

May 17, 2011

Investment Grade Credit

## European Banks

### The Case for Non-Calls

**Non-called Tier 1 will count as Tier 2** in a strong resolution regime, in our view, as we discussed in our [note of April 14](#). With the EC introducing resolution regimes across all of Europe in the next few years, we believe that the argument for leaving callable debt capital outstanding has strengthened, as non-called Tier 1 should now be viewed as perpetual Tier 2, not just senior funding. A shock non-call is not priced into Tier 1, in our view.

**Regulators getting stricter on pre-financing**, rather than simply allowing banks to call without replacing the capital. Again, this makes a bank's decision on calling bonds much more difficult, considering the cost of pre-financing. We believe that the FSA is (surprisingly) joining others such as the BaFin and Bank of Italy in a hard line on pre-financing. Our attention was caught by Barclays' end-March €1 billion LT2 at z+315bp.

**Any sub debt is good debt:** With senior debt still seemingly sacrosanct (at least in the euro-zone), the EU resolution regime proposals tip-toeing around outstanding senior debt, and Ireland testing its regime on AIB, sub debt at large seems likely to play a greater role in any future bank resolution – and hence is gaining more regulatory importance.

**Tier 2 is the most likely place for a shock non-call**, as we still believe that the absolute strongest banks will continue to call, and in Tier 1s, these are the only issuers with calls this year, outside of those with EC call restrictions. Tier 2s are much more of a mixed bag and, of course, generally have far lower steps than Tier 1s. In our view, a 'shock' non-call in Tier 2 will impact Tier 1 trading levels too.

**Many non-calls have resulted in relatively generous alternatives:** However, Banesto's surprise decision not to call its recent LT2 was accompanied by a far from generous exchange into senior. Further, non-calls are increasing on a number of fronts, which risk gradually changing banks' attitudes towards them.

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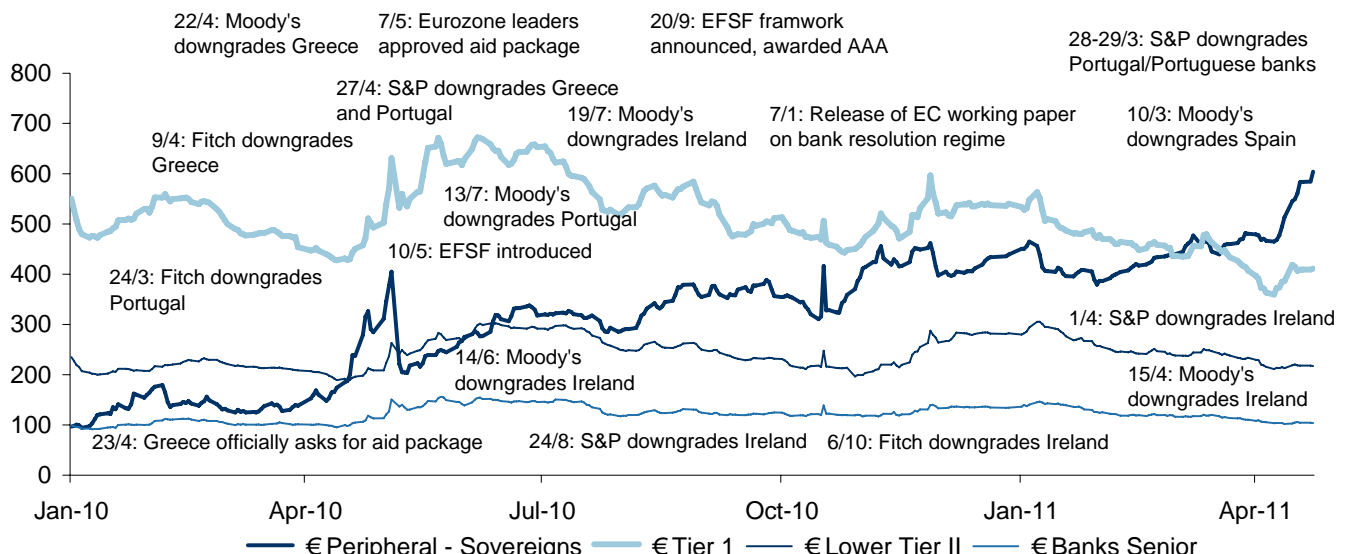
We still remain concerned about peripheral volatility seeping into our bank capital markets and causing significant price falls. We've written about our fears on the Spanish caja sector many times already, and separately, the upcoming regional elections may also shed further light on the state of their finances and how they will be tackled (they are not included in Spain's ~63% debt/GDP ratio). Spanish CDS has clearly tracked tighter over the past few months to drop below 200bp in early April, but has recently been out to 250bp (with this week's pullback, now around 225bp). Aside from a recent minor pull-back linked to worsening Greek headlines, the Tier 1 market has remained resilient to any periphery concerns over the past few months (see Exhibit 1).

#### Increasingly Concerned about Non-Calls

We would not be so concerned about the periphery if it wasn't for what we believe are pretty tight levels in the Tier 1 market. We were bullish for all of last year and in 2009 (despite periphery Europe), but in the midst of far better trading levels/yields. We were also convinced that Basel III would leave little role for Tier 1s, and hence were also convinced of continuing calls in subordinated debt, which very much drove our bullish view, coupled with valuations. Now that we are at much tighter levels, our concerns about Tier 1s reacting to negative periphery news have heightened.

Exhibit 1

#### Tier 1 Securities Coming to Call (asset swap spread, bp)



Source: Morgan Stanley Research

However, **our concerns about a shock non-call in the European bank debt capital space have grown since January and have now overtaken our broad periphery fears.** In our view, the likelihood of a surprise non-call has significantly risen due to a number of factors.

- **Non-called Tier 1s will count as perpetual LT2** – under a strong resolution regime, in our view.
- **A more generous approach to grandfathering**, increasing the incentive for banks to leave non-steps, at least, outstanding as grandfathered Tier 1 and step-up Tier 1s as perpetual Tier 2.
- **SIFI buffers will likely be additive** – hence banks will likely still need to maintain a certain amount of Tier 2 capital outstanding (and not count CoCos as Tier 2).
- **Regulators becoming increasingly cautious on calls**, requiring banks to pre-finance securities coming to call.
- **A growing 'non-call club'** – the original non-caller, Deutsche, has been rather discretely joined by a number of other names, either through smaller banks not calling or a range of banks opting for some kind of exchange. These have served to make the occurrence of non-calls a lot more commonplace.

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We went through the first three issues above in detail in our April 14 note, [Why Non-Called Tier 1 Can Count as Tier 2](#). As promised in that note, we follow up here with a focus on the last two points – the broader regulatory focus on calls, and the growing list of non-callers.

## A Surprise Non-Call Is Not Priced in at All

To reiterate from our previous note – bottom line, we do not necessarily expect a dramatic change in call policy from the largest banks in the short term. However, to us, the direction of travel for the broader market is clear and **there is a much greater risk of surprise non-calls, and already for the weaker names they are becoming more commonplace and accepted** (although for now, they are normally accompanied by exchanges). In our view, a non-call, be it in Tier 2 or Tier 1, from let's say, perhaps not the strongest banks but for example a large Italian or Spanish name, is absolutely not priced into the market and would affect all callable debt.

The market has become complacent about call risk, leading us on a practical level to downgrade many high-priced securities with low back-end steps (see [Strategic Tier 1 Switches](#), February 24, 2011). As such, **we believe that there should be a growing differentiation in how low back-end steps trade versus high back-end steps**. We've seen underperformance of low steps in the past month, but expect more. Again, should there be an unexpected non-call, even in the LT2 sector, we would expect the majority of the Tier 1 market to reprice (led by low steps), although this could be a buying opportunity for the strongest names, in our view.

## Deciding to Call...or Not

Ultimately, a bank considers a myriad of issues when thinking about a call, boiling down very simply to three questions:

- **Do the economics work?** Prior to January's Basel release (*Basel Committee issues final elements of the reforms to raise the quality of regulatory capital*, January 2011), we believed that all subordinated debt would need explicit loss absorption under Basel III, so outstanding Tier 1s would not be compliant as any form of regulatory capital under Basel III – neither Tier 1 nor Tier 2. Hence, in our view, the question a bank was asking itself was, should it call the Tier 1, or “does this non-called Tier 1 represent cheap senior funding?” Post January, in our view this question is now **“does this represent cheap perpetual LT2 capital?”** The differential between perpetual senior and LT2 would be significant (100-300bp according to name, we'd estimate), meaning that this economic decision is now a lot tougher, and certainly more skewed to a non-call than before.

- **Protecting reputation:** Over recent years, we've consistently argued that the strongest banks will call, and we had over 70 uneconomic calls in 2010 alone (i.e., banks calling bonds that step to a level over libor far lower than where they could issue the same type of bond). We maintain that the strongest banks will continue to call, but again, this conviction linked to reputation has diminished somewhat recently. Aside from the ‘creeping non-calls’ that we'll return to later, it's become clearer over the past year that **any subordinated debt issued under Basel III (and CRD IV) rules will not have steps**. On balance, we believe that this diminishes the reputational issue slightly, as if banks had to issue bonds they were trying to get the market to value to the step/call, it would make it more difficult not to call outstanding step bonds. However, this is just a very marginal negative – the potential impact on the bank's overall access to the debt markets would still be front and centre for any bank, in our view.

- **Will the regulator allow a call?** As we understand it, Germany's BaFin has been pretty focused on maintaining a bank's level of any kind of subordinated debt (brought most to light by the difficulties Commerzbank had, we believe, in trying to do initial tenders/exchanges for its outstanding Tier 1s, prior to the latest equity raise). The Bank of Italy has long required banks to pre-finance any upcoming calls with the same, or a stronger, type of capital. We now believe that the UK's FSA has also joined this club, and we're wondering who else might follow. Considering the criticism leveled at LT2 by the Chairman of the FSA (Turner Review, February 2009, page 55: “The FSA therefore believes that required capital ratios...should be expressed entirely in terms of high-quality capital – broadly speaking the current core Tier 1 and Tier 1 definitions – and should not count dated subordinated debt as providing relevant support”), we're surprised that the FSA seems to be taking this stance.

However, again, the introduction of strong resolution regimes (January's EC paper on the topic, and Basel's January paper linking write-down/conversion of subordinated debt to resolution regimes) pulls sub debt back into focus. The EC paper tip-toed around applying such tools – including transferring debt instruments, encompassing bonds, the power to convert certain debt instruments or other non-core Tier 1 instruments into shares, and the power to require the conversion of debt instruments which contain a contractual term for conversion on an official action/decision – to senior debt, with all of these ‘not envisaged’ to apply to outstanding senior debt.

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These tools certainly apply to all subordinated debt – giving a clear and enhanced regulatory role for Tier 1 and Tier 2 (and non-called Tier 1). Hence, this regulatory question too has become more difficult – rather than simply “Will the regulator let me call?”, it’s more – **“If I want to call, will the regulator let me do so without forcing me to refinance?”** While the Bank of Italy has clearly forced (p)re-financing, it appears to us that the FSA is now more focused on this and, again, this changes the dynamics of a call decision.

We covered the first ‘economics’ question above in our April 14 note, and why we now believe that this is all about whether non-called Tier 1 is cheap perpetual LT2. We also talked through the more generous grandfathering arrangements detailed in Basel’s December 2010 release in that note, which again makes the decision somewhat harder than previously as, if left outstanding, the Tier 1 has a better chance of falling into the Tier 1 grandfathered category for longer. Indeed, one (totally hypothetical) idea would be to not call any Tier 1s until January 2, 2013, to maximise the grandfathering limit for outstanding Tier 1s for the following ten years. On reputation, we also talked in our April 14 note about the pure focus on non-step structures going forward.

Here, we’ll go into more detail on the ‘creeping non-calls’ we’ve mentioned in the past, and why these make us more nervous about the market. First though, we’ll focus on the changing regulatory approach to calls – or at least, the pre-financing of them.

## Growing Regulatory Caution on Calls

As we wrote in our April 14 note, the generic theme among European regulators is that banks are going to be required to hold more capital, at least in the short term. Banks will achieve this in multiple ways (e.g., earnings retention, rights issues, RWA management), but **we also believe that regulators will be increasingly strict on requiring banks to refinance calls**. Just six months ago, we were under the strong impression that all subordinated debt would have to have explicit loss absorption/conversion features at the point of non-viability (PONV) and, additionally, Tier 1 bonds would have to have such a feature at a set trigger point linked to capital ratios. Hence, we thought that outstanding Tier 1 would really only have value as senior funding under Basel III.

**Resolution regimes change everything:** With the UK, Germany, Denmark and Ireland – and a Dutch regime at the consultative level – there’s a growing realisation that the ability to impose losses on bondholders is there – in particular, on any kind of subordinated debt, hence the absolute level of subordinated debt a bank has outstanding has increased in importance, in our view. The EU resolution regime/crisis-

management framework should be set in stone by mid-2012, with implementation likely in 2014/15. With the publication of the EU’s working paper on resolution regimes in January, and the Basel III final clarification that, going forward, LT2 would not have to have explicit loss absorption language if it’s in a strong resolution regime, the rationale for leaving subordinated debt outstanding is clear.

What’s currently happening in Ireland, with the Irish government using its regime to implement a Subordinated Liabilities Order (SLO) on AIB subordinated debt, **mandatorily altering terms to zero coupons with 2035 maturities**, speaks to this change in attitude. We’re sure that regulators around Europe will be closely watching these developments in Ireland.

## FSA Joining the Pre-Financing Club

In our view, Germany’s BaFin has long been a proponent of the ‘any sub debt is good debt’ argument even before it implemented its own resolution regime and the Bank of Italy adopted this approach over the course of last year. Italian banks must pre-finance any call with the same, or stronger, capital. This has clearly created problems for many of the Italian banks, not least forcing Intesa and UniCredit to issue ‘new-style’ Tier 1s last year to pre-finance old issues, even though Basel III guidelines on Tier 1 debt have not yet been transposed into an EU directive (this will hopefully come next month, in the form of the CRD IV). See our [CoCo Compendium](#), March 4, 2011, for more details on these bonds. The most recent example of this is UniCredit pricing a new €750 million 10-year bullet LT2 in early April at ms+245bp, to pre-finance calls this year. A host of smaller Italians have not called bonds, with the largest being UBI (see [UBIIM – The Season for Giving](#), December 22, 2010) and Monte dei Paschi, who both increased the coupon step-up to compensate investors. We’ll return to these later.

What we did not expect was that the UK’s FSA would also join this ‘pre-financing’ club, particularly considering Adair Turner’s comments, which we highlighted above. We appreciate that in April, the Co-op Bank announced an exchange of its €300 million 2016 FRN LT2 into pretty generous new fixed-rate € or £ LT2. However, considering its size and strength, this is not what caught our eye; instead, it was Barclays’ issuance of €1 billion of 6.625% LT2, bullet maturity 2022, at the end of March. At Bunds+351bp, z+315bp, this is certainly relatively expensive, particularly as it didn’t look like Barclays needed this capital.

As an aside, in a recent questionnaire to a variety of European banks, at least one Austrian bank mentioned that the regulator requires it to pre-finance any called subordinated debt, and we’d note that RBI issued a LT2 last week specifically to pre-finance a call.

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## Taking a Step Back – Barclays' Capital Base

Looking at the 2010 annual accounts, Barclays had £42.861 billion of core Tier 1, £53.546 billion of qualifying total Tier 1 (including £6.317 billion of preference shares, £6.098 billion of RCIs and £1.046 billion of TONs) and RWAs of £398.031 billion, giving core Tier 1 of 10.8% and Tier 1 of 13.5%. Total qualifying Tier 2 capital was £16.019 billion, which includes £1.628 billion of perpetuals (UT2), £16.565 billion of 'dated loan capital' or LT2, and £2.409 billion of 'collectively assessed impairment allowances' and is net of £5.204 billion of regulatory deductions. Adding total Tier 1 and Tier 2 and subtracting 'other regulatory deductions' of £2.250 billion gives total net capital resources of £67.315 billion, or a total capital ratio of 16.9%. All deductions from Tier 2 and from total capital amount to £7.454 billion. The current minimum total capital ratio is 8%, but of course any bank would want to keep a substantial margin between its actual ratio and the minimum.

Thinking about why Barclays would want to issue LT2 at these expensive levels, it could be linked to regulatory deductions. If Barclays had no Tier 2 at all, regulatory deductions would have to be taken from Tier 1 capital resources, impacting the more important Tier 1 ratio (compared to the total capital ratio). **Barclays currently has over £21 billion of deductions-absorbing Tier 2.** With regulatory deductions from Tier 2/total capital standing at £7.5 billion, Barclays could burn through over £13 billion of outstanding Tier 2 before it did not have enough to absorb these regulatory deductions at the Tier 2/total level. Only after Tier 2 falls by over £13 billion would these deductions have to start coming off Tier 1. Further, if £13 billion suddenly dropped off Tier 2, the total capital ratio would fall to 13.6%, from 16.9%, again, hardly disastrous – and the core and Tier 1 ratios would remain the same. **Our conclusion remains that Barclays had no need to issue this LT2 in March.**

Maybe the answer is at the solo bank level. Unfortunately, looking at Barclays Bank Plc's 2010 accounts reveals little, with just a short summary of the capital position. The bank's core Tier 1 is 10.9%, but all other numbers are given at group level.

**It is our view that the FSA is increasingly requiring calls for UK banks to be pre-financed, and occasions where calls are not pre-financed should be exceptional ones.** We appreciate that a bank's decision on calls, and the regulator's attitude to calls and whether or not a pre-financing is required, would depend on a myriad of factors. However, **Barclays paying out z+315bp for a LT2 which is absolutely not needed from a capital ratio perspective, in our view, suggests that the UK's FSA is focused on pre-financing, we believe.** Again, we appreciate that there will be

a myriad of issues impacting a call decision, but it's interesting to simply go back over the past two years and look at Barclays' issuance and call pattern.

**2010 issuance and calls:** Looking back to 2010, Barclays issued two LT2s, €1.5 billion of 6% in July and \$1.25 billion of 5.14% in October, both bullets. In 2010, Barclays called a LT2 \$1.5 billion FRN in May and a €850 million 7.5% Tier 1 in December. Using an exchange rate of 1.43, Barclays issued \$3.4 billion of LT2 in 2010, and called \$2.7 billion of sub debt, hence net issuance of \$700 million.

**2011 issuance and calls:** Already in 2011, Barclays has announced the call of a €1.25 billion FRN (**step I+67.5bp – in our view, the bond the z+315bp LT2 pre-financed**) for April 20, and €1 billion of 5.75% bullet LT2s matured in March. The bank has four other subordinated issues coming to call in the rest of 2011. These are the \$1.25 billion 8.55% Tier 1 (step I+300bp) on June 15, a \$ FRN on June 27 (final maturity 2016) of \$750 million stepping to I+70bp, then a retail pref share of \$750 million 6.625% in September and an institutional \$750 million 7.375% Tier 1 (step I+233bp) on December 15. Presuming that the retail deal may not be called, this amounts to \$2.75 billion to call for the rest of this year.

Adding these up, calls in 2011 would be \$4.55 billion and \$1.4 billion of maturities. So far, Barclays has issued the one LT2 in March, of €1 billion (\$1.4 billion). Starting in June, we have a further \$2.75 billion coming to call. Taking into account the net issuance of \$700 million in 2010, the €1 billion LT2 March issue takes us to a running total of \$1.7 billion in 2011. This would really just cover the €1.25 billion (\$1.75 billion) called on April 20. We'll ignore maturities, as the FSA cannot prevent those; in our mind, there's clearly more pressure to pre-finance discretionary calls, rather than unavoidable maturities. In this case, there's a further \$2.75 billion of subordinated calls to finance.

**If we had written this note a week ago, we would have expressed some caution on the upcoming June calls of €2 billion – but Barclays issued call notices on the Tier 1 and LT2 FRN already.** What we haven't seen is any pre-financing yet. What we don't know is if Barclays must pre-finance at all (we believe that it should, with any outright calls without pre-financing only being exceptional), and if so, what timeframe it might be given. Considering we have no EU-fixed framework for what new Tier 1 should be (the CRD IV will hopefully be with us next month), it may well be that if Barclays has to refinance the Tier 1 call, it will wait for clear guidance on what it must look like before it does it. However, from the track record, we would expect at least the \$750 million LT2 to be refinanced.



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On type of pre-financing, it's our understanding that at least in Italy, retained earnings are not taken into account when looking at pre-financing, and anyway, if they were in the UK, it would beg the question as to why Barclays did its 'expensive' €1 billion LT2 in March, having announced on February 14 its 2010 net income of £4.5 billion.

As an aside here, although the press made much of the so-called 'CoCos' Barclays was said to have issued to remunerate staff, these were only issued to around 230 'code staff'. In terms of the scheme, it is not a capital instrument but simply deferred cash with a core Tier 1 trigger – not a real CoCo. It effectively gives Barclays regulatory capital benefit as core Tier 1 while it is not paid out (effectively as it does not deplete retained earnings now). This is different to deferred cash paid to other staff which is not contingent on anything and hence is recognised in the P&L (and therefore goes out of retained earnings straight away). According to Barclays, this scheme was all about meeting compensation guidelines and not preserving capital/creating a new type of capital instrument. The amount is not disclosed in the annual report, but our very rough calculations indicate that this is very unlikely to be more than £200 million.

## A Look at HSBC

As we'd expect, we never get clear answers when we ask banks about what the regulator is telling them vis-à-vis calls, and we believe that if a regulator was 'forcing' a bank to pre-finance, the bank would not put it that way. Looking to test our view on the FSA's tougher approach to financing calls, the only other large UK bank we can really look at is HSBC, as RBS and Lloyds are of course restricted from calling.

HSBC has so far in 2011 called a 4.25% €600 million LT2 and a €800 million FRN (step 1+70bp) in March, and another \$300 million 6.95% LT2 bullet matured in March. However, HSBC has not issued any LT2 so far this year – so is our theory about the FSA looking more closely at calls wrong? We don't think so, and the answer lies in the (admittedly very broad-brush) approach to looking at net issuance over the recent past. Starting from HSBC's mammoth equity issuance of £12.9 billion in March 2009, we get net issuance of \$16.2 billion in 2009, \$5.2 billion in 2010 and, if HSBC calls everything we expect it to in 2011 (and including maturities), a negative \$3.8 billion this year. Hence, even if HSBC does not issue any subordinated debt this year, it has a 'running total' of net positive \$17.6 billion. On this extremely crude basis, **there is no need to 'refinance' any upcoming calls this year.** Further, if we ignore 2009 (and we didn't go back that far for Barclays), HSBC would still be at a net positive Tier 2 level.

**Our concern remains – the economic argument for non-calling strengthens, if a bank is forced to refinance it in the current environment.** With, in our view, the FSA now taking a tougher stance on calls (and remember the pre-resolution regime Turner report – stating that dated subordinated debt should play no part in regulatory capital), **we believe that the introduction of resolution regimes changes regulators' attitudes to sub debt**, and we wonder which regulator may be next to overtly take this tougher stance.

Further, as regulators get increasingly vocal about Basel providing only guidelines and national pillar 2 requirements potentially being a lot higher, could it be that a certain regulator takes the step of publicly announcing its aversion to calls? Or, a regulator simply announcing that if, say, a bank does not look like it will reach 10% core Tier 1 under Basel III (or even that it will not surpass this level by a strong margin), then it would be expected to keep a higher level of other forms of debt capital? This would imply that Tier 2/outstanding Tier 1 may have a greater role in future, particularly in a strong resolution regime – which is just what the EU is trying to introduce for all countries. Naturally, any announcements along the above lines would likely reprice any callable debt – those with low steps more acutely.

## Large Exposures – a Reason to Issue LT2

This time last year we thought there was little point in issuing much LT2 as first, we thought it would have to have explicit loss absorption language (which is now not the case, if there's a strong resolution regime), but also because its use as absorbing regulatory deductions and 'saving' Tier 1 would get phased out by 2018 under Basel III. Now it seems that the regulators are increasingly re-thinking the value of subordinated debt generally, but there's another reason a bank may focus on its total capital ratio. Banks have limits on the aggregate size of large exposures they can hold. Simply put, a large exposure is the bank's total exposure to a counterparty or connected counterparties (across trading and banking book), which in aggregate exceeds more than 10% of the bank's capital resources. Limits on large exposures are set at 25% of the same capital base, with some exceptions (for example, exposures which would carry 0% risk-weighting under the standardised approach). Any exposures over this 25% will attract additional capital charges. **The capital resources to be used to measure large exposures include Tier 2 capital** (and are net of deductions).

Once Basel III has completed new capital and liquidity standards, we understand it will be examining the LE regime. As a regulatory requirement, no information on large exposures are published, and we certainly couldn't find any

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details whatsoever in Barclays' year-end reports, for example. Therefore, it's hard to gauge this as a real driver of LT2 issuance, but it's at least worth a mention.

## Creeping Non-Calls

We discussed in our note of April 14 how the way grandfathering buckets are calculated at the aggregate level, rather than bond-by bond (clarified in Basel's December 2010 paper) means that banks will have a greater incentive to leave non-step Tier 1 outstanding as they continue to receive Tier 1 capital benefit for a greater period of time. The idea of managing grandfathering buckets was also behind Commerzbank's recent LT2 exchange. Commerzbank has two LT2s coming to call in 2011 and 2012, and while we doubt its desire to call them, the securities would have lost all capital benefit under Basel III (reducing Tier 2 by 60% on January 1, 2013 if it's conservatively assumed that Germany does not have a strong resolution regime – not our base case); hence, by exchanging them into a longer-dated 2019 LT2 (and issuing a 2021 LT2), Commerzbank is able to maximise its LT2 grandfathering buckets. This was also the driver of ABN's LT2 exchange, where it proposed an exchange of six LT2s coming to call in 2010-13 into new 2021 and 2022 LT2.

Note that even if these securities do not need to be grandfathered as Holland and Germany are deemed to have strong resolution regimes (which we expect to be the case), then by extending the maturity, the banks also push back the regulatory amortisation of these securities in the years preceding their final maturity. Equally, we would note that Credit Agricole highlighted at our recent banks conference that it would look to fully use grandfathering for its existing Tier 1s. **We highlight these as examples of banks actively managing (or suggesting that they will actively manage) their grandfathering buckets to maximise capital benefit under Basel III to show that this is a genuine focus for banks.**

## It Is No Longer Just Deutsche

For an extended period of time, Deutsche was seemingly very much an exception in being the only major bank that had not called its securities at the first call date. However, we are now seeing the number of banks in the non-call category slowly rise for a variety of reasons. First, we have a whole series of banks that have not been able to call as a result of EC restriction (e.g., RBS, Lloyds, Dexia, Irish banks, ING, etc.). These make up the majority of Tier 1 non-callers in Exhibit 2. All LT2 non-calls are listed in Appendix 1, and selected events in the non-call calendar, including details of tenders and exchanges, are in Appendix 2.

Exhibit 2

### Tier 1 Calls and Non-Calls 2009 to Date

Called	Not called
Intesa	Fortis Group
Barclays	KBC
Nordea	Credit Logement
Soc Gen	UBIIM
Swedbank	RBS
Standard Chartered	Lloyds/HBOS
CS	Natixis
HSBC	ING
UBS	Monte
UniCredit	AIB
BNP	BKIR
Credit Agricole	Deutsche Bank

Source: Morgan Stanley Research

Second, we have other banks that have stated that calls will only be made on an economic basis going forward after having offered liability-management schemes with premiums, e.g., Santander, BBVA, RBS, Lloyds (for certain securities). Third, given the Italian regulators require banks to pre-finance their securities coming to call, given their inability to access to the market and the lack of clarity on new-style Tier 1 securities, we have seen UBIIM and Monte not call Tier 1 securities at the first call date. Finally, we have Credit Logement that has not called, although that is somewhat of a case apart (see [Credit Logement – Low Risk with Optionality](#), March 4, 2010).

**All this means that Deutsche has slowly been joined by other banks in the non-call camp and is no longer in an exclusive club of one.** While the banks following the LM route have effectively offered investors a way out, it does mean that with the amounts of banks falling into the non-call category increasing over time, the stigma of not calling, coupled with only non-steps being issued, is likely to fall away. As a result, this potentially paves the way for others not to call going forward.

To be fair, in the short term, banks remain concerned about their reputation (e.g., we saw both Monte and UBIIM significantly increase the back-end steps on their securities on a voluntary basis post the non-call). Commerzbank and ABN exchanges were also on relatively generous terms. However, as cash prices have risen, the level of premiums paid has fallen significantly compared to the original tenders/exchanges that took place, and we'll dwell on Banesto in the next section. Overall, liability management remains a legitimate tool for banks to use to offset the negative impact of not calling to a large extent. However, **the level of premium paid has consistently dwindled and, as more banks fall into the non-call camp, the necessity to undertake liability-management schemes should diminish.** What we're saying here is that if you are not overweight banks right now, there's no strong reason to buy, if you're looking for great premia on exchanges linked to non-calls.

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## The Banesto Exchange – a Surprise, Badly Taken

Santander has long made it clear that it will make economic decisions on perpetuals previously included in liability management. However, there has been no such comment on LT2s, and it has continued to call these, and is fully expected by the market to continue doing so, in our view.

Hence, it was a surprise when Banesto, 90% owned by Santander, did not call its €500 million 4% LT2, due for call on March 23 (step to euribor+95bp). Banesto had previously called a €500 million LT2 issue in September 2008. Instead, it announced an exchange offer at par into new senior bonds maturing on the same date as the original maturity of the LT2s with a fixed coupon (4.08%) set at a spread of 125bp to mid-swaps, only 30bp wider than the back-end step of the LT2 and more than 15bp tight to shorter-dated Banesto seniors at the time of issue. Before the offer was made the LT2 was trading in the low to mid 90s, implying a z-spread of 300bp. The new senior traded at 94.5 on reoffer, implying two or three points of capital gain at best and with ~80bp tighter z-spread, capturing the reduced subordination of the new security.

Banesto is not the first example of this kind of exchange – elsewhere in Spain, Bilbao Bizkaia Kutxa (BILBIZ) offered a similar exchange of 2011 callable LT2 into senior (albeit with a more generous spread – ms+157bp). In Italy, BPEIM, a second-tier popolare bank, offered a similar exchange of non-called LT2 into senior (although the terms here were again somewhat more generous than those seen at Banesto or BILBIZ, with an exchange into a senior with shortened maturity of two years rather than five). These types of exchanges of LT2 into senior clearly have nothing to do with capital; they're clearly simply linked to funding pressures, or else the exchanges would remain in subordinated debt. However, these are again clear examples of 'creeping non-calls', in our view.

For us, the most striking thing here is what happened with Banesto. Clearly very closely linked to Santander, the non-call was a surprise. The slim premium offered was a further disappointment. Although this does make us more concerned about a Santander non-call, we'd note that Santander since called a £ 5.375% LT2 on April 18.

## A Lack of Near-Term Catalysts in Tier 1

Based on the fact that most Tier 1s coming to call this year (see Appendix 3) are from high-quality names (and so should call), or small banks, or those with call bans (and so would not surprise if they didn't call), **it's really tough to put our finger on a Tier 1 'shock non-call' candidate to serve as a catalyst for a sudden repricing of low back-end Tier 1s.** As we noted in our April 14 piece, the more likely problem is a non-call of a LT2 (given the volume of bonds outstanding).

## Where's the Danger in Upcoming LT2 Calls?

It's fair to say that, since Deutsche, we haven't really had a 'shock' non-call in our European banks world. However, we understand that Bank of America's recent decision not to call a CAD 4.81% LT2 (callable June 1) was unexpected. Previously we understand that investors in that market fully expected calls, and that banks were attuned to this – not calling in domestic US\$, but calling in CAD. BofA cited a number of factors influencing its decision, one of them being capital treatment and regulatory considerations. This broke a tradition of calls in this market (JPM called a similar bond last September), reminiscent of Deutsche's non-call in December 2008.

Looking at the upcoming LT2s in Exhibit 3 overleaf, we believe **danger areas are primarily with the large Spanish (particularly considering the Banesto episode), Austrians (as we understand they must pre-finance), and large Italians** (we expect that Intesa's planned €5 billion and continued UniCredit LT2 fresh issuance should cover upcoming calls, but are very aware of the Bank of Italy's focus on capital). We've highlighted the steps on all these bonds, and in Appendix 4, note the levels of recent LT2 issues, to show that we are still far away from truly economic calls on these bonds.

**Ultimately, we are looking for a repricing of bank debt capital, considering current levels and the lack of any discount in callable structures – of course, particularly low steps – to take account of the risk of a surprise non-call.** We fear a regulator, or regulators, becoming more vocal on their aversion to calls, or at least, strengthening views on refinancing. We also fear greater focus more generally on the role of sub debt to practically aid banks in resolution regimes – increasing its importance and again suggesting that sub debt in general, and non-called Tier 1 in particular, has a clear role. In addition to this, periphery issues are far from over, and while the market is focusing more on Greece right now, the Spanish banks have still not been recapitalised.

## A Final Word – CRD IV

As we mention in every thematic piece we put out, Basel III is with us and finalised, as regards capital and grandfathering. However, these guidelines still have to be put into EU law via a directive (CRD IV) or legislation. Hence, details could change. Although we believe Basel III will be 'written out' into EU law, we cannot rule out that outstanding subordinated debt takes on more importance than it does in Basel (remember, the majority of Basel III was fleshed out while the debate was ongoing about resolution regimes). Hence, we could possibly get more generous grandfathering, or some other nod to banks raising new Basel III-compliant capital, but also being more cautious about redeeming any debt capital currently outstanding.



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Exhibit 3

## Upcoming LT2 Calls

Next call	Issuer parent	Ccy	CPN	Step up
26-May-11	Marfin Popular Bank Public Co	EUR	FRN	3m€Libor+175bp
07-Jun-11	Banca Carige SpA	EUR	FRN	3m€Libor+102bp
15-Jun-11	Banco Popolare Scarl	EUR	FRN	3m€Libor+100bp
16-Jun-11	Caja de Ahorros y Monte de Piedad de Navarra - Caja Navarra	EUR	FRN	3m€Libor+89bp
20-Jun-11	Banco Santander SA	USD	5.805	3m\$Libor+86bp
20-Jun-11	Banco Santander SA	USD	FRN	3m\$Libor+86bp
21-Jun-11	Fortis Group	EUR	FRN	3m€Libor+75bp
22-Jun-11	Swedbank AB	GBP	5.25	3m£Libor+173.5bp
22-Jun-11	Raiffeisen Zentralbank Oesterreich AG - RZB	EUR	FRN	3m€Libor+83bp
23-Jun-11	Bankinter SA	EUR	FRN	3m€Libor+80bp
30-Jun-11	Unione di Banche Italiane Scpa - UBI Banca	EUR	FRN	3m€Libor+110bp
08-Jul-11	Principality Building Society	GBP	5.375	3m£Libor+100.5bp
08-Jul-11	Commonwealth Bank of Australia	USD	FRN	3m\$Libor+73bp
27-Jul-11	Kazkommertsbank OAO	USD	8.625	5yr UST+ 526.5bp
28-Jul-11	Banco Finantia SA	EUR	FRN	3m€Libor+135bp
13-Sep-11	IKB Deutsche Industriebank AG	EUR	FRN	3m€Libor+90bp
14-Sep-11	ABN AMRO Holding NV	EUR	FRN	3m€Libor+70bp
19-Sep-11	Macquarie Bank	GBP	5.5	3m£Libor+92.5bp
20-Sep-11	Deutsche Bank AG	EUR	FRN	3m€Libor+80bp
20-Sep-11	UniCredit SpA	EUR	FRN	3m€Libor+90bp
20-Sep-11	Oesterreichische Volksbanken AG	EUR	FRN	3m€Libor+79bp
26-Sep-11	ING	USD	FRN	3m\$Libor+71bp
28-Sep-11	Banco Santander SA	EUR	FRN	3m€Libor+85bp
28-Sep-11	National Australia Bank Ltd	EUR	FRN	3m€Libor+75bp
29-Sep-11	Caja de Ahorros del Mediterraneo - CAM	EUR	FRN	3m€Libor+40bp
30-Sep-11	Nordea Bank AB (publ)	EUR	4	3m€Libor+179bp
30-Sep-11	HBOS plc	USD	FRN	3m\$Libor+70bp
06-Oct-11	HSBC Holdings plc	USD	FRN	3m\$Libor+70bp
10-Oct-11	Nationwide	GBP	7.125	5y UK gilt+320
11-Oct-11	Mediobanca - Banca di Credito Finanziario SpA	EUR	FRN	3m€Libor+90bp
14-Oct-11	Royal Bank of Scotland Group plc	USD	FRN	3m \$Libor+78
17-Oct-11	BNP Paribas SA	EUR	FRN	3m€Libor+72bp
18-Oct-11	DnB NOR ASA	EUR	FRN	3m€Libor+105bp
20-Oct-11	Societe Generale	USD	FRN	3m\$Libor+71bp
20-Oct-11	Westpac	USD	FRN	3m\$Libor+71bp
21-Oct-11	UniCredit SpA	EUR	FRN	3m€Libor+105bp
24-Oct-11	Banco Bilbao Vizcaya Argentaria SA - BBVA	EUR	FRN	3m€Libor+80bp
30-Oct-11	Banco Gallego SA	EUR	FRN	3m€Libor+115bp
31-Oct-11	Turk Ekonomi Bankasi AS	EUR	6.1	7.10%
07-Nov-11	Irish Life & Permanent	EUR	FRN	3m€Libor+80bp
08-Nov-11	SNS Reaal Groep NV	AUD	FRN	BBSW3M + 92
22-Nov-11	Banco Popolare Scarl	EUR	FRN	3m€Libor+45bp
28-Nov-11	Sella Holding Banca SpA	EUR	FRN	3m€Libor+110bp
28-Nov-11	Oesterreichische Volksbanken AG	EUR	FRN	3m€Libor+85bp
28-Nov-11	Swedbank AB	EUR	FRN	3m€Libor+174bp
06-Dec-11	Nationwide	GBP	5.75	5yr UKT+162
08-Dec-11	Landesbank Hessen-Thueringen Girozentrale - Helaba	EUR	4.125	3m€Libor+83bp
09-Dec-11	BNP Paribas SA	USD	FRN	3m\$Libor+70bp
15-Dec-11	Commonwealth Bank of Australia	USD	FRN	3m\$Libor+72bp
18-Dec-11	Bankinter SA	EUR	FRN	3m€Libor+84bp
19-Dec-11	Unione di Banche Italiane Scpa - UBI Banca	EUR	FRN	3m€Libor+100bp
19-Dec-11	Group Credit Mutuel CEE	EUR	FRN	3m€Libor+75bp
20-Dec-11	ANZ	USD	FRN	3m\$Libor+71bp
21-Dec-11	Nationwide	EUR	FRN	3m€Libor+72bp
22-Dec-11	Banco Internacional do Funchal - Banif	EUR	FRN	3m€Libor+125bp

Source: Morgan Stanley Research; Bloomberg

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## Appendix 1: LT2 Non-Calls since 2009

Call date	Issuer	Ccy	Cpn	Step up	Comments
23-Apr-09	Deutsche Bank AG	AUD	FRN	3m-BBSW+100bp	Not called
23-Apr-09	Deutsche Bank AG	AUD	6.5	3m-BBSW+100bp	Not called
28-Jun-09	Credit Agricole SA	EUR	5.4		Not called, retail bond
29-Jun-09	Caja de Ahorros de la Inmaculada de Aragon	EUR	FRN	3m-€Libor+106bp	Not called, retail bond
30-Jun-09	Kaupthing Bank hf	EUR	0	3m-€Libor +165bp	In default
30-Jun-09	Banco Popular Espanol SA	EUR	FRN		Not called, retail bond
01-Jul-09	Deutsche Bank AG	JPY	1.287	3m-¥Libor+75bp	Not called
15-Jul-09	Caja de Ahorros y Monte de Piedad de Madrid - Caja Madrid	EUR	FRN	3m-€Libor +75bp	Not called, exchanged
28-Jul-09	Deutsche Bank AG	EUR	5.248	3m-€Libor+83bp	Not called
30-Jul-09	Credit Agricole SA	USD	6.65	3m-€Libor+105bp	Not called, retail bond
20-Aug-09	Raiffeisen Zentralbank Oesterreich AG - RZB	EUR	5.75	12m-€Libor+150bp	Not called, retail bond
21-Sep-09	UniCredit SpA (HVB)	EUR	0	No step up	Not called, unusual structure
30-Sep-09	Banco Popular Espanol SA	EUR	FRN		Not called, retail bond
01-Oct-09	Deutsche Bank AG	JPY	1.287	3m-¥Libor+75bp	Not called – originally not called in July 2009
15-Oct-09	Banca Italease	EUR	FRN	3m-€Libor+110	Not called, exchanged
16-Oct-09	Deutsche Bank AG	EUR	3.875	3m-€Libor+88bp	Not called
21-Oct-09	Glitnir Banki hf	EUR		3m-€Libor +145bp	In default
27-Oct-09	Royal Bank of Scotland Group plc	AUD	FRN	3m-BBSW+87bp	Not called
27-Oct-09	Royal Bank of Scotland Group plc	AUD	6	3m-BBSW+87bp	Not called
30-Oct-09	Credito Valtellinese	EUR	FRN	3m-€Libor +160bp	Not called – originally not called in April 2008
12-Nov-09	Veneto Banca SCARL	EUR	FRN	3m-€Libor+120bp	Not called, retail bond
02-Dec-09	UniCredit SpA	EUR	FRN	6m-€Libor	Not called, retail bond
15-Dec-09	Sella Holding Banca SpA	EUR	FRN	3m-€Libor +115bp	Not called - not economic to refinance
20-Dec-09	Caja de Ahorros de Castilla La Mancha	EUR	FRN	3m-€Libor+95bp	Effectively insolvent – taken over by central bank, uncertain outlook. Prefs tendered at par.
23-Dec-09	Unione di Banche Italiane SCPA	EUR	FRN	3m-€Libor+72.5bp	Not called - retail
13-Jan-10	Northern Rock plc	GBP	5.625	5yr UKT+155bp	Not called
13-Jan-10	Northern Rock plc	GBP	5.625	5yr UKT+155bp	Not called
03-Feb-10	Banca Popolare di Vicenza Scarl	EUR	FRN	3m-€Libor+105bp	Not called - not economic to call
17-Feb-10	Deutsche Bank AG	USD	FRN	3m \$Libor+80bp	Not called
09-Mar-10	ABN AMRO Holding NV	USD	FRN	3mLibor+70bp	Going to RBS, subject to EC intervention
11-Mar-10	Caja de Ahorros y Monte de Piedad de Cordoba	EUR	FRN		Not called
14-Mar-10	Credito Valtellinese Scarl	EUR	FRN	3mEuribor+107.5bp	Not called
16-Mar-10	Caja Rural Intermediterranea - CAJAMAR	EUR	FRN	3mEuribor+80bp	Not called
23-Mar-10	Landsbanki Islands hf	EUR	5.355		In default
23-Mar-10	Allied Irish Banks plc	EUR	FRN	3mEuribor+80bp	Not called, subject to EC intervention
04-May-10	Banco Finantia SA	EUR	FRN	3m-Euribor+135bp	Not called, very small issue
08-Jun-10	ABN AMRO Holding NV	EUR	FRN	3m-Euribor+75bp	Not called, subject to EC intervention, RBS security
10-Jun-10	Cassa dei Risparmi di Forli SpA	EUR	FRN	3m-Euribor+100bp	Not called
29-Jun-10	Banca Popolare di Milano Scarl	EUR	FRN	3m-Euribor+105bp	Not called, not economic to refinance
30-Jul-10	Allied Irish Banks plc	USD	FRN	3m\$Libor+80bp	Not called, subject to EC intervention
28-Sep-10	Bilbao Bizkaia Kutxa - BBK	EUR	FRN	3mEuribor+80bp	Not called, exchanged into senior at par
22-Sep-10	Deutsche Bank AG	EUR	FRN	3mEuribor+70bp	Not called
29-Sep-10	Royal Bank of Scotland Group plc	USD	FRN	3m\$Libor+74bp	Not called, subject to EC intervention
30-Oct-10	Allied Irish Bank	USD	FRN	3m\$Libor+80bp	Not called
29-Sep-10	Royal Bank of Scotland Group plc	USD	FRN	3m\$Libor+74bp	Not called, subject to EC intervention
03-Nov-10	Banca Vicenza	EUR	FRN	3mEuribor+105bp	Not called
04-Nov-10	Caja General de Ahorros de Canarias	EUR	FRN	3mEuribor+84bp	Not called
04-Nov-10	Deutsche Postbank AG	EUR	FRN	3mEuribor+80bp	Not called, not economic to refinance
22-Nov-10	Caja Rural del Mediterraneo - RURALCAJA	EUR	FRN	3mEuribor+50bp	Not called

Source: Morgan Stanley Research, Bloomberg

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## Appendix 1: LT2 Non-Calls since 2009 (continued)

Call date	Issuer	Ccy	Cpn	Step up	Comments
15-Dec-10	Deutsche Bank AG	GBP	5.25	3m- £Libor+89bp	Not called
07-Dec-10	Caja Espana de Inversiones CAMP - Caja Espana	EUR	FRN	3mEuribor+85bp	Not called
07-Dec-10	Irish Life & Permanent plc	EUR	FRN	3mEuribor+75bp	Not called
14-Dec-10	KBC Group NV	EUR	FRN	3mEuribor+70bp	Not called – restricted
22-Dec-10	Fortis Bank NL	EUR	FRN	3mEuribor+77bp	Not called – restricted
23-Dec-10	Allied Irish Bank	EUR	FRN	3mEuribor+80bp	Not called
29-Dec-10	Banca Popolare di Milano	EUR	FRN	3mEuribor+105bp	Not called – IR said waiting to see what LT2 will need to look like under Basel III before they issue a new security to replace this
22-Dec-10	Man Group	USD	FRN	3m\$Libor+165bp	Not called
23-Dec-10	Banco Popular Espanol SA	EUR	FRN	3mEuribor+65bp	Not called – previously exchanged
20-Jan-11	IKB Deutsche Industriebank AG	EUR	FRN	3m€Libor+78.5bp	Not called
28-Jan-11	Royal Bank of Scotland Group plc	EUR	4.5	3m€Libor+85bp	Restricted
01-Mar-11	Investec Finance Plc	GBP	7.75	5yr UK Gilt+350bp	Exchange offer
01-Mar-11	Bilbao Bizkaia Kutxa - BBK	EUR	FRN	3m€Libor+80bp	Not called
21-Mar-11	Banco Guipuzcoano SA	EUR	FRN	3m€Libor+90bp	Exchange offer
21-Mar-11	Bankinter SA	EUR	FRN	3m€Libor+50bp	Exchanged
23-Mar-11	Banesto Bank Emisiones	EUR	4	3€Libor+95bp	Exchange offer
18-Mar-11	ING	EUR	FRN	3m€Libor+105bp	Not called - EC restriction
15-Mar-11	Cassa di Risparmio di Rimini SpA - CARIM	EUR	FRN	3m€Libor+105bp	Not called – subject to Bank of Italy pre-financing requirements
23-Mar-11	Banca Popolare dell'Emilia Romagna Scarl	EUR	FRN	3m€Libor+100bp	Not called – subject to Bank of Italy pre-financing requirements, subsequently exchanged
29-Mar-11	HBOS plc	EUR	FRN	3m€Libor+67.5bp	Not called – restricted
11-Apr-11	Royal Bank of Scotland Group plc	USD	FRN	3m\$Libor+70bp	Not called – restricted
18-May-11	Co-Operative Bank Plc	EUR	FRN	3m€Libor+78bp	Exchange offer
19-Apr-11	Caixa Economica Montepio Geral	EUR	FRN	3m€Libor+95bp	Not called
29-Apr-11	Lloyds TSB Group plc	GBP	FRN	3m£Libor+73bp	Restricted
05-May-11	Caixa Manresa	EUR	FRN	3m€Libor+85bp	Not called
16-May-11	Dexia SA	USD	FRN	3m\$Libor+70bp	Restricted
23-May-11	ING	USD	FRN	3m\$Libor+67.5bp	Restricted
25-May-11	Banco de Sabadell SA	EUR	FRN		Exchange offer
01-Jun-11	BAC	CAD	4.81	1mCDOR+60bp	Not called
14-Jun-11	Dexia SA	CHF	2.75	3m CHF Libor+57.5bp	Restricted
15-Jun-11	Banca della Marche SpA	EUR	FRN	3m€Libor+115bp	Not called

Source: Morgan Stanley Research, Bloomberg

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## Appendix 2: Non-Call Details since December 2008

Date	Event	Details on the tenders/exchanges
Dec-08	Original DB LT2 non-call	
Feb-09	Sabadell LT2 non-call (subsequently called)	
Jul-09	Santan LM scheme – economic calls on UT2/Tier 1 going forward	€9.1 billion of Tier 1 and UT2 securities in different currencies were offered to be exchanged into new Tier 1 and UT2 securities. Bondholders were offered premiums ranging between 0-15 points on the securities. The average participation rate was 50.5% on the Tier 1 securities and 45.0% on the Upper Tier 2 securities.
Oct-09	RBS UT2 non-call (restricted pending EC review)	
Oct-09	ING LT2 call (per bond language, this was irreversible)	Dutch regulator allowed the call; the EC was not consulted.
Oct-09	Dexia UT2 called, then revoked at the request of the EC	
Oct-09	EC guidelines restricting state aid banks from paying optional coupons/calling securities	In our view, issued in part as a response to ING's call in September.
Oct-09	BBVA LM scheme – economic calls on UT2/Tier 1 going forward	€1.5 billion of Tier 1 securities in different currencies were offered to be exchanged into new Tier 1 securities. € Tier 1s were offered at an exchange price of 81.5% and £ Tier 1s at 69%. The average participation rate was 75.7% on € Tier 1 securities and 92.2% on £ Tier 1 securities.
Nov-09	Lloyds ECN exchange, economic calls going forward on securities included within the exchange	Exchanged into new LT2 ECNs or shares.
Nov-09	Non-payment of optional Tier 1 coupons by Dexia	
Apr-10	RBS LM exercise, economic calls on Tier 1/UT2 going forward	Tier 1 securities in different currencies were offered to be tendered at prices ranging from 14% to 100% per face amount. Upper Tier 2 securities were offered at exchange prices ranging from 60% to 100% per face amount.
Sep-10	Santander (Abbey) non-call of EUR and GBP UT2	Has been previously exchanged
Nov-10	Credit Logement Tier 1 non-call	Linked to Basel II floors.
Dec-10	ING Tier 1 non-call, denied permission by the EC at the request of the EC	
Dec-10	UBI Tier 1 non-call but coupon voluntarily increased by UBI	UBI announced a non-call of its three Tier 1 securities coming to call in 2011 but announced that the spread will be raised from 460bp, 337.5bp and 540bp over 3m €libor to 3m€libor+594bp for all three issues.
Feb-11	Monte Tier 1 non-call but coupon voluntarily increased by MPS	MPS announced a non-call of two of its Tier 1 preferred securities coming to call in 2011 but announced that the spread will be raised from 390bp and 562.5bp over €libor to 3m€libor+630bp for both issues.
Mar-11	CMZB LT2 exchange (economic calls going forward)	€2 billion of Lower Tier 2 securities were offered to be exchanged into new Lower Tier 2 securities at an exchange price of 106% and 100%. The average participation rate was 55%.
Mar-11	Banesto LT2 exchange offer into senior	€500 million of Lower Tier 2 securities were offered to be exchanged into new senior security instead of being called at an exchange price of 100%. The average participation rate was 98%.
Mar-11	Co-operative Bank non-call of LT2 (proposing par for par exchange)	€184 million of Lower Tier 2 FRN were offered to be exchanged into new Lower Tier 2 securities, instead of being called at an exchange price of 100%
Apr-11	ABN Amro	Offer made for exchange of six outstanding Lower Tier 2 securities at an exchange price ranging from 95.5% to 97.5% per face amount.

Source: Company data, Morgan Stanley Research

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## Appendix 3: Tier 1 Securities Coming to Call in 2011

Next call	Issuer parent	Currency	Structure	CPN	Step-up	Comment
15-Jun-11	Barclays plc	USD	T1	8.55	3m \$Libor+300bp	Called
27-Jun-11	Unione di Banche Italiane Scpa - UBI Banca	EUR	T1	9	3m €Libor+540bp	Step to be increased, will not call
29-Jun-11	DnB NOR ASA	USD	T1	7.729	3m \$Libor+272bp	High quality
02-Jul-11	Banca Popolare di Milano Scarl	EUR	T1	8.393	3m €Libor+470bp	High risk of non-call
06-Jul-11	Dexia SA	EUR	T1	6.821	3m €Libor+230bp	Call ban
12-Jul-11	Intesa Sanpaolo SpA	EUR	T1	6.988	3m €Libor+260bp	€5bn equity issue
10-Aug-11	Caixa d'Estalvis de Terrassa	EUR	T1	8		
15-Sep-11	Barclays plc	USD	T1	6.625		Retail pref
26-Sep-11	Fortis Group	EUR	T1	6.5	3m €Libor+237bp	BNP called FBAVP LT2 in March
27-Sep-11	Banca Monte dei Paschi di Siena SpA - MPS	EUR	T1	FRN	3m €Libor+465bp	High risk of non-call
18-Oct-11	NIBC NV	USD	T1	7.625		
23-Oct-11	BNP Paribas SA	EUR	T1	6.625	3m €Libor+160bp	High quality
07-Nov-11	Credit Suisse Group	EUR	T1	6.905	6m €Libor+320bp	High quality
09-Dec-11	HBOS plc	EUR	T1	7.627	3m €Libor+287.5bp	Call ban
15-Dec-11	SocGen	USD	T1	6.302	3m \$Libor + 192bp	High quality
15-Dec-11	Barclays plc	USD	T1	7.375	3m \$Libor+233bp	High quality

Source: Morgan Stanley Research

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## Appendix 4: LT2 Issuance – 2010 Onwards

Date	Issuer	Ccy	Size	Cpn	Spread
11-Jan-10	Credit Suisse	USD	2,500,000,000	5.4	T+162/MS+148
17-Feb-10	Credit Suisse	CHF	200,000,000	3.375	MS+107
17-Mar-10	Nordea Bank	EUR	1,000,000,000	4.50	MS+123
17-Mar-10	Lloyds TSB	EUR	1,500,000,000	6.5	MS+325
23-Mar-10	HSBC	GBP	900,000,000	6	G+150/MS+219
12-Apr-10	Monte Dei Paschi	EUR	500,000,000	5	MS+180
15-Apr-10	Lloyds TSB	GBP	750,000,000	7.625	G+320/MS+376
19-Apr-10	Banco Sabadell	EUR	500,000,000	6.25	MS+310
17-Jun-10	Deutsche Bk	EUR	1,150,000,000	5	MS+210
17-Jun-10	Standard Chartered	USD	750,000,000	5.875	T+275/MS+263
22-Jun-10	Nord LB	EUR	500,000,000	6	MS+310
07-Jul-10	Barclays	EUR	1,500,000,000	6	MS+310
08-Jul-10	Intesa Sanpaolo	EUR	1,250,000,000	5.15	MS+230
13-Jul-10	Nationwide BS	EUR	750,000,000	6.75	MS+400
17-Aug-10	HSBC	USD	1,250,000,000	4.875	T+225/MS+225
02-Sep-10	MPS	EUR	500,000,000	5.6	MS+320
07-Sep-10	Lloyds TSB	USD	2,000,000,000	6.5	T+400/MS+394
20-Sep-10	HSBC	USD	750,000,000	5	T+240/MS+227
21-Sep-10	Nordea Bank	EUR	750,000,000	4	MS+125
06-Oct-10	BFCM	EUR	750,000,000	4	MS+145
06-Oct-10	Barclays	USD	1,250,000,000	5.14	T+275/MS+264
08-Oct-10	Banco Popular Espanol	EUR	200,000,000	6.873	MS+425
11-Oct-10	Credit Agricole	EUR	1,250,000,000	3.9	MS+130
14-Oct-10	BFCM	EUR	250,000,000	4	MS+138
19-Oct-10	SNS Bank	EUR	500,000,000	6.25	MS+360
27-Oct-10	Banco Popolare	EUR	1,000,000,000	6	MS+320
02-Nov-10	Rabobank	EUR	1,000,000,000	3.75	MS+112
19-Nov-10	Banque Postale	EUR	750,000,000	4.375	MS+143
15-Dec-10	Banca Carige	EUR	65,000,000	7.321	MS+400
10-Feb-11	Credit Logement	EUR	500,000,000	5.454	T+215.2/MS+188
11-Feb-11	Investsec	GBP	500,000,000	9.625	T+539.3/MS+558
17-Feb-11	Credit Suisse	USD	2,000,000,000	7.875	T+522/MS+420
22-Feb-11	Banca Popolare di Milano	EUR	400,000,000	7.125	MS+375
09-Mar-11	Commerzbank	EUR	1,250,000,000	7.75	MS+420.6
23-Mar-11	Barclays	EUR	1,000,000,000	6.625	B+350.8/MS+312
08-Apr-11	SNS Bank	EUR	400,000,000	9	MS+525
12-Apr-11	UniCredit	EUR	750,000,000	6.125	MS+245

Source: Morgan Stanley Research



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Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)		
	Count	% of Total	Count	% of Total IBC	% of Rating Category
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<b>Equal-weight/Hold</b>	<b>1158</b>	<b>41%</b>	<b>386</b>	<b>39%</b>	<b>33%</b>
<b>Not-Rated/Hold</b>	<b>114</b>	<b>4%</b>	<b>20</b>	<b>2%</b>	<b>18%</b>
<b>Underweight/Sell</b>	<b>384</b>	<b>14%</b>	<b>102</b>	<b>10%</b>	<b>27%</b>
<b>Total</b>	<b>2,828</b>		<b>978</b>		

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