European Credit Research 8 January 2013

SNS Reaal: unlikely to call subordinated bonds but the 11.25% Tier 1s have upside

Luba Fakhrutdinova, Olivia Frieser, Ivan Zubo, European Banks +44(0)207595 8082

Rafael Villarreal, European Insurance +44(0)207595 8918

- **We initiate coverage of SNS Reaal Group with a Reduce recommendation but we assign an Add recommendation to the 11.25% Tier 1.**
- **SNS needs to 1) repay State aid of €848mn in total by the end of 2013; 2) build its bank capital position to 10% for CT1; 3) reduce holding company double leverage; 4) repay the Foundation; 5) reduce leverage at the insurer; and probably 6) strengthen the loan loss provisions at the Property Finance (PF) arm. However, losses emerging from the PF portfolio erode the bank's ability to do so.**
- **In July 2012, SNS announced a strategic review to strengthen its capital. The Group said that it would consider all options. We explored the various options available to the Group and the conclusion is twofold: 1) no one measure alone will achieve the results required; and 2) SNS Reaal requires years to restore its financial position. We estimate that SNS needs c.€2bn-€3bn of fresh capital. Hence, it seems likely that SNS will need to apply for an extension of the deadline and this could lead to new measures being imposed by the EC, such as restricting the payment of optionally deferrable coupons or preventing the optional redemption by the issuer of all hybrid and subordinated debt. This would be clearly negative for all subordinated bonds, but not all prices reflect these risks.**
- **We believe that subordinated bonds will not be called at the first call date. We value selected subordinated bonds of the bank, the insurer and the holding company and express our recommendations. SNS Bank's senior bonds trade around par as they are relatively safe even if capital requirements are not met. SRLEV's 9% and 7% subordinated bonds trade at 95 and 97, respectively and exhibit more downside than upside (Reduce or Sell).**
- **Two undated bonds (SNS Reaal 6.258% Perp NC July-17 and SNS Bank 11.25% Perp NC Nov-19) are priced at 54 and 72 cents, respectively. The coupon payments, if deferred, would be effectively cumulative (via ACSM) but can be cancelled if they cannot be settled by this means over a specific period. Our analysis leads us to a Reduce or Sell recommendation on the 6.258% Tier 1and an Add recommendation on the 11.25% Tier 1 (high coupon and high step up).**

Background

- **Organisational structure**: SNS Reaal Groep (SNS or the Group) is a Netherlands-based bancassurance group. In 1997, SNS Bank bought all shares of Reaal (a Dutch insurer).
- In 2006, the Group listed its shares in Euronext. Stichting Beheer (the Foundation) became the Group's majority shareholder and over time reduced its stake as more issues were made to finance acquisitions, but remained the marginal majority shareholder. Until 2008, the Group pursued acquisition-led growth, becoming the fifth largest retail bank in the Netherlands with a 10% market share in retail mortgages in 2009 (which by 2012 had dropped to 8%) and an important participant in Dutch insurance with, for instance, a Q3 2012 market share of 18.8% in individual regular premium life assurance and pension premiums.
- SNS Bank's prime focus is Dutch retail banking; the SME and property finance businesses have caused difficulties in the downturn. Insurance operations are wholly focused on the Netherlands (SRLEV for life assurance and REAAL Schadeverzekeringen for non-life insurance).

A challenge for SNS is a risk for bondholders

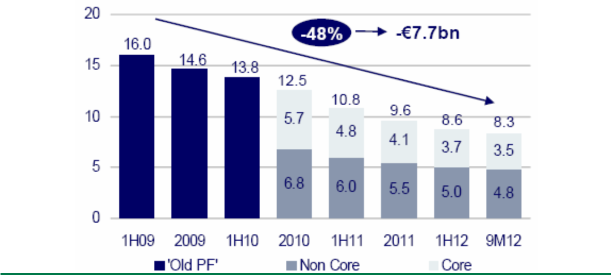
- **State aid**: In December 2008, SNS issued a five year €750mn core capital security to the Dutch state (at 8.5%). The securities issued to the Dutch State are convertible into equity but the State can opt for payment in cash. In 2009, SNS raised equity and repaid €185mn. **SNS needs to repay the remaining €565mn plus a 50% repayment premium (or €848mn in total) by December 2013.**
- To prevent failing to repay the state aid in full by December 2013, SNS has to renegotiate the terms of its restructuring plan with the EC. In this case, the EC could impose additional restrictions on SNS. The final terms between SNS and the EC on the support package and restructuring plan are important as they could be detrimental to hybrid security and subordinated bond holders, such as by limiting the Group's capacity to pay optional coupons or to call its subordinated debt at the first call date.
- **Strategic review**: In July 2012, SNS announced a strategic review of its business operations with the aim of restoring the bank's capital and building a capital buffer against future losses in the PF portfolio. The Group said that all possible options would be considered including the sale of its different businesses. No decisions have been made yet. In our opinion, a combination of all of the above options is needed.

- At the same time as SNS issued notes to the State in December 2008, the Group issued €500mn in non-voting securities capital to the Trust Stichting Beheer (the Foundation or the Trust), with a 6% coupon.
- In April 2008, the Foundation injected €600mn in equity through B-shares for the acquisition of Zwitserleven. These do not have to be repaid at this time, but in the context of considering new equity injections it is important to see the gearing incurred and recognise that the Foundation is still due c.€0.4bn in securities and at least a return on the €0.6bn of equity injected.

Property Finance: high non-performing loans (NPL), low provisions

- The PF portfolio consists of short-term project finance to real estate developers and loans to professional real estate investors. The book value of non-core PF reached €4.8bn in Q3 2012. It consists of commercial and residential real estate portfolios in the Netherlands and other countries including Spain. SNS intends to wind down the non-core part of PF within the next five years. However, it could take longer due to the depressed price levels of international and Dutch real estate markets. The mark-to-market value of these portfolios has been affected by rising vacancy rates of Dutch commercial real estate and a deteriorating real estate situation in Spain too.

Chart 1: Commitments 'Old' Property Finance (€bn)



Source: SNS Reaal Q3 presentation

- Despite the recorded provisions on its property finance business since 2009, the challenge remains as the central bank, investors and the state ask for regular revaluations of the property portfolios of Dutch banks.
- NPLs reached €2bn in Q3 or 41.1% of gross loans, with a 37% coverage ratio (provisions as a % of NPLs), which looks low. Property Finance reported a net loss of €99mn in Q3 2012 with a 43% increase yoy wholly attributable to higher loan impairments.
- The greatest concern relates to exposures to offices (34% of PF loan book) and retail loans (24% of PF total loans). The loan-to-value (LTV) of the NPL portion of the portfolio is 147% and the LTV of the performing portion is 96%, for an overall LTV of 112%.
- The situation is discouraging: notwithstanding the low interest rate environment, NPLs, which appear to be under provisioned, could rise as a result of adverse economic conditions. Once the LTV rises above 100%, management is no longer in control but is subject to the trend in property values which will move as all participants lower prices to sell properties and protect their equity bases.

Chart 2: Non-performing loans Property Finance (€mn)

(€m)	2010	2011	9M12
Total NPLs	**1,761**	**1,728**	**1,966**
% of gross outstanding loans	**27.1%**	**32.3%**	**41.1%**
Dutch NPLs	788	1,130	1,408
Other Europe NPLs	393	337	417
North America NPLs	580	261	141

Source: SNS Reaal Q3 results

- The 'clearing level' of property prices is unknown, as there is not always a willing buyer in a falling market. If banks in the Netherlands were forced to repossess properties and to sell them, prices would fall. The fall in property prices would be steeper and faster and the capital positions of the banks could deteriorate quickly (a downward spiral). This dynamic is similar to other markets.
- Alternatively, financing a non-performing portfolio is a slow burn approach, even at low interest rates, but prolongs uncertainty.
- As €5bn of the SNS SME portfolio is added to PF, the provisions on this division may rise. The SNS SME portfolio is of better quality, with only 7% NPLs and still enjoys a LTV of 79%, but the trend is not favourable: the LTV was 70% two years ago.
- A further fall in property prices would increase the LTV across the €9bn combined portfolio.
- As an illustration, according to our calculations, SNS would need an additional €686mn of provisions on its PF NPLs if LTVs rose to 162% from 147% and NPLs rose to 50% from 41%. While this amount does not seem large in absolute terms, it represents more than five years of average net income.
- Transferring non-performing loans is not a cost-free option either. A 'bridge bank' would require a 'first loss' capital injection to protect those who fund it.

Assessing the shortfall against capital required

- We look at the capital required according to the minimum requirements of the legislation in force and the Dutch bank and insurance regulators' adjustments: €2bn for a CT1 of 10% to €2.8bn total capital ratio of 14% for the bank; under 175% solvency ratio, the insurer would need €1.36bn or €2.4bn of capital or €4.4bn to €5.2bn total capital requirements for the Group.
- At the end of June 2012, SNS Reaal had assets of €134bn, of which approximately €80bn were at the bank and property finance arms and €54bn at the

insurers. The loan portfolio to customers (€58.5bn) and banks (€6.7bn) at SNS Bank was €65.2bn and the RWA were under €20bn.

- We estimate that the Group had participation certificates of €0.3bn, subordinated debt of €1.5bn; a remaining balance of capital securities issued to the State and the Foundation of c.€1bn; and shareholders' equity of €3.8bn. After deducting intangible assets of €1.7bn, Tangible Core Equity (TCE) was c.€2.1bn. In addition, there is substantial senior financing debt.
- The bank's CT1 ratio dropped to 8.8% during Q3 (from 9.6% in June) due to an increase in RWA and the loss in the Property Finance division. If the CT1 ratio requirement is 10% and RWA is c.€20bn, then the bank requires €2bn in CT1 as a minimum. If Tier 2 of €0.8bn is also deemed necessary at the bank, then the total capital required is €2.8bn.
- The insurance operations reported a solvency ratio of 198% at the end of Q3 2012. Despite having excess capital in insurance, it is unlikely that the regulator would allow a transfer to SNS Bank. The total insurance capital requirement is €1.36bn and needs to be covered at 175%, i.e. the insurer has €2.7bn but €2.4bn is the *de facto* minimum required.

Table 1: Capital structure and changes if capital repaid and provisions increased (€bn)

	Bank	PF	Insurer	Other	Total
TCE	1.45	0.14	1.84	-1.31	2.12
Cap secs	0.16	-	0.40	0.43	0.99
Part certs	0.28	-	0.52	-0.43	0.37
Sub debt	0.63	-	0.50	0.33	1.46
Total	**2.52**	**0.14**	**3.26**	**-0.98**	**4.94**
Deduct					
Provisions		(0.69)			(0.69)
State aid	(0.16)		(0.40)		(0.57)
Premium	(0.08)		(0.20)		(0.28)
Total	**(0.24)**	**(0.69)**	**(0.60)**	**(0.01)**	**(1.53)**
TCE	1.37	-0.55	1.64	-1.31	1.15
Cap secs	-	-	-	0.42	0.42
Part certs	0.28	-	0.52	-0.43	0.37
Sub debt	0.63	-	0.50	0.33	1.46
Total	**2.29**	**-0.55**	**2.66**	**-0.99**	**3.41**

Source: BNP Paribas

- Table 1 summarises what we see as SNS Reaal's challenge: 1) we deduct the €565mn repayable to the State and the €282.5mn premium from Capital Securities and TCE, respectively. We can assume that the payment of the premium comes from the bank and the insurer on a pro rata basis or from the holding company; it is the same at the Group level; 2) we believe that due to the state of the economy and the non-performing loans in the PF portfolio SNS could require more provisions in the near future, so we estimate a need of €686mn under certain assumptions described later in this note.
- The tangible capital resources as of 30 June were €4.9bn against requirements ranging from €4.4bn to €5.2bn. Hence, there appeared to be a surplus of about €500mn or a deficit of €300mn, depending on what is needed at the bank, but that is before repaying the State (€0.85bn), the Foundation (€0.4bn) and before making additional loan loss provisions should NPLs and LTVs deteriorate (e.g. €0.7bn), which turns it into a capital requirement deficit in the range of €1.4bn to €2.2bn (€1bn to €1.8bn if the Foundation's securities are excluded).
- The repayment of state aid and added loan loss provisions for PF of €1.5bn in total, leave approximately €3.4bn in capital, against requirements of €4.4bn to €5.2bn. That would leave the bank and the PF divisions with a shortfall and the holding company leveraged. Since repayment to the Foundation is not urgent, we exclude it for the time being. The insurer appears to still meet requirements but the capital structure is geared; calling its bonds does not look likely but the calls are not soon.

All options considered? All needed

- First of all, renegotiating terms and conditions with the EC and extending the deadline of the state aid would be a relief but it is not a solution.
- **The options to any financial group when capital is needed to avoid failing to meet capital requirements** are: 1) raise equity; 2) gear up with subordinated debt or hybrid instruments; 3) retain earnings, including harvested capital gains from investment portfolios and reduced dividends; 4) reduce capital requirements by reducing volumes of business or assets (runoff); and/or 5) raise cash and reduce requirements through disposals.
- **The first option, raising equity**, seems unlikely for SNS given the share price, projected earnings and cash flows, dividend prospects (nil for some time) and the magnitude of capital needed (dilution). It is not an attractive investment proposition.

Chart 3 : SNS Reaal NV share price

Source: Bloomberg

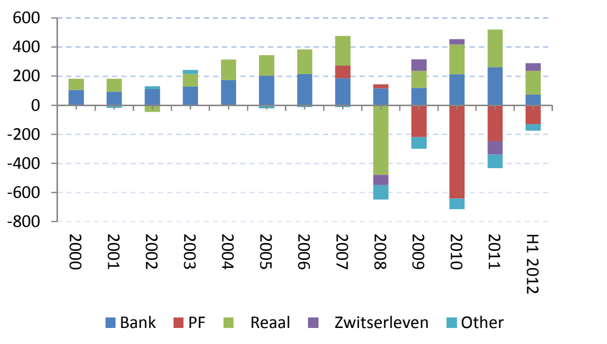
- As Chart 3 shows, the SNS share price dropped towards the end of 2008 and has not recovered. There are 287.6mn shares outstanding (€1.05 per share) of which the Foundation owns 50%. Given the amounts of fresh capital that are required and the current share price, the number of shares that would be needed would be large in relation to shares outstanding, even for a partial equity injection.

- According to the original terms of the capital securities issued to the state, SNS could convert the CT1 securities into ordinary shares at €5.25 per share. At the beginning of 2008 the price per share was €15.64; by the end of 2008 it was €3.63. The current price of €1.05 per share and total market capitalisation of €298mn make conversion unlikely.
- It seems to us that the Foundation may not have sufficient financial resources to maintain its majority position by subscribing to a large equity rights issue if there were to be one. It had already injected capital for the acquisition of Zwitserleven and to boost capital in April and December of 2008.
- **The second option, gearing up**, is already largely exhausted: the Group's equity base is highly geared. We estimate €2.1bn of TCE and €2.8bn of other capital securities and subordinated debt (57%) and that is without taking into account financing senior debt, which appears to be substantial.
- After the repayment of the State aid, the premium and the increase in provisions, the Group position would be even more geared, with hybrid and subordinated debt securities of €2.3bn and TCE of c.€1.1bn (68%), see Table 1. Thus, in addition to raising capital, SNS Reaal needs to rebalance its capital structure and reduce gearing.
- **The third option, earnings retention**, is not possible in the existing timeframe: we are one year away from maturity of the 5-year 'loan' from the State and the earnings power of the Group has been eroded by losses from property and SME lending. Economic conditions, property markets and the magnitude of potential provisions are just not in the Group's favour.
- As a reference, in the context of a €1bn-€1.8bn shortfall and the Group's historical average net income of €133mn (2000 to H1 2012), it would need eight to fourteen years of earnings and no dividends paid. The cumulative net income of the Group from 2000 to H1 2012 was only €1.6bn. The contributions of PF, the holding company and Zwitserleven are negative or negligible in absolute terms and detrimental to the average. SNS Reaal Group reported a Q3 net profit of €34mn (€149mn YTD).
- **The fourth option, reducing capital requirements through volume reduction (run off)**, is necessary but takes time. As an illustration, at a 10% CT1 requirement, a €1bn reduction in requirements would mean a €10bn reduction in RWA, which is one half of the bank's RWA. With this as a backdrop, the PF and SNS SME runoffs are understandable; as they have higher risk weights and capital requirements than retail mortgages. Given the asset duration at SNS, capital and property markets conditions and funding challenges for potential investors, a natural attrition run off could take several years.
- Furthermore, assets cannot be transferred to a 'Bridge Bank' under the Dutch Intervention Act without a 'first loss' layer of capital also being transferred to protect the investor, whether this be another bank (Bridge bank or banks supporting the Bridge bank) or, indirectly, the taxpayer. Investors know what they are getting into and want a margin of protection.
- Evidently, €1.8bn of capital required reduction would demand an almost complete runoff of the bank (€18bn reduction in RWA at a 10% requirement) hence the raising of capital cannot be entirely left to the bank and PF divisions.
- **The fifth option, disposals**, in particular the sale of the insurance group, is the most talked about in the market but could be insufficient according to our estimates and it could backfire. First of all, the insurer is neither the 'jewel in the crown', despite its profitability, nor the 'silver bullet' solution.
- According to our analysis, selling the insurer does not achieve the results the Group needs. Of the €1.6bn cumulative Group net income from 2000 to H1 2012, €1.13bn was derived from the insurer Reaal, but a significant part of the leverage and intangible assets of the Group are due to the acquisition of insurers in 2007 and 2008 and the insurer's capital structure remains highly geared.
- Adding the holding company financial position cancels out the perceived strength and we show this in our analysis and projections, Tables 10-12.

Insurer profits and valuations

- For illustration purposes, assume a complete disposal of the insurer: 1) the capital requirements fall by €2.4bn; 2) debt of €0.4bn is repaid to the State and some participation certificates and subordinated debt are assumed by the buyer; and 3) tangible net assets fall by €1.8bn. All of this goes and in its place there is now a consideration in cash. How much? Good question.

Chart 4: Net income history with insurer



Source: SNS Reaal

- Looking at 12.5 years of profit for Reaal and the profit of Zwitserleven since it was acquired, reveals that Reaal averaged a net income of €90mn and Zwitserleven barely broke even.

- Based on Reaal's average net income of €90mn from 2000 to H1 2012 and €1.2mn from Zwitserleven since 2008, a negative economic backdrop, a mature insurance market, being perceived as a forced seller and an average P/E ratio of 9x for other groups, we estimate that SNS could be looking at a price of €1bn for both REAAL and Zwitserleven against a tangible book value (TBV) of €1.8bn and an embedded value in 2011 of €3.8bn.
- €1.5bn of intangible assets were booked at the insurer at the end of June 2012. If these were recognised in full, added to TBV of €1.8bn we would have €3.3bn but we cannot relate that value to the Group's earnings. In our opinion, if management believes there is that much value in its books, such a discrepancy means that the Group would not sell at this time.
- We noticed that the average profit of insurance operations doubled from 2009 to H1 2012 compared to the long-term average. We are sceptical about this. Even when taking the more recent profits at the same average P/E multiples for groups operating in more dynamic markets than the Netherlands, we estimate values of €2.1bn to €2.3bn for the insurance operations. We are not sure whether these more recently reported profits are sustainable.
- In other words, just to obtain a price slightly above TBV requires making liberal assumptions about profit sustainability.

Table 2: Summary of insurance valuations

The various values attributed to insurance businesses	€bn
In relation to historical accounting profits at P/E of 9x	0.8-1.0
On earnings from 2009 onwards at P/E of 9x	1.8
Book value minus intangible assets of €1.5bn	1.8
Book value	3.3
Embedded value 2011	3.8

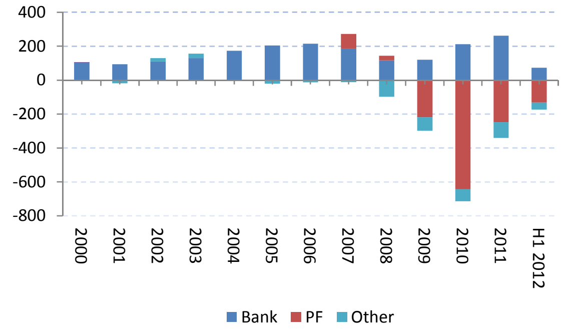
Source: BNP Paribas

- Management could argue that embedded value profits are far larger than accounting profits and that might well be the case, but over a long period of time and given the seasoning of the book of business, there would have been signs about those higher profits and we only saw them after the crisis demanded an offset for PF provisions. Of course, this could be a coincidence. Is anyone likely to pay €3bn or more for it to achieve a leading position in mortality business in the Netherlands? We find that hard to believe. According to our calculations, if the insurer were worth that much it might make a difference to the Group, but if its valuation is somewhere between €1bn and €1.8bn, selling it does not make a difference, as we describe next.

What if the insurer were sold at €1bn or €1.8bn?

- We know that if the Group sells the insurer, the rest of the Group would have reported consecutive net losses from 2009 to H1 2012 and total cumulative net losses of €815mn for that period.
- Furthermore, without the insurer, the rest of the Group would have reported an average profit of €37mn from 2000 to H1 2012 (give or take some insurer-related costs at the holding company), neither of which is encouraging in the context of current needs. The absence of a buffer of profit from insurance would make the Group riskier to bondholders.
- We consider four scenarios, assuming that the Group sells for €1bn and for €1.8bn and in each case we apply the proceeds to 1) repay the state debt and premium and 2) to increase loan loss provisions by €686mn. We present the results in terms of deficits and effects on gearing.

Chart 5: Net income history excluding the insurer



Source: SNS Reaal, BNP Paribas

- The measure of the bank's deficit of €0.1bn in these scenarios is just against a capital requirement of €2bn, but a 14% requirement would mean a deficit of another €0.4bn-€0.5bn at the bank, on top of the PF deficit.

Table 3: Four scenarios on selling insurer for €1bn or €1.8bn

Scenario	Results
€1bn state aid repaid	Deficit at bank CT1 of 10% €0.1bn, hold co leverage reduced by €0.5bn injection but group gearing higher at 60%. **Only €0.8bn of TCE at group**.
€1bn state aid repaid and loss provisions increased	Deficit at bank CT1 of €0.1bn, **PF deficit of €0.55bn**, hold co leverage reduced by €0.5bn injection but **group gearing 90%**. **Only €0.1bn of TCE at group**.
€1.8bn state aid repaid	Deficit at bank CT1 of 10% €0.1bn, hold co has no double leverage, **gearing 88%**. **€1.6bn of TCE at group**, group gearing drops to 43%
€1.8bn state aid repaid and loss provisions increased	Deficit at bank CT1 of €0.1bn, **PF deficit of €0.55bn**, hold co leverage reduced by €0.5bn injection but **gearing is 88%**. Group gearing 57%, which is where it was before the disposal of the insurer. **€0.9bn of TCE at group**.

Source: BNP Paribas

- Please note that we are not using stress scenarios and that the situation could in fact be worse than an LTV of 162% (currently 147%) and NPLs of 50% (currently 41%) and that even in this case, there are deficits as a starting point and high gearing. After provisions, PF is in deficit and the bank is short, depending on 10% or 14% requirements, so it would still be necessary to inject about €1bn after the disposal of the insurer.
- The position does not improve much because of the potential discount on the sale of the insurance operations, the larger provisions assumed and the repayment of capital securities.
- This means that as a single solution, the insurer would need to be sold for about €2.8bn in order to make a difference. We find this challenging.

Reducing holding company leverage

- It is hard to conclude the analysis regarding the capital needs of the SNS Reaal Group without addressing the holding company's position, which until now we have not covered and which is leveraged to present the position of the bank, PF and/or insurer in a different light. It is unrealistic to consider the disposal of the insurer, for instance, without considering the adjustment to the holding company's position: who would repay that debt?
- What would the negative equity position mean for the remaining members of the Group? It is also unrealistic to think that the Group only needs to come up with €848mn for the state and nothing else as per the previous discussion.
- Based on the Group's financials and data from Bloomberg, we have tried to determine the capital structure of the Group's companies (see Table 1) because the financial statements do not separate participating certificates from subordinated debt, but the former are Tier 1 and the latter mostly Tier 2 so we need a clearer split.
- At the end of June 2012, the holding company showed a negative equity balance of €1.3bn and subordinated debt of €0.3bn. The remaining balance of capital securities from the Foundation was €0.4bn and some participating certificates with a negative balance of €0.4bn cancel out. The net holding company position then is one of negative €1bn. This large negative position means that some 'equity' at one of the other operations does not exist and that extra debt at the holding company adds to the Group's gearing.
- In general, there is no reason why a holding company should not borrow independently from the operating companies, but in this case we need to 'clear the decks' to assess the Group's needs. Hence, we assume that the position of the holding company need to be neutral, i.e. repay its debt, deduct negative equity from the insurers' reported equity and add holding company debt to the insurer; before re-evaluating capital needs.
- When the financial positions of the holding company and the insurer are combined, the insurer no longer looks like the jewel in the crown but as having a deficit in relation to the regulatory requirements of nearly €1bn.
- Assuming a requirement of €2.8bn at the bank and €2.4bn at the insurer, we estimate the starting position, before all these payments and provisions as a Group deficit of €262mn (negative €535mn in T2 and a €273mn surplus in T1).
- After increased provisions, repayment to the state, payment of the 50% premium, a neutral position at the holding company, repayment to the Foundation of its remaining balance of €0.4bn, etc., the Group would need c.€2bn in capital to rebalance the positions of the bank, the PF and the insurer: €1.4bn in Tier 1 and €535mn in Tier 2. For this purpose, we assume that the capital requirement of the insurer is evenly split between T1 and T2.
- This €2bn injection would leave the PF operations without any capital but also without a deficit (neutral).

Review of recapitalisation options

- If the Group needs €2bn the recapitalisation options as single actions are all unlikely to occur.

Table 4: Review of recapitalisation options

Options	How much?	View
Equity	€2bn	Unattractive proposition
Gearing	€2bn	Gearing already high
Retained earnings	Avg €133mn	8 to 14 years
Bank / PF run off	€10bn-€18bn RWA	End of bank, long time
Disposal of insurer	€2.8bn	Unlikely to achieve that

Source: BNP Paribas

- It seems clear that the holding company cannot borrow from equity investors and bond investors some €2bn in Tier 1 and Tier 2 because the earnings and dividends of the companies would not allow repayment for a long time.

Result of projections (no stress test)

- Trying to determine whether it is a good idea to invest in the bonds of SNS Reaal (bank, insurer or holding company) requires taking a view about the financial position of the Group and each of its component parts at the time the bonds mature or are due for a call and then comparing the expected value to the price today.
- For this purpose, we have projected the balance sheet against the requirements to 2022 and this requires making some assumptions which we have kept as close to reality as possible (See Tables 10, 11 and 12).

- We have not used this as a stress test at all; we have simply extended the figures from 2012 to 2022 according to basic assumptions and averages, making repayments and assuming the subordinated bonds are called. If there are no deficits to requirements, they can be called. If there are deficits or the resulting capital is too close to the minimum requirements, they cannot be called.
- We add the bank and PF and assume the requirements will fall by €500mn over a period of five years: €100mn p.a. as the PF book runs off (Table 11) and then by €200mn p.a. over five years, or €1bn reduction (€10bn reduction in RWA over 5 years).
- We add the insurer and the holding company because it is our view that the leverage at the holding company was increased to make insurance acquisitions in 2007 and 2008, that increased the size of the insurance operations by multiples, but brought with it debt and intangible assets.
- We assume starting capital requirements are €2.8bn for the bank (T1: €2bn and T2 €0.8bn) and €2.4bn at the insurer (T1: €1.2bn and T2: €1.2bn).
- In both projections we assume average group earnings of €170mn, which is above the historical average, assuming the insurer and bank earn €260mn and the PF divisions loses €90mn p.a. (in Projection 3 only for five years, since it has been run off).
- In **Projection 1** we assume that the state is repaid, provisions are increased, the premium is paid and the main subordinated bonds from the bank, holding company and insurer are called when due or when they mature. The Trust is not repaid the remaining balance of €0.4bn.
- In **Projection 2** we assume the Group renegotiates a five year extension and repays the State (including the premium) at the end of 2017 and capital requirements are reduced by €500mn over five years as a result of the PF run off.
- In **Projection 3** we assume the Group renegotiates a five year extension and repays the State (including the premium) at the end of 2017 and capital requirements are reduced by €1bn over five years as a result of the PF and SME run off.
- **The conclusion under Projections 1 and 2 is that SNS Reaal is unlikely to call bonds as its financial position is unlikely to recover sufficiently. The existence of large deficits confirms this.**
- **Under Projection 3, there is a surplus in the 2016 and 2017 periods, but it is insufficient to allow repayment to the State in that year.** If the repayment is made, we see that there is almost no surplus over requirements in 2018, so we believe that the regulators might object to the call of bonds in 2016 and 2017 while the State is not yet repaid. Calling bonds will result in a Group position close to the minimum. Furthermore, the issue here is that it is assumed that the Bank and PF combination will reduce their RWA by €10bn over five years without incurring larger losses and we realise that conditions are far from ideal for such an assumption to be made comfortably. Any sensitivity analysis around NPLs, property prices, LTVs, etc. could confirm the weak capital position.

Structural subordination

- In general, if a business' financial position is strong, the issue of debt location within the legal structure is not relevant. However, when a group or some of its component parts are close to insolvency, it is of the essence. Failure to pay the State when due could constitute a default, but we do not believe that this is a highly probable event. An extension might be granted.
- The case of SNS falls in between these two extremes: it is not strong but it is not facing insolvency. It would face technical insolvency (i.e. not meeting regulatory requirements) if it were to repay the State in 2013 and provision more adequately, call bonds, etc.
- If the repayment and the likely increase in provisions were made, the deficit would make the consideration of position within the legal structure relevant.
- We believe that it is unlikely that any capital securities or subordinated bonds will be called at the first call date because, according to our calculations, SNS Reaal Group and component parts show deficits in relation to the capital requirements from 2012 to 2022.
- In the case of SNS, senior bank debt is top in security. At the insurer, while it is the conventional wisdom that it is better to be at the operating company, priority of claim for policyholders and the existence of technical solvency deficits invalidate that approach.
- Subordinated debt at the bank, the insurer or the holding company is not safe as most likely it will not be called. Tier 1 runs the added risk of coupon cancellation as the ACSM could be inoperative under the circumstances.
- This means that the valuations that are more relevant are those we entitle 'uncalled' in the following section.

Bond valuations and recommendations

- SNS has issued bonds out of the holding company (SNS Reaal Groep NV), the bank (SNS Bank NV) and the insurer (SRLEV). The prices of most senior bonds are in the mid to high 90s; many close to par. Short dated senior debt at the SNS Reaal Groep NV also trades at about par (e.g. XS0470928846) or above par (e.g. XS0848012323).
- The only **senior bonds** trading at a discount are bonds with low coupons and medium or long-term floaters. The pricing of these notes does not reveal any market concern about potential burden-sharing changes even if the resolution regime were in place in the Netherlands, which is important when valuing other securities in terms of what the market is implying. There are also notes that are not priced (e.g. XS0382843802), which are not publicly traded.
- Then there are two **Tier 1** bonds one issued by the Group (SNS Reaal Groep NV €250mn 6.258% Perpetual callable in July 2017 priced at 54) and the other by SNS Bank NV (SNS Bank NV €320mn 11.25% Perpetual callable in November 2019 priced at c. 72).
- Our discounted cash flow model shows the values under different scenarios for these two bonds. We use a discount rate of 10% given the weak equity position of the Group i.e. the subordinated debt is seen as likely to remain as the solvency capital of the Group (see our projections on Tables 10 and 11).

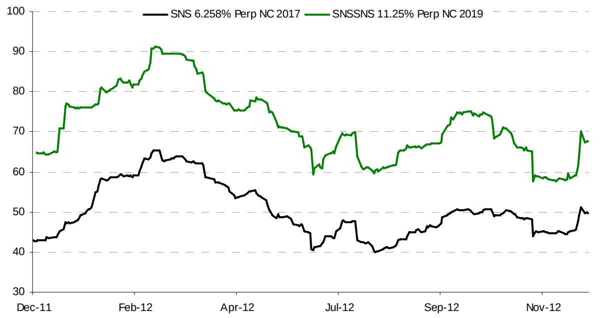
Table 5: Bond valuations Reaal and Bank

Scenarios	SNSSNS 6.258% Reaal €250mn Perp call 2017	SNSSNS 11.25% Bank €320mn Perp call 2019
Price at 08/01/2013	**54**	**72**
If called	**86**	**106**
w/1 coupon deferred	84	102
w/1 coupon lost	80	96
w/2 coupons deferred	83	98
w/2 coupons lost	75	87
w/3 coupons deferred	82	95
w/3 coupons lost	70	78
w/4 coupons deferred	81	94
w/4 coupons lost	66	70
If uncalled	**39**	**109**
w/1 coupon lost	33	99
w/2 coupons lost	28	89
w/3 coupons lost	23	81
w/4 coupons lost	19	73

Source: BNP Paribas

- Will the Group be in a position to call subordinated bonds in 2017 or 2019? At this stage, based on our analysis, it looks improbable. Its current financial condition needs to be resolved long before then. If the calls were in 2013 and 2014, we could safely assume that they would not be called, but being in 2017 and 2019, the probabilities could change.
- We assume that if the bonds are not called, the first to fourth most recent coupons would be lost rather than deferred. In a Tier 1 it is more likely, but the possibility of recovery at some point in the future, given that it is meant to be cumulative, could conceal extra value.
- Notice that if not called, the 11.25% bond would add value as the coupon would remain above the discount rate of 10%, even after the step down. The high step-up margin protects the cash flows and value of the bond.
- From these scenarios alternative values can be calculated by assuming different probabilities of call or not call and of coupons lost or not lost, but the general conclusion is that the 6.258% is worth less than the current market price if uncalled, but more than the current level if called, even if some coupons were to be deferred or cancelled.
- For instance, the price of the 6.258% suggests a 25% probability of a call and the coupon falling to 2.44% from 2018. There could be value in the 11.25% bond but not in the 6.258% bond.

Chart 6: Tier 1s historical prices



Source: BNP Paribas Global Markets

- Both bonds have optional deferral language. In our view, the EC could request coupon payment deferrals on these instruments should SNS require an extension of state aid.
- Deferring coupons, when they are (effectively) cumulative and compounding, does not reduce the liability of the bank and from our point of view is pointless, even if they could ease the cash flow for the time being. However, the Group faces a solvency – not cash flow – difficulty. The glitch here is that SNS may also need to suspend the coupons of these securities due to lack of profitability and the need to build up its capital. The coupon payments are effectively 'cumulative' but have to be paid in accordance with an Alternative Coupon Settlement Mechanism (ACSM). However, we have already said that issuing shares is unlikely, which means that at some point the coupons can be cancelled.
- Our analysis leads us to a Reduce or Sell recommendation on the 6.258% Tier 1and an Add recommendation on the 11.25% Tier 1 (high coupon and high step up).

- There are **two subordinated bonds issued by the insurer** (SRLEV €400mn 9% Tier 2 2041 callable in April 2021, issued in 2011 and the SRLEV CHF105mn 7% Perpetual callable in December 2016) that trade in the mid to high 90s, which present substantial downside (see Table 6). We assume that if the bonds are not called, the most recent coupons might be lost rather than deferred, which is not necessarily the case and which assumption might conceal some extra value. However, we believe the message is clear in relation to the current high prices: Reduce or Sell.
- The lack of a potential buyer for the insurer is understandable due to the market's maturity, competitiveness and the market shares and own challenges of domestic peers.

Table 6: Bond prices of the insurer

Scenarios	SRLEV €400mn 9% 2041 call 21	SRLEV CHF 105mn 7% undated call 16
Price at 4/01/2013	**96**	**95**
If called	**94**	**90**
w/1 coupon deferred	90	89
w/2 coupons deferred	86	88
w/3 coupons deferred	83	87
w/4 coupons deferred	81	N/A
If uncalled	**82**	**63**
w/1 coupon lost	74	57
w/2 coupons lost	67	51
w/3 coupons lost	60	46
w/4 coupons lost	54	41

Source: BNP Paribas

A second opinion: the equity market

- Judging by the market capitalisation as of 4 January 2013 of €298mn, which is a fraction of book value, the equity market seems pessimistic. Such a deep discount could be seen as an opinion on future earnings, on loan loss provisions or on some other hidden losses and exceeds our current capital requirement calculations.

A third opinion: ratings

- In November, both S&P and Moody's downgraded SNS's standalone and issuer credit ratings, concerned with the Group's weakening franchise and business position. All subordinated debt is rated below Investment Grade.

Table 7: Senior ratings

	SNS REAAL	SNS Bank	SRLEV NV
Moody's	Baa3 (WL-)	Baa2 (WL-)	Baa1 (WL-)
S&P	BBB- (Neg)	BBB (Neg)	BBB (CWN)
Fitch	BBB+ (on review)	BBB+ (Stable)	A- (on review)

Source: Rating agencies

- Moody's also downgraded SNS's sub debt rating by three notches to Ba2 and its preference shares to B1. After the downgrades, Moody's kept the Group's BFSR and issuer ratings on review for possible downgrade, mainly due to the rapid deterioration of the Dutch CRE and rising likelihood of future losses in the SNS PF portfolio.
- Moody's also highlighted its view of an increasing probability that the Group might need external support to preserve its solvency. The final agency's review is pending the outcome of the Group's strategic review.

Additional information

Table 8: SNSSNS 6.258% Perp NC July 17 - XS0310904155

Issuer	**SNS Reaal Group NV**
Issuance date	Jul-07
Outstanding amount	€250mn
Issue spread	129bp
Call	Optional call from 17 Jul 2017 onwards at the nominal amount + accrued interest with 30-60 days' notice. After the first call date, the coupon switched to 3 month Libor + 229
Cumulative	If any Deferred Coupon Payment is to be made, it will be satisfied using the ACSM, i.e. via the proceeds from the issue of ordinary shares, but payment has to be made in cash.
Optional deferral	Yes, subject to dividend pusher language, the issuer may defer all or part of coupon payments by giving a 16 business day notice. There is interest on optionally deferred interest at the applicable coupon rate.
Mandatory deferral	Yes
Ratings	Ca (WL-)/BB(CWN)/B-
Dividend pusher	Yes
Loss absorption	No

Source: SNS Reaal prospectus

Table 9: SNSSNS 11.25% Perp NC Nov 19 - XS0468954523

Issuer	**SNS Bank NV**
Issuance date	Nov-09
Outstanding amount	€320mn
Issue spread	775.5bp
Call	Optional call 27 Nov 2019 onwards at the nominal amount + accrued interest with 30-60 days' notice. After the first call date, the coupon switched to 3 month Libor + 975
Cumulative	If any Deferred Coupon Payment is to be made, it will be satisfied using the ACSM, i.e. via the proceeds from the issue of ordinary shares, but payment has to be made in cash.
Optional deferral	Optional deferral for any period of time is subject to suspension of payment on Junior securities. Any payment deferral will bear interest. Deferred coupon payments can be satisfy by issuing of Ordinary Shares (ACSM) and subject to a cap on the issue of ordinary shares.
Mandatory deferral	Yes
Ratings	Baa2 (WL-)/BB-(CWN)/B-
Dividend pusher	Yes
Loss absorption	No

Source: SNS Reaal prospectus, BNP Paribas

Bridge bank

- In the context of the Dutch Intervention Act introduced in June 2012, the Dutch Ministry of Finance and the Dutch central bank (DNB) received more options for dealing with ailing financial institutions, including the transfer of assets and liabilities to the bridge bank.
- According to Bloomberg the Dutch media reports that the Dutch CB, in consultation with SNS, has asked the three biggest Dutch banks (ING, Rabobank and ABN) whether they could help to create a bridge bank which could absorb some of SNS's non-performing PF assets.
- However banks would want to see a full or partial government guarantee of the investments before contributing to the bridge bank. This is the cost we referred to as a first loss capital cushion.

No bail-in

- It is important to highlight that the purpose of the Intervention Act is different to a resolution regime, for example the Intervention Act does not contain proposals for any bail-in arrangements.
- The Dutch resolution regime was drafted in 2011 and there are ongoing consultations. Its implementation is expected before January 2015.
- It is our view that SNS remains one of the systemically important banks in the Netherlands, given the bank's 8% retail-deposit market share. Therefore, we believe that the Dutch state will endeavour to support SNS's restructuring, albeit with some conditions attached.

LME would not help

- In our view, **LME** is not currently an option to increase capital for SNS. Increasing Core Tier 1 through capital gains on discounted bond buybacks would reduce the overall level of solvency capital and thus increase the risk for all creditors.
- For an **LME in Tier 1s**, we understand that the regulator would require SNS to replenish Tier 1 bonds with similar quality capital, which is highly unlikely at this time and with current trading levels. Although we cannot exclude that the regulator could relax this condition. For example, SNS exchanged two € LT2s for new senior bonds in November 2011.
- The risk here is that subordinated bondholders at the bank, insurer or holding company may be asked to contribute to the cause one way or another.

Table 10: Projection 1 of technical solvency at bank+PF and insurer+holding company: State repaid

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Bank profit		0.160	0.160	0.160	0.160	0.160	0.160	0.160	0.160	0.160	0.160
Equity	1.600	1.760	1.920	2.080	2.240	2.400	2.560	2.720	2.880	3.040	3.200
Cap secs	0.156	-	-	-	-	-	-	-	-	-	-
Part certificates and sub											
Part certificates	0.281	0.281	0.281	0.281	0.281	0.281	0.281	0.281	0.281	0.281	0.281
Sub debt	0.634	0.634	0.634	0.634	0.634	0.634	0.558	0.238	-0.024	-0.024	-0.024
Capital resources	2.671	2.675	2.835	2.995	3.155	3.315	3.399	3.239	3.137	3.297	3.457
Intangible assets	0.150	0.150	0.150	0.150	0.150	0.150	0.150	0.150	0.150	0.150	0.150
TCE	1.450	1.610	1.770	1.930	2.090	2.250	2.410	2.570	2.730	2.890	3.050
TCE + hybrid + sub debt	2.521	2.525	2.685	2.845	3.005	3.165	3.249	3.089	2.987	3.147	3.307
Property Finance		-0.686	-0.090	-0.090	-0.090	-0.090	-0.090	-0.090	-0.090	-0.090	-0.090
Equity	0.137	0.549	-0.639	-0.729	-0.819	-0.909	-0.999	-1.089	-1.179	-1.269	-1.359
Cap secs											
Part certificates and sub											
Part certificates											
Sub debt											
Capital resources	0.137	-0.549	-0.639	-0.729	-0.819	-0.909	-0.999	-1.089	-1.179	-1.269	-1.359
Intangible assets											
TCE	0.137	-0.549	-0.639	-0.729	-0.819	-0.909	-0.999	-1.089	-1.179	-1.269	-1.359
TCE + hybrid + sub debt	0.137	-0.549	-0.639	-0.729	-0.819	-0.909	-0.999	-1.089	-1.179	-1.269	-1.359
state repaid, premium											
Requirements											
Tier 1	2.000	1.950	1.900	1.850	1.800	1.750	1.750	1.750	1.750	1.750	1.750
Tier 2	0.800	0.750	0.700	0.650	0.600	0.550	0.550	0.550	0.550	0.550	0.550
Combined bank +PF	**2.800**	**2.700**	**2.600**	**2.500**	**2.400**	**2.300**	**2.300**	**2.300**	**2.300**	**2.300**	**2.300**
Surplus/(deficit) T1	0.024	-0.608	-0.488	-0.368	-0.248	-0.128	-0.058	0.012	0.082	0.152	0.222
Surplus/(deficit) T2	-0.166	-0.116	-0.066	-0.016	0.034	0.084	0.008	-0.312	-0.574	-0.574	-0.574
Surplus/(deficit)	-0.142	-0.724	-0.554	-0.384	-0.214	-0.044	-0.050	-0.300	-0.492	-0.422	-0.352
Insurer+ hold co P&L		-0.183	0.100	0.100	0.100	0.100	0.100	0.100	0.100	0.100	0.100
Equity	2.068	1.886	1.986	2.086	2.186	2.286	2.386	2.486	2.586	2.686	2.786
Cap secs	0.831	0.422	0.422	0.422	0.422	0.422	0.422	0.422	0.422	0.422	0.422
Part certificates and sub											
Part certificates	0.088	0.088	0.088	0.088	0.001	0.001	0.001	0.001	0.001	0.001	0.001
Sub debt	0.831	0.831	0.831	0.831	0.831	0.581	0.581	0.581	0.581	0.181	0.181
Capital resources	3.818	3.227	3.327	3.427	3.440	3.290	3.390	3.490	3.590	3.290	3.390
Intangible assets	1.538	1.538	1.538	1.538	1.538	1.538	1.538	1.538	1.538	1.538	1.538
TCE	0.530	0.348	0.448	0.548	0.648	0.748	0.848	0.948	1.048	1.148	1.248
TCE + hybrid + sub debt	2.280	1.689	1.789	1.889	1.902	1.752	1.852	1.952	2.052	1.752	1.852
Gearing	77%	79%	75%	71%	66%	57%	54%	51%	49%	34%	33%
Tier 1	1.200	1.200	1.200	1.200	1.200	1.200	1.200	1.200	1.200	1.200	1.200
Tier 2	1.200	1.200	1.200	1.200	1.200	1.200	1.200	1.200	1.200	1.200	1.200
Insurer	**2.400**	**2.400**	**2.400**	**2.400**	**2.400**	**2.400**	**2.400**	**2.400**	**2.400**	**2.400**	**2.400**
Surplus/(deficit) T1	0.249	-0.343	-0.243	-0.143	-0.129	-0.029	0.071	0.171	0.271	0.371	0.471
Surplus/(deficit) T2	-0.369	-0.369	-0.369	-0.369	-0.369	-0.619	-0.619	-0.619	-0.619	-1.019	-1.019
Surplus/(deficit)	-0.120	-0.712	-0.612	-0.512	-0.498	-0.648	-0.548	-0.448	-0.348	-0.648	-0.548
Group											
Equity	3.805	3.097	3.267	3.437	3.607	3.777	3.947	4.117	4.287	4.457	4.627
Cap secs	0.987	0.422	0.422	0.422	0.422	0.422	0.422	0.422	0.422	0.422	0.422
Part certificates and sub											
Part certificates	0.369	0.369	0.369	0.369	0.282	0.282	0.282	0.282	0.282	0.282	0.282
Sub debt	1.465	1.465	1.465	1.465	1.465	1.215	1.139	0.819	0.557	0.157	0.157
Capital resources	6.626	5.353	5.523	5.693	5.776	5.696	5.790	5.640	5.547	5.317	5.487
Intangible assets	1.688	1.688	1.688	1.688	1.688	1.688	1.688	1.688	1.688	1.688	1.688
TCE	2.117	1.409	1.579	1.749	1.919	2.089	2.259	2.429	2.599	2.769	2.939
TCE + hybrid + sub debt	4.938	3.665	3.835	4.005	4.088	4.008	4.102	3.952	3.859	3.629	3.799
Gearing	57%	62%	59%	56%	53%	48%	45%	39%	33%	24%	23%
Tier 1	3.200	3.150	3.100	3.050	3.000	2.950	2.950	2.950	2.950	2.950	2.950
Tier 2	2.000	1.950	1.900	1.850	1.800	1.750	1.750	1.750	1.750	1.750	1.750
Group	**5.200**	**5.100**	**5.000**	**4.900**	**4.800**	**4.700**	**4.700**	**4.700**	**4.700**	**4.700**	**4.700**
Surplus/(deficit) T1	0.273	-0.951	-0.731	-0.511	-0.377	-0.157	0.013	0.183	0.353	0.523	0.693
Surplus/(deficit) T2	-0.535	-0.485	-0.435	-0.385	-0.335	-0.535	-0.611	-0.931	-1.193	-1.593	-1.593
Surplus/(deficit)	-0.262	-1.436	-1.166	-0.896	-0.712	-0.692	-0.598	-0.748	-0.841	-1.071	-0.901

Source: BNP Paribas

Table 11: Projection 2 of technical solvency at bank+PF and insurer+holding company: 5-year extension €0.5bn reduction in PF capital requirements over 5 years

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Bank profit		0.160	0.160	0.160	0.160	0.160	0.160	0.160	0.160	0.160	0.160
Equity	1.600	1.760	1.920	2.080	2.240	2.400	2.560	2.720	2.880	3.040	3.200
Cap secs	0.156	0.156	0.156	0.156	0.156	0.156	-	-	-	-	-
Part certificates and sub											
Part certificates	0.281	0.281	0.281	0.281	0.281	0.281	0.281	0.281	0.281	0.281	0.281
Sub debt	0.634	0.634	0.634	0.634	0.634	0.634	0.558	0.238	-0.024	-0.024	-0.024
Capital resources	2.671	2.831	2.991	3.151	3.311	3.471	3.399	3.239	3.137	3.297	3.457
Intangible assets	0.150	0.150	0.150	0.150	0.150	0.150	0.150	0.150	0.150	0.150	0.150
TCE	1.450	1.610	1.770	1.930	2.090	2.250	2.410	2.570	2.730	2.890	3.050
TCE + hybrid + sub debt	2.521	2.681	2.841	3.001	3.161	3.321	3.249	3.089	2.987	3.147	3.307
Property Finance		-0.686	-0.090	-0.090	-0.090	-0.090	-0.090	-0.090	-0.090	-0.090	-0.090
Equity	0.137	-0.549	-0.639	-0.729	-0.819	-0.909	-0.999	-1.089	-1.179	-1.269	-1.359
Cap secs											
Part certificates and sub											
Part certificates											
Sub debt											
Capital resources	0.137	-0.549	-0.639	-0.729	-0.819	-0.909	-0.999	-1.089	-1.179	-1.269	-1.359
Intangible assets											
TCE	0.137	-0.549	-0.639	-0.729	-0.819	-0.909	-0.999	-1.089	-1.179	-1.269	-1.359
TCE + hybrid + sub debt	0.137	-0.549	-0.639	-0.729	-0.819	-0.909	-0.999	-1.089	-1.179	-1.269	-1.359
state repaid, premium											
Requirements											
Tier 1	2.000	1.950	1.900	1.850	1.800	1.750	1.750	1.750	1.750	1.750	1.750
Tier 2	0.800	0.750	0.700	0.650	0.600	0.550	0.550	0.550	0.550	0.550	0.550
Combined bank +PF	**2.800**	**2.700**	**2.600**	**2.500**	**2.400**	**2.300**	**2.300**	**2.300**	**2.300**	**2.300**	**2.300**
Surplus/(deficit) T1	0.024	-0.452	-0.332	-0.212	-0.092	0.028	-0.058	0.012	0.082	0.152	0.222
Surplus/(deficit) T2	-0.166	-0.116	-0.066	-0.016	0.034	0.084	0.008	-0.312	-0.574	-0.574	-0.574
Surplus/(deficit)	-0.142	-0.568	-0.398	-0.228	-0.058	0.112	-0.050	-0.300	-0.492	-0.422	-0.352
Insurer+ hold co P&L		0.100	0.100	0.100	0.100	0.100	-0.183	0.100	0.100	0.100	0.100
Equity	2.068	2.168	2.268	2.368	2.468	2.568	2.386	2.486	2.586	2.686	2.786
Cap secs	0.831	0.831	0.831	0.831	0.831	0.831	0.431	0.431	0.431	0.431	0.431
Part certificates and sub											
Part certificates	0.088	0.088	0.088	0.088	0.001	0.001	0.001	0.001	0.001	0.001	0.001
Sub debt	0.831	0.831	0.831	0.831	0.831	0.581	0.581	0.581	0.581	0.181	0.181
Capital resources	3.818	3.918	4.018	4.118	4.131	3.981	3.399	3.499	3.599	3.299	3.399
Intangible assets	1.538	1.538	1.538	1.538	1.538	1.538	1.538	1.538	1.538	1.538	1.538
TCE	0.530	0.630	0.730	0.830	0.930	1.030	0.848	0.948	1.048	1.148	1.248
TCE + hybrid + sub debt	2.280	2.380	2.480	2.580	2.593	2.443	1.861	1.961	2.061	1.761	1.861
Gearing	77%	74%	71%	68%	64%	58%	54%	52%	49%	35%	33%
Tier 1	1.200	1.200	1.200	1.200	1.200	1.200	1.200	1.200	1.200	1.200	1.200
Tier 2	1.200	1.200	1.200	1.200	1.200	1.200	1.200	1.200	1.200	1.200	1.200
Insurer	**2.400**	**2.400**	**2.400**	**2.400**	**2.400**	**2.400**	**2.400**	**2.400**	**2.400**	**2.400**	**2.400**
Surplus/(deficit) T1	0.249	0.349	0.449	0.549	0.562	0.662	0.080	0.180	0.280	0.380	0.480
Surplus/(deficit) T2	-0.369	-0.369	-0.369	-0.369	-0.369	-0.619	-0.619	-0.619	-0.619	-1.019	-1.019
Surplus/(deficit)	-0.120	-0.020	0.080	0.180	0.193	0.043	-0.539	-0.439	-0.339	-0.639	-0.539
Group											
Equity	3.805	3.379	3.549	3.719	3.889	4.059	3.947	4.117	4.287	4.457	4.627
Cap secs	0.987	0.987	0.987	0.987	0.987	0.987	0.431	0.431	0.431	0.431	0.431
Part certificates and sub											
Part certificates	0.369	0.369	0.369	0.369	0.282	0.282	0.282	0.282	0.282	0.282	0.282
Sub debt	1.465	1.465	1.465	1.465	1.465	1.215	1.139	0.819	0.557	0.157	0.157
Capital resources	6.626	6.200	6.370	6.540	6.623	6.543	5.799	5.649	5.556	5.326	5.496
Intangible assets	1.688	1.688	1.688	1.688	1.688	1.688	1.688	1.688	1.688	1.688	1.688
TCE	2.117	1.691	1.861	2.031	2.201	2.371	2.259	2.429	2.599	2.769	2.939
TCE + hybrid + sub debt	4.938	4.512	4.682	4.852	4.935	4.855	4.111	3.961	3.868	3.638	3.808
Gearing	57%	63%	60%	58%	55%	51%	45%	39%	33%	24%	23%
Tier 1	3.200	3.150	3.100	3.050	3.000	2.950	2.950	2.950	2.950	2.950	2.950
Tier 2	2.000	1.950	1.900	1.850	1.800	1.750	1.750	1.750	1.750	1.750	1.750
Group	**5.200**	**5.100**	**5.000**	**4.900**	**4.800**	**4.700**	**4.700**	**4.700**	**4.700**	**4.700**	**4.700**
Surplus/(deficit) T1	0.273	-0.103	0.117	0.337	0.470	0.690	0.022	0.192	0.362	0.532	0.702
Surplus/(deficit) T2	-0.535	-0.485	-0.435	-0.385	-0.335	-0.535	-0.611	-0.931	-1.193	-1.593	-1.593
Surplus/(deficit)	-0.262	-0.588	-0.318	-0.048	0.135	0.155	-0.589	-0.739	-0.832	-1.062	-0.892

Source: BNP Paribas

Table 12: Projection 3 of technical solvency at bank+PF and insurer+holding company: 5-year extension €1bn reduction in PF and SME capital requirements over 5 years

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Bank profit		0.160	0.160	0.160	0.160	0.160	0.160	0.160	0.160	0.160	0.160
Equity	1.600	1.760	1.920	2.080	2.240	2.400	2.560	2.720	2.880	3.040	3.200
Cap secs	0.156	0.156	0.156	0.156	0.156	0.156	-	-	-	-	-
Part certificates and sub											
Part certificates	0.281	0.281	0.281	0.281	0.281	0.281	0.281	0.281	0.281	0.281	0.281
Sub debt	0.634	0.634	0.634	0.634	0.634	0.634	0.558	0.238	-0.024	-0.024	-0.024
Capital resources	2.671	2.831	2.991	3.151	3.311	3.471	3.399	3.239	3.137	3.297	3.457
Intangible assets	0.150	0.150	0.150	0.150	0.150	0.150	0.150	0.150	0.150	0.150	0.150
TCE	1.450	1.610	1.770	1.930	2.090	2.250	2.410	2.570	2.730	2.890	3.050
TCE + hybrid + sub debt	2.521	2.681	2.841	3.001	3.161	3.321	3.249	3.089	2.987	3.147	3.307
Property Finance		-0.686	-0.090	-0.090	-0.090	-0.090					
Equity	0.137	-0.549	-0.639	-0.729	-0.819	-0.909	-0.909	-0.909	-0.909	-0.909	-0.909
Cap secs											
Part certificates and sub											
Part certificates											
Sub debt											
Capital resources	0.137	-0.549	-0.639	-0.729	-0.819	-0.909	-0.909	-0.909	-0.909	-0.909	-0.909
Intangible assets											
TCE	0.137	-0.549	-0.639	-0.729	-0.819	-0.909	-0.909	-0.909	-0.909	-0.909	-0.909
TCE + hybrid + sub debt	0.137	-0.549	-0.639	-0.729	-0.819	-0.909	-0.909	-0.909	-0.909	-0.909	-0.909
Requirements											
Tier 1	2.000	1.900	1.800	1.700	1.600	1.500	1.500	1.500	1.500	1.500	1.500
Tier 2	0.800	0.700	0.600	0.500	0.400	0.300	0.300	0.300	0.300	0.300	0.300
Combined bank +PF	**2.800**	**2.600**	**2.400**	**2.200**	**2.000**	**1.800**	**1.800**	**1.800**	**1.800**	**1.800**	**1.800**
Surplus/(deficit) T1	0.024	-0.402	-0.232	-0.062	0.108	0.278	0.192	0.262	0.332	0.402	0.472
Surplus/(deficit) T2	-0.166	-0.066	0.034	0.134	0.234	0.334	0.258	-0.062	-0.324	-0.324	-0.324
Surplus/(deficit)	-0.142	-0.468	-0.198	0.072	0.342	0.612	0.450	0.200	0.008	0.078	0.148
Insurer+ hold co P&L		0.100	0.100	0.100	0.100	0.100	-0.183	0.100	0.100	0.100	0.100
Equity	2.068	2.168	2.268	2.368	2.468	2.568	2.386	2.486	2.586	2.686	2.786
Cap secs	0.831	0.831	0.831	0.831	0.831	0.831	0.431	0.431	0.431	0.431	0.431
Part certificates and sub											
Part certificates	0.088	0.088	0.088	0.088	0.001	0.001	0.001	0.001	0.001	0.001	0.001
Sub debt	0.831	0.831	0.831	0.831	0.831	0.581	0.581	0.581	0.581	0.181	0.181
Capital resources	3.818	3.918	4.018	4.118	4.131	3.981	3.399	3.499	3.599	3.299	3.399
Intangible assets	1.538	1.538	1.538	1.538	1.538	1.538	1.538	1.538	1.538	1.538	1.538
TCE	0.530	0.630	0.730	0.830	0.930	1.030	0.848	0.948	1.048	1.148	1.248
TCE + hybrid + sub debt	2.280	2.380	2.480	2.580	2.593	2.443	1.861	1.961	2.061	1.761	1.861
Gearing	77%	74%	71%	68%	64%	58%	54%	52%	49%	35%	33%
Requirements											
Tier 1	1.200	1.200	1.200	1.200	1.200	1.200	1.200	1.200	1.200	1.200	1.200
Tier 2	1.200	1.200	1.200	1.200	1.200	1.200	1.200	1.200	1.200	1.200	1.200
Insurer	**2.400**	**2.400**	**2.400**	**2.400**	**2.400**	**2.400**	**2.400**	**2.400**	**2.400**	**2.400**	**2.400**
Surplus/(deficit) T1	0.249	0.349	0.449	0.549	0.562	0.662	0.080	0.180	0.280	0.380	0.480
Surplus/(deficit) T2	-0.369	-0.369	-0.369	-0.369	-0.369	-0.619	-0.619	-0.619	-0.619	-1.019	-1.019
Surplus/(deficit)	-0.120	-0.020	0.080	0.180	0.193	0.043	-0.539	-0.439	-0.339	-0.639	-0.539
Group		-0.426	0.170	0.170	0.170	0.170	-0.023	0.260	0.260	0.260	0.260
Equity	3.805	3.379	3.549	3.719	3.889	4.059	4.037	4.297	4.557	4.817	5.077
Cap secs	0.987	0.987	0.987	0.987	0.987	0.987	0.431	0.431	0.431	0.431	0.431
Part certificates and sub											
Part certificates	0.369	0.369	0.369	0.369	0.282	0.282	0.282	0.282	0.282	0.282	0.282
Sub debt	1.465	1.465	1.465	1.465	1.465	1.215	1.139	0.819	0.557	0.157	0.157
Capital resources	6.626	6.200	6.370	6.540	6.623	6.543	5.889	5.829	5.826	5.686	5.946
Intangible assets	1.688	1.688	1.688	1.688	1.688	1.688	1.688	1.688	1.688	1.688	1.688
TCE	2.117	1.691	1.861	2.031	2.201	2.371	2.349	2.609	2.869	3.129	3.389
TCE + hybrid + sub debt	4.938	4.512	4.682	4.852	4.935	4.855	4.201	4.141	4.138	3.998	4.258
Gearing	57%	63%	60%	58%	55%	51%	44%	37%	31%	22%	20%
Requirements											
Tier 1	3.200	3.100	3.000	2.900	2.800	2.700	2.700	2.700	2.700	2.700	2.700
Tier 2	2.000	1.900	1.800	1.700	1.600	1.500	1.500	1.500	1.500	1.500	1.500
Group	**5.200**	**5.000**	**4.800**	**4.600**	**4.400**	**4.200**	**4.200**	**4.200**	**4.200**	**4.200**	**4.200**
Surplus/(deficit) T1	0.273	-0.053	0.217	0.487	0.670	0.940	0.362	0.622	0.882	1.142	1.402
Surplus/(deficit) T2	-0.535	-0.435	-0.335	-0.235	-0.135	-0.285	-0.361	-0.681	-0.943	-1.343	-1.343
Surplus/(deficit)	-0.262	-0.488	-0.118	0.252	0.535	0.655	0.001	-0.059	-0.062	-0.202	0.058

Source: BNP Paribas

Contacts

Robert McAdie, Global Head of Fixed Income Strategy and Credit Research		+44 20 7595 8885	robert.mcadie@uk.bnpparibas.com

European Credit Research

Olivia Frieser, Head of Investment Grade Research - Banks		+44 20 7595 8591	olivia.frieser@uk.bnpparibas.com
Jean-Yves Coupin, CFA, Senior Credit Analyst	Retail, Metals & Mining, Building Products	+44 20 7595 8360	jean-yves.coupin@uk.bnpparibas.com
Luba Fakhrutdinova, Junior Credit Analyst	Banks	+44 20 7595 8082	luba.fakhrutdinova@uk.bnpparibas.com
Heiko Langer, Senior Credit Analyst	Covered Bonds	+44 20 7595 8569	heiko.langer@uk.bnpparibas.com
Norbert Ling, Junior Credit Analyst	Chemicals, Industrials, Consumer Products and Food & Beverage	+44 20 7595 8853	norbert.ling@uk.bnpparibas.com
Hunter Martin, CFA, Credit Analyst	TMT	+44 20 7595 8491	hunter.martin@uk.bnpparibas.com
Timothy Rea, Credit Analyst	Autos, Aero & Def, Pharma	+44 20 7595 8317	timothy.rea@uk.bnpparibas.com
James Sparrow, Senior Credit Analyst	Utilities	+44 20 7595 1269	james.sparrow@uk.bnpparibas.com
Rafael Villarreal, Senior Credit Analyst	Insurance	+44 20 7595 8918	rafael.villarreal@uk.bnpparibas.com
Ivan Zubo, Credit Analyst	Banks	+44 20 7595 1428	ivan.zubo@uk.bnpparibas.com

European Credit Strategy

Matthew Leeming, Head of Quantitative & European Credit Strategy		+44 20 7595 1230	matthew.leeming@uk.bnpparibas.com
Pierre-Yves Bretonniere, Senior Credit Strategist	Relative Value & Quantitative Credit Strategy	+44 20 7595 8973	pierre-yves.bretonniere@uk.bnpparibas.com
Joanna Chan, Graduate	Relative Value & Quantitative Credit Strategy	+44 20 7595 8185	joanna.chan@uk.bnpparibas.com
Mehernosh Engineer, Senior Credit Strategist	Macro Credit Strategy	+44 20 7595 8338	mehernosh.engineer@uk.bnpparibas.com
Paola Lamedica, Senior Credit Strategist	Option & Structured Product Strategy	+44 20 7595 8081	paola.lamedica@uk.bnpparibas.com
Greg Venizelos, Senior Credit Strategist	Macro & Relative Value Credit Strategy	+44 20 7595 8296	greg.venizelos@uk.bnpparibas.com

Sector Specialists

Jean-Yves Guibert, Head of European High Yield Sector Specialists - HY TMT		+44 20 7595 8308	jean-yves.guibert@uk.bnpparibas.com
Helen Rodriguez, Senior Sector Specialist	HY Consumer, Food & Beverage, Retail and Gaming	+44 20 7595 1285	helen.rodriguez@uk.bnpparibas.com
Phil Spencer, CFA, Senior Sector Specialist	HY Industrials: Paper & Packaging, Chemicals, Manufacturing	+44 20 7595 8810	philip.spencer@uk.bnpparibas.com
Anthony Langlois, Sector Specialist	High Yield	+44 20 7595 3329	anthony.langlois @uk.bnpparibas.com
Belle Yang, Senior Sector Specialist - Credit Trading	Special Situations	+44 20 7595 8445	belle.yang@uk.bnpparibas.com

Production

Barbara Hickling, Editor/Research Assistant		+44 20 7595 8599	barbara.hickling@uk.bnpparibas.com
Patricia Ivory, Deputy Editor/Research Assistant		+44 20 7595 8260	patricia.ivory@uk.bnpparibas.com

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.

IMPORTANT DISCLOSURES: Please see important disclosures in the text of this report.