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AIB Tier 1 and Tier 2 securities tender

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- **Consistent with our expectations AIB is offering 25%[1] of notional for LT2s lower than the 30% offered in the voluntary tender but higher than 20% offered by Anglo.**
- **This is negative for BKIR LT2s which have recently been trading well over the price offered in the voluntary exchange.**
- **Furthermore 10% of notional offered by AIB for UT2s and T1s is more than the 5% offered by Anglo.**
- **For holders of unhedged cash positions we recommend taking the offer.**
- **Either a Failure to Pay or a Restructuring credit event on CDS contracts remains a distinct possibility depending on the outcome of the SLO hearing and the dates set forth in the Tender and Consent Memorandum, to be published this Friday.**

AIB today announced its intention to launch tender offers for all of its outstanding Tier 1 and Tier 2 securities on Friday 13 May. This liability management exercise was widely anticipated given that it was previously communicated by AIB, most recently in conjunction with the announcement of the Subordinated Liability Order (SLO) in April. Consistent with our expectations, the price offered for the LT2 securities is 25% of the notional value[1], which is below the 30% offered in the voluntary liability management exercise conducted in January, but above the 20% that was offered by Anglo. In our view this is also a negative sign for the BKIR LT2s, which have recently been trading well over the price offered in the voluntary liability management exercise. AIB is also offering 10% of notional value to any and all holders of its perpetual UT2 and T1 securities, again more than the 5% offered to the holders of Anglo perps.

Similar to the structure of the subordinated liability management exercise carried out by Anglo last October, those tendering their bonds will also have to vote for a change in the bond language whereby the notes become callable at €0.01 per €1,000 (or whatever the relevant currency happens to be). No accrued interest will be paid. Below is the list of relevant bonds, which we understand to include all subordinated bond issues:

Lower Tier 2 Issues

Notes description	ISIN	Outstanding amount	Tender price / 1000
£350mn FRN due 2030	XS0180778507	£145,000	£250
$400mn FRN due 2015	XS0197993875	£39.3mn	$250
€400mn FRN due 2015	XS0208845924	€48.5mn	€250
£500mn FRN due 2025	XS0214107053	£1.2mn	£250
€500mn FRN due 2017	XS0232498393	€75.2mn	€250
£700mn FRN due 2023	XS0368068937	£35.3mn	£250
£368mn 12.5% due 2019	XS0435957682	£216mn	£250
€869mn 12.5% due 2019	XS0435953186	€628mn	€250
€419mn 10.75% due 2017	XS0498532117	€218mn	€225
$177mn 10.75% due 2017	XS0498530178	$108mn	$225
£1,096mn 11.5% due 2022	XS0498531069	£385mn	£225

Source: AIB Press Release

Upper Tier 2 Issues

Notes description	ISIN	Outstanding amount	Tender price / 1000
€200mn FRN perp	XS0100325983	€53.8mn	€100
£400mn FRN perp	XS0227409629	£58.6mn	£100
$100mn FRN perp	IE0000189625	$100mn	€100

Source: AIB Press Release

[1] With the exception of 3 bonds where a coupon was recently paid – for those it's 22.5% of the notional.

Tier 1 Issues

Notes description	ISIN	Outstanding amount	Tender price / 1000
€500mn 7.5% RCI perp	XS0120950158	€240.4mn	€100
€1bn FRN PPS	XS0208105055	£191.4mn	€100
€500mn FRN PPS	XS0257734037	€95.0mn	€100
£350mn FRN PPS	XS0257571066	£36.7mn	£100

Source: AIB Press Release

Schedule of Relevant dates

Date	Event
Friday 13 May	Expected launch date of the Offers
Monday 13 June	Earliest expected expiration deadline
Tuesday 14 June	Earliest expected preliminary results announcement
Thursday 16 June	Earliest expected meeting dates in relation to the applicable Consent Invitation
As soon as reasonably practicable after conclusion of the Meetings	Earliest expected announcement of results of meetings and Offers
Friday 17 June	Earliest expected settlement date

Source: AIB Press Release

Crucially, for CDS holders the dates of the various bondholder meetings that will determine the variables under any CDS trigger and the potential deliverables will only be disclosed in the full offering memorandum that is to be published on Friday 13 May. Furthermore, the various outcomes for CDS remain dependent on the timing surrounding the court challenge to the Subordinated Liabilities Order (SLO) where a hearing date has been scheduled for 2 June.

Somewhat reassuringly, today's statement contained the following, "The Bank intends, so far as it is able and to the extent that it is consistent with the Bank's broader objectives, to accommodate an orderly unwind of credit default swap positions…" Without the actual dates of the bondholder meetings, we cannot be more precise, but we would understand this to mean the following:

- similarly to the Anglo Irish liability management exercise, this tender offer involves holders of the bonds voting, as they tender, to insert an issuer call option to repurchase any untendered notes at €0.01 or £0.01;
- a successful vote on any one bond (which requires a meeting quorum of 75% outstanding held by at least 2 persons and a vote in favour by 75% of those present) would trigger a Restructuring credit event under the CDS – a voluntary or "soft" credit event;
- if the meeting dates for each vote to amend the terms of the bonds are staggered, which the statement appears to imply, this permits a Restructuring credit event to occur upon the first successful vote but leaves other bond(s) unamended until a later date, thereby providing subordinated deliverable(s) for any ISDA auction held pursuant to a Restructuring credit event. Logically, to allow for the maximum amount of deliverables into a Restructuring credit event, the earliest maturity bond (in this case the 2015 bonds) should have the latest meeting date. This would ensure that there is at least one subordinated deliverable obligation in both the second and third maturity buckets;
- however, if in the meantime the Subordinated Liabilities Order is declared effective, all the LT2 bonds will have their maturity automatically extended to 2035 (thereby excluding them as subordinated deliverable obligations in any of the first several buckets of a Restructuring credit event, hence resulting in senior recovery levels) and subordinated CDS holders will have to look for another credit event to monetise their CDS positions.

Subordinated Liabilities Order

The SLO made by the Irish High Court with respect to the subordinated liabilities of AIB is the subject of a court challenge filed by a group of investors in April and has therefore not become effective. As a result, the terms of the AIB subordinated debentures have not yet been altered. News reports have stated the expectation that the court hearing could take up to four days. In addition, it is likely that the court will reserve its judgment and not deliver it immediately. Therefore, although the SLO could become effective at the 2 June court hearing, it is likely that the process will take longer (not taking into account any appeals, if permitted, to the Supreme Court). Although we cannot predict the length of time required for a judicial hearing, we believe it is reasonable to expect a decision of first instance prior to the expiration of the earliest offer deadline (13 June). The government made its own view clear this morning with the Finance Minister stating that "the subordinated liabilities order was sought by the Minister and was issued by the High Court in accordance with the provisions of the relevant legislation. The Minister considers that these challenges are entirely unfounded."

All CDS holder eyes will therefore focus on the 5 June coupon payment due for the £35mn 7.875% 23s. We remind readers of our publication *AIB: It's a credit event*, dated 15 April, discussing soft and hard triggers. If a coupon payment is not made on 5 June (in practicality 6 June) and within the 14 day grace period, this could potentially trigger a Failure To Pay "hard" credit event on 19 June. Whilst the launch of the liability management exercise complicates the trigger for a Failure to Pay, if the SLO is declared effective **prior to** the expiration of this grace period, all LT2 bonds would automatically be extended to 2035. This would result in no subordinated deliverable obligations in the early buckets in any auction following a Restructuring credit event but would authorise coupon deferral if the coupon payment on 5 June had not already been made, resulting in a Failure to Pay credit event that would trigger senior and subordinated CDS and not limit the maturity of any deliverables beyond the standard 30 years. CDS holders must hope therefore that the 5 June coupon remains unpaid (at least through the grace period) until there is more clarity on the SLO.

Last chance – this time for real

The Finance Minister also said in his statement that he "wants to make it clear to investors that, if the LME fails to deliver the required core Tier 1 capital gain to the bank, the Government will take whatever steps are necessary under the Credit Institutions (Stabilisation) Act 2010 or otherwise, to achieve at least that level of contribution. Any further action, after investors have had an opportunity to take part in the LME, will result in severe measures being taken in respect of subordinated liabilities. "

What happens next?

The action is relatively simple for unhedged holders of the bonds – this is your last chance to monetize your bonds and we believe you should take the offer. The picture becomes a lot more nuanced for basis holders and outright CDS holders. All CDS holders have the option of waiting to see what the outcome of the SLO court challenge hearing is. Provided that the 5 June coupon payment is not made; basis holders should look to the expiration date of the tender offer for their bonds. If there is no resolution under the SLO challenge by such date, we believe basis holders (from the second bucket onwards) should tender and hope for a Restructuring credit event as a result of the liability management exercise. In that scenario, outright subordinated CDS holders should consider triggering their CDS in the Restructuring credit event to avoid the scenario of either (1) the bonds being either entirely bought back in the liability management, or (2) being wiped out by a further SLO; in each case the risk being no subordinated deliverable obligations. If the SLO is declared effective and the 5 June coupon is not made prior to the expiration of the tender offers, both basis and outright CDS holders could expect a Failure to Pay credit event cleaning up all CDS positions.

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Research Disclaimers:

Recommendation System:

Type	Terminology	Horizon
Credit Trend (1)	Positive/ Stable/ Negative	6 months
Investment Recommendation (2)	Buy/ Add/ Hold/ Reduce/ Sell (*)	Up to 6 months

(1) Credit Trend is based on underlying Credit fundamentals, business environment and industry trends;
(2) Investment Recommendations are as follows:
(*) BUY – Maximise exposure based on improving financial profile and/or significant under-valuation.
ADD – Overweight exposure within industry sector/index, based on improving financial profile, and/or defensive characteristics and/or cheap valuation.
HOLD – Maintain position based on stable credit fundamentals and/or average expected return characteristics within peer group.
REDUCE – Underweight exposure within industry sector/index based on weakening financial profile, increased volatility and/or rich valuation.
SELL – Sell exposure/Maximise protection largely based on deteriorating credit fundamentals, negative headline/event risks and/or significant over-valuation.