SICIM

Bank Contingent Convertible ("CoCo") Primer

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Key Features of CoCo Securities

How CoCos Work

CoCos are issued as securities with a fixed interest coupon. Unlike other hybrid capital instruments, CoCo securities have a trigger (threshold for the issuing bank's capital ratio). If the trigger is breached, the CoCo is automatically converted into equity or the nominal value is written off.

The trigger can also be activated by the regulatory authority in charge if it considers the bank's existence threatened. This may be the case whenever the bank still has sufficient capital but is having difficulties with liquidity.

Distinction between two types of CoCo securities

Additional Tier 1 ("AT1") CoCos:

- *Rank directly ahead of equity capital in the capital structure*
- *Coupon payments can be suspended even if the capital ratio is above the trigger level*
- *No fixed maturity, but issuer has a call option*

Tier 2 CoCos:

- *Rank directly ahead of AT1 CoCos in the capital structure*
- *Limited term with or without a call option*
- *Coupon payments cannot be suspended*

Two forms of Loss Absorption when Trigger is breached

Conversion to equity with the following options:

- *Fixed number of shares*
- *Variable number of shares*

Writeoff of face value with the following options:

- *Complete writeoff*
- *Partial writeoff*
- *Permanent writeoff*
- *Temporary writeoff*

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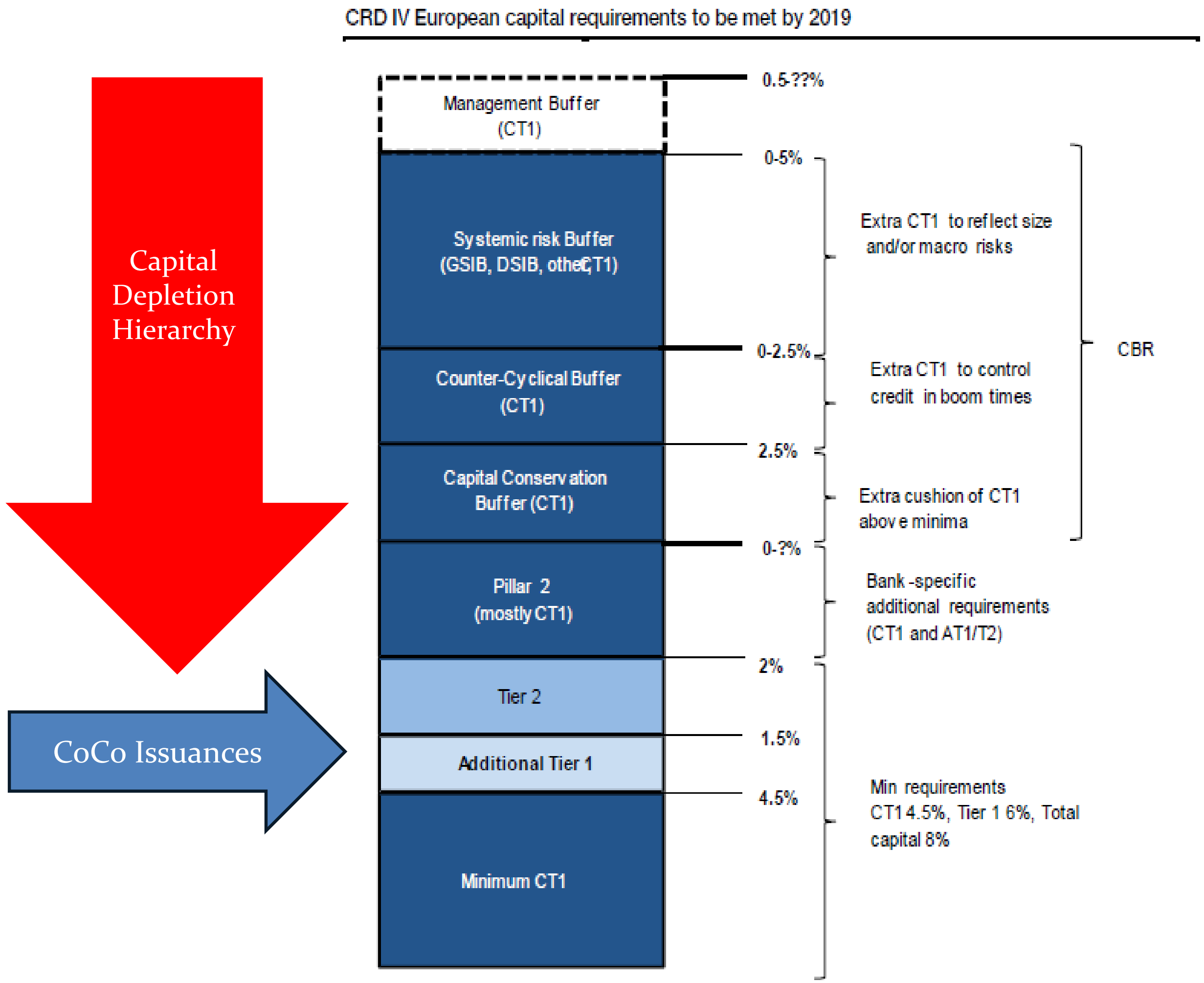
Where CoCos sit within the Capital Structure of Banks



Source: Excerpt of CRDIV/CRR Frequently asked Questions published by European Commission 16/7/2013

Specific Structure Risks related to AT1 CoCos

Conversion risk:

- *Low probability given existing large bank capital buffers but with a very high impact – ie Capital writedown or conversion to equity*

Coupon Risk:

- *Payment of coupons requires 1) Capital to be above regulatory buffer levels & 2) Sufficient Available Distributable Items (ADI) to be present*
- *1Q16 saw volatility in AT1 securities prices in relation to investor's uncertainty over the interpretation of regulatory language governing coupon distributions threshold levels.*
- *In 3Q16, the European Banking Authority ("EBA") announced important positive changes to the framework governing coupon skip for AT1s which has since seen coupon restriction thresholds being relaxed.*

Maturity Extension risk:

- *No coupon step-up reduces economic incentive to call (once min regulatory issuance requirement is filled)*
- *Changes in regulatory treatment of AT1 allow issues to be called out of period ("Regulatory Call")*

	Bail-in Eligible	Subordinated	Maturity Extension Risk	Coupon Deferral	Conversion/ Write-down Risk
Covered Bonds					
Senior Bonds	✔				
Subordinated Bonds	✔	✔			
Tier 2 CoCo	✔	✔			✔
US Additional Tier 1 / Preferred	✔	✔	✔	✔	
Additional Tier 1 (AT1)	✔	✔	✔	✔	✔

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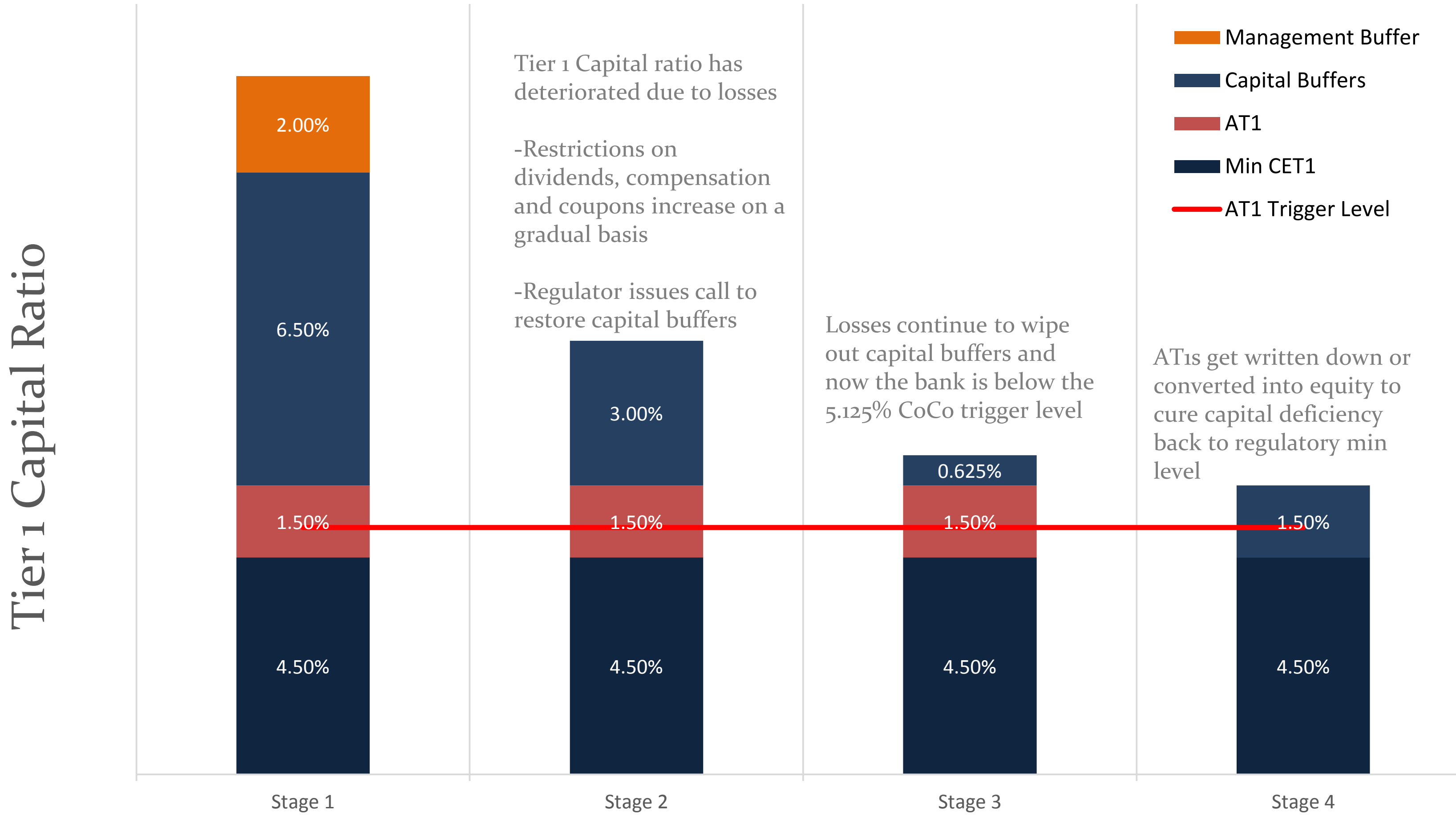
AT1 Contractual Loss Absorption Mechanism



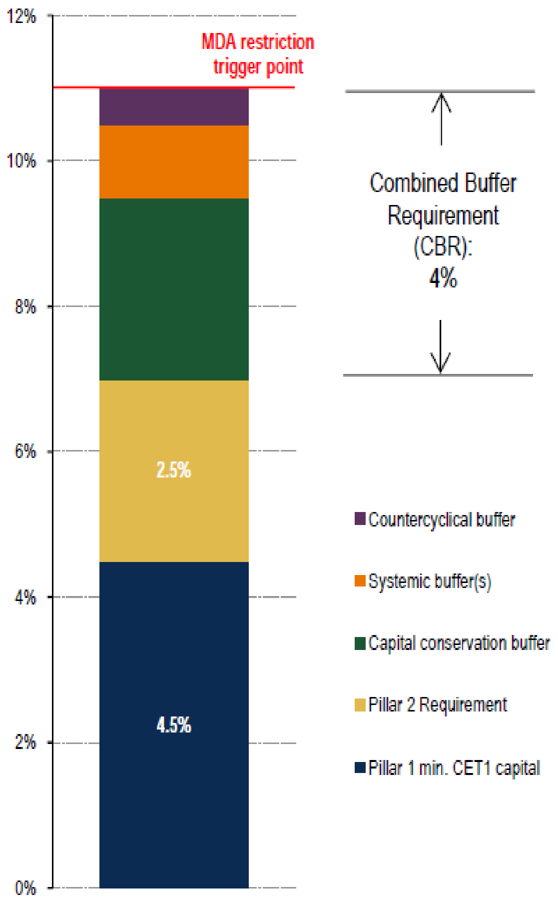
Total CET1 = 13% (excluding AT1)

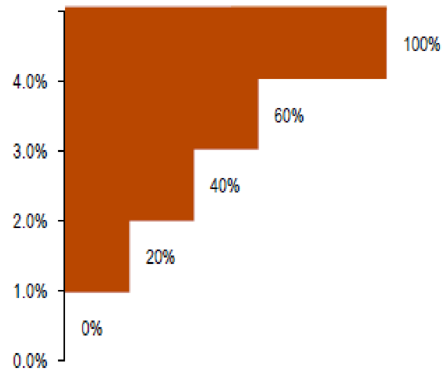
Total CET1 = 7.5% (excluding AT1)

Total CET1 = 5.125% (excluding AT1)

Total CET1 = 6% (AT1 written down)

How Coupon Cancellation Occurs





Restrictions on distributions payable **from current year earnings** upon a breach of the CBR

Note: We assume that there is no shortfall in Pillar 1 AT1/T2 requirement.
Source: BofA Merrill Lynch Global Research

Distributions which will be restricted as Capital Levels decline:

- Common equity distributions (dividends, bonus shares, redemption or repurchase)
- Additional Tier 1 distributions
- Bonuses or other discretionary payments including pensions to employees

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