additional 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 statutory 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

Key risk: coupon cancellation

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

Available Distributable Items

The ability for Deutsche to pay coupons on its AT1 notes will depend on its ability to generate enough Available Distributable Items (ADIs) at the parent company level. Deutsche's ADIs over the last three years and its estimate of payment capacity in 2017 are summarized in Table 2.

Table 1: Available Distributable Items (ADIs) Deutsche Bank AG Parent company 2013-2016E, EUR m

	YE2013	YE2014	YE2015	YE2016E
Distributable Profit	920	1,169	165	1,600[1]
Other revenue reserves after net income attribution	6,111	6,332	6,323	1,900[2]
= Net distributable profit/ Total dividend potential	7,031	7,501	6,488	3,500
Minus non-distributable reserves (dividend amount blocked § 268 Abs. 8 HGB)	5,064	5,483	6,254	n.a.[3]
= ADIs	1,967	2,018	234	3,500
+ Increase for interest expenses on T1 instruments	756	852	858	800
Total amount available for interest payments on T1 instruments (ADIs)	2,723	2,870	1,092	4,300

[1]Pro-forma for the sale of 19,99% stake in Hua-Xia Bank [2] Only includes HGB 340e/g reserves [3] Not estimated
Source: Company data, Scope Ratings

The ADIs have been so far superior to the annual distributable profits of the company for the reason that past retained earnings are included in their calculation. However, non-distributable reserves are excluded, which means that 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. This was the case in 2015 in which distributable profits at the parent company level stood at EUR165 m.

For 2015 Deutsche Bank had EUR 1bn ADIs, enough to pay coupons on the four notes in object due in April and totalling EUR350 m. Moreover payments in 2016 on legacy Tier 1 securities were mostly linked to pusher events like the not materialized 2015 dividend payment.

Management presented an estimate of ADIs at YE2016. Distributable profit factors solely the impact from the sale of Hua-Xia and is subject to the operational results for 2016. Other reserves, excluding the residual '*Reserve* for General Banking Risks' in accordance with section 340e/g *HGB for EUR 1.9bn, could potentially increase significantly the estimated ADIs but non-distributable reserves (related to the recognition of self-developed intangible assets, deferred tax assets and unrealized gains on plan assets) could easily offset such increase.*

Combined buffer requirement (CBR)

In its Opinion 2015/24 dated 18 December 2015, the EBA clarified the interaction between Pillar 1 and Pillar 2 capital requirements and the CBR (see "EBA Opinion 24/2015: Clarity added to the MDA debate", January 2016). The buffers sit on top of Pillar 1 and Pillar 2 requirements and restrictions on distributions apply when CET1 capital falls below the buffers. These restrictions became effective from 1 January 2016 and are based on transitional CET1 requirements.

We note the ongoing discussions about Pillar 2 needs and whether a portion should be considered guidance rather than a requirement; this would impact the level of CET1 capital that must be maintained in order to avoid restrictions on paying AT1 coupons.

Helpful for investors, banks have started to disclose their capital requirements stemming from the Supervisory Review and Evaluation Process (SREP). The SREP capital requirement comprises the minimum Pillar 1 CET1 requirement, an institution-specific Pillar 2 CET1 requirement for risks not covered explicitly under CRD IV and a frontloading of the capital conservation buffer.

Deutsche Bank disclosed its SREP capital requirement of 10.25% for 2016. In addition DB is subject to a G-SIB buffer currently set at 2%, to be phased-in from 2016 over 4 years. The countercyclical capital buffer for significant exposures in Germany is currently set by the BaFin at 0% with effect from 1 January 2016. Assuming the countercyclical buffer remains at this level, in 2019 Deutsche Bank will be subject to a CET1 requirement of 12.25% on a fully-loaded basis. It is our understanding that SREP capital requirements should not change materially between now and 2019 as the capital conservation buffer has been front-loaded.

The phased-in CET1 ratio of Deutsche Bank as of Q1 2016 stood at 12%, 125bps (or EUR 5bn on the back of Q1 RWAs) above the 2016 requirement; the fully-loaded CET1 ratio was 10.7%. The sale of the 19.99% stake in Hua-Xia, expected to close in Q2, would add 40bps to the phased-in ratio on a pro-forma basis.

We note that Deutsche's new fully–loaded CET1 ratio target (as per "Strategy 2020") stands at or above 12.5% in 2018, which they intend to meet exclusively via RWAs reduction. In the hypothesis of a linear path towards the target, the gap to CET1 requirement is bound to be limited to a mere 80bps on average (from 2015 onwards and on a fully-phased basis).

Table 2: Combined buffer requirements

Deutsche Bank Group	2016	2017E	2018E	2019E
Combined buffer:				
- Capital Conservation Buffer	0.63%	1.25%	1.88%	2.50%
- Systemic[1]	0.50%	1.00%	1.50%	2.00%
- Countercyclical[2]	0.00%	0.00%	0.00%	0.00%
ECB SREP requirement add-on[3]	5.13%	4.50%	3.88%	3.25%
Minimum CET1 (Pillar I)	4.50%	4.50%	4.50%	4.50%
Required CET1 associated with distribution restrictions	**10.75%**	**11.25%**	**11.75%**	**12.25%**
Deutsche Bank CET1 (transitional) / target (FL)	12% (as of Q1)		≥12.5%	≥12.5%
Distance to CBR (%)	1.25%		≥0.75%	≥0.25%
Distance to CBR (EUR bn) [4]	5.02			

[1] Buffer for G-SIB, phased-in between 2016 and 2019 [2] If applicable, in the range [0-2.5%]. Would normally be phased-in between 2016 and 2019 [3] Based on SREP capital requirement of 10.25% [4] Based on EUR 401.5bn transitional RWAs as of Q1 2016
Source: Company data, Scope Ratings

Key risk: principal loss absorption

Under the terms of the securities, there is a temporary write-down of the principal when the trigger is breached, i.e. when Deutsche Bank consolidated transitional CET1 ratio falls below 5.125%. Moreover the notes may be written down or converted into shares at the occurrence of a non-viability event or in resolution.

Distance to trigger

Deutsche Bank reported a transitional CET1 ratio of 13.2% as of YE2015 and 12% as of Q1 2016. The gap in Q1 was 6.88% or EUR 27.6bn, which is average compared to other issuers/issues which present comparatively low triggers. We would expect this gap to narrow between 2015 and 2019, as the transitional ratio converges toward the fully-loaded one, with the progressive de-recognition of legacy instruments and the increasing weight of capital deductions. As mentioned above, with the bank aiming for a CET1 fully-loaded ratio at or above 12.5%, the targeted distance to trigger would stand at above 7%. We note that potential litigation charges could impact earnings and increase volatility in the CET1 ratio going forward, hence reducing such gap.

Table 13: Distance to trigger

	2015	1Q 2016	2017E	2018E	2019E
Trigger level	5.125%	5.125%	5.125%	5.125%	5.125%
Deutsche Bank CET1 ratio (transitional) / target (FL)	13.20%	12% (as of Q1)		≥12.5%	≥12.5%
Gap (%)	8.08%	6.88%		≥7.4%	≥7.4%
Gap (bn EUR)[1]	32.1	27.6			

[1] Based on EUR 397.4bn transitional RWAs as of YE2015, EUR 401.5bn as of Q1 2016

Source: Company data, Scope Ratings

Intesa – AT1 rating report

Security ratings

Outlook	Stable
7.7% USD 1.0bn perpetual AT 1 notes (September 2015) temporary write-down on 5.125% trigger	BB+
7% EUR 1.25bn perpetual AT 1 notes (January 2016) temporary write-down on 5.125% trigger	BB+

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+, with a stable outlook, to Intesa 7.7% USD 1.0bn Additional Tier 1 notes issued in September 2015 and to the 7% EUR 1.25bn AT1 notes issued in February 2016. The ratings are based on the following considerations:

- Senior unsecured debt rating: A-, stable outlook
- Minimum notches down from senior unsecured debt rating: 4
- Additional notches: 0

In accordance with our recently updated rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating and no longer the issuer credit-strength rating (ICSR). Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in May 2016 for more details.

The minimum 4 notches reflect the deeply subordinated status of AT1 capital instruments in the priority of claims, their going concern loss absorbing features and investors' exposure to coupon-cancellation risks.

The lack of additional notching for these securities reflects the following considerations:

1) Intesa has a very strong capital position, and on our estimates will have a buffer of over EUR22.6bn to the trigger at group level at the end of 2016. Despite the notes carry a separate trigger on the parent company CET1 ratio, we deem it irrelevant given the parent company is very well capitalised.

2) We do not see a need to add further notches for coupon cancellation risks. The buffers to both the Pillar 1 CBR and the total SREP requirements are significant and we estimate that Intesa has ample distributable items, which should not represent a constraint to coupon payments.

Issuer credit profile

In October 2015 Scope upgraded the Issuer Credit-Strength Rating (ICSR) of Intesa Sanpaolo SpA to A-, with a stable outlook. The rating upgrade reflects the bank's increased profitability, as well as expectations of an improvement in asset quality trends in the coming years on the back of a more favourable macroeconomic landscape, currently affecting the rating negatively. The short-term rating is S-2, with Stable Outlook.

The ratings are driven by Intesa's strong capital position and resilient profitability despite the challenging operating environment in Italy, where 80% of the loan portfolio is based. The group has been the leading retail and commercial bank in Italy since the merger of Intesa BCI and San Paolo IMI in 2007.

Group earnings and asset quality have suffered from the weak domestic economic environment, but pre-provision profitability has been resilient and the group has remained profitable if we exclude large writedowns of goodwill in 2011 and 2013.

Although it has operations in Central and Eastern Europe (CEE), Intesa's primarily domestic-based operations combined with significant holdings in Italian sovereign debt, mean it is particularly exposed to market confidence in Italian banks and Italy in general.

Summary terms

Issuer	Intesa Sanpaolo S.p.a.
Issue Date	17 September 2015
Amount	USD 1bn
Coupon	• 7.70% from 17/09/2015 to 17/09/2025, then 5y US Mid-Swap + 5.462% • Paid Semi-annually (March 17 and Sept. 17)
Format	• Non-Cumulative Temporary Write-Down Deeply Subordinated Fixed Rate Resettable Notes (Perpetual) • Redeemable at the option of the bank, subject to regulator consent, in case of change in capital treatment or tax treatment; • Redeemable at the sole option of the bank, subject to regulator consent, from first call date (17 Sept. 2025)
ISIN	US46115HAU14 / US46115HAV96 / IT0005136251 / IT0005136269

Issue Date	19 January 2016
Amount	EUR 1.25bn
Coupon	• 7.0% from 19/01/2016 to 19/01/2021, then 5y Mid-Swap + 6.884% • Paid Semi-annually (Jan. 19 and July 19)
Format	• Non-Cumulative Temporary Write-Down Deeply Subordinated Fixed Rate Resettable Notes (Perpetual) • Redeemable at the option of the bank, subject to regulator consent, in case of regulatory event (change in classification) or change in tax treatment; • Redeemable at the sole option of the bank, subject to regulator consent, from first reset date (19 Jan. 2021)
ISIN	XS1346815787

Capital Treatment	Additional Tier 1
Coupon Cancellation	• Fully discretionary; • Mandatory if (i) there are insufficient Distributable Items**; (ii) a distribution would cause the Maximum Distributable Amount (issuer or group) to be exceeded
Principal Loss Absorption	• Temporary Write-down upon Trigger Event: reduce the current principal amount of each note by the relevant write-down amount (pro rata with other notes and equal Loss absorbing instruments). A write-up can occur at the Issuer discretion, after a positive net income is recorded, subject to the MDA limit. • Permanent writedown or conversion to Equity at the PoNV
Trigger for Principal Loss Absorption	• CRD IV transitional CET1 Ratio (Group) < 5.125% or • CRD IV transitional CET1 Ratio (Intesa Sanpaolo Spa) < 5.125%

Source: Prospectus. Scope Ratings

Key risk: coupon cancellation

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

We see no need for further notching for coupon cancellation risk due to the comfortable distance to CBR and SREP requirements, the availability of sufficient available distributable items and the significant managerial flexibility to adjust dividend policy if needed.

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".

Intesa disclosed the ADIs as of YE2014 at EUR24bn, on our calculations the distributable items in 2015 would stand around EUR 28bn. It is worth highlighting that our calculation excludes part of the share premium account (EUR 2.34bn) related to the merger reserve. For a more detailed calculation of Intesa's ADI please refer to our recent research report "Identifying and Calculating Available Distributable Items (ADI): The Example of Italian Banks"

Combined buffer requirement (CBR)

The CRDIV-CRR restrictions on discretionary distributions are based on transitional CET1 requirements. Restrictions on discretionary distributions apply when CET1 capital falls below the level of the combined buffer (CBR), defined as the sum of the capital conservation buffer, the countercyclical buffer and systemic risk buffers as applicable. These restrictions became effective from 1 January 2016 and are based on transitional CET1 requirements.

In Opinion 2015/24 dated 18 December 2015, the EBA clarified the interaction between Pillar 1 and Pillar 2 capital requirements and the CBR (see *"EBA Opinion 24/2015: Clarity added to the MDA debate"*, January 2016). The buffers sit on top of Pillar 1 and Pillar 2 requirements and restrictions on distributions apply when CET1 capital falls below the buffers. (see "EBA Opinion 24/2015: Clarity added to the MDA debate"). We note the ongoing discussions about Pillar 2 needs and whether a portion should be considered guidance rather than a requirement as this would impact the level of CET1 capital that must be maintained in order to avoid restrictions on paying AT1 coupons.

Helpfully for investors, many banks disclose their capital requirements stemming from the Supervisory Review and Evaluation Process (SREP). The SREP capital requirement comprises the minimum Pillar 1 CET1 requirement, an institution-specific Pillar 2 CET1 requirement for risks not covered explicitly under CRD IV and a front-loading of the capital conservation buffer.

For 2016, Intesa has disclosed a SREP CET1 requirement of 9.5%. We know that Intesa is subject to the 2.5% capital conservation buffer, which in Italy applies since

2014. Not being a G-SIB, the bank is not subject to a global systemic buffer requirement; however, given its systemic importance in Italy, it is identified as domestically systemically important in Italy. Bank of Italy has set the other systemically important institution (O-SII) buffer for Intesa at 0% as Intesa's SREP capital requirement already includes a 1% charge for systemic risk. Currently, the countercyclical buffer rate for Italy is also set at 0%.

Table 14: Combined buffer requirements

Intesa	2015	2016 E	2017 E	2018 E	2019 E
Combined buffer:					
- Capital Conservation Buffer		2.50%	2.50%	2.50%	2.50%
- Systemic[1]		0.00%	0.00%	0.00%	0.00%
- Countercyclical[2]		0.00%	0.00%	0.00%	0.00%
ECB SREP requirement add-on[3]		2.50%	2.50%	2.50%	2.50%
Minimum CET1 (Pillar I)		4.50%	4.50%	4.50%	4.50%
Required CET1 associated with distribution restrictions	**9%**	**9.50%**	**9.50%**	**9.50%**	**9.50%**
Intesa Group CET1 ratio (transitional/convergence)[4]	13%	12.91%	12.67%	12.45%	12.24%
Distance to CBR (%)	4%	3.41%	3.17%	2.95%	2.74%
Distance to CBR (EUR bn) [5]	11.4	9.9	9.4	8.9	8.4

1 O-SII buffer currently set at 0% 2 Set at 2.5% for the whole period 3 Based on SREP capital requirement of 9.5% 4 Assumes linear convergence to fully loaded CRD4 regime, RoRWA of ca.1.4% on average for the next four years, average cash dividend payout of 86% and RWAs growth of 2% p.a.
Source: Company data, Scope Ratings estimates

Intesa's solvency position is very strong: its CET1 ratio in December 2015 stood at 13%, giving Intesa a distance to CBR, including the Pillar 2 requirement for 2016, of 3.5% - which is high. While this distance is in our view set to decline over time, especially if new buffer requirements are announced, we note that management has significant flexibility to adjust if needed, as the current business plan includes a generous dividend policy, which are also factored in our estimates of capital buildup.

Key risk: principal loss absorption

We see no need for further notching for principal loss absorption risk due to the comfortable distance to triggers as well as the significant managerial flexibility to adjust dividend policy if needed.

The mechanism for loss absorption is temporary write-down. The securities have 5.125% CET1 triggers, where CET1 capital is based on transitional rules. The triggers apply both to Intesa Sanpaolo group and Intesa parent company. However, the parent company had a CET1 ratio of 19.3% at the end of 2015 and we believe the risk of the two reference entities having a material divergence in capital evolution is immaterial; as Intesa's operations are almost entirely based in the EU, the risk of regulatory ring-fencing of capital is very remote.

Distance to trigger

We forecast the distance to trigger for the Group to stand at 7.8% in 2016. Based on our estimates of capital formation at Intesa, this distance is set to decline slightly both in percentage of RWAs and in absolute terms. The estimated increase in RWAs and the deductions will offset the capital build up going forward, but we regard both present and future gap as material thanks to the bank strong organic capital generation and despite generous dividend payments.

Table 15: Distance to trigger – Intesa Group

	2015	2016 E	2017 E	2018 E	2019 E
Trigger level	5.125%	5.125%	5.125%	5.125%	5.125%
Intesa Group CET1 ratio (transitional/convergence)	13.00%	12.91%	12.67%	12.45%	12.24%
Gap (%)	7.88%	7.79%	7.55%	7.33%	7.12%
Gap (bn EUR)	22.4	22.6	22.3	22.1	21.9

Source: Company data, Scope Ratings estimates

ING Group N.V. – AT1 rating report

Security ratings

Outlook	Positive
6.00% USD 1bn perpetual AT1 contingent convertible securities	BBB-
6.50% USD 1.25bn perpetual AT1 contingent convertible securities	BBB-

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-, with Positive outlook, to the above noted perpetual subordinated contingent convertible securities issued by ING Groep N.V. based on the following:

- Senior unsecured debt rating: A, Positive outlook
- Minimum notches down from senior unsecured debt rating: 4
- Additional notches: 0

In accordance with our recently updated rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating and no longer the issuer credit-strength rating (ICSR). Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in May 2016 for more details. The lack of additional notching for these securities reflects the following:

- A single trigger at the group level, which is 7% on a transitional basis
- Both distance to combined buffer requirement and distance to trigger are average compared to other rated AT1 securities. Moreover, we deem the group capable of accumulating capital if needed.

Issuer credit profile

With the disposal of investment management and insurance businesses, the balance sheets of ING Bank and ING Group have converged.

The ICSR of A for ING is driven by its strong and resilient retail and commercial banking franchise in the Benelux region. As well, ING continues to be at the forefront of direct retail banking operations in several important markets, including Germany. The bank has remained profitable despite restructuring, impairments on financial assets and elevated credit costs. At the same time, both the bank's funding profile and capital position have been strengthened. Management's success in restructuring and the normalisation of earnings are key drivers for the Positive Outlook. Meanwhile, with management now focused on executing its "Think Forward" strategy, we see some uncertainties related to the potential risks of the group's growth strategies.

Summary terms

Issuer	ING Groep N.V.
Issue Date	16 April 2015
Amount	USD 1bn
Coupon	• 6.00% fixed until first call date, reset every 5 years thereafter • If any, payable semi-annually
Format	• Perpetual subordinated contingent convertible securities, callable April 2020 and every five years thereafter • Redeemable at the issuer discretion after first call date or at any time following a Regulatory or Tax event, in either case subject to regulator consent
ISIN	US456837AE31

Issue Date	16 April 2015
Amount	EUR 1.25bn
Coupon	• 6.50% fixed until first call date, reset every 5 years thereafter • If any, payable semi-annually
Format	• Perpetual subordinated contingent convertible securities, callable April 2025 and every five years thereafter • Redeemable at the issuer discretion after first call date or at any time following a Regulatory or Tax event, in either case subject to regulator consent
ISIN	US456837AF06

Capital Treatment	Additional Tier 1
Coupon Cancellation	• Fully discretionary • Mandatory: (i) if there are insufficient distributable items to pay coupons on these securities and future payments on other own funds items in the then current financial year or, (ii) if aggregated with other distributions would cause the MDA to be exceeded
Principal Loss Absorption	• Full conversion into ordinary shares upon trigger breach at conversion price • Upon exercise of the Dutch Bail-in Power by the relevant resolution authority
Trigger for Principal Loss Absorption	Consolidated group CET1 < 7% on a transitional basis

Source: Prospectuses, Scope Ratings

Key risk: coupon cancellation

Coupon payments are fully discretionary and are subject to payment restrictions. Notwithstanding coupon cancellation on the securities, the issuer would be allowed to make dividend and interest payments in relation to other securities. During its roadshow presentation for the securities, however, ING specified that during the financial crisis it continued to pay coupons on Tier 1 instruments, while dividend payments were suspended.

There is mandatory cancellation of coupons in the event of insufficient available distributable items (ADI). We do not expect the lack of ADI to be limiting factor for the payment of coupons. As of YE2015, the ADI of the issuer, ING Group, stood at EUR 36.2bn, stable compared to the EUR 36bn in 2014.

ING has not issued any other CRD IV compliant AT1 securities.

Combined buffer requirement (CBR)

In Opinion 2015/24 dated 18 December 2015, the EBA clarified the interaction between Pillar 1 and Pillar 2 capital requirements and the CBR (see "EBA Opinion 24/2015: Clarity added to the MDA debate", January 2016). The buffers sit on top of Pillar 1 and Pillar 2 requirements and restrictions on distributions apply when CET1 capital falls below the buffers. These restrictions became effective from 1 January 2016 and are based on transitional CET1 requirements.

We note the ongoing discussions about Pillar 2 needs and whether a portion should be considered guidance rather than a requirement; this would impact the level of CET1 capital that must be maintained in order to avoid restrictions on paying AT1 coupons.

Helpfully for investors, banks have started to disclose their capital requirements stemming from the Supervisory Review and Evaluation Process (SREP). The SREP capital requirement comprises the minimum Pillar 1 CET1 requirement, an institution-specific Pillar 2 CET1 requirement for risks not covered explicitly under CRD IV and a frontloading of the capital conservation buffer.

Along with 4Q 2015 results, ING Group disclosed its SREP capital requirement of 9.5% for 2016. In addition, ING is subject to a 3% systemic risk buffer imposed by De Nederlandsche Bank, to be phased-in from 2016 over four years. The countercyclical capital buffer rate for exposures in the Netherlands is currently set at 0% and will be reviewed quarterly. Assuming the countercyclical buffer remains at 0%, the group would be subject to a CET1 requirement of 12.5% in 2019. It is our understanding that SREP capital requirements should not change materially between now and 2019 as the capital conservation buffer has been front-loaded.

Consequently, management has set a new CET1 target for the group of above 12.5% and will over time build a "comfortable management buffer". As of Q1 2016, ING Group's fully-loaded CET1 capital ratio stood at 12.9% while the transitional figure was 13%. We believe that the group's solvency is strong and that their dividend policy, which resumed relatively aggressively this year, already incorporates these capital targets.

Table 16: Combined buffer requirements

ING Group	2016 E	2017 E	2018 E	2019 E
Combined buffer:				
- Capital Conservation Buffer	0.63%	1.25%	1.88%	2.50%
- Systemic[1]	0.75%	1.50%	2.25%	3.00%
- Countercyclical[2]	0.00%	0.00%	0.00%	0.00%
ECB SREP requirement add-on[3]	4.38%	3.75%	3.13%	2.50%
Minimum CET1 (Pillar I)	4.50%	4.50%	4.50%	4.50%
Required CET1 associated with distribution restrictions	**10.25%**	**11.00%**	**11.75%**	**12.50%**
ING Group CET1 ratio (transitional) / target (FL)	13% (1Q16)		12.50% + management buffer	
Distance to CBR (%)	2.75%			
Distance to CBR (EUR bn) [4]	8.75			

[1] Buffer for Dutch systemic banks. Phased-in between 2016 and 2019 [2] If applicable, may range from 0-2.5%. Would normally be phased-in between 2016 and 2019
[3] Based on SREP capital requirement of 9.5% [4] Based on EUR 318bn of RWAs as of Q1 2016
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, i.e. when the consolidated group transitional CET1 ratio falls below the 7% threshold.

In addition, investors in the security agree and consent to the exercise of any Dutch bail-in power by the 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.

When these securities were issued in April 2015 the Netherlands had not transposed BRRD into national legislation, which they did in November 2015. Reference to the Point of Non-viability (PONV) is only present in the General Risk Factors, and gives power to the resolution authority to write down and convert notes at the PONV independently from any other resolution tool.

Distance to trigger

ING Group reported a transitional CET1 ratio of 12.9% as of YE2015 and 13% as of Q1 2016. The gap in Q1 was 6.0% or EUR 19.1bn, which we consider to be material compared to other issuers. In April 2016 ING announced the sale of its remaining 14.1% stake in NN Group, an Insurance and Asset management company. The impact from the transaction would bring the Q1 2016 pro-forma fully loaded CET1 ratio of the Group to 13.2% (excluding both the net positive P&L impact from the sale and the Q1 net profits). Going forward, we expect the gap to the trigger level to be at least 550 bps in light of the group's CET1 target; however, this could potentially be even wider in 2016, given this last transaction which completes the restructuring agreed with the European Commission.

Table 17: Distance to trigger

	2015	2016 E	2017 E	2018 E	2019 E
Trigger level	7.0%	7.0%	7.0%	7.0%	7.0%
ING Group CET1 ratio (transitional) / Target (FL)	12.90%	13% (1Q16)	12.50% + management buffer		
Gap (%)	5.9%	6%			
Gap (bn EUR) [1]	19.0	19.1			

1 Based on EUR 321bn of RWAs at YE2015 and EUR 318bn as of Q1 2016. Source: Company data, Scope Ratings

DNB Bank ASA – AT1 rating report

Security ratings

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

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

- Senior unsecured debt rating: A+, Stable Outlook
- Minimum notches down from senior unsecured debt rating: 4
- Additional notches: 1

In accordance with our recently updated rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating and no longer the issuer credit-strength rating (ICSR). Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in May 2016 for more details.

DNB maintains a solid capital position driven by its strong earnings capabilities and comparatively high regulatory capital requirements. With management targeting a CET1 ratio of about 15.5% in 2017, this means that the distance to trigger on the Notes is ample. We acknowledge that Pillar 2 requirements in Norway are not included in determining when automatic restrictions on distributions apply. However, the gap to the higher SREP requirement which includes Pillar 2 is expected to remain relatively narrow and this accounts for the additional notch off the senior unsecured debt rating. This is mitigated somewhat by DNB's track record of profitability and success in meeting target capital levels.

Issuer credit profile

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 sound market. This enables the group to generate resilient earnings and to maintain a solid capital positon. To date, the impact of lower oil prices on the group has remained limited but is expected to rise. 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	• 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	• 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. As of year-end 2015, DNB Bank ASA reported available distributable items of NOK 132bn (calculated as total equity of NOK 152bn minus share capital of NOK 18bn and minus fund for realised gains of NOK 1bn). Coupon payments on the Notes are estimated to be less than NOK 400m per annum.

Combined buffer requirement (CBR)

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 (Table 1):

- Capital conservation buffer of 2.5%,
- Systemic risk buffer of 3%,
- Systemically important institution buffer of 2%, and
- Countercyclical buffer of 1.5% 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 13.5% in 2016 in order to avoid restrictions on paying coupons on the Notes. Capital requirements must be met at group level (DNB Group) and bank group level (DNB Bank Group).

To date, the Ministry of Finance has stated that buffer requirements should be based on total risk-weighted assets, including international exposures. In March 2016, however, the Norwegian FSA recommended that countercyclical buffer requirements set in other countries be recognised (as per EU regulations). If implemented, DNB's countercyclical buffer would be reduced by 30bp to 1.2% as approximately 25% of the group's exposures are to countries with 0% buffer rates.

Meanwhile, in May 2016, the Norwegian FSA proposed a change to the treatment of investments in insurance subsidiaries under Norwegian Basel 1 floor regulation. If approved, this would have no effect on the CET1 ratio of DNB Bank Group but would reduce the CET1 ratio of DNB Group pro-forma by 0.2% to 15% from 15.2% at end-March 2016.

Under the supervisory review and evaluation process (SREP), DNB is subject to a total CET1 requirement of 15% in 2016 as SREP includes the Pillar 2 requirement of 1.5%. Importantly for AT1 investors, the Norwegian FSA in February 2016 confirmed that Pillar 2 requirements are not included in the MDA trigger level. A breach of SREP requirements does not lead to automatic distribution restrictions. However, the group would need to present a plan to the Norwegian FSA for restoring capital ratios. If insufficient, others measures may be considered.

While we recognise that Pillar 2 requirements are not included in the MDA trigger level in Norway, we believe that investors and regulators would be more comfortable with DNB maintaining a CET1 capital ratio above the higher SREP requirement. Given the comparatively higher capital requirement, the gap to SREP requirements is expected to remain relatively narrow. DNB has said that it intends to maintain a minimum management buffer of 0.5% with a target CET1 ratio of around 15.5% in 2017. DNB's track record in generating earnings and capital provides us with a constructive view on its ability to pay coupon payments. Since late 2014, DNB has identified and implemented various capital efficiency measures such as the sale of non-performing loans and optimising the use of capital in the large corporates portfolio which has bolstered its capital position to target levels.

Table 18: Estimated CET1 requirements

	YE2014	YE2015	YE2016 E	YE2017 E
Combined buffer:				
- Capital conservation	2.5%	2.5%	2.5%	2.5%
- Systemic	3.0%	3.0%	3.0%	3.0%
- SIFI		1.0%	2.0%	2.0%
- Countercyclical[1]		1.0%	1.5%	1.2%
Minimum CET1 (Pillar I)	4.5%	4.5%	4.5%	4.5%
Required CET1 associated with distribution restrictions	**10%**	**12.0%**	**13.5%**	**13.2%**
Pillar 2[2]		1.5%	1.5%	1.5%
SREP requirement		**13.5%**	**15.0%**	**14.7%**
DNB Group CET1 ratio	12.7%	14.4%	15.2% (1Q16)	~15.5% target
Distance to MDA trigger level	2.7%	2.4%	1.7%	
Distance to SREP requirement		0.9%	0.2%	
DNB Bank Group CET1 ratio	12.5%	14.3%	14.7% (1Q16)	
Distance to MDA trigger level	2.5%	2.3%	1.2%	
Distance to SREP requirement			(0.3%)	

1 Subject to quarterly review. 2 Subject to annual review.
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. As of end-May 2016, there are 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.

The implementation of BRRD in Norway is in progress with draft legislation expected to be finalised in the first half of 2016. Consequently, the Notes are currently 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 were in excess of NOK 150bn while share capital was NOK 18bn (as of YE2015). 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 are 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 2016, the distance to trigger for DNB Group was over 10%, or approximately NOK 160bn. 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 2015, we estimate the asset risk intensity of the group to be above 40%.

Table 19: CET1 ratios compared to trigger level

	2014	2015	2016	2017
Trigger level	5.125%	5.125%	5.125%	5.125%
DNB Group CET1 ratio	12.7%	14.4%	15.2% (1Q16)	~15.5% target
DNB Bank Group CET1 ratio	12.5%	14.3%	14.7% (1Q16)	
DNB Bank CET1 ratio	13.2%	15.1%	15.8% (1Q16)	

Source: Company data, Scope Ratings

Banco Santander S.A. – AT1 rating report

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-

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

Rating rationale

Scope assigns long term ratings of BBB- to Santander's three Additional Tier 1 notes listed in the table above. For details on the rated instruments, see next page. The ratings are based on the following considerations:

- Senior unsecured debt (eligible for MREL): A+, stable outlook
- Minimum notches down from the senior unsecured debt rating: 4
- Additional notches: 1

In accordance with our recently updated rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating and no longer the issuer credit-strength rating (ICSR). Please refer to Scope's Bank Capital Instruments Rating Methodology published in May 2016 for more details.

The minimum 4 notches reflect the deeply subordinated status of AT1 capital instruments in the priority of claims, their going concern loss absorbing features and investors' exposure to coupon-cancellation risks.

The additional notch for these securities reflects the double trigger structure, which limits the benefits of earnings diversification in case the domestic profit outlook deteriorates and the bank is not allowed to upstream earnings from other parts of the group. We also note the increased uncertainty around coupon cancellation risk following the clarification that Pillar 2 requirements count towards the MDA threshold.

Issuer credit profile

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

The ratings are driven by the bank's strong and seasoned 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

Issue Date	March 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

Source: Prospectus, Scope Ratings

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

Source: Prospectus, Scope Ratings

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

Source: Prospectus, Scope Ratings

Main Risks	
Coupon Cancellation	• 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	• 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: • 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: Prospectuses, 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”.

Santander reports ADI of EUR 48.3bn at the parent company level.

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.

Table 1: Distance to CBR

Santander Group	2015	2016E	2017E	2018E	2019E
Combined buffer:					
- Capital Conservation Buffer		0.63%	1.25%	1.88%	2.50%
- Systemic		0.25%	0.50%	0.75%	1.00%
- Countercyclical		0.00%	0.00%	0.00%	0.00%
Pillar 2		4.38%	3.75%	3.13%	2.50%
Minimum CET1 (Pillar I)		4.50%	4.50%	4.50%	4.50%
Required CET1 associated with distribution restrictions		**9.75%**	**10.00%**	**10.25%**	**10.50%**
Santander CET1 ratio (transitional) / target (FL)	12.5%	12.2%	11.8%	11.5%	11.1%
Distance to CBR (%)		**2.5%**	**1.8%**	**1.2%**	**0.6%**
Distance to CBR (EURm)		14,831	11,292	7,689	3,979

Source: Source

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 12.5% as of year end 2015, giving AT1 investors an ample buffer of almost 3% from the CET1 requirement in 2016. Over time, this buffer is set to decline as the new CRD4 capital requirements and deductions are phased in. We estimate that the CET1 ratio may decline to 11.1% by 2019 (in line with management's long term target of at least 11%. Based on our current knowledge, the CET1 requirement for Santander will reach 10.5% in 2019 on account of the gradual introduction of the G-SIFI buffer of 1%. Our projections point to a 0.6% buffer in 2019, which includes an estimate of the gradual transition to fully phased CRD4 regime. 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.

We note that based on distance-to-CBR, Santander will go from the higher end to the lower end of the large European banks peer group, which is a cause of caution, although mitigated by our conviction in Santander's earnings model stability.

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%. On the other hand, our estimates include significant dividend payments (dividend payout ratio of 40%) and RWA growth of 3-4%. We believe that management would use these levers to remain ahead of the CET1 requirement if this was to move higher.

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 2015, Santander group had a CET1 ratio of 12.5%, while Banco Santander SA had a CET1 ratio of 14.22%.

Distance to trigger

The current distance to trigger is a comfortable 9% for the parent bank and 7.4% for the Group. Based on our estimates of capital formation at Santander group, we expect the distance to slightly decline to 6% in 2019 but stabilise thereafter. Indeed, while profits would push up the CET1 ratio, the gradual phasing in of CRD4 CET1 deduction will cancel out and reverse that impact on the reported regulatory ratio.

Table 2: Distance to trigger

Santander Group	2015	2016 E	2017 E	2018 E	2019 E
Trigger level	5.125%	5.125%	5.125%	5.125%	5.125%
Santander CET1 ratio (transitional) / target (FL)	12.55%	12.23%	11.83%	11.45%	11.10%
Gap (%)	7.42%	7.10%	6.70%	6.33%	5.98%
Gap	43,466	42,513	41,385	40,399	39,523

Source: Scope Ratings

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. 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.

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.

BBVA SA – AT1 rating report

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+
8.875% EUR 1bn perpetual AT1 notes (2016) equity conversion on 5.125% trigger	BB+

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

Rating rationale

Scope assigns long term ratings of BB+ to BBVA's four Additional Tier 1 notes listed in the table above. For details on the rated instruments, see next page. The ratings are based on the following considerations:

- Senior unsecured debt (eligible for MREL): A, stable outlook
- Minimum notches down from the senior unsecured debt rating: 4
- Additional notches: 1

In accordance with our recently updated rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating and no longer the issuer credit-strength rating (ICSR). Please refer to Scope's Bank Capital Instruments Rating Methodology published in May 2016 for more details.

The minimum 4 notches reflect the deeply subordinated status of AT1 capital instruments in the priority of claims, their going concern loss absorbing features and investors' exposure to coupon-cancellation risks.

The additional notch for these securities reflects the double trigger structure, which limits the benefits of earnings diversification in case the domestic profit outlook deteriorates and the bank is not allowed to upstream earnings from other parts of the group. We also note the increased uncertainty around coupon cancellation risk following the clarification that Pillar 2 requirements count towards the MDA threshold.

Issuer credit profile

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

The ratings are 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.

With the domestic economic environment improving, the weigh of Spanish legacy assets on the group's earnings capacity is set to decline. The recovery, if sustained, should also have a positive impact on 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

Issue Date	May 2013
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, from first reset date
ISIN	XS0926832907
Capital Treatment	Additional Tier 1

Issue Date	February 2014
Amount	EUR 1.5bn
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, from first reset date
ISIN	XS1033661866
Capital Treatment	Additional Tier 1

Issue Date	February 2015
Amount	EUR 1.5bn
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 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, from first reset date
ISIN	XS1190663952
Capital Treatment	Additional Tier 1

Issue Date	April 2016
Amount	EUR 1.0bn
Coupon	• 8.875% from 2016 to 2021, then switches to 5y midswap rate + 9.177% • 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, from first reset date
ISIN	XS1394911496
Capital Treatment	Additional Tier 1

Main Risks	
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*	• CRD IV transitional CET1 Ratio (Group) < 5.125% • CRD IV 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".

We estimate BBVA's ADI at c. EUR 9.8bn, comprising of EUR 2.9bn in net profit and EUR 7bn of voluntary reserves at the parent company level, before deducting any distribution of dividends. The amount declines to c. EUR 9bn after deducting dividends and AT1 coupons already paid in 2015. Including the 8.8% AT1 note issued in April 2016, we estimate that BBVA will need to pay c. EUR 400m in AT1 coupons annually.

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 AT1 notes.

Combined buffer requirement (CBR)

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. From 2017, BBVA will cease to be a G-SIB, but will remain subject to a systemic buffer of 0.5% in Spain – subject to phase in arrangements.. 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.

It is also now clear, following the publication of opinion 24/2015 by the EBA that the Combined Buffer Requirements sits above Pillar 2 requirements and therefore has to be included in the calculation of distance-to-CBR.

The EBA's opinion states that "Pillar 1 and Pillar 2 capital requirements should be a minimum to be preserved at all times based on an institution-specific assessment of the risks not covered, or fully covered, by Pillar 1 capital requirements." Furthermore, according to the EBA, the MDA should be calculated using CET1 capital held in excess of Pillar 1 and 2 required levels. The opinion also addresses the effects of non-compliance. In the case of a breach of the CET1 requirement (or likelihood of a breach within 12 months), including CBR, the supervisory authority must take early-stage measures.

BBVA's total CET1 requirement including buffers for 2016 was 9.75% - including the full front loading of the capital conservation buffer through Pillar 2. We expect the total requirement to be fairly stable over time, with a small increase over the years accounted for by the phasing in of the systemic buffer.

At year end 2015, BBVA's CET1 ratio stood at 12.1%, well above the requirement. However, over the coming years BBVA's CET1 ratio will be pressured by the gradual phasing in of CRD4 deductions.

Table 20: Combined buffer requirements

Distance to CBR – BBVA group	2015	2016E	2017E	2018E	2019E
Combined buffer:					
- Capital Conservation Buffer		0.63%	1.25%	1.88%	2.50%
- Systemic[1]		0.25%	0.25%	0.38%	0.50%
- Countercyclical[2]		0.00%	0.00%	0.00%	0.00%
Pillar 2		4.38%	3.75%	3.13%	2.50%
Minimum CET1 (Pillar I)		4.50%	4.50%	4.50%	4.50%
Required CET1 associated with distribution restrictions		**9.75%**	**9.75%**	**9.88%**	**10.00%**
BBVA CET1 ratio (transitional) / target (FL)[3]	12.09%	11.79%	11.57%	11.43%	11.37%
Distance to CBR (%)		**2.04%**	**1.82%**	**1.55%**	**1.37%**
Distance to CBR		8,419	7,731	6,810	6,185

BBVA will cease to be a G-SIFI in 2017, but as a domestic SIFI will be subject to an OSII buffer of 0.5%, subject to transitional arrangements.
2) A countercyclical buffer of up to 2.5% may apply in the future
3) Assumes linear convergence to fully loaded CRD4 regime, RoRWA of c. 1% over the period, cash dividend payout of 35%, RWA growth of 3%
1) Source: Scope Ratings

On our estimate the ratio will decline to 11.4% in 2019. Combined with the phasing in of the systemic buffer requirement this would lead the distance to CBR to decline to 1.4% in 2019 from over 2% currently.

We highlight the considerable uncertainty inherent to forecasting distance-to-CBR over the medium term: on one hand, 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%. On the other hand, BBVA could adjust its dividend policy and growth strategy to accommodate changing requirements.

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 December 2015, BBVA group had a transitional CET1 ratio of 12.1%, while BBVA SA had a transitional CET1 ratio of 18.3%.

Distance to trigger

The current distance to trigger is already a comfortable 13% for the parent bank and 7% for the Group.

Table 3: Distance to trigger

BBVA Group	2015	2016E	2017E	2018E	2019E
Trigger level	5.125%	5.125%	5.125%	5.125%	5.125%
BBVA CET1 ratio (transitional) / target (FL)[1]	12.09%	11.79%	11.57%	11.43%	11.37%
Gap (%)	6.97%	6.66%	6.44%	6.30%	6.24%
Gap (EURm)	27,970	27,538	27,423	27,642	28,206

Source: Scope Ratings

Based on our forecasts of capital formation, the distance will remain material over time.

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 2015 was EUR 2.86bn, and included EUR 2.1bn in dividend income.

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.

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Nordea Bank AB – AT1 rating report

Security ratings

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

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

Rating rationale

Scope assigns long term ratings of BBB- to Nordea's three Additional Tier 1 notes listed in the table above. For details on the rated instruments, see next page. The rating is based on the following considerations:

- Senior unsecured debt (eligible for MREL): A+, stable outlook
- Minimum notches down from the senior unsecured debt rating: 4
- Additional notches: 1

In accordance with our recently updated rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating and no longer the issuer credit-strength rating (ICSR). Please refer to Scope's Bank Capital Instruments Rating Methodology published in May 2016 for more details.

The minimum 4 notches reflect the deeply subordinated status of AT1 capital instruments in the priority of claims, their going concern loss absorbing features and investors' exposure to coupon-cancellation risks.

The additional notch for these securities reflects the following considerations:

1. The presence of a double trigger, of which the one based on group CET1 is a high trigger of 8%
2. The low average risk intensity of Nordea's balance sheet, which may cause volatility in the capital ratios.

Issuer credit profile

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 localised macro downturns in the countries where it operates.

At the same time, our forward-looking ratings acknowledge the more problematic outlook for further sustainable net interest income (NII) growth, as inexpensive funding and competition have eroded asset margins for several years and the bank faces low or negative rates.

However, the asset management business is delivering strong results – which we expect to continue to support revenue growth. The use of wholesale funding, including in foreign currency, exposes the bank to sudden changes in the funding environment, which remains favourable at present.

Summary terms – 6.125% USD 500mn, Sept 2014

Issuer	Nordea Bank AB
Issue Date	23 September 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

Source: Prospectuses, Scope Ratings

Issuer	Nordea Bank AB
Issue Date	23 September 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

Summary terms – Multicurrency, March 2015

Issuer	Nordea Bank AB
Issue Date	12 March 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

Main Risks	
Coupon Cancellation	• 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	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
Trigger 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: Prospectuses, 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”.

Nordea discloses its distributable amount at EUR16bn, including EUR10bn of retained earnings, EUR1.9bn of net profit, EUR1bn of share premium reserve and EUR2.7bn of other free funds. We do not expect lack of distributable element to be a limiting factor in the payment of coupons for Nordea.

Combined buffer requirement (CBR) and CET1 total requirement

Based on the Capital Memorandum form May 2016, the Capital requirement relevant for MDA calculation at Nordea stood at 10.4%:

- 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 0.4%

On top of the Pillar 1 buffers, Nordea is subject to additional CET1 requirement guidance under Pillar 2, which we calculate at 5.2% (based on May 2016 FSA memorandum - our estimate includes 2.2% own fund requirement, 2% systemic buffer, 1% for Swedish and Norwegian Mortgages). Including the Pillar 2 add-on, we estimate Nordea CET1 minimum capital requirement guidance to stand at 15.6% at the end of March 2016.

Table 21: Combined buffer requirements

	2015	2016E	2017E	2018E	2019E
Combined buffer:					
- Capital Conservation Buffer	2.50%	2.50%	2.50%	2.50%	2.50%
- Systemic	3.00%	3.00%	3.00%	3.00%	3.00%
- Countercyclical	0.20%	0.40%	0.40%	0.40%	0.40%
Pillar 2 guidance (not included in MDA calculations)	4.60%	5.20%	5.20%	5.20%	5.20%
Minimum CET1 (Pillar I)	4.50%	4.50%	4.50%	4.50%	4.50%
Required CET1 associated with distribution restrictions	**10.20%**	**10.40%**	**10.40%**	**10.40%**	**10.40%**
Nordea CET1 ratio	16.45%	16.49%	16.49%	16.49%	16.49%
Distance to CBR (%)	6.25%	6.09%	6.09%	6.09%	6.09%
Distance to CBR (EUR bn)	**9.0**	**8.9**	**9.1**	**9.3**	**9.4**

Source: Company data, Scope Ratings estimates

On our estimates, Nordea will have a CET1 ratio of As of the end of 16.5% at the end of 2016. This offers ample distance to the Pillar 1 Combined Buffer Requirement. However, it is a more modest buffer of 90 bps to its total CET1 requirement. Nordea has indicated it will maintain a buffer of 50-150bps over the CET1 requirement. We note that in Sweden, the Pillar 2 add-on is not considered a hard requirement until a formal decision is taken, and is rather a “strict guidance”. As such, it does not currently affect MDA calculations for Nordea. The FSA has further indicated that it does not intend, in normal circumstances, to take a formal decision. However, should material losses arise that erode capital below the total capital guidance arise, these could lead to a firmer stance from the supervisor and to a formal decision with respect to Pillar 2.

Our understanding is that, should losses arise in the normal course of business or as a result of a systemic deterioration in the operating environment, the FSA would take a pragmatic approach and refrain from making a formal decision – and could even reduce the Pillar 2 guidance. On the other hand, should losses arise due to a firm specific weakness the FSA would in our view take a tougher stance, especially if there is evidence of weak risk governance or risk mismanagement. Even in the scenario where a formal Pillar 2 decision is taken, the first port of call to restore capital levels would probably be dividends, offering additional protection to AT1 holders.

As an additional risk, we highlight that while Nordea 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.

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 (18.8% as of year end 2015) 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.

Table 22: Distance to Trigger

Nordea Group	2015	2016 E	2017 E	2018 E	2019 E
Trigger level	**8.0%**	**8.0%**	**8.0%**	**8.0%**	**8.0%**
Nordea CET1 ratio	16.5%	16.5%	16.5%	16.5%	16.5%
Gap (%)	8.5%	8.5%	8.5%	8.5%	8.5%
Gap (EUR bn)	12.1	12.4	12.6	12.9	13.2

Source: Company data, Scope Ratings estimates

Based on 2015 full year data, Nordea's CET1 ratio is 8.5% higher than the trigger point and management target of 50-150bps ahead of the total CET1 requirement (15.6% currently) would imply over 8% 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.

Svenska Handelsbanken AB – AT1 rating report

Security ratings

Outlook	Stable
5.25% USD 1.2bn perpetual AT1 notes (Feb 2015) temporary write-down	BB+

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

Rating rationale

We assign ratings of BB+, with a stable outlook, to Handelsbanken's Additional Tier 1 notes issued in February 2015. The rating is based on the following considerations:

- Senior unsecured debt (eligible for MREL): A, stable outlook
- Minimum notches down from the senior unsecured debt rating: 4
- Additional notches: 1

In accordance with our recently updated rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating and no longer the issuer credit-strength rating (ICSR). Please refer to Scope's Bank Capital Instruments Rating Methodology published in May 2016 for more details.

The minimum 4 notches reflect the deeply subordinated status of AT1 capital instruments in the priority of claims, their going concern loss absorbing features and investors' exposure to coupon-cancellation risks.

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 Handelsbanken's balance sheet, which may cause volatility in the capital ratios.

Issuer credit profile

Handelsbanken ICRS is A, Stable outlook

Our ratings reflect the Handelsbanken's strong financial fundamentals, to some extent supported by a positive macroeconomic cycle but also by company-specific factors, such as a well-tested risk culture and incentive structure.

The ratings also reflect the concentrated exposure to what we consider an overvalued real estate sector in Sweden, an economy with very high levels of household borrowing. As highlighted by the Riksbank in its latest financial stability report, Sweden's banking system is sensitive to shocks due to its high proportion of wholesale funding, a large part of which is in foreign currency.

Handelsbanken's degree of international diversification offers some additional protection against potential domestic asset quality shocks, and we note that international revenues are growing strongly in recent years, with the UK franchise driving the growth.

Summary terms – 5.25% USD 1.2bn, Feb 2015

Issuer	Svenska Handelsbanken AB
Issue Date	25 February 2015
Amount	USD 1.2bn
Coupon	• Paid annually in arrear on March 1 • 5.25% from 3/2016 to 3/2021 • then: 5 year US Mid-Swap Rate + Margin (3.335%)
Format	• Perpetual Non-Call Additional Tier 1 Notes (issued under USD50bn EMTN Program) • Redeemable by the issuer on first reset date (2021) and every subsequent reset 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	XS1194054166
Capital Treatment	Additional Tier 1

Main Risks	
Coupon Cancellation	• 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	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 USD0.01 • by the supervisory authority at the Point of non-viability Reinstatement, if a Positive net profit at Issuer and Group level is recorded
Trigger 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: Prospectuses, 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 items to be a limiting factor in the payment of coupons for Handelsbanken.

We estimate the available distributable reserves of Handelsbanken based on Handelsbanken AB unconsolidated accounts and calculations assume the item "Other funds" does not include any reserve which is deemed "non-distributable". Our calculations point to the availability of SEK 101bn in distributable items, including SEK 91bn in the form of retained and current earnings, which give ample comfort that AT1 coupon payments would not be restricted by the lack of available ADIs.

Combined buffer requirement (CBR) and CET1 total requirement

Based on the Capital Memorandum form May 2016, the Capital requirement relevant for MDA calculation at Handelsbanken stood at 10.6%:

- 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 0.6%

On top of the Pillar 1 buffers, Handelsbanken is subject to additional CET1 requirement guidance under Pillar 2, which we calculate at 8.3% (based on May 2016 FSA memorandum - our estimate includes 2% own fund requirement, 2% systemic buffer, 4.3% for Swedish and Norwegian Mortgages). Including the Pillar 2 add-on, we estimate Handelsbanken's CET1 minimum capital requirement guidance to stand at 19% at the end of March 2016.

Table 1: Combined buffer requirements

Handelsbanken	2015	2016E	2017E	2018E	2019E
Combined buffer:					
- Capital Conservation Buffer	2.50%	2.50%	2.50%	2.50%	2.50%
- Systemic	3.00%	3.00%	3.00%	3.00%	3.00%
- Countercyclical	0.60%	0.60%	0.60%	0.60%	0.60%
Pillar 2	7.90%	8.30%	8.30%	8.30%	8.30%
Minimum CET1 (Pillar I)	4.50%	4.50%	4.50%	4.50%	4.50%
Required CET1 associated with distribution restrictions	**10.60%**	**10.60%**	**10.60%**	**10.60%**	**10.60%**
Handelsbanken CET1 ratio	21.20%	21.45%	21.65%	21.81%	21.97%
Distance to CBR (%)	10.60%	10.85%	11.05%	11.21%	11.37%
Distance to CBR (SEK bn)	**50.2**	**53.0**	**55.6**	**58.1**	**60.7**

Source: Company data, Scope Ratings

We forecast Handelsbanken to have a CET1 ratio of 21.4% at the end of 2016. This offers ample distance to the Pillar 1 Combined Buffer Requirement. However, it is a more modest buffer of 2.4% to its total CET1 requirement. Handelbanken has indicated it will maintain a buffer of 100-300bps over the CET1 requirement. We note that in Sweden, the Pillar 2 add-on is not considered a hard requirement until a formal decision is taken, and is rather a “strict guidance”. As such, it does not currently affect MDA calculations for Handelsbanken. The FSA has further indicated that it does not intend, in normal circumstances, to take a formal decision. However, should material losses arise that erode capital below the total capital guidance arise, these could lead to a firmer stance from the supervisor and to a formal decision with respect to Pillar 2.

Our understanding is that, should losses arise in the normal course of business or as a result of a systemic deterioration in the operating environment, the FSA would take a pragmatic approach and refrain from making a formal decision – and could even reduce the Pillar 2 guidance. On the other hand, should losses arise due to a firm specific weakness the FSA would in our view take a tougher stance, especially if there is evidence of weak risk governance or risk mismanagement. Even in the scenario where a formal Pillar 2 decision is taken, the first port of call to restore capital levels would probably be dividends, offering additional protection to AT1 holders.

As an additional risk, we highlight that while Handelsbanken 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.

Key risk: principal loss absorption

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

- 5.125% based on Svenska Handelsbanken AB unconsolidated
- 8% based on Handelsbanken Group consolidated accounts

In our view, the existence of a double trigger generally represents a factor of risk, partly offsetting the benefits of Handelsbanken's diversification, a key factor supporting the Issuer credit strength rating of the group. The difference between the two capital ratios trigger reference entities consists of Handelsbanken subsidiaries, including the covered bond issuer (Stadshypotek), the life insurance subsidiary (Liv), the fund management company (Fonder) and the public finance unit (Finans). As of year end 2015, Svenska Handelsbanken AB CET1 ratio stood at 19.9%, a reassuring gap to trigger of almost 15%.

For the parent company reference trigger to become relevant, one has to assume a marked divergence between the performances of the subsidiaries businesses and the parent as well as a regulatory ring-fencing of the former with respect to capital. While this is a possibility, we deem it 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.

Table 2: Distance to trigger

Handelsbanken Group	2015	2016 E	2017 E	2018 E	2019 E
Trigger level	8.000%	8.000%	8.000%	8.000%	8.000%
Handelsbanken CET1 ratio	21.20%	21.45%	21.65%	21.81%	21.97%
Gap (%)	13.20%	13.45%	13.65%	13.81%	13.97%
Gap (SEK bn)	62.6	65.7	68.7	71.6	74.5

Source: Company data, Scope Ratings

At the end of 2015, the gap to trigger at group level was 13.2%, or SEK 62.6bn, which we expect to improve slightly over our forecast horizon, driven by small improvements in the CET1 ratio. We view this as ample, although we note the high sensitivity of Handelsbanken's capital ratios to changes in RWA calculation inputs.

Swedbank AB – AT1 rating report

Security ratings

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

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 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 ratings are based on the following considerations:

- Senior unsecured debt rating: A-, stable outlook
- Minimum notches down from senior unsecured debt rating: 4
- Additional notches: 1

In accordance with our recently updated rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating and no longer the issuer credit-strength rating (ICSR). Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in May 2016 for more details.

The minimum 4 notches reflect the deeply subordinated status of AT1 capital instruments in the priority of claims, their going concern loss absorbing features and investors' exposure to coupon-cancellation risks.

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 very low average risk intensity of Swedbank balance sheet, which could add volatility to the capital ratios.

Issuer credit profile

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

Swedbank's ratings reflect the bank's strong and low-risk franchise in Sweden, featuring a low level of both impaired loans and credit charges.

With a 25% market share, Swedbank is Sweden's largest mortgage lender and also the market leader in the Baltic states. It has a very strong capital position and a very low level of problematic assets, as well as a high level of profitability. At their level, the long-term ratings also reflect a degree of caution about Swedbank's considerable revenue and balance-sheet growth reliance on the increasingly overheated real estate sector in Sweden – both housing and commercial property.

Summary terms – 5.5% USD 750mn, February 2015

Issuer	Swedbank AB
Issue Date	19 February 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

Main Risks	
Coupon Cancellation	• 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	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
Trigger 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: Prospectuses, 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 46.5bn, composed primarily of retained earnings. The position of Swedbank is very comfortable to pay annual coupons on the AT1 notes.

Combined buffer requirement (CBR) and CET1 total requirement

Based on the Capital Memorandum form May 2016, the Capital requirement relevant for MDA calculation at Swedbank stood at 10.7%:

- 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%

On top of the Pillar 1 buffers, Swedbank is subject to additional CET1 requirement guidance under Pillar 2, which we calculate at 8.6% (based on May 2016 FSA memorandum - our estimate includes 0.9% individual requirement, 2% systemic buffer, 5.7% for Swedish and Norwegian Mortgages). Including the Pillar 2 add-on, we estimate Nordea CET1 minimum capital requirement guidance to stand at 19.3% at the end of March 2016.

Table 1: Combined buffer requirements

	2015	2016E	2017E	2018E	2019E
Combined buffer:					
- Capital Conservation Buffer	2.50%	2.50%	2.50%	2.50%	2.50%
- Systemic	3.00%	3.00%	3.00%	3.00%	3.00%
- Countercyclical	0.70%	0.70%	1.30%	1.30%	1.30%
ECB SREP requirement add-on	8.60%	8.60%	8.60%	8.60%	8.60%
Minimum CET1 (Pillar I)	4.50%	4.50%	4.50%	4.50%	4.50%
Required CET1 associated with distribution restrictions	**10.70%**	**10.70%**	**11.30%**	**11.30%**	**11.30%**
Swedbank CET1 ratio (transitional) / target (FL)	24.14%	24.54%	24.96%	25.40%	25.85%
Distance to CBR (%)	13.44%	13.84%	13.66%	14.10%	14.55%
Distance to CBR (SEK bn)	**52.3**	**54.9**	**55.3**	**58.2**	**61.3**

Source: Company data, Scope Ratings

On our estimates, Swedbank will have a CET1 ratio of 24.5% at the end of 2016. This offers ample distance both to the Pillar 1 Combined Buffer Requirement as well as to the total CET1 requirement. Swedbank has indicated it will maintain a buffer of 100-2000bps over the CET1 requirement. We note that in Sweden, the Pillar 2 add-on is not considered a hard requirement until a formal decision is taken, and is rather a "strict guidance". As such, it does not currently affect MDA calculations for Swedbank. The FSA has further indicated that it does not intend, in normal circumstances, to take a formal decision. However, should material losses arise that erode capital below the total capital guidance arise, these could lead to a firmer stance from the supervisor and to a formal decision with respect to Pillar 2.

Our understanding is that, should losses arise in the normal course of business or as a result of a systemic deterioration in the operating environment, the FSA would take a pragmatic approach and refrain from making a formal decision – and could even reduce the Pillar 2 guidance. On the other hand, should losses arise due to a firm specific weakness the FSA would in our view take a tougher stance, especially if there is evidence of weak risk governance or risk mismanagement. Even in the scenario where a formal Pillar 2 decision is taken, the first port of call to restore capital levels would probably be dividends, offering additional protection to AT1 holders.

As an additional risk, we highlight that while Swedbank 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.

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. At the end of 2015, Swedbank's AB (parent company) CET1 ratio stood at 17.9%.

Distance to trigger

The distance-to-trigger for the rated security stood at 16.1% in 2015. 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 (18% in 2015).

Table 2: Distance to trigger

Swedbank Group	2015	2016 E	2017 E	2018 E	2019 E
Trigger level	8.0%	8.0%	8.0%	8.0%	8.0%
Swedbank CET1 ratio	24.14%	24.54%	24.96%	25.40%	25.85%
Gap (%)	16.14%	16.54%	16.96%	17.40%	17.85%
Gap (SEK bn)	62.8	65.6	68.7	71.8	75.2

Source: Company data, Scope Ratings

Credit Suisse Group AG (Guernsey) II Limited – AT1 rating report

Security ratings

Outlook	Stable
9.5% USD 1.725bn Tier 1 Buffer Capital Notes, with 7% trigger	BB+

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 referenced *high-trigger* Tier 1 Capital Notes issued by Credit Suisse Group (Guernsey) II Limited. The Notes are irrevocably guaranteed on a subordinated basis by Credit Suisse Group AG. The rating is based on the following considerations:

- Senior unsecured debt rating (eligible for TLAC): A, Stable Outlook
- Minimum notches down from senior unsecured debt rating: 4
- Additional notches: 1

In accordance with our recently updated rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating and no longer the issuer credit-strength rating (ICSR). The minimum four notches reflect the deeply subordinated status of AT1 capital instruments in the priority of claims, their going concern loss absorbing features and investors' exposure to coupon-cancellation risks. Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in May 2016 for more details.

The additional notch reflects the positioning of the Notes in the group's capital structure. They are "designed to be first in line to absorb losses, before all of Credit Suisse's other regulatory capital instruments". The trigger is relatively high at 7% and is based on the group's CET1 ratio. Meanwhile, the group's other regulatory capital instruments have lower triggers of 5.125% and 5% and as well are measured against the sum of the group's CET1 and High-Trigger capital ratios.

Issuer credit profile

The ICSR of A+ for Credit Suisse is driven by the group's strong and resilient wealth management franchise as well as its position as a leading universal bank in Switzerland. In light of the challenging operating environment and the material weight of investment banking in the group's business mix, we view positively management's latest strategic plans.

Credit Suisse has defined its ambition to be a leading private bank and wealth manager with strong investment banking capabilities. The group recently raised external capital of CHF 6bn and is implementing measures to improve its ability to generate capital internally. These actions include further right-sizing of the investment banking business, disciplined capital allocation, cutting fixed costs and reducing non-core assets. While execution risks are material, if successfully completed, the group will improve the quality and resilience of earnings and position itself well to meet increasing solvency requirements.

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 6-month USD LIBOR rate plus 6.64%. • If any, payable annually in arrears on 14 February until the first interest payment date following the first call date (23 October 2018); semi-annually in arrears thereafter on 14 February and 14 August.
Format	Perpetual Tier 1 contingent convertible securities, callable 23 October 2018 and every six months thereafter.
ISIN	XS0810846617

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.
Principal Loss Absorption	• Upon a Contingency Event or a Viability Event, the Notes are mandatorily converted into ordinary shares; • A Contingency Event refers to the CET1 ratio of Credit Suisse Group AG (CSG) 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 an 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 Notes 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	Credit Suisse Group AG CET1 < 7%, transitional basis

Source: Prospectuses, Scope Ratings

Key risk: coupon cancellation

Coupon payments on the Notes are fully discretionary and non-cumulative. In addition, they are subject to distribution restrictions. However, Switzerland is not bound by CRD IV and therefore the concepts of the combined buffer requirement and the maximum distributable amount do not apply.

Further, unlike with AT1 securities issued by other European banks, the Notes contain a dividend stopper – i.e. if Credit Suisse does not pay a coupon, the group shall not recommend to ordinary shareholders 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 permitted.

At the same time, if Credit Suisse elects to pay dividends on ordinary shares corresponding to a period when there is pending interest on the Notes, then CSG should pay Note holders the aggregate amount of all pending interest which has arisen during the period.

Conditions under which coupon payments are prohibited

CSG is prohibited from making coupon payments on the Notes in in following circumstances:

- Distributable profits are less than the sum of (i) the aggregate amount of such interest payments and (ii) all other payments (except redemptions) made by CSG since the last financial year on the Notes and any other Tier 1 instruments or shares – excluding any portion of such payment already accounted for in determining distributable profits. This clause prevents double-counting AT1 coupons already provisioned and paid for – other European banks re-integrate these coupons in their distributable profits;
- CSG is not in compliance with all applicable minimum capital adequacy requirements after paying interest on the Notes;
- FINMA has required CSG not to make such an interest payment.

As of end-2015, CSG had CHF 15.8bn in distributable profits, comprised of CHF 10.5bn in statutory and discretionary reserves, CHF5.2bn in retained earnings brought forward and CHF 0.1bn in net profit. Distributable profits are defined as the aggregate of net profits carried forward and freely distributable reserves (other than reserves for own shares). CSG estimates coupons on all AT1s to total around CHF 1bn in 2016.

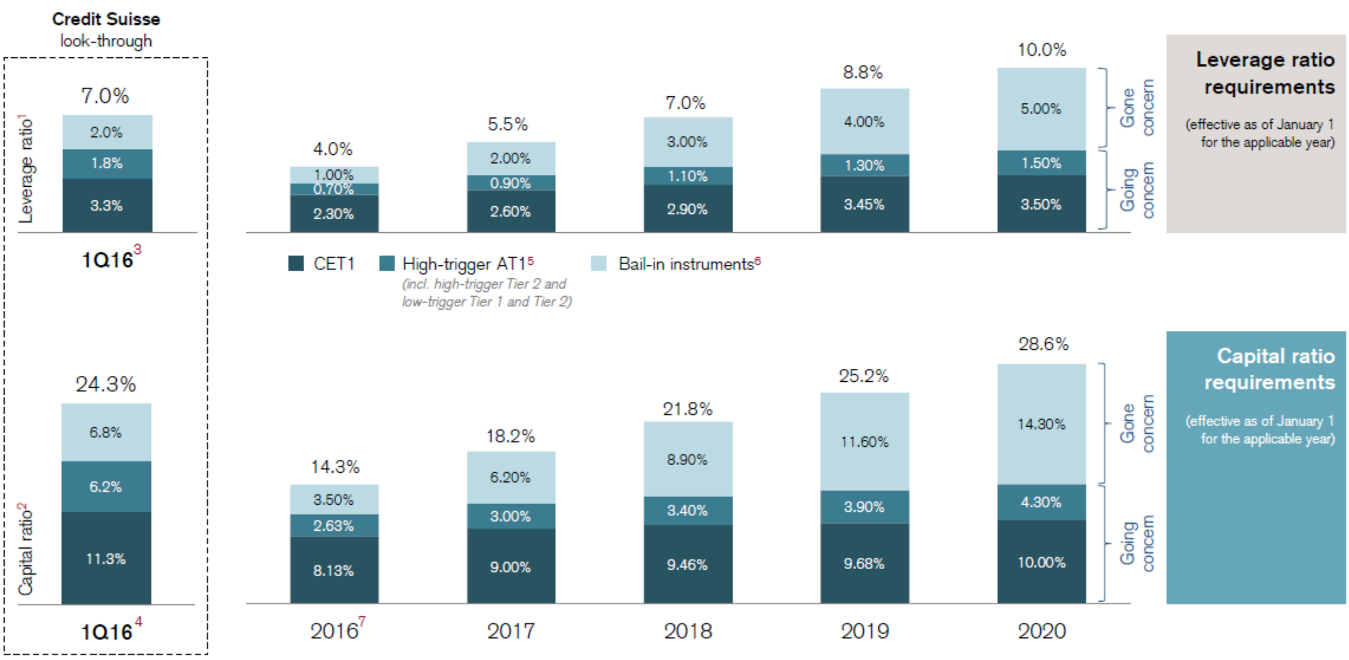
Applicable capital requirements

Per the latest Swiss TBTF requirements which are effective from 1 July 2016 and which will be phased-in until end-2019, the group will need to maintain a minimum going concern capital requirement of 14.3% of RWAs, of which 10% must be met with CET1 capital and the remainder with high-trigger AT1 instruments. As well the group must maintain a minimum leverage ratio of 5%, of which at least 3.5% must be with CET1 capital and the remainder with high-trigger AT1 instruments.

The provisions provide for the grandfathering of low trigger AT1 securities (including the Notes) and low and high trigger Tier 2 securities. Low trigger AT1 securities will qualify as going concern capital until the first call date and thereafter may be used to meet gone concern requirements. Gone concern requirements mirror going concern requirements, i.e. 14.3% of RWAs and 5% leverage ratio but may be met with bail-in debt instruments.

At end-March 2016, Credit Suisse Group AG had a phase-in CET1 ratio of 13.5% and a look through CET1 ratio of 11.3%. Meanwhile, the phase-in and fully applied leverage ratios which include loss absorbing capital under Swiss rules were 6% and 5.1%, respectively.

Figure 1: Phase–in leverage and capital requirements



Notes: 1. Percentage of leverage exposure. 2. Percentage of RWAs. 3. Based on 1Q 2016 look-through leverage exposure of CHF 970bn. 4. Based on 1Q 2016 look-through RWAs of CHF 281bn. 5. Includes CHF 4.2bn of existing low-trigger Tier 2 capital instruments under grandfathering rules; any excess over the requirement can be used to fill gone concern requirements. 6. Includes CHF 19bn of senior holding company debt outstanding as of 30 April 2016. 7. Effective as of 1 July 2016.

Source: Credit Suisse, May 2016 Fixed Income Investor Update

Key risk: principal loss absorption

Within the group's capital structure, these high-trigger Notes are "designed to be first in line to absorb losses, before all of Credit Suisse's other regulatory capital instruments". The trigger is relatively high at 7% and is based on CSG's CET1 ratio. Meanwhile, the group's other regulatory capital instruments have lower triggers of 5.125% and 5% and as well are measured against the sum of the group's CET1 and High-Trigger capital ratios. For these reasons, we have notched down the rating on these Notes more than for the group's other AT1 securities.

Meanwhile, we note that the 7% trigger is well below the group's minimum capital requirements under Swiss regulations. We highlight that under the Swiss Capital Adequacy Ordinance both high and low trigger contingent convertible securities (including the Notes) may be triggered before the point of non-viability. Further, FINMA retains a fair degree of discretion in determining the point of non-viability.

Distance to trigger

We expect CSG's CET1 capital ratio to remain solidly above the 7% trigger level. The group targets a look-through CET1 ratio of around 13% by end-2018.

Figure 2: Distance to trigger – Credit Suisse Group AG

	2015	1Q 2016	2017	2018	2019
Trigger level	7.0%	7.0%	7.0%	7.0%	7.0%
CET1 capital ratio, phase-in	14.2%	13.5%	~13% look-through CET1 target		
Gap (%)	7.2%	6.5%			
Gap (CHF bn)	21.3	18.5			

Note: 2015 and 1Q 2016 capital ratios are on a phase-in basis.
Source: Company data, Scope Ratings

Crédit Suisse Group (Guernsey) AG – Tier 2 rating report

Security ratings

Outlook	Stable
Credit Suisse Group (Guernsey) I Limited 7.875% USD 2bn Tier 2 Buffer Capital Notes due 2041, with 7% trigger	BBB
Credit Suisse Group (Guernsey) IV Limited 7.125% CHF 0.75bn Tier 2 Buffer Capital Notes due 2022, with 7% trigger	BBB

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 noted *high-trigger* Tier 2 Capital Notes issued by Credit Suisse Group (Guernsey) I Limited and Credit Suisse Group (Guernsey) IV Limited, funding entities wholly-owned by Credit Suisse Group AG. Both issues are irrevocably guaranteed on a subordinated basis by Credit Suisse Group AG. The rating is based on the following considerations:

- Senior unsecured debt rating (eligible for TLAC): A, Stable Outlook
- Minimum notches down from senior unsecured debt rating: 2
- Additional notches: 1

In accordance with our recently updated rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating and no longer the issuer credit-strength rating (ICSR). The minimum two notches reflect the subordinated status of Tier 2 capital instruments in the priority of claims and their loss absorbing features. Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in May 2016 for more details.

The additional notch is due to the relatively high 7% CET1 ratio trigger on the Notes and the ambiguities regarding the ranking of the Notes in the group's capital structure. The trigger for the Notes is based on the group's CET1 ratio while on other Credit Suisse Tier 2 securities that we rate one notch higher at BBB+ the trigger is based on the sum of the group's CET and High-Trigger capital ratios.

Issuer credit profile

The ICSR of A+ for Credit Suisse is driven by the group's strong and resilient wealth management franchise as well as its position as a leading universal bank in Switzerland. In light of the challenging operating environment and the material weight of investment banking in the group's business mix, we view positively management's latest strategic plans.

Credit Suisse has defined its ambition to be a leading private bank and wealth manager with strong investment banking capabilities. The group recently raised external capital of CHF 6bn and is implementing measures to improve its ability to generate capital internally. These actions include further right-sizing of the investment banking business, disciplined capital allocation, cutting fixed costs and reducing non-core assets. While execution risks are material, if successfully completed, the group will improve the quality and resilience of earnings and position itself well to meet increasing solvency requirements.

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 arrears
Format	Tier 2 Buffer Capital Notes due 2041, callable on 24 August 2016 and every six months thereafter
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 arrears on 22 March each year
Format	Tier 2 Buffer Capital Notes due 2022, callable on 22 March 2017
ISIN	CH0181115681

Capital Treatment	Tier 2 grandfathered (details below)
Principal Loss Absorption	• Upon a Contingency Event or a Viability Event, the Notes are mandatorily converted into ordinary shares • A Contingency Event refers to the CET1 ratio of Credit Suisse Group AG (CSG) 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 and (2) CSG has received a 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 Notes due 2022 only, a third Viability Event is noted: CSG’s CET1 ratio 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 Notes 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	Credit Suisse Group AG CET1 ratio <7%, transitional basis

Source: Prospectuses, Scope Ratings

Key risk: principal loss absorption

With the securities being issued by special purpose vehicles (Credit Suisse Group (Guernsey) I Ltd and Credit Suisse Group (Guernsey) IV Limited), 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&Cs enable Credit Suisse to substitute all the Notes for other compliant securities if the Notes cease at some point to be treated as Buffer Capital under National Regulations and/or Tier 2 Capital under BIS regulations.

We note that the CET1 ratio of CSG can be below 7% without triggering a Contingency Event if the regulator is satisfied that the bank has taken sufficient measures to restore the capital ratio to a level above 7%.

The only material difference in T&Cs between the 7.875% Notes due 2041 and the 7.125% Notes due 2022 is that the latter adds a third Viability Event (as per the Summary Terms above). Our understanding 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 Notes (including the 7.875% Notes due 2041) would also be converted 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. We do not view this supplementary clause as being material enough to justify differentiating the ratings on the two Notes issues.

Under the Swiss Capital Adequacy Ordinance both high and low trigger contingent convertible securities (including the Notes) may be triggered before the point of non-viability. Further, FINMA retains a fair degree of discretion in determining the point of non-viability.

Distance to trigger

We expect the group's capital position to remain solidly above the trigger level. The group targets a look-through CET1 ratio of around 13% by end-2018.

Table 1: Distance to trigger – Credit Suisse Group AG

	2015	1Q 2016	2017	2018	2019
Trigger level	7%	7%	7%	7%	7%
CET1 capital ratio, phase-in	14.2%	13.5%	~13% look-through CET1 target		
Gap (%)	7.2%	6.5%			
Gap (CHF bn)	21.2	18.6			

Source: Company data, Scope Ratings

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

The ranking of these Tier 2 Notes in the group's capital structure is not clear considering that their 7% trigger is higher than the 5.125% trigger attached to some AT1 securities issued by Credit Suisse. If a Contingency Event were to happen, we question whether the Tier 2 Notes would be converted ahead of the AT1 securities with 5.125% triggers, therefore reversing the usual creditor hierarchy.

The latest Swiss TBTF requirements provide for the grandfathering of both high and low trigger Tier 2 securities. They will qualify as going concern capital until the earliest of end-2019, maturity or the first call date. Thereafter, they may be used to meet gone concern requirements.

Credit Suisse Group AG – AT1 rating report

Security ratings

Outlook	Stable
6% CHF 0.29bn Tier 1 Capital Notes, with 5.125% trigger	BBB-
7.5% USD 2.25bn Tier 1 Capital Notes, with 5.125% trigger	BBB-
6.25% USD 2.5bn Tier 1 Capital Notes, with 5.125% trigger	BBB-

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 referenced low-trigger Tier 1 Capital Notes issued by Credit Suisse Group AG. The rating is based on the following considerations:

- Senior unsecured debt rating (eligible for TLAC): A, Stable Outlook
- Minimum notches down from senior unsecured debt rating: 4
- Additional notches: 0

In accordance with our recently updated rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating and no longer the issuer credit-strength rating (ICSR). The minimum four notches reflect the deeply subordinated status of AT1 capital instruments in the priority of claims, their going concern loss absorbing features and investors' exposure to coupon-cancellation risks. Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in May 2016 for more details.

Issuer credit profile

The ICSR of A+ for Credit Suisse is driven by the group's strong and resilient wealth management franchise as well as its position as a leading universal bank in Switzerland. In light of the challenging operating environment and the material weight of investment banking in the group's business mix, we view positively management's latest strategic plans.

Credit Suisse has defined its ambition to be a leading private bank and wealth manager with strong investment banking capabilities. The group recently raised external capital of CHF 6bn and is implementing measures to improve its ability to generate capital internally. These actions include further right-sizing of the investment banking business, disciplined capital allocation, cutting fixed costs and reducing non-core assets. While execution risks are material, if successfully completed, the group will improve the quality and resilience of earnings and position itself well to meet increasing solvency requirements.

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 arrears
Format	Perpetual Tier 1 contingent convertible securities, callable 4 September 2018 and every year thereafter
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 arrears
Format	Perpetual Tier 1 contingent convertible securities, callable 11 December 2023 and every five years thereafter
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 arrears
Format	Perpetual Tier 1 contingent convertible securities, callable 18 December 2024 and every five years thereafter
ISIN	XS1076957700 / US225436AA21

Capital Treatment	Tier 1 capital grandfathered (see below)
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 payments 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. • A Contingency Event refers to the sum of the CET1 ratio and the Higher Trigger Capital Ratio of Credit Suisse Group AG (CSG) being 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 a 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 regulations regarding capital requirements change.
Trigger for Principal Loss Absorption	Credit Suisse Group AG's CET1 + Higher-Trigger capital ratios <5.125%, transitional basis

Source: Prospectuses, Scope Ratings

Key risk: coupon cancellation

Coupon payments on the Notes are fully discretionary and non-cumulative. In addition, they are subject to distribution restrictions. However, Switzerland is not bound by CRD IV and therefore the concepts of the combined buffer requirement and the maximum distributable amount do not apply.

Further, unlike with AT1 securities issued by other European banks, the Notes contain a dividend stopper – i.e. if Credit Suisse does not pay a coupon, the group shall not recommend to ordinary shareholders 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 permitted.

At the same time, if Credit Suisse elects to pay dividends on ordinary shares corresponding to a period when there is unpaid interest on the Notes, then CSG should pay Notes holders the aggregate amount of all unpaid interest which has arisen during the period.

Conditions under which coupon payments are prohibited

CSG is prohibited from making coupon payments on the Notes in in following circumstances:

- Distributable profits are less than the sum of (i) the aggregate amount of such interest payments and (ii) all other payments (except redemptions) made by CSG since the last financial year on the Notes and any other Tier 1 instruments or shares – excluding any portion of such payment already accounted for in determining distributable profits. This clause prevents double-counting AT1 coupons already provisioned and paid for – other European banks re-integrate these coupons in their distributable profits;

- CSG is not in compliance with all applicable minimum capital adequacy requirements after paying interest on the Notes;
- FINMA has required CSG not to make such an interest payment.

As of end-2015, CSG had CHF 15.8bn in distributable profits, comprised of CHF 10.5bn in statutory and discretionary reserves, CHF5.2bn in retained earnings brought forward and CHF 0.1bn in net profit. Distributable profits are defined as the aggregate of net profits carried forward and freely distributable reserves (other than reserves for own shares). CSG estimates coupons on all AT1s to total around CHF 1bn in 2016.

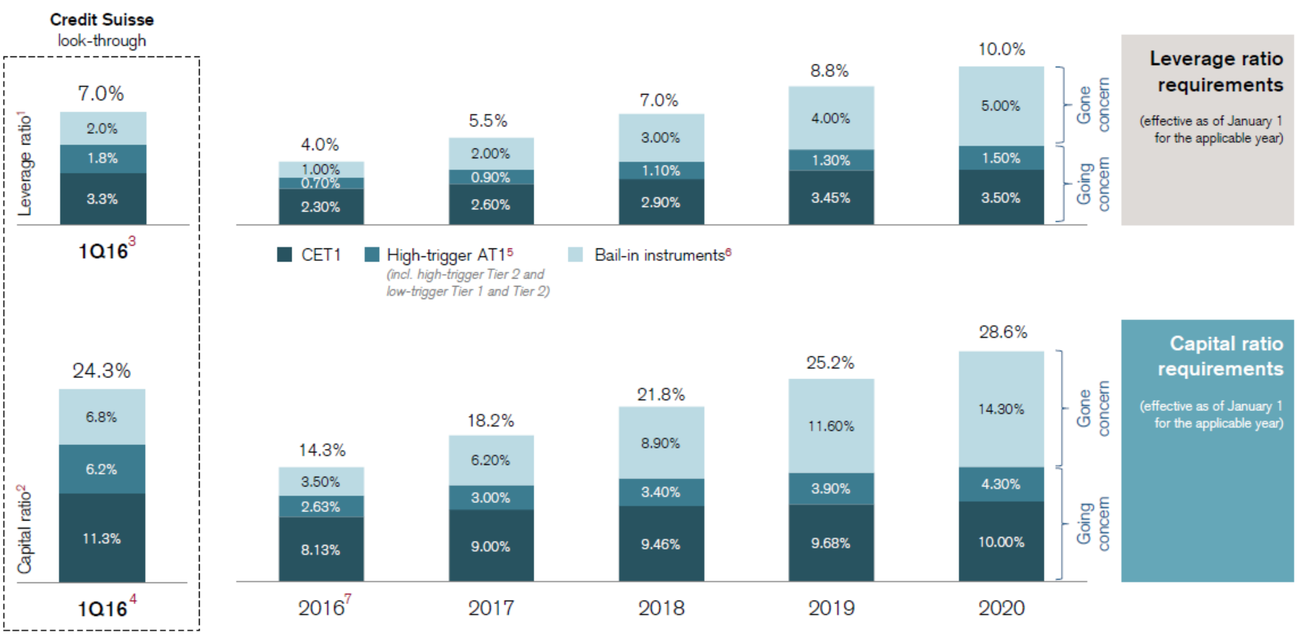
Applicable capital requirements

Per the latest Swiss TBTF requirements which are effective from 1 July 2016 and which will be phased-in until end-2019, the group will need to maintain a minimum going concern capital requirement of 14.3% of RWAs, of which 10% must be met with CET1 capital and the remainder with high-trigger AT1 instruments. As well the group must maintain a minimum leverage ratio of 5%, of which at least 3.5% must be with CET1 capital and the remainder with high-trigger AT1 instruments.

The provisions provide for the grandfathering of low trigger AT1 securities (including the Notes) and low and high trigger Tier 2 securities. Low trigger AT1 securities will qualify as going concern capital until the first call date and thereafter may be used to meet gone concern requirements. Gone concern requirements mirror going concern requirements, i.e. 14.3% of RWAs and 5% leverage ratio but may be met with bail-in debt instruments.

At end-March 2016, Credit Suisse Group AG had a phase-in CET1 ratio of 13.5% and a look through CET1 ratio of 11.3%. Meanwhile, the phase-in and fully applied leverage ratios which include loss absorbing capital were 6% and 5.1%, respectively.

Figure 1: Phase –in leverage and capital requirements



Notes: 1. Percentage of leverage exposure. 2. Percentage of RWAs. 3. Based on 1Q 2016 look-through leverage exposure of CHF 970bn. 4. Based on 1Q 2016 look-through RWAs of CHF 281bn. 5. Includes CHF 4.2bn of existing low-trigger Tier 2 capital instruments under grandfathering rules; any excess over the requirement can be used to fill gone concern requirements. 6. Includes CHF 19bn of senior holding company debt outstanding as of 30 April 2016. 7. Effective as of 1 July 2016.
Source: Credit Suisse, May 2016 Fixed Income Investor Update

Key risk: principal loss absorption

In our opinion, the write-down risk for these Notes is quite low (outside of a resolution scenario) in light of the group's minimum solvency requirements under Swiss regulations and the way the trigger metric is determined (sum of CET1 capital ratio and High-Trigger capital ratio). At end-March 2016, CSG had a phase-in CET1 ratio of 13.5%. In addition, the group had another CHF 8.3bn in high-trigger loss absorbing capital instruments outstanding (equivalent to 2.9% of RWAs).

As these Notes have a 5.125% trigger, the above mentioned CHF 8.3bn in high-trigger loss absorbing capital instruments (with 7% trigger) provide some protection for Notes holders as they would be converted or written down first. We remark however that the CHF 8.3bn includes CHF 2.6bn in Tier 2 instruments which normally rank above AT1 instruments.

We highlight that under the Swiss Capital Adequacy Ordinance both high and low trigger contingent convertible securities (including the Notes) may be triggered before the point of non-viability. Further, FINMA retains a fair degree of discretion in determining the point of non-viability.

Distance to trigger

Considering the undemanding trigger of the Notes, we expect the sum of CSG's CET1 and Higher-Trigger capital ratios to remain largely above the 5.125% trigger level. The group targets a look-through CET1 ratio of around 13% by end-2018.

Figure 2: Distance to trigger – Credit Suisse Group AG

	2015	1Q 2016	2017	2018	2019
Trigger level	5.125%	5.125%	5.125%	5.125%	5.125%
Sum of CET1 + High-Trigger capital ratio	17.3%	16.4%	~13% look-through CET1 target		
Gap (%)	12.2%	11.3%			
Gap (CHF bn)	36.0	32.2			

Note: 2015 and 1Q 2016 capital ratios are on a phase-in basis.
Source: Company data, Scope Ratings

Credit Suisse AG – Tier 2 rating report

Security ratings

Outlook	Stable
6.5% USD 2.5bn Tier 2 Capital Notes due 2023, with 5% trigger	BBB+
5.75% EUR 1.25bn Tier 2 Capital Notes due 2025, with 5% trigger	BBB+

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 noted *low-trigger* Tier 2 Capital Notes issued by Credit Suisse AG. The rating is based on the following considerations:

- Senior unsecured debt rating (eligible for TLAC): A, Stable Outlook
- Minimum notches down from senior unsecured debt rating: 2
- Additional notches: 0

In accordance with our recently updated rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating and no longer the issuer credit-strength rating (ICSR). The minimum two notches reflect the subordinated status of Tier 2 capital instruments in the priority of claims and their loss absorbing features. Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in May 2016 for more details. At this time, we have not identified any additional factors which would warrant further notching from the senior unsecured debt rating other than the minimum two.

Issuer credit profile

The ICSR of A+ for Credit Suisse is driven by the group's strong and resilient wealth management franchise as well as its position as a leading universal bank in Switzerland. In light of the challenging operating environment and the material weight of investment banking in the group's business mix, we view positively management's latest strategic plans.

Credit Suisse has defined its ambition to be a leading private bank and wealth manager with strong investment banking capabilities. The group recently raised external capital of CHF 6bn and is implementing measures to improve its ability to generate capital internally. These actions include further right-sizing of the investment banking business, disciplined capital allocation, cutting fixed costs and reducing non-core assets. While execution risks are material, if successfully completed, the group will improve the quality and resilience of earnings and position itself well to meet increasing solvency requirements.

Summary terms

Issuer	Credit Suisse AG
Issue Date	8 August 2013
Amount	USD 2.5bn
Coupon	• 6.5% per annum • payable semi-annually in arrears on 8 February and 8 August each year
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 arrears on 18 September each year
Format	Tier 2 Capital Notes due 2025, callable on 18 September 2020
ISIN	XS0972523947

Capital Treatment	Tier 2 grandfathered (see below)
Principal Loss Absorption	• While the issuer of the Notes is Credit Suisse AG, the trigger is based on the capital metrics of Credit Suisse Group AG (CSG). • 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. • A Contingency Event refers to the sum of CSG's CET1 ratio and Higher Trigger Capital Ratio falling 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 an 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. • In the event of changes in national regulations on capital, the Contingency and Viability Events provisions may no longer apply to the Notes.
Trigger for Principal Loss Absorption	• Sum of CSG's CET1 + Higher-Trigger capital ratio <5%, transitional basis

Source: Prospectuses, Scope Ratings

Key risk: principal loss absorption

The Notes are subject to permanent write-down if the sum of Credit Suisse Group AG's (CSG) CET1 and High Trigger capital ratio falls below 5%. There is a possibility that a write-down will not occur if FINMA agrees that as a result of actions taken by CSG, or due to circumstances or events, the CET1 Ratio has been or will be restored above 5%.

In addition, the Notes are subject to write-down upon the occurrence of a Viability Event. if FINMA determines that a write-down of the Notes as well as other similar capital instruments is essential in order to prevent CSG from becoming insolvent, bankrupt, unable to pay a material part of its debts or unable to carry on its business; or CSG has received an irrevocable commitment of direct or indirect extraordinary support from the public sector in order to prevent CSG from becoming insolvent, bankrupt, unable to pay a material part of its debts or unable to carry on its business.

We highlight that under the Swiss Capital Adequacy Ordinance high and low trigger contingent convertible securities (including the Notes) may be triggered before the point of non-viability. Further, FINMA retains a fair degree of discretion in determining the point of non-viability.

In the event of changes in national regulations on capital, the Contingency and Viability Event provisions may no longer apply to the Notes. As the latest Swiss TBTF regulations which become effective 1 July 2016 contain grandfathering rules for both high and low trigger Tier 2 securities (including the Notes), we believe the Contingency and Viability Event provisions will continue to be applicable. Tier 2 securities will qualify as going concern capital until the earliest of end-2019, maturity or the first call date. Thereafter, they may be used to meet gone concern requirements.

Distance to trigger

In our opinion, the write-down risk for these Notes is quite low outside of a resolution scenario. First, this is because of the way the trigger metric is determined (sum of CET1 capital and High-Trigger capital ratio) as well as the low level of the threshold at 5%. As of end-March 2016, CSG had a phase-in CET1 ratio of 16.4%. In addition, the group had another CHF 8.3bn in high-trigger loss absorbing capital outstanding (equivalent to 2.9% of RWAs).

Investors in the Notes benefit from the lower ranking of the group's other regulatory capital instruments – in particular, the above mentioned CHF 8.3bn in high-trigger loss absorbing capital securities with a 7% trigger and another CHF 5bn in AT1 securities with a 5.125% trigger.

Considering the undemanding trigger of the Notes, we expect CSG's CET1 and High-Trigger capital ratios to remain largely above the 5% trigger level. The group targets a CET1 ratio of around 13% on a look-through basis by end-2018.

Table 1: Distance to trigger – Credit Suisse Group AG

	2015	1Q 2016	2017	2018	2019
Trigger level	5%	5%	5%	5%	5%
Sum of CET1 + High-Trigger capital ratio	17.3%	16.4%	~13% look-through CET1 target		
Gap (%)	12.3%	11.4%			
Gap (CHF bn)	36.4	32.6			

Note: 2015 and 1Q 2016 capital ratios are on a phase-in basis.
Source: Company data, Scope Ratings

UBS Group AG – AT1 rating report

Security ratings

Outlook	Positive
5.75% EUR 1bn Tier 1 Capital Notes, with 5.125% trigger	BBB-
7% USD 1.25bn Tier 1 Capital Notes, with 5.125% trigger	BBB-
7.125% USD 1.25bn Tier 1 Capital Notes, with 7% trigger	BBB-
6.875% USD 1.575bn Tier 1 Capital Notes, with 7% trigger	BBB-
6.875% USD 1.5bn Tier 1 Capital Notes, with 7% trigger	BBB-

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 referenced Tier 1 Capital Notes issued by UBS Group AG. While two of the Notes have a 5.125% trigger for permanent write down and three have a 7% trigger, we do not view the risks as being materially different and have not assigned different ratings. The rating is based on the following considerations:

- Senior unsecured debt rating (eligible for TLAC): A, Positive Outlook
- Minimum notches down from senior unsecured debt rating: 4
- Additional notches: 0

In accordance with our recently updated rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating and no longer the issuer credit-strength rating (ICSR). The minimum four notches reflect the deeply subordinated status of AT1 capital instruments in the priority of claims, their going concern loss absorbing features and investors' exposure to coupon-cancellation risks. Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in May 2016 for more details. At this time, we have not identified any factors which would justify additional notching beyond the minimum four.

Issuer credit profile

The ICSR of A+ for UBS is underpinned by the group's very significant focus on capital and balance sheet strength, driven in part by the influence of two proactive policy and supervisory authorities in Switzerland. As well, UBS is ahead of many global peers in reshaping its business model. Consequently, the group has a mix of businesses which is well adapted to a changed operating environment. Earnings have also recovered since the financial crisis although more can be done to improve costs and efficiency. Potential conduct and litigation costs remain a risk.

On 20 June 2016, we changed the outlook on the ICSR to Positive from Stable. The outlook change reflects the successful reshaping of the group's business model and the group's reassuring credit metrics.

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 arrears on 19 February of each year
Format	Perpetual Tier 1 capital notes, callable 19 February 2022 and every year thereafter.
Trigger for Principal Loss Absorption	Consolidated group CET1 capital ratio + Higher-Trigger capital ratio <5.125%, transitional basis
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 arrears on 19 February of each year
Format	Perpetual Tier 1 capital notes, callable 19 February 2025 and every year thereafter.
Trigger for Principal Loss Absorption	Consolidated group CET1 capital ratio + Higher-Trigger capital ratio <5.125%, transitional basis
ISIN	CH0271428333

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 arrears on 19 February of each year
Format	Perpetual Tier 1 capital notes, callable 19 February 2020 and every year thereafter.
Trigger for Principal Loss Absorption	Consolidated group CET1 capital ratio + Higher-Trigger capital ratio <7%, transitional basis
ISIN	CH0271428317

Continued on following page.

Issue Date	7 August 2015
Amount	USD 1.575bn
Coupon	• 6.875% fixed until first call date, and thereafter at a rate equal to the Mid Market Swap Rate plus 4.59% • If any, payable annually in arrears on 7 August of each year
Format	Perpetual Tier 1 capital notes, callable 7 August 2025 and every year thereafter.
Trigger for Principal Loss Absorption	Consolidated group CET1 capital ratio + Higher-Trigger capital ratio <7%, transitional basis
ISIN	CH0286864027

Issue Date	21 March 2016
Amount	USD 1.5bn
Coupon	• 6.875% fixed until first call date, and thereafter at a rate equal to the Mid Market Swap Rate plus 5.4965% • If any, payable annually in arrears on 22 March of each year
Format	Perpetual Tier 1 capital notes, callable 22 March 2021 and every year thereafter.
Trigger for Principal Loss Absorption	Consolidated group CET1 capital ratio + Higher-Trigger capital ratio <7%, transitional basis
ISIN	CH0317921697

Capital Treatment	AT1 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. • A Trigger Event refers to the sum of the CET1 ratio and the High-Trigger Capital Ratio of UBS Group AG being less than 5.125% or 7% as applicable; • 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 UBS Group AG from becoming insolvent, bankrupt, unable to pay a material part of its debt or ceasing to carry on its business; or (2) UBS Group AG has received an irrevocable commitment of extraordinary support from the public sector without which UBS Group 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.

Source: Prospectuses, Scope Ratings

Key risk: coupon cancellation

Coupon payments on the Notes are fully discretionary and non-cumulative. In addition, they are subject to distribution restrictions. However, Switzerland is not bound by CRD IV and therefore the concepts of the combined buffer requirement and the maximum distributable amount do not apply.

Further, unlike with AT1 securities issued by other European banks, the Notes contain a dividend stopper – i.e. if UBS does not pay a coupon, the group shall not recommend to ordinary shareholders 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 permitted.

Conditions under which coupon payments are prohibited

UBS is prohibited from making coupon payments on the Notes in the following circumstances:

- The amount of distributable items 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 clause prevents double-counting AT1 coupons already provisioned and paid for – other European banks re-integrate these coupons into their distributable profits.
- UBS Group AG is not in compliance with all applicable minimum capital adequacy requirements after paying interest on the Notes;
- FINMA has required UBS not to make such an interest payment.

As UBS Group AG had CHF 38bn in distributable items as of end-2015, we do not see this as a constraint for paying coupons. Distributable items are defined as the aggregate of net profits carried forward and freely distributable reserves. Share premium is included in general capital reserves under Swiss corporate law.

Applicable capital requirements

Per the latest Swiss TBTF requirements which are effective from 1 July 2016 and which will be phased-in until end-2019, the group will need to maintain a minimum going concern capital requirement of 14.3% of RWAs, of which 10% must be met with CET1 capital and the remainder with high-trigger AT1 instruments. As well the group must maintain a minimum leverage ratio of 5%, of which at least 3.5% must be with CET1 capital and the remainder with high-trigger AT1 instruments.

The provisions provide for the grandfathering of low trigger AT1 securities (including the two Notes with a 5.125% trigger) and low and high trigger Tier 2 securities. Low trigger AT1 securities will qualify as going concern capital until the first call date and thereafter may be used to meet gone concern requirements. Gone concern requirements mirror going concern requirements, i.e. 14.3% of RWAs and 5% leverage ratio but may be met with bail-in debt instruments. UBS intends to use the four-year phase-in period to fully implement the new requirements. For further details, please refer to the *UBS AG Issuer Rating Report*.

At end-March 2016, UBS Group AG had a phase-in CET1 ratio of 16.9% and a fully applied CET1 ratio of 14.9%. Meanwhile, the phase-in and fully applied leverage ratios which include loss absorbing capital were 6% and 5.4%, respectively.

Key risk: principal loss absorption

In our opinion, the write-down risk for these Notes is quite low (outside of a resolution scenario) in light of the sound capital position of the group and the way the trigger metric is determined (sum of CET1 capital ratio and High-Trigger capital ratio). At end-March 2016, UBS Group AG had a phase-in CET1 ratio of 16.9%. In addition, the group had another CHF 6.1bn in high-trigger loss absorbing capital outstanding (equivalent to 2.8% of RWAs).

We further note that UBS has issued nearly CHF 1bn in Basel 3 compliant AT1 securities as part of its employee compensation program (DCCP). These securities contain a trigger for permanent write down if the phase-in CET1 ratio of the group falls below 10% for grants awarded to the group's executive board members; otherwise the trigger is 7%. As the 10% trigger on the DCCP securities is above the triggers on the Notes, we believe that they provide some additional protection for investors in the Notes.

Nevertheless, we highlight that FINMA has broad statutory powers, including the power to impose protective measures and institute restructuring proceedings.

Distance to trigger

We expect the sum of UBS Group AG's CET1 and Higher-Trigger capital ratios to remain largely above the 5.125% and 7% trigger levels. The group targets a fully applied CET1 ratio of at least 13%.

Table 23: Distance to 7% trigger

	2015	1Q 2016	2017	2018	2019
Trigger level	7%	7%	7%	7%	7%
Sum of CET1 + High-Trigger capital ratio	21.3%	19.7%	> 13% CET1 fully applied target		
Gap (%)	14.3%	12.7%			
Gap (CHF bn)	30.3	27.5			

Source: Company data, Scope Ratings

Table 3: Distance to 5.125% trigger

	2015	1Q 2016	2017	2018	2019
Trigger level	5.125%	5.125%	5.125%	5.125%	5.125%
Sum of CET1 + High-Trigger capital ratio	21.3%	19.7%	> 13% CET1 fully applied target		
Gap (%)	16.1%	14.6%			
Gap (CHF bn)	34.2	31.6			

Source: Company data, Scope Ratings

UBS AG – Tier 2 rating report

Security ratings

Outlook	Positive
7.25% USD 2bn Tier 2 Subordinated Notes due 2022	BBB+
7.625% USD 2bn Tier 2 Subordinated Notes due 2022	BBB+
4.75% USD 1.5bn Tier 2 Subordinated Notes due 2023	BBB+
4.75% EUR 2bn Tier 2 Subordinated Notes due 2026	BBB+
5.125% USD 2.5bn Tier 2 Subordinated Notes due 2024	BBB+

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 noted low-trigger Tier 2 Subordinated Notes issued by UBS AG. The 7.25% and the 7.625% USD 2bn Tier 2 Subordinated Notes due 2022 were issued by UBS AG acting through its Jersey and Stamford branches, respectively. The other three Tier 2 Subordinated Notes were issued by UBS AG directly. The rating is based on the following considerations:

- Senior unsecured debt rating (eligible for TLAC): A, Positive Outlook
- Minimum notches down from senior unsecured debt rating: 2
- Additional notches: 0

In accordance with our recently updated rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating and no longer the issuer credit-strength rating (ICSR). The minimum of two notches reflect the subordinated status of Tier 2 capital instruments in the priority of claims and their loss absorbing features. Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in May 2016 for more details.

Issuer credit profile

The ICSR of A+ for UBS is underpinned by the group's very significant focus on capital and balance sheet strength, driven in part by the influence of two proactive policy and supervisory authorities in Switzerland. As well, UBS is ahead of many global peers in reshaping its business model. Consequently, the group has a mix of businesses which is well adapted to a changed operating environment. Earnings have also recovered since the financial crisis although more can be done to improve costs and efficiency. Potential conduct and litigation costs remain a risk.

On 20 June 2016, we changed the outlook on the ICSR to Positive from Stable. The outlook change reflects the successful reshaping of the group's business model and the group's reassuring credit metrics.

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 arrears
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 arrears
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 arrears
Format	Tier 2 Subordinated Notes due 2023, callable on 22 May 2018
ISIN	CH0214139930
Issue Date	13 February 2014
Amount	USD 2bn
Coupon	• 4.75% fixed until first call date, reset once on that date • payable annually in arrears
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 arrears
Format	Tier 2 Subordinated Notes due 2024
ISIN	CH0244100266

Capital Treatment	Tier 2 grandfathered (details below)
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. • 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 of 5%. • A Viability Event refers to (1) FINMA notifying UBS 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	UBS AG's CET1 capital ratio + Higher Trigger capital ratio <5%, transitional basis

Source: Prospectuses, Scope Ratings

Key risk: principal loss absorption

The Notes are subject to permanent write-down if The Relevant Trigger Capital Ratio (defined as the sum of the CET capital ratio and the High-Trigger Capital ratio) is less than 5% and 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 of a trigger event write-down has been given.

If there is any High-Trigger Contingent Capital outstanding, these shall be written down before the Notes. This specification provides some protection to Tier 2 holders, in our view.

There is also the possibility that a write-down will not occur if FINMA agrees that as a result of actions taken by UBS AG, or due to circumstances or events, the Relevant Capital Ratio has been or will be restored above 5%.

In addition, the Notes are subject to write-down upon the occurrence of a Viability Event. if FINMA determines that a write-down of the Notes as well as other similar capital instruments is essential in order to prevent UBS AG from becoming insolvent, bankrupt, unable to pay a material part of its debts or unable to carry on its business; or UBS AG has received an irrevocable commitment of direct or indirect extraordinary support from the public sector in order to prevent UBS AG from becoming insolvent, bankrupt, unable to pay a material part of its debts or unable to carry on its business. The Terms and Conditions of the Notes also clearly state that a Viability Event may occur irrespective of whether or not a Trigger Event has occurred, highlighting the discretion of the regulator in determining the point of non-viability.

In our opinion, the write-down risk for these Notes is very low outside of a resolution scenario. First, this is because of the way the trigger is determined (sum of CET1 capital ratio and High-Trigger capital ratio) as well as the low level of the threshold at 5%. As of end-March 2016, UBS AG had a phase-in CET1 ratio of 17.8%. In addition, UBS AG had another CHF 2.0bn in high-trigger loss absorbing capital outstanding (equivalent to 0.9% of RWAs).

Secondly, per the latest Swiss TBTF requirements which must be met by end-2019 the group will need to maintain a minimum going concern capital requirement of 14.3% of RWAs, of which 10% must be met with CET1 capital and the remainder with high-trigger AT1 instruments. The provisions provide for the grandfathering of both high and low trigger Tier 2 securities (including the Notes). They will qualify as going concern capital until the earliest of end-2019, maturity or the first call date. Thereafter, they may be used to meet gone concern requirements.

Distance to trigger

Considering the undemanding trigger of the Notes, we expect the sum of UBS AG's CET1 and High-Trigger capital ratios to remain largely above the 5% trigger level. Since the establishment of UBS Group AG as the holding company for the group and the parent company of UBS AG, UBS Group AG is the primary financial reporting entity for the group. There are limited differences in the financial profiles of the two entities. The group targets a CET1 ratio of at least 13% on a fully applied basis.

Table 1: Distance to trigger – UBS AG

	2015	1Q 2016	2017	2018	2019
Trigger level	5%	5%	5%	5%	5%
Sum of CET1 + High-Trigger capital ratio	19.5%	18.7%	> 13% CET1 fully applied target		
Gap (%)	14.5%	13.7%			
Gap (CHF bn)	30.9	29.9			

Source: Company data, Scope Ratings

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Barclays plc – AT1 rating report

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
7.875% GBP 1bn fixed rate resetting perpetual subordinated contingent convertible securities	BB

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 referenced perpetual subordinated contingent convertible securities issued by Barclays plc based on the following:

- Senior unsecured debt rating (eligible for MREL/TLAC): A, Stable Outlook
- Minimum notches down from senior unsecured debt rating: 4
- Additional notches: 2

In accordance with our recently updated rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating and no longer the issuer credit-strength rating (ICSR). The minimum four notches reflect the deeply subordinated status of AT1 capital instruments in the priority of claims, their going concern loss absorbing features and investors’ exposure to coupon-cancellation risks. Please refer to Scope’s *Bank Capital Instruments Rating Methodology* published in May 2016 for more details.

The additional notches reflect several factors: (a) the absolute level of the trigger is relatively high at 7% and is on a fully-loaded basis, (b) the UK regulator has proven to be relatively demanding in regards to capital requirements and (c) Barclays is in the midst of a restructuring which is subject to execution risks

Issuer credit profile

The ICSR of A+ for Barclays is driven by the group's continuing efforts to adapt its business model to a changed operating environment. Excluding the Africa business which Barclays intends to sell down to a stake below 20%, nearly half of group income currently stems from strong franchises in UK retail and business banking and credit cards. The size of the core investment banking business, which had been reduced to less than a third of group RWAs, is expected to remain relatively unchanged going forward and contribute to earnings diversification. While performance may suffer over the next two years this reshaping combined with the run-down of non-core assets should enable the group to generate long-term sustainable earnings. We take comfort in management's track record of strengthening the group's capital and liquidity and funding positions. Potential conduct and litigation costs remain a risk.

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 • From first call date at Mid Market Swap rate plus 6.705% • If any, payable quarterly in arrears
Format	Perpetual subordinated contingent convertible securities, callable December 2018 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 • From first call date at Mid Market Swap rate plus 6.75% • 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 • From first call date at Mid Market Swap rate plus 5.084% • 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 • From first call date at Mid Market Swap Rate plus 5.875% • If any, payable quarterly in arrears
Format	Perpetual subordinated contingent convertible securities, callable 2019 and every five years thereafter
ISIN	XS1068574828

Issue Date	June 2014
Amount	USD 1.2bn
Coupon	• 6.625% fixed until first call date, reset every 5 years thereafter • From first call date at Mid-Market Swap Rate plus 5.022% • If any, payable quarterly in arrears
Format	Perpetual subordinated contingent convertible securities, callable 2019 and every five years thereafter
ISIN	US06738EAB11

Issue Date	August 2015
Amount	GBP 1.0bn
Coupon	• 7.875% fixed until first call date, reset every 5 years thereafter • From first call date at Mid-Market Swap Rate plus 6.099% • If any, payable quarterly in arrears
Format	Perpetual subordinated contingent convertible securities, callable 2022 and every five years thereafter
ISIN	XS1274156097

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. While not Barclays' intention, the group has the right to pay dividends on ordinary or preference shares notwithstanding coupon cancellation on the AT1 securities.

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 2015, Barclays plc had GBP 7.1bn in distributable reserves.

Barclays currently has outstanding six issues of CRD IV compliant AT1 securities, totalling GBP 5.3bn. In 2015, Barclays made GBP 345m in distributions related to these securities from after-tax profit of GBP 623m.

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 (CBR)

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 became effective from 1 January 2016 and are based on transitional CET1 requirements.

Barclays' combined buffer is comprised of the capital conservation buffer, a buffer for being a global systemically important bank (G-SIB) and a countercyclical buffer (CCyB). The capital conservation buffer of 2.5% and the G-SIB buffer of 2% are being phased-in between 2016 and 2019.

From end-March 2017, the CCyB for UK exposures will be 0.5%. As the Financial Policy Committee (FPC) has signalled its intention to set the UK CCyB around 1% in a "standard risk environment", we expect the CCyB for UK exposures to increase to 1%. Barclays anticipates a CCyB of 0.25% for 2017 and from 2018 onwards a CCyB of 0.5%. This is based on the group's exposure to the UK and the FPC increasing the UK CCyB to 1%.

The PRA has confirmed that Pillar 2A capital should sit on top of the 4.5% of CET1 capital required under CRD IV and below the combined buffer in the capital stack. Therefore, the restrictions on distributions apply at a higher level of CET1 capital. For Barclays, the PRA has set a Pillar 2A guidance of 3.9% for 2016 (2.8% in 2015), of which at least 2.2% should be met with CET1 capital.

By 2019, we currently estimate that Barclays may need to maintain a CET1 ratio well in excess of 11% in order to avoid distribution restrictions on its AT1 securities (Table 1). This assumes that various components of the combined buffer as well as Pillar 2A guidance do not change. Management has communicated that the group's future CET1 ratio will take into consideration future minimum requirements and CRD IV buffers plus a management buffer of 100bps to 150bps, rather than a fixed target. In addition, the ability to successfully pass Bank of England stress tests is a key part of the group's capital planning. As of end-March 2016, the group's fully loaded CET1 ratio was 11.3%.

Table 24: Estimated CET1 requirements

	2015	2016E	2017E	2018E	2019E
Combined buffer:					
- Capital Conservation		0.63%	1.25%	1.88%	2.50%
- Systemic[1]		0.50%	1.00%	1.50%	2.00%
- Countercyclical[2]	0.00%	0.00%	0.25%	0.50%	0.50%
Pillar 2A[3]	1.60%	2.20%	2.20%	2.20%	2.20%
Minimum CET1 (Pillar I)	4.50%	4.50%	4.50%	4.50%	4.50%
Required CET1 associated with distribution restrictions	**6.1%**	**7.8%**	**9.2%**	**10.6%**	**11.7%**
Barclays plc CET1, fully-loaded	11.4%	11.3% (1Q16)	100-150bps management buffer		
Gap (%)	5.3%	3.5%			
Gap (GBP bn) [4]	19.0	12.7			

Notes: 1 Current G-SIB buffer of 2%. Phased-in between 2016 and 2019. 2 Assumes CCyB of 0.25% in 2017 based on 0.5% CCyB for UK exposures. Assumes CCyB of 0.5% from 2018 onwards based on 1% CCyB for UK exposures. 3. Subject to annual review by PRA. Set at 3.8% for 2016 of which at least 56% must be met with CET1 capital. 4. Based on RWAs of GBP 36bn as of YE2015 and 1Q 2016.
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 Barclays' consolidated CET1 ratio is less than 7% on a fully-loaded basis. As of January 2015, Barclays' transitional and fully-loaded CET1 capital ratios have become aligned as the transitional regulatory adjustment for unrealised gains is no longer applicable. We note that AT1 capital instruments issued by-UK banks generally have fully-loaded CET1 triggers while non-UK banks have transitional CET1 triggers.

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. The offering documents for the securities issued in August 2015 include explicit references to the bail-in tool and the point of non-viability.

Distance to trigger

We expect the group's CET1 ratio to remain solidly above the 7% trigger level on the securities as management intends to maintain a 100-150bp buffer above minimum CET1 capital requirements – anticipated to be well above 11% in 2019.

Table 25: Distance to trigger

	2015	1Q 2016	2017	2018	2019
Trigger level	7.0%	7.0%	7.0%	7.0%	7.0%
Barclays plc CET1, fully-loaded	11.4%	11.3%			
Gap (%)	4.4%	4.3%			
Gap (GBP bn)	15.8	15.6			

Source: Company data, Scope Ratings

Barclays Bank plc – Tier 2 rating report

Security ratings

Outlook	Stable
7.625% USD 3bn fixed rate contingent capital notes	BBB+
7.75% USD 1bn fixed to fixed rate contingent capital notes	BBB+

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 7.625% USD 3bn and 7.75% USD 1bn contingent capital notes based on the following:

- Senior unsecured debt rating (eligible for MREL/TLAC): A, Stable Outlook
- Minimum notches down from senior unsecured debt rating: 2
- Additional notches: 0

In accordance with our recently updated rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating and no longer the issuer credit-strength rating (ICSR). The minimum two notches reflect the subordinated status of Tier 2 capital instruments in the priority of claims and their loss absorbing features. Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in May 2016 for more details.

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 (CRD IV transitional basis, FSA October 2012 statement), we take the view that the PONV may be below or above this level. Therefore, the minimum two notches for Barclays Bank's Tier 2 securities in our opinion sufficiently captures the potential principal loss absorption risks.

Issuer credit profile

The ICSR of A+ for Barclays is driven by the group's continuing efforts to adapt its business model to a changed operating environment. Excluding the Africa business which Barclays intends to sell down to a stake below 20%, nearly half of group income currently stems from strong franchises in UK retail and business banking and credit cards. The size of the core investment banking business, which had been reduced to less than a third of group RWAs, is expected to remain relatively unchanged going forward and contribute to earnings diversification. While performance may suffer over the next two years this reshaping combined with the run-down of non-core assets should enable the group to generate long-term sustainable earnings. We take comfort in management's track record of strengthening the group's capital and liquidity and funding positions. Potential conduct and litigation costs remain a risk.

Summary terms

Issuer	Barclays Bank plc
Issue Date	November 2012
Amount	USD 3bn
Coupon	• 7.625% • Payable semi-annually in arrears
Format	Fixed rate contingent capital notes due November 2022
ISIN	US06740L8C27
Principal Loss Absorption	• Upon capital adequacy trigger event, there will be an automatic transfer of interests in the notes to the parent, Barclays plc, for nil consideration.

Issue Date	April 2013
Amount	USD 1bn
Coupon	• 7.75% fixed until call date, reset thereafter • From first call date at Mid-Market Swap Rate plus 6.833% • Payable semi-annually in arrears
Format	Fixed to fixed rate contingent capital notes due April 2023, callable April 2018
ISIN	US06739FHK03
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

Capital Treatment	Tier 2
Trigger for Principal Loss Absorption	Consolidated group CET1 < 7% on transitional basis (per FSA October 2012 statement)

Source: Prospectuses, Scope Ratings

Key risk: principal loss absorption

Both securities contain loss absorption features. Investors will lose their entire investment in the notes upon a breach of the trigger. The trigger level is breached when Barclays' consolidated CET1 ratio is below 7% on a transitional basis as per the FSA October 2012 statement.

For the USD 1bn notes issued in 2013, the loss would happen via a permanent write-down of the notes. Noted 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 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.

For the USD 3bn notes issued in 2012, the loss would happen via an automatic transfer of interests in the notes to Barclays plc for nil consideration. While these securities do not contain a contractual acknowledgement of UK bail-in power, the prospectus highlights the broad powers of the UK regulator to cause the notes to absorb losses.

Distance to trigger

As of 31 March 2016, Barclays' transitional CET1 ratio was 12.5% (as per the FSA October 2012 statement) based on GBP 45.3bn of transitional CRD IV CET1 capital and GBP 363bn of RWAs. This compares to a fully-loaded CET1 ratio of 11.3%.

Management has communicated that the group's target future CET1 ratio will take into consideration future minimum requirements and CRD IV buffers plus a management buffer of 100bps to 150bps, rather than a fixed target. In addition, the ability to successfully pass Bank of England stress tests is a key part of the group's capital planning. By 2019, we currently estimate that Barclays may need to maintain a minimum fully-loaded CET1 ratio well in excess of 11%; based on the Pillar 1 minimum of 4.5%, a capital conservation buffer of 2.5%, a G-SIB buffer of 2%, a countercyclical buffer of 0.5% and Pillar 2A of 2.2%.

As the trigger is measured against the group's transitional CET1 ratio, we would expect the distance to trigger to decline as we approach 2019. However, in light of the group's estimated minimum CET1 ratio requirements in 2019 (above 11%), we would still anticipate a solid distance to trigger.

Table 26: Distance to trigger

	2015	1Q 2016	2017	2018	2019
Trigger level	7.0%	7.0%	7.0%	7.0%	7.0%
Barclays plc CET1, transitional	13.1%	12.5%			
Gap (%)	6.1%	5.5%			
Gap (GBP bn)	21.9	20.0			

Notes: 2015 CET1 ratio is based on transitional CRD IV CET1 capital of GBP 46.8bn and RWAs of GBP 358bn.
Source: Company data, Scope Ratings

Other outstanding capital instruments

Within the group, Barclays plc, the holding company, has issued over GBP 5bn 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 Tier 2 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's 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 Tier 2 securities issued by the operating bank. Both the AT1 and Tier 2 securities have the same trigger at 7%.

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
6% EUR 1bn perpetual subordinated contingent convertible securities	BBB
6.875% USD 2bn perpetual subordinated contingent convertible securities	BBB

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 noted issues of perpetual subordinated contingent convertible securities issued by HSBC Holdings plc. We have also assigned an initial rating to the 6.875% USD 2bn perpetual subordinated contingent convertible securities issued in June 2016. The ratings are based on the following:

- Senior unsecured debt rating (eligible for TLAC/MREL): AA-, Stable Outlook
- Minimum notches down from senior unsecured debt rating: 4
- Additional notches: 1

In accordance with our recently updated rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating and no longer the issuer credit-strength rating (ICSR).). The minimum four notches reflect the deeply subordinated status of AT1 capital instruments in the priority of claims, their going concern loss absorbing features and investors' exposure to coupon-cancellation risks. Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in May 2016 for more details.

The additional notch for these securities reflects two main factors: (i) the absolute level of the trigger is relatively high at 7% and is on a fully-loaded basis and (ii) the UK regulator has proven to be relatively demanding in regards to capital requirements.

Issuer credit profile

The ICSR of AA for HSBC is based on the group's very diverse and unique business franchise which generates resilient earnings. This capability enabled HSBC to maintain strong liquidity and capital positions during the financial crisis and will be a key factor for successfully navigating the 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 the potential volatility inherent in these markets.

Summary terms

Issuer	HSBC Holdings plc
Issue Date	**17 September 2014**
Amount	USD 1.5bn
Coupon	• 5.625% fixed until first call date, reset every 5 years thereafter • From first call date at mid-swaps rate + 3.625% • If any, payable in arrears semi-annually
Format	Perpetual subordinated contingent convertible securities, callable January 2020 and every five years thereafter
Conversion rate	USD 4.35578 per ordinary share
ISIN	US404280AR04
Issue Date	**17 September 2014**
Amount	USD 2.25bn
Coupon	• 6.375% fixed until first call date, reset every 5 years thereafter • From first call date at mid-swaps rate + 3.705% • If any, payable in arrears semi-annually
Format	Perpetual subordinated contingent convertible securities, callable September 2024 and every five years thereafter
Conversion rate	USD 4.33578 per ordinary share
ISIN	US404280AS86
Issue Date	**17 September 2014**
Amount	EUR 1.5bn
Coupon	• 5.25% fixed until first call date, reset every 5 years thereafter • From first call date at mid-swaps rate + 4.383% • If any, payable in arrears semi-annually
Format	Perpetual subordinated contingent convertible securities, callable September 2022 and every five years thereafter
Conversion rate	EUR 3.37514 per ordinary share
ISIN	XS1111123987

Issue Date	**30 March 2015**
Amount	USD 2.25bn
Coupon	• 6.375% fixed until first call date, reset every 5 years thereafter • From first call date at mid-swaps rate + 4.3675% • If any, payable in arrears semi-annually
Format	Perpetual subordinated contingent convertible securities, callable March 2025 and every five years thereafter
Conversion rate	USD 4.03488 per ordinary share
ISIN	US404280AT69
Issue Date	**29 September 2015**
Amount	EUR 1bn
Coupon	• 6% fixed until first call date, reset every 5 years thereafter • From first call date at 5 year EUR mid-swaps + 5.338% • If any, payable in arrears semi-annually
Format	Perpetual subordinated contingent convertible securities, callable September 2023 and every five years thereafter
Conversion rate	EUR 3.73559 per ordinary share
ISIN	XS1298431104
Issue Date	**1 June 2016**
Amount	USD 2bn
Coupon	• 6.875% fixed until first call date, reset every 5 years thereafter • From first call date at 5-year USD mid-swaps rate + 5.514% • If any, payable in arrears semi-annually
Format	Perpetual subordinated contingent convertible securities, callable June 2021 and every five years thereafter
Conversion rate	USD 3.9474 per ordinary share
ISIN	US404280BC26
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 • Upon order of regulator
Principal Loss Absorption	• Full conversion into ordinary shares upon trigger breach at conversion price subject to conversion shares offer • Point of non-viability • Subject to powers of UK PRA
Trigger for Principal Loss Absorption	Consolidated group CET1 ratio < 7% on fully-loaded basis

Source: Prospectuses, Scope Ratings

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 2015, the issuer, HSBC Holdings plc, had USD 46.6bn in reserves available for distribution.

In addition, 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.

Lastly, coupons may also be cancelled upon orders of the regulator. This is most likely to occur if the group is failing or expected to fail to meet its capital requirements. These include a new PRA buffer to be met with 100% CET1 capital and which is not publicly disclosed as well as a leverage ratio requirement. Failure to do so could result in a capital restoration plan which entails restrictions on coupons on the securities.

Combined buffer requirement (CBR)

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 became effective from 1 January 2016 and are based on transitional CET1 requirements.

HSBC's combined buffer is comprised of the capital conservation buffer, a buffer for being a global systemically important bank (G-SIB) and a countercyclical capital buffer (CCyB). The capital conservation buffer of 2.5% and the G-SIB buffer of 2.5% are being phased-in between 2016 and 2019.

Since January 2016, the CCyB for HK exposures has been 0.625% and is expected to increase in equal increments to 2.5% by January 2019. From end-March 2017, the CCyB for UK exposures will be 0.5%. As the Financial Policy Committee has signalled its intention to set the UK CCyB around 1% in a "standard risk environment", we would expect the CCyB for UK exposures to increase to 1%. We estimate that the group will be subject to a CCyB of about 0.5% by 2019.

The PRA has confirmed that Pillar 2A capital should sit on top of the 4.5% of CET1 capital required under CRD IV and below the combined buffer in the capital stack. Therefore, the restrictions on distributions apply at a higher level of CET1 capital. For HSBC, the PRA has set a Pillar 2A guidance of 2.3% for 2016 (2% in 2015), of which at least 1.1% should be met with CET1 capital.

By 2019, we estimate that HSBC will need to maintain a CET1 ratio in excess of 11% in order to avoid distribution restrictions on its AT1 securities (Table 1). In the medium term, the group targets an end-point CRD IV CET1 ratio of 12-13% and has stated that it intends to maintain a management buffer above requirements.

Table 27: Estimated CET1 requirements

	2015	2016E	2017E	2018E	2019E
Combined buffer:					
- Capital Conservation		0.63%	1.25%	1.88%	2.50%
- Systemic[1]		0.63%	1.25%	1.88%	2.50%
- Countercyclical[2]	0.00%	0.00%	0.20%	0.35%	0.50%
Pillar 2A[3]	1.10%	1.30%	1.30%	1.30%	1.30%
Minimum CET1 (Pillar I)	4.50%	4.50%	4.50%	4.50%	4.50%
Required CET1 associated with distribution restrictions	**5.6%**	**7.1%**	**8.5%**	**9.9%**	**11.3%**
HSBC Holdings CET1	11.9%	11.9% (1Q16)	12-13% target		
Gap (%)	6.3%	4.8%			
Gap (USD bn)[4]	69.5	53.5			

Notes: 1. G-SIB buffer. 2. Estimated countercyclical buffer based for exposures in HK and the UK. 3. Subject to annual review. 4. Based on RWAs of USD 1,103bn at year-end 2015 and RWAs of USD 1,115bn at end-March 2016.
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. As of January 2015, HSBC's transitional and fully-loaded CET1 capital ratios have become aligned due to the recognition of unrealised gains on investment property and available-for-sale securities. We note that AT1 capital instruments issued by UK banks generally have fully-loaded CET1 triggers while non-UK banks have transitional CET1 triggers.

Further, by acquiring the securities, investors "acknowledge, accept, consent and agree … to be bound by the exercise of any UK bail-in power". These include the power to write-down and convert capital instruments when an institution is no longer considered viable and the use of the bail-in tool to cancel all or a portion of the principal amount of, or interest on, certain unsecured liabilities of a failing institution and/ or convert certain debt claims into another security, including ordinary shares.

Distance to trigger

As of 31 March 2016, HSBC's fully-loaded CET1 ratio was 11.9%, 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 28: Distance to trigger

	2015	1Q 2016	2017	2018	2019
Trigger level	7.0%	7.0%	7.0%	7.0%	7.0%
HSBC Holdings CET1	11.9%	11.9%	12-13% target		
Gap (%)	4.9%	4.9%			
Gap (USD bn) [1]	54.0	54.6			

Note: 1. Based on RWAs of USD 1,103bn at year-end 2015 and RWAs of USD 1,115bn at end-March 2016.
Source: Company data, Scope Ratings

Lloyds Banking Group plc – AT1 rating report

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+

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

Rating rationale

Scope assigns long term ratings of BB+ to Lloyds's five Additional Tier 1 securities listed in the table above. For details on the rated instruments, see next page. The ratings are based on the following considerations:

- Senior unsecured debt (eligible for MREL): A, Stable Outlook
- Minimum notches down from the senior unsecured debt rating: 4
- Additional notches: 1

In accordance with our recently updated rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating and no longer the issuer credit-strength rating (ICSR). Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in May 2016 for more details.

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

Issuer credit profile

The ICSR of A+ for Lloyds Bank plc 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

Issue Date	April 2014
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

Issue Date	April 2014
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

Issue Date	April 2014
Amount	EUR 750m
Coupon	• 6.375% 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

Issue Date	April 2014
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	US539439AG42

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 2015, the parent company Lloyds Banking Group plc had available distributable reserves of approximately GBP 7.5bn.

Combined buffer requirement (CBR)

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 at the group level. These restrictions became effective from 1 January 2016 and are based on transitional CET1 requirements.

Lloyds' combined buffer is currently comprised of the capital conservation buffer, and a countercyclical buffer (CCyB). The capital conservation buffer of 2.5% is being phased-in between 2016 and 2019.

From end-March 2017, the CCyB for UK exposures will be 0.5%. As the Financial Policy Committee has signalled its intention to set the UK CCyB around 1% in a “standard risk environment”, we would expect the CCyB for UK exposures to increase to 1%.

From 2019, Lloyds will also be subject to a domestic systemic risk buffer (D-SIB), calculated at the level of the ring fenced bank. The actual level of this buffer has not yet been finalised.

The PRA has confirmed that Pillar 2A capital should sit on top of the 4.5% of CET1 capital required under CRD IV and below the combined buffer in the capital stack. Therefore, the restrictions on distributions apply at a higher level of CET1 capital. For Lloyds, the PRA has currently set a Pillar 2A guidance of 4.6%, of which at least 2.6% should be met with CET1 capital.

Lloyds sets its required CET1 at 12%, while our estimate points to 10.5% excluding the systemic buffer.

Assuming a systemic buffer of 2.5% at the RFB level, the total requirement could exceed Lloyds’ guidance of 12%. We note that the Bank of England Financial Policy Committee has stated that there is sufficient capital in the banking system and hence we deem that material further increases are unlikely.

We calculate that Lloyds has sufficient headroom to its total CET1 requirement for 2016 and while this will decline over time as the various buffers are phased in, we believe Lloyds should be able to adjust its capital levels organically to accommodate any increase in requirements.

Table 29: Estimated CET1 requirements and distance-to-CBR

	2015	2016E	2017E	2018E	2019E
Combined buffer:					
- Capital Conservation Buffer	0.00%	0.63%	1.25%	1.88%	2.50%
- Systemic[1]	0.00%	0.00%	0.00%	0.00%	0.00%
- Countercyclical[2]	0.00%	0.00%	0.50%	1.00%	1.00%
Pillar 2A requirement[3] (CET1 portion)	2.58%	2.58%	2.58%	2.58%	2.58%
Pillar 1 Minimum Requirement	4.50%	4.50%	4.50%	4.50%	4.50%
Required CET1 associated with distribution restrictions	**7.08%**	**7.70%**	**8.83%**	**9.95%**	**10.58%**
Lloyds CET1 ratio	12.8%	13.0%	13.3%	13.6%	
Distance to CBR (%)	5.7%	5.3%	4.5%	3.6%	
Distance to CBR (GBPm)	12,743	11,949	10,047	8,239	

Notes: 1 Systemic buffers will be introduced from 2019 and range between 0% and 3%, calculated on the ring fenced bank. 2. Assumes CCyB of 0.5% in 2017 and 1% from 2018 onwards. 3. Subject to annual review by PRA. Set at 4.6% for 2016 of which at least 56% must be met with CET1 capital.
Source: 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 CRDIV. In addition, investors in the securities are subject to write-down or conversion risks upon 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 December 2015, Lloyds' fully-loaded CET1 ratio was 12.8%, 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 30: Distance to trigger

	2015	2016 E	2017 E	2018 E	2019 E
Trigger level	7.0%	7.0%	7.0%	7.0%	7.0%
Lloyds CET1 ratio (fully loaded)	12.8%	13.0%	13.3%	13.6%	
Gap (%)	5.8%	6.0%	6.3%	6.6%	
Gap (GBPm)	12,913	13,519	14,162	14,931	

Source: Company data, Scope Ratings

Regulatory Disclosures

Information pursuant to Regulation (EC) No 1060/2009 on credit rating agencies, as amended by Regulations (EU) No. 513/2011 and (EU) No. 462/2013

Responsibility

The party responsible for the dissemination of the financial analysis is Scope Ratings AG, Berlin, District Court for Berlin (Charlottenburg) HRB 161306 B, Executive Board: Torsten Hinrichs (CEO), Dr. Stefan Bund and Dr. Sven Janssen.

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The rating analysis of Danske Bank A/S, Intesa Sanpaolo, Banco Santander SA, BBVA SA, Nordea Bank AB, Svenska Handelsbanken AB, Swedbank AB and Lloyds Bank plc have been prepared by Marco Troiano, Director.

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