Thomas Rahman, CFA, Credit Strategist thomas.rahman@ria.co.uk +44(0)131 222 3220

SNS Reaal NV - Summary

Background

The Finance Ministry of Netherlands issued a Decree on 1st February 2013 stating that the securities of SNS Reaal NV and SNS Bank NV will be expropriated. The securities that would be expropriated would include Equity, Tier 1, Upper Tier 2 and Lower Tier 2 products.

The Ministry stated that a number of factors were considered before taking its course of action. These included:

- Potential additional losses of €1.4bn to €2.1bn within the bank's property portfolio.
- The current Core Tier 1 ratio of 7.7% would have been negatively impacted by these property losses.
- The bank had been suffering from deposit withdrawals, thus affecting its funding ratios.
- Talks with private investors (buyers) collapsed, thus rendering the government with little choice.

European Precedents

Northern Rock

100% losses were imposed on shareholders and preference shares with voting rights. The preferred shareholders have failed thus far to recover any compensation.

Bradford & Bingley

100% losses imposed on shareholders and preference shares with voting rights.

Icelandic Banks

Although there was no government expropriation, recovery on subordinated bondholders were zero. Losses were also imposed on senior debtholders, with recovery on these instruments of up to 30%.

Irish Banks

Shareholders suffered 100% of losses and Liability Management Exercises (LME) were conducted imposing up to 95% losses on Tier 1 instruments and up to 80% on Tier 2 debt.

Amagerbanken

Shareholders and subordinated debt holders had zero recovery. Losses of up to 40% were imposed on senior creditors.

Bankia

Losses are likely to be imposed on subordinated debt. However, details of this have still not been finalised, with market participants expecting losses similar to Irish banks.

Other Bank Rescues

Other banks which have received government support but that have not suffered from subordinated losses include: RBS, Lloyds, IKB, Hypo Real Estate, Commerzbank/Eurohypo, BayernLB, LBBW, HSH Nordbank, WestLB, Dexia, ABN Amro, ING and Monte Dei Paschi. Debtholders within these banks in some cases have witnessed a suspension/deferral/cancellation of coupon but interestingly not yet suffered from capital losses (although LME exercises have been conducted).

Recovery

Any recovery of principal on subordinated debt will be extremely uncertain both in principal amount and timing. Investors are likely to take their claim to the Amsterdam Court of Law, where they will argue that some of the instruments (particularly Lower Tier 2 bonds) have some recovery value.

The Ministry of Finance will seek maximum bail-in conditions for subordinated bondholders as per their actions and also the statement made by the Finance Minister where he stated he would impose the maximum limit of what was allowed under European legislation.

At the end of 2011 (according to the annual statements), there was €5,428m of equity and €1,831m of subordinated debt (equating to €7,259m). Any recovery of debt instruments will be dependent on recoveries on the following assets:

- Intangible Assets: €2,179m
- Investments: €31,435m
- Loans and Advances to customers: €67,534m
- Loans and Advances to banks: €2,171m

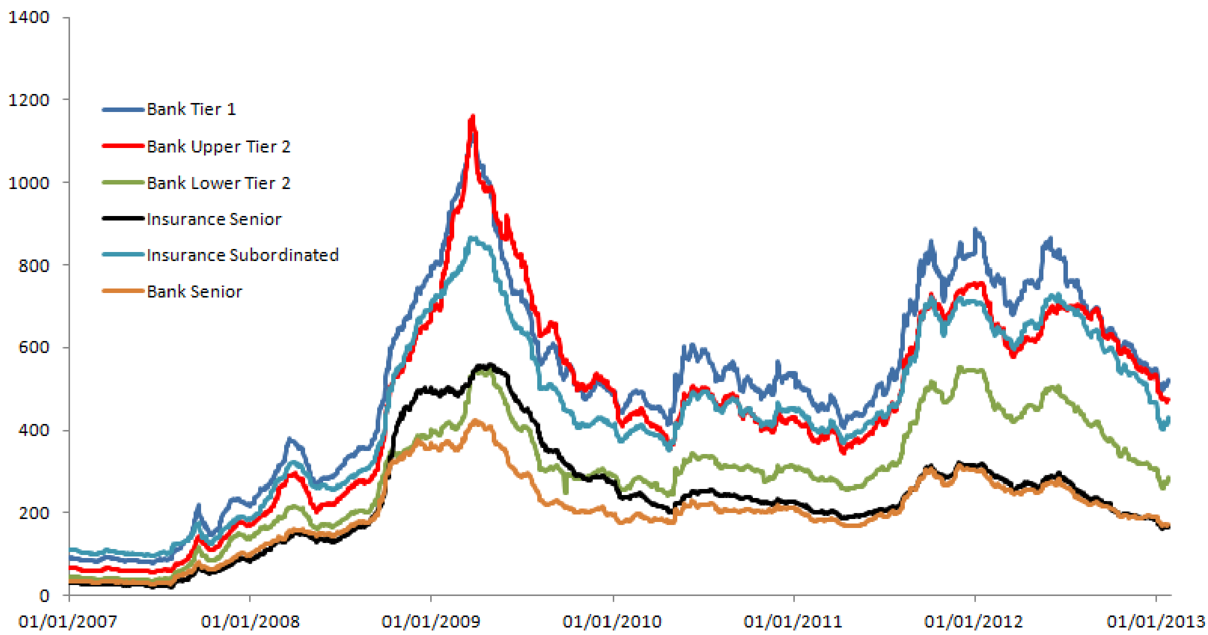
We believe recovery on intangible assets is likely to be minimal. Furthermore, the accounts provide little detail on the quality of the investment portfolio and loans and advances to customers.

Assuming a total loss on intangible losses and 5% of losses on both the investments and loans and advances to customers results in aggregate losses of €7,127m. Hence, under this scenario subordinated noteholders would likely see a recovery of around 7%. Given, the tremendous uncertainty surrounding the investment portfolio and loans and advances to customers, it is difficult to accurately calculate recoveries, but we estimate this to be between 5-25% based on a range of recovery values.

Read Across

Senior Debt – Given that no losses have been imposed by the Dutch Finance Ministry on senior bonds, we expect spreads on senior to tighten marginally further. Governments continue to be extremely reluctant on imposing losses to senior creditors particularly in those countries that have adopted the Euro. Denmark and Iceland (both maintaining an independent currency) are the only nations in Europe to have imposed losses on senior creditors.

Subordinated Debt – We expect subordinated debt to widen marginally given the actions on SNS Reaal. But those banks currently under government scrutiny such as Spanish Banks and Monte Dei Paschi could potentially suffer from further widening. However, within the general framework, the widening of spreads is likely to be short-lived as investors continue to search for yield, which will severely limit any spread widening.



Source: iBoxx (22 January 2013)

SNS Bank Covered Bonds

SNS Bank has €4.3bn of covered bonds outstanding, which is AA+ rated by Fitch. The nationalisation of SNS Bank could potentially result in the covered bonds being upgraded due to the covered bond now being managed by a better rated issuer/entity (i.e. the Dutch Government).

We do not envisage any risk to the holders of the covered bonds have recourse to a pool of assets, which continue to perform.

Conclusion

Given the actions taken by the Dutch Government we would not recommend investors take any of the following actions:

1. Reduce holdings in Lower Tier 2 instruments within European Banks – We believe European banks are continuing to deleverage and improve their balance sheets. As such this should translate into a tightening of spreads for the majority of Lower Tier 2 bonds. We would however, tread carefully in Spanish Banks (particularly those currently controlled by FROB) and certain Italian Banks (most notably Monte Dei Paschi).

2. Invest in Subordinated SNS Reaal NV and/or SNS Bank NV debt – Certain investors may be tempted into purchasing subordinated debt with a view to benefiting from potential recoveries. However, given the strong language originating from the Dutch Government and the extreme sensitivity in recovery values, we would consider this to be an extremely risky strategy.

RIA Capital Markets Ltd.

County House, 20-22 Torphichen Street, Edinburgh EH3 8JB. TEL +44 (0) 131 222 3200