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HYBRID CAPITAL PRODUCT DEVELOPMENT

FOCUSING ON TIER 1 AND OTHER HYBRID CAPITAL PRODUCTS

March 2010

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INTRODUCTION

2009 – 2010 HYBRID CAPITAL ISSUES AND SELECTED DEVELOPMENTS

It is our pleasure to provide you with the eleventh edition of Sidley's publication on hybrid capital product development. The purpose of this edition, as with previous editions, is twofold: first, to provide a general survey of the regulatory developments, whether global, regional or country specific, and executed Tier 1 and other hybrid capital transactions that have taken place in the past year; and, second, to provide a readily accessible guide, organized by product type and country, of the Tier 1 and other hybrid capital products that have been executed since 1989.[1]

There is real value in seeing how structured Tier 1 and other hybrid products have evolved to achieve broader goals, reach more types of issuers and respond to changing regulatory, tax, accounting, credit rating, financial and product market environments. This is especially the case in light of the difficult market conditions many issuers have faced since the beginning of the global financial crisis in the summer of 2007 and the changing regulatory landscape in which we currently find ourselves.

Overview

Significant additions to this year's edition include:

- anticipated changes to the definition of regulatory capital for banks and other regulatory developments resulting from the global financial crisis are discussed below in this Introduction as well as in Chapter 3 (*The Basel Framework*) and Appendix A (*Basel Committee and US Regulatory Innovative Tier 1 Capital Requirements*);

- the addition of Chapter 11 (*Bank Contingent Capital Instruments*) as a result of the recent focus by banks and bank regulators on contingent capital;

- an updated Chapter 17 (*Liability Management Transactions*) reflecting a significant increase in the number and diversity of exchange offers, cash tender offers and other liability management transactions in 2009 and to date this year as compared to 2008 (we report exchange offers by 18 issuers and cash tender offers by eight issuers in 2009 and to date this year versus two exchange offers in 2008);

- a description of 72 new hybrid capital issuances during 2009 and to date this year resulting from new issues for cash and in exchange offers, chronicled by country and product type, 12 of which involve issuers from Hong Kong or Japan, four of which involve Australian issuers, 42 of which involve issuers from Europe, 13 of which involve

[1] While an effort has been made to provide a comprehensive summary of the Tier 1 and other hybrid capital products executed since 1989, certain, limited products/transactions have not been covered. For instance, the senior preferred shares the US Department of Treasury purchased pursuant to the Capital Purchase Program, which was introduced on October 14, 2008 and formed part of the Troubled Asset Relief Program, have not been included. In addition, the recent investments made by many sovereign wealth funds in hybrid products offered by, among others, Citigroup, UBS, Merrill Lynch and Morgan Stanley, have not been included.

issuers from the United States or Canada, one of which involves an issuer from South America and one of which involves an issuer from the Caribbean; and

- an increase in bank regulatory capital transactions focused on common or ordinary equity in 2009 and to date this year, undoubtedly due to the focus on core capital by banks, regulators and rating agencies driven by the impact on banks of the global financial crisis, as well as the uncertainty of the future of hybrid capital; these include exchange offers of hybrid capital for common stock by a number of US bank holding companies (see Chapter 17 (*Liability Management Transactions*)), the issuance of mandatory convertible preference shares by Australia and New Zealand Banking Group and of an instrument that is mandatorily convertible into common stock three years from the date of issuance by Citigroup Inc. (see pages 223 and 221 in Chapter 10 (*Bank Mandatory Convertible or Exchangeable Tier 1 Instruments*)), and the issuance of contingent capital instruments by Lloyds Banking Group plc ("Lloyds") and Coöperative Centrale Raiffeisen-Boerenleenbank B.A. ("Rabobank Nederland") (see Chapter 11 (*Bank Contingent Capital Instruments*)).

During the last 12 months, in response to the global financial crisis, regulators (including the Basel Committee on Banking Supervision ("Basel Committee"), the Committee of European Banking Supervisors ("CEBS") and the UK Financial Services Authority ("FSA")) have responded to repeated calls for regulatory capital reform by proposing a number of measures that, when fully implemented, will fundamentally shift the hybrid capital landscape. As a result of these proposed reforms, which many commentators view as the most challenging proposals within the context of regulatory capital development over the last two decades, the need for a concise summary of the various proposals, the timelines for implementation and the impact these proposals could have on future hybrid products is more important than ever. Accordingly, this year a significant portion of the update portion of this book focuses on three regulatory proposals: (i) the Basel Committee's December 2009 consultative document, "Strengthening the resilience of the banking sector" (colloquially referred to as "Basel III")[2]; (ii) the November 2009 amendments CEBS adopted to the European Union Capital Requirements Directive ("CRD")[3]; and (iii) Moody's November 2009 revised guidelines/methodology for rating bank hybrid securities and subordinated debt.[4]

Despite continued economic uncertainty, compared to 2008, 2009 was a year in which an increased number of issuers, from a broader array of sectors (including banks, insurance companies and corporates), accessed the hybrid capital markets. Because many Tier 1 and other hybrid products continued to trade below par throughout the year (due to, among other things,

[2] The Basel Committee is a committee of banking supervisory authorities established by the central bank Governors of the Group of Ten countries in 1975. The Basel Committee's consultative document, "Strengthening the resilience of the banking sector," can be found at http://www.bis.org/publ/bcbs164.pdf?noframes=1. See also Appendix A (*Basel Committee and US Regulatory Innovative Tier 1 Capital Requirements*) for a further discussion of Basel III. Please note that the Basel Committee also released a second consultative document in December 2009, "International framework for liquidity risk measurement, standards and monitoring," which can be found at: http://www.bis.org/publ/bcbs165.pdf?noframes=1.

[3] The amending Directive (Directive 2009/111/EC), which was published on November 17, 2009, can be found at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:302:0097:0119:EN:PDF. See also Appendix A (*Basel Committee and US Regulatory Innovative Tier 1 Capital Requirements*).

[4] Although access to this document is limited to subscribers of particular Moody's services, subscribers can access the document at: http://v3.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_120307.

hybrid instruments being downgraded by rating agencies, the decline in the creditworthiness of many issuers and the general uncertainty over the likelihood of issuers calling outstanding hybrid securities on their first optional call date), 2009 also saw an increased number of issuers seeking to deleverage, restructure and/or buy-back or exchange existing debt and hybrid securities. For investors, an opportunity to sell underperforming debt and hybrid securities in return for more liquid assets, the chance to move up the capital structure or even the ability to trade into a higher valued hybrid capital instrument, among other things, gained more traction.

One notable liability management transaction from 2009 was Lloyds' November 2009 exchange offer of 52 separate series of existing subordinated notes and hybrid capital securities for contingent convertible capital securities, known as enhanced capital notes ("ECNs"), which convert at a specified Tier 1 capital ratio trigger point into common equity. While contingent convertible (or "CoCo") securities are not new, the Lloyds issue attracted considerable interest from regulators and potential issuers on both sides of the Atlantic given the possibility of these securities providing additional core Tier 1 capital in times of stress. The interest in contingent capital securities that Lloyds' ECNs generated has, more recently, been further heightened by the successful issuance in March 2010 of contingent capital securities, known as senior contingent notes ("SCNs"), by Rabobank Nederland, a cooperative bank. As Rabobank Nederland is a cooperative, instead of the equity conversion mechanism of the ECNs, the SCNs were structured to result in a principal write-down (of 75 percent) and related redemption (of the outstanding 25 percent in principal amount) of all the SCNs when a specified equity capital ratio trigger point is reached. Although there are some practical concerns with ECNs and SCNs, it seems likely that other issuers will seek to emulate their recent success.[5] The added emphasis on loss absorbency in both the Basel III proposals and CEBS' consultation paper of December 10, 2009 on its implementation guidelines on hybrid capital instruments (the "CEBS Guidelines"), and in particular the requirement under the CEBS Guidelines for "going concern" capital to provide features resulting in either mandatory conversion into equity capital securities or principal write-downs in the event of stress situations, both suggest that CoCo securities and other contingent capital securities are likely to be a product of substantial attention and discussion over coming months. As issuers seek to restructure balance sheets to comply with the Basel III proposals and/or the CEBS Guidelines, we also expect that the trend for exchange offers, consent solicitations and other liability management transactions we saw in 2009 and to date in 2010 will only continue, albeit at a more measured pace. For additional discussion on the Lloyds' November 2009 exchange offer and Rabobank Nederland's March 2010 SCNs issue, please see Chapter 11 (*Bank Contingent Capital Instruments*) and page 310 of Chapter 17 (*Liability Management Transactions*).

The following is a synopsis of the notable regulatory and rating agency developments, as well as new issues and other transactions, categorized by region, that took place in 2009 and to date in 20l0.

[5] As described in Chapter 11 (*Bank Contingent Capital Instruments*), other contingent capital instruments, such as five series issued by Deutsche Bank AG since 2007, have been issued in the prior years. However, as a result of investor and pricing concerns, among other things, until recently issuers preferred instruments that provide immediate treatment as Tier 1 regulatory capital. The current regulatory focus on core capital seems to be motivating the development of instruments that provide contingent core capital, with such instruments effectively by-passing the hybrid capital step.

Regulatory Reform

Until the start of the global financial crisis, the paramount concern for most issuers of hybrid capital securities had been not only to engineer a product that met their funding needs, but also to reconcile the seemingly conflicting imperatives of capital adequacy, corporate laws, tax laws, settlement systems, listing rules and investor perceptions. If structured properly, hybrid capital securities, among other things, obtain favorable equity treatment from rating agencies, permit issuers to make tax-effective coupon payments and qualify as Tier 1 capital for banks, bank holding companies and insurance companies. While there have been, and continue to be, real and significant cost savings to be achieved by getting this balance correct, it often results in complex products that can be difficult to understand (not only in terms of their structure, but also how they will react in times of distress) and to properly value.

As a result of the global financial crisis, many institutions that had previously been considered pillars of stability were tested in ways most never envisioned, leading some to fail outright and others to be rescued by their respective governments. The strain experienced by these institutions also had deep and lasting ramifications on the global capital markets. For instance, during the most severe periods of the crisis the market appeared to lose confidence in the solvency and liquidity of many banking institutions, which loss of confidence infected the rest of the financial system and the real economy, resulting in a sizable contraction of liquidity and credit availability. Hybrid capital security holders and rating agencies also witnessed several events that, prior to the crisis, would have been largely unthinkable, such as issuers not calling securities at their first optional call date, coupon deferrals and regulatory restrictions on coupon payments for leading European banks. Because of these developments, there has been a fundamental shift in the way hybrid securities are being treated, both in terms of their performance and the risks associated with investing in these products.

Historically, hybrid capital securities have been measured against common equity and placed on a debt-equity continuum in an effort to properly categorize them for purposes of the Basel capital framework. For this comparison, a hybrid capital product would be broken down into its constituent parts, including, among others, maturity, call options, conversion options, deferral mechanisms and priority of claim in liquidation. Once these characteristics had been identified, the hybrid capital product would then be compared to three primary features of equity: (i) no maturity, (ii) no ongoing payments and (iii) loss absorption for all creditors. By carrying out this process, and placing the hybrid capital product on the debt-equity continuum, it was thought that an institution's capital base could be categorized and managed in such a way as to ensure a sufficient capital buffer which could – in the event of severe financial distress – be relied upon to absorb losses. Unfortunately, as the global financial crisis began to unfold, it quickly became apparent that the shortcomings of the Basel II (as defined below) regulatory regime resulted in the banking sector entering the crisis with a definition of capital that was neither harmonized nor transparent, and it allowed a number of banks to report high Tier 1 ratios despite having relatively low levels of common equity. Compounding the problem, the hybrid capital securities that were included in banks' Tier 1 capital baskets did not perform as expected, namely, while outstanding they were less able to directly absorb losses on a going-concern basis than common equity as issuers were not willing, except in rare cases, to defer payments or fail to call hybrid capital securities on their first optional call date. On the other hand, issuers that repurchased or exchanged their outstanding hybrid capital securities at a substantial discount to

their par value in 2009 and this year gained a significant equity benefit, albeit one that was not originally contemplated when the securities were issued.

Concerned with the shortcomings of the Basel II capital framework, a number of regulators, including, among others, the Basel Committee, CEBS and the FSA, started developing comprehensive reform packages to strengthen the quality, consistency and transparency of the regulatory capital base. These proposals focus on perceived shortcomings of the Basel II framework, such as flaws in the current definition of capital, with the goal of improving the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source, consequently reducing the risk of spillover from the financial sector into the real economy. While many of these reform packages are still in their infancy, it is clear that if the final product in anyway resembles what is currently proposed, the hybrid capital market space is going to look dramatically different. For instance, Basel III emphasizes that common equity should be the predominant form of Tier 1 capital. For a non-common equity product to be classified as Tier 1, the instrument will need to be sufficiently loss absorbent on a going-concern basis. To be considered loss absorbent on a going-concern basis, under Basel III, the instrument will need to be subordinated, provide for full discretion to cancel (and not merely defer) dividends or coupons (*i.e.*, be non-cumulative) and have neither a maturity date nor an incentive to redeem (*i.e.*, no step-up). If brought into force as currently drafted, the effect of Basel III would be to prohibit the inclusion in Tier 1 capital of innovative capital instruments, such as trust preferred securities, and of cumulative perpetual preferred stock (which currently may be included by US bank holding companies in Tier 1 capital, subject to certain limitations). Importantly, however, the various proposals currently in circulation are not uniform. For instance, the various amendments to the CRD adopted in November 2009, with an implementation date set for December 31, 2010, make clear that certain dated instruments (*i.e.*, instruments that have a maturity of at least 30 years) are allowed, which directly contradicts Basel III. Furthermore, the CRD amendments allow undated (or perpetual instruments) to provide for a moderate incentive to redeem, while Basel III does not.

Given the significance of these proposals, it is important that issuers and investors alike are aware of them, but with the Basel Committee accepting comments until April 16, 2010, and the final Basel III to be implemented in phases by December 31, 2012, it is going to take some time for the major pieces of regulatory reform to come together. This is especially the case for European banks with the CRD coming into effect in December 2010. Many important questions remain, such as will the CRD lead the reform initiative or will CEBS need to revisit its guidelines once Basel III (if adopted) is implemented in December 2012. Until clarity is obtained, it will not be possible to ascertain how all of the elements of reform will work together and consequently innovation of hybrid capital instruments may have to wait.

While certain regulatory shifts in the hybrid capital markets space are occurring, other trends which began to emerge before the global financial crisis continue to strengthen and evolve. For instance, in an arena which has become the preserve of banks and insurance companies, traditional non-financial corporate entities from the United States, Europe, Asia and, more recently, Latin America and the Caribbean, have begun to access the hybrid capital markets.

Rating Agency Guidelines

In February 2005, January 2006 and April 2007 Moody's Investors Service refined its 1999 Moody's Tool Kit, which is a comparative framework for calibrating the relative debt and equity characteristics of hybrid securities. Prior to these revisions, Moody's characterized most forms of innovative capital securities as being more like debt than equity and, as such, generally gave little or no equity credit for those securities.[6] After reviewing its approach to assessing capital securities (as well as the behavior of loss absorption features of certain capital securities relative to common equity), Moody's decided to give increased equity credit for certain capital security structures. Following Moody's first release, Fitch and Standard & Poor's also refined their respective debt-to-equity continuums for capital securities to clarify existing classifications and, in the case of Fitch, to allow for greater equity credit for certain capital security structures.[7]

In November 2009, following extensive discussions with various market participants, Moody's revised its methodology for rating bank hybrid products and subordinated debt. The revised guidelines replace Moody's current methodology entitled, "Guidelines for Rating Bank Junior Securities," which was released in April 2007. Moody's previous hybrid and subordinated debt rating methodology was based on the belief that all classes of debt shared a similar default probability, with a notching system guided by subordination to reflect relative loss severity in the event of a bank-wide default. For hybrid securities, Moody's assumed that the ability to suspend coupon payments, whether on a cumulative or non-cumulative basis, would be utilized only in circumstances where a bank was on the verge of liquidation. Contrary to historical precedent, however, the credit crisis has demonstrated that hybrid default probability is higher than for bank senior debt, and losses could occur in a restructuring outside of liquidation through coupon suspension, principal write-downs, good bank/bad bank structures and distressed exchanges. As a result, in addition to capturing the risk of loss from subordination in liquidation, Moody's revised hybrid methodology also incorporates the risk of loss from the suspension of coupon payments and the potential for a principal loss outside of liquidation.

Moody's previous methodology for rating bank hybrid products also generally assumed that the systematic support extended to senior creditors would also extend to hybrid securities.

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[6] Fitch, Moody's and Standard & Poor's use the concept of "equity credit" to explain the credit rating effect of issuing a particular hybrid security relative to the effect of issuing common stock. For example, if issuing a certain amount of common equity would cause a two notch upgrade, the issuing of a like amount of a security with 50 percent equity credit would result in a one notch upgrade. Alternatively, an issuer would need to double the amount of the particular security to achieve the two notch upgrade. The equity credit metrics set forth in the Standard & Poor's, Moody's and Fitch publications are inferred from published scales that set forth typical equity credit metrics of various "hybrid" securities issued by investment grade companies. The reader is advised that Fitch, Moody's and Standard & Poor's intend their scales to be used only as a "communication device" and warn against reducing the analysis of hybrid securities to formulas. According to Fitch, Moody's and Standard & Poor's, the determination of the rating implications of a particular issuance for existing ratings varies with company specific circumstances and the size of the issuance relative to existing capital structure.

[7] Moody's approach to equity credit does not distinguish between bank/insurance company and non-bank/insurance company issuers (although, in recognition of bank and insurance regulators' ability to restrict cash redemptions, certain bank and insurance capital securities are given higher equity credit than corporate hybrid securities that have identical loss absorbing features). Unlike Moody's, the equity credit analysis of Fitch and Standard & Poor's for capital security issuances by banks parallels the regulatory approach; *i.e.*, such capital securities receive 100 percent equity credit but can only constitute a portion of a particular bank's adjusted total equity (*e.g.*, 25 percent). Standard & Poor's also uses this approach for issuances of capital securities by insurance companies. For corporate hybrid securities (and, in the case of Fitch, issuances by insurance companies), Fitch and Standard & Poor's generally follow the approach of Moody's and assign equity credit to a particular hybrid security based generally on its loss absorbing features.

Recent events, however, have shown that this is not always the case. At the same time this was observed, the loss of principal on these instruments and non-payment of interest have exceeded Moody's original expectations. As a result of these observations, Moody's changed its starting point for bank hybrid notching from the bank's senior unsecured rating or Bank Debt Rating, which reflects systematic and other forms of external support, to the stand-alone intrinsic strength of the bank as expressed through Moody's Bank Financial Strength Rating. Because certain classes of hybrid securities have proven to be more loss absorbing than others, for instance, non-cumulative preferred securities have proven to be more loss absorbing than junior subordinated debt with cumulative coupon skip features, Moody's is now applying a wider notching policy among different classes of hybrid securities to capture these relative risks. Finally, although hybrid securities may be poised to absorb losses to varying degrees, the speed by which regulators make use of their loss absorbing features is often driven by jurisdictional considerations. Consequently, Moody's revised guidelines provide flexibility to position hybrid ratings based on case-specific and country-specific considerations with a qualitative overlay. For the complete text of the current rating agency frameworks and proposals, please go to the rating agencies' respective websites.[8]

National Association of Insurance Commissioners – Hybrid Security Classification

In the United States, the National Association of Insurance Commissioners or "NAIC," through the Securities Valuation Office or "SVO," regulates the investment activities of insurance companies by, among other things, classifying hybrid securities that insurance companies hold for investment purposes as falling in debt, preferred equity or common equity "baskets" and assigning risk-based capital requirements based on such classifications. SVO classification of hybrid securities is a two-step process. First, the SVO reviews five key contractual terms of the relevant security (*i.e.*, claim status, right to influence management, right to periodic payment, agreement as to maturity and involuntary redemption) and makes a preliminary assessment of how its characteristics compare to benchmark profiles for each basket. Second, the SVO reviews how the security will behave under stress situations (*i.e.*, whether it will act more like debt or equity), the "synergy" of the contract provisions in their totality and any other matter that is relevant to such classification. Prior to September 2006, an SVO classification of a hybrid security as common equity carried a 30 percent risk-based capital charge, as opposed to as little as a 0.3 percent risk-based capital charge for debt or preferred equity. Trust preferred securities have historically been classified as debt or preferred equity.

Prior to March 2006, hybrid capital securities had been presumptively treated as debt by the NAIC and SVO. In March 2006, the NAIC reclassified as common equity a new hybrid capital instrument that had been structured to get greater equity credit under Moody's new "basket" guidelines – Lehman Brothers' Enhanced Capital Advantaged Preferred Securities, known as "ECAPS." In risk-based capital terms, common stock at that time was 100 times more expensive for insurers than debt. Since then, the SVO has been examining and reclassifying many hybrid capital instruments and reclassifying many of them as common equity, particularly hybrid capital instruments issued by non-US issuers where the tax laws allow for interest deductibility on instruments that would be classified as equity by the US Internal Revenue Service (the "IRS").

[8] See *Where you can find more information* below for further information from Moody's, Fitch and Standard & Poor's.

In September 2006, the NAIC agreed not to overrule the SVO's decision to review and reclassify hybrid capital securities held by insurance companies, but rather to change the risk-based capital charge for hybrids – even those classified as common equity by the SVO – to a lower percentage (*i.e.*, in a range of between 0.3 percent and 2 percent). Subsequently, the NAIC has established a working group, in which Sidley is participating, that is evaluating other changes to the hybrid capital securities valuation process. Some commentators take the position that it should be the credit ratings of hybrid capital securities, not the SVO's analysis of their characteristics, that determine the risk weightings the NAIC should apply to investments by insurance companies.

As of March 2010, the NAIC is still re-evaluating its procedures with the aim of developing regulatory changes that will ultimately result in improved identification, classification and accounting guidance for hybrid products. Based upon recent reports published by the NAIC, it appears a belief is forming that regulatory attention should broaden from specific risk-based capital for defined hybrid securities to a re-evaluation of the risk-based capital formula that incorporates a much wider innovation in the structuring of investments generally. The NAIC believes that this re-evaluation should incorporate a review of how SVO analytical processes (including classification analysis), statutory accounting, reporting and NAIC risk-based capital formulas align to address risks in hybrid securities. For the NAIC and SVO's rules and regulations and current developments, please visit the NAIC's website.[9]

2009 – 2010 Transactions

Asia

Hybrid capital issuance by the Asian banking sector continued in 2009 and to date in 2010, but at significantly lower levels than in previous years, reflecting difficult capital market conditions throughout 2009 and early 2010. Activity was concentrated on Hong Kong and Japanese issuers. The markets saw little activity from India, Korea, Kazakhstan, the Philippines, Singapore, Malaysia or Thailand – jurisdictions from which issuers in the past have issued hybrid capital instruments.

Direct Issue Tier 1 Instruments

One Hong Kong bank raised Tier 1 capital through a stapled direct issue in 2009:

- ***Hong Kong* – The Bank of East Asia Limited** issued a subordinated note stapled to a non-dividend paying preference share issued by a wholly owned subsidiary in October 2009 (*page 208, Chapter 9*).

Subsidiary and other SPV Tier 1 Instruments

The following Japanese banks and banking groups raised Tier 1 capital through issues of subsidiary preferred securities in 2009:

[9] See *Where you can find more information* below.

- ***Japan* – Sumitomo Mitsui Financial Group, Inc.** issued subsidiary preferred securities in January, September and October 2009, **Mizuho Financial Group, Inc.** issued subsidiary preferred securities in February, June, August and September 2009, **Mitsubishi UFJ Financial Group, Inc.** issued subsidiary preferred securities in March and July 2009 and **Shinsei Bank, Limited** issued subsidiary preferred securities in March and October 2009 (*page 115, Chapter 5*).

All of the preferred securities issued by Japanese issuers in 2009 were offered by way of private placements to qualified institutional investors in Japan, except for the February 2009 issue by Mizuho Financial Group, Inc., which came to market by way of an offering in the Euromarkets and a private placement to qualified institutional buyers in the United States.

Australia and New Zealand

Australian banks continued to issue hybrid capital instruments in 2009, primarily reflecting the strength of those institutions compared to their international peers and the continued receptiveness of Australia's retail investors to hybrid capital instruments. Unlike recent prior years, there was little activity from New Zealand banks.

Direct Issue Tier 1 Instruments

Australian banks that raised Tier 1 capital in 2009 and to date in 2010 through direct issues include:

- ***Australia*** – **Westpac** issued floating rate non-cumulative subordinated securities that were stapled to a series of Westpac preferred securities in February 2009, **National Australia Bank Limited (acting through its New York branch)** issued perpetual capital notes in September 2009 (*page 164, Chapter 8)* and also issued preference shares stapled to a subordinated note issued through its New York branch in September 2009 (*page 193, Chapter 9*), **Commonwealth Bank of Australia** issued preference shares stapled to a subordinated note issued through its New Zealand branch in October 2009 (*page 193, Chapter 9*) and **Australia and New Zealand Banking Group Limited** issued mandatory convertible preference shares in November 2009 (*page 223, Chapter 10*).

Europe

Direct Issue Tier 1 Instruments

As in 2008, European banks continued to rely on direct issues of hybrid instruments for their capital needs, although, unlike 2008, no banks from Austria, Norway, Iceland, Belgium or Slovakia came to market. Some of the instruments, where noted, were issued in exchange for existing hybrid capital securities, which are discussed in Chapter 17. European banks and finance companies that raised Tier 1 capital in 2009 and to date in 2010 through direct issues include:

- ***Denmark*** – **Nykredit Realkredit A/S** issued perpetual hybrid core capital notes in October 2009 (*page 165, Chapter 8*).

- ***France*** – **Credit Agricole S.A.** issued pound sterling, Euro and US dollar denominated perpetual notes in June and September 2009 and three series of notes in October 2009, **Société Générale** issued perpetual non-call notes in August 2009 and perpetual fixed-to-floating rate notes in September 2009 and **BPCE** issued perpetual subordinated notes in October 2009 and deeply subordinated notes in March 2010 (*pages 164 and 165, Chapter 8*).

- ***Germany*** – **Unicredit Bank AG** issued perpetual non-call notes in November 2009 (*page 165, Chapter 8*).

- ***Italy*** – **Intesa Sanpaolo S.p.A** issued fixed-to-floating rate perpetual subordinated notes in October 2009 (*page 165, Chapter 8*).

- ***Netherlands*** –**Rabobank Nederland** issued fixed-to-floating rate perpetual securities pursuant to an exchange offer in May 2009 (*page 164, Chapter 8 and page 311, Chapter 17*) and **SNS Bank N.V.** issued resettable Tier 1 notes in November 2009 (*page 165, Chapter 8*). **Rabobank Nederland** also issued fixed rate senior contingent notes or "SCNs" in March 2010 (*page 229, Chapter 11).*

- ***Spain*** – **Banco de Sabadell, S.A.** issued a series of preference shares in January 2009 (*page 180, Chapter 8*).

- ***Sweden*** – **Nordea Bank AB** issued non-cumulative step-up securities in September 2009 and **Skandinaviska Enskilda Banken AB (publ)** issued fixed rate resettable capital contribution notes in September 2009 (*pages 164 and 165, Chapter 8*).

- ***United Kingdom*** **– Lloyds TSB** issued callable step-up Tier 1 perpetual securities in January 2009 and fixed-to-floating rate perpetual securities in December 2009, **Standard Chartered Bank** issued step-up callable perpetual preferred securities in June 2009 and **The Co-operative Bank plc** issued perpetual subordinated securities in July 2009 (*page 169, Chapter 8*). **Lloyds Banking Group plc** issued two series of enhanced capital notes or "ECNs" pursuant to an exchange offer in December 2009 (*page 227, Chapter 11 and page 310, Chapter 17*).

In comparison to 2008, issuances in 2009 and to date in 2010 by European insurance companies were roughly the same, although the UK did see more activity. European insurance companies that raised Tier 1 capital in 2009 through direct issues include:

- ***Netherlands*** **- ASR Nederland** issued perpetual guaranteed capital securities pursuant to an exchange offer and consent solicitation in August 2009 (*page 234, Chapter 12 and page 308, Chapter 17*).

- ***UK*** **– Prudential plc** issued perpetual Tier 1 Notes in June 2009 (*page 234, Chapter 12*), **RSA Insurance Group plc** issued fixed rate guarantee subordinated notes due 2039 in May 2009 and **Legal & General Group plc** issued fixed rate subordinated notes in July 2009 (*page 244, Chapter 12*).

In the first half of 2009, no European corporations raised hybrid capital. In the latter half of 2009 and to date in 2010, however, the market became more active. European corporations that raised hybrid capital in 2009 and to date in 2010 include:

- ***Finland* – Finnair plc** issued perpetual hybrid securities in September 2009 (*page 264, Chapter 15*).

- ***Netherlands* – TenneT** issued fixed-to-floating rate perpetual capital securities in February 2010 (*page 262, Chapter 15*).

- ***Switzerland* – Hero AG** issued perpetual non-call securities in October 2009. This was the first corporate hybrid security issue denominated in Swiss francs. (*page 278, Chapter 15*).

Subsidiary and other SPV Tier 1 Instruments

As in 2008, European banks, bank holding companies and financial services companies raised Tier 1 capital in 2009 and to date in 2010 through subsidiaries or other captive vehicles. Unlike 2008, there were no issuances from Austria, Belgium, Ireland, Luxembourg or the Switzerland. The following transactions were completed:

- ***Germany* – Deutsche Bank** issued guaranteed non-cumulative perpetual trust preferred securities through a Delaware trust in September 2009. (*page 96, Chapter 5*) and **Münchener Hypothekenbank eG** issued perpetual securities through a Jersey limited partnership in November 2009 (*page 96, Chapter 5*).

- ***Greece* – EFG Eurobank Ergasias S.A.** issued non-cumulative guaranteed non-voting exchangeable preferred securities through a Greek subsidiary in July 2009 (*page 37, Chapter 5*).

- ***Italy* – Unicredit S.p.A.**, through a limited liability company organized under the laws of Luxembourg, issued non-cumulative step-up fixed-to-floating rate subordinated notes in December 2009 (*page 149, Chapter 6*).

- ***Spain* – Banco Santander** issued four series of guaranteed subsidiary preferred securities through a Spanish non-operating subsidiary in January, March and July 2009 (*page 37, Chapter 5*). **Banco Santander** also issued two series of non-cumulative guaranteed preferred securities pursuant to an exchange offer in September 2009 (*page 37, Chapter 5* and *page 308, Chapter 17*). **Banco Bilbao Vizcaya Argentaria, S.A.** issued non-cumulative perpetual preferred securities pursuant to an exchange offer in October 2009 (*page 37, Chapter 5 and page 309, Chapter 17*).

North America

Trust Preferred Securities

The number of trust preferred issuances by North American issuers in 2009 and to date in 2010 is significantly down from previous years. Through our research, we believe that in 2009 and to date in 2010 six US bank holding companies or "BHCs" registered trust preferred and other capital security transactions with the Securities and Exchange Commission or "SEC".[10]

In light of the continued stress of the financial markets, the Federal Reserve Board ("FRB") in March 2009 announced the adoption of a rule that delays until March 31, 2011 the effective date of new limits on the inclusion of trust preferred securities and other restricted core capital elements in the Tier 1 capital of BHCs. The new limits were scheduled to take effect on March 31, 2009, pursuant to a final rule adopted by the Federal Reserve Board on March 10, 2005. As a result of delaying implementation of the new limits and until the new effective date in 2011, all BHCs may include cumulative perpetual preferred stock and trust preferred securities in their Tier 1 capital up to 25 percent of total core capital elements.

Direct Issue, Subsidiary and other SPV Tier 1 Instruments

There was only one issue by a North American insurance company of Tier 1 capital through a direct issuance in 2009 and to date in 2010:

- ***United States* – Metlife, Inc.** issued fixed-to-floating rate junior subordinated debentures due 2069 in June 2009 (*page 244, Chapter 12*).

Compared to 2008, in 2009 and to date in 2010 a fewer number of North American banks, BHCs and financial services companies raised Tier 1 capital through direct issues:

- ***United States* – Flagstar Bancorp, Inc.** issued fixed rate cumulative perpetual preferred stock in July 2009 (*page 184, Chapter 8*) and **Citigroup Inc.** issued tangible dividend enhanced common stock ("T-DECs") comprised of a prepaid stock purchase contract and a junior subordinate amortizing note in December 2009 (*page 221, Chapter 10*).

- ***Canada* – Manulife Financial Corporation** issued fixed non-cumulative preference shares in February 2009 (*page 184, Chapter 8*).

Compared to 2008, in 2009 and to date in 2010 there was a similar number of North American banks, BHCs and financial services companies that raised Tier 1 capital through a subsidiary or other captive vehicle:

- ***United States* – Capital One** issued cumulative trust preferred securities through a Delaware trust in July 2009, **BB&T Corporation** through a Delaware trust issued enhanced trust preferred securities in July 2009, **US Bancorp** issued trust

[10] For a comparison with previous years, see page 57, Chapter 5 (*Bank Tax Deductible Non-Operating Subsidiary Tier 1 Instruments*).

preferred securities through a Delaware trust in December 2009, **JP Morgan Chase & Co.** issued fixed-to-floating rate capital securities through a Delaware trust in December 2009, and **Citigroup Inc.** issued trust preferred securities through a Delaware statutory trust in March 2010 (*page 57, Chapter 5*). **General Electric Capital Corporation**, a savings and loan holding company, which is not subject to minimum capital requirements, also issued cumulative fixed-to-floating rate trust preferred securities through a Delaware trust in March 2010 pursuant to an exchange offer by the trust for outstanding subordinated debentures of the corporation (*page 57, Chapter 5 and page 310, Chapter 17*).

- ***Canada* – Toronto-Dominion Bank** through a trust established under the laws of Ontario issued two series of subordinated capital trust notes due 2108 in January 2009, **Canadian Imperial Bank of Commerce** issued subordinated capital trust notes due 2108 through a Ontario trust in March 2009 and **Scotiabank** issued subordinated securities due 2108 through a Ontario trust in April 2009 (*page 62, Chapter 5*).

Through our research we believe that in 2009 and to date in 2010 no North American corporations raised hybrid capital.

South America and Bermuda

The following South American bank raised Tier 1 capital in 2009 through a direct issuance:

- ***Brazil* – Banco do Brasil S.A.** issued perpetual non-cumulative junior subordinated securities in October 2009 (*page 165, Chapter 8*).

The following Bermudan bank raised Tier 1 capital through a direct issuance in 2009:

- ***Bermuda* – The Bank of N.T. Butterfield & Son Limited** issued perpetual limiting voting preference shares in June 2009 (*page 186, Chapter 8*).

Where you can find more information

The following websites are helpful to those involved in the development and execution of Tier 1 and other hybrid capital products (in some cases, access is limited to registered users):

- Basel's capital guidelines for banking institutions and links to regulatory capital guidelines of national bank regulators are available at www.bis.org/bcbs.
- US capital guidelines for insurance companies are available at www.naic.org.
- EU capital guidelines for banking institutions and investment firms are available at http://ec.europa.eu/internal_market/bank/regcapital/index_en.htm.
- UK capital guidelines for banking institutions, investment firms and insurance companies are available at www.fsa.gov.uk.

- German capital guidelines for banking institutions and investment firms are available at www.bundesbank.de.
- Treatment of capital instruments under US generally accepted accounting principles is discussed at www.aicpa.org.
- Information regarding the SVO and its classification analysis is available at www.naic.org.
- Treatment of capital instruments under international accounting standards and international financial reporting standards is discussed at www.iasb.org.
- Fitch's credit rating of capital instruments is available at www.fitchratings.com.
- Moody's credit rating of capital instruments is available at www.moodys.com.
- Standard & Poor's credit rating of capital instruments is available at www.standardandpoors.com.
- SEC-filed Tier 1 and other regulatory capital offerings can be found on the SEC's website, www.sec.gov.
- General legal and regulatory information and Sidley contacts are available at www.sidley.com.

Thanks

As has been the case in past years, the Sidley team that works in this area has made a sincere effort to ensure this book will be a useful resource for our clients. Special thanks to our associates Ben Stacke (London) and Kunle Deru and Laila Afridi (New York), and our trainee solicitor Vishal Mawkin (London). Please feel free to contact any Sidley lawyer if we can be of further assistance.[11]

March 19, 2010

[11] Contact information for our Hybrid Capital Securities Group is contained in Appendix H (*Sidley Austin LLP Hybrid Capital Securities Group Directory*).

CHAPTER 1

HYBRID CAPITAL PRODUCT PARAMETERS

- **Basic Equity Products**

  Common equity

  Preferred stock, preference shares and similar equity securities

  Convertible debt and equity products

  Perpetual and dated debt securities

- **Capital Goals**

  Lowest possible cost

  Regulatory capital credit, in the case of banks, insurance companies, financial holding companies and other regulated entities (*e.g.*, utilities)

  - Innovative Tier 1 bank capital (generally, maximum 15 percent of total capital)
  - Other Tier 1 bank capital instruments (outside 15 percent basket)

  Rating agency credit

  - Maintain or lower overall cost of funding
  - Highest possible equity credit

  Improve return on common equity

  - No limited or delayed dilution to common equity
  - Leverage common equity

  Acquisition capital

  Capital hedge against foreign exchange risk

- **Factors that can Reduce the Cost of Capital**

  Higher product credit rating

  Convertibility or exchangeability into common equity or other profit or gain participation features

  Broadest possible investor base assisted by, among other things:

  - Investment grade rated securities
  - Freely tradable securities
  - Debt treatment vs. equity treatment
  - Regulatory treatment for investment purposes
  - Internal bank legal investment rules
  - Better investment ratings under NAIC investment guidelines, as interpreted by the SVO
  - Widest possible investment eligibility for insurance company general accounts and US pension funds under the Employment Retirement Income Security Act of 1974 or "ERISA"
  - More investor tax benefits such as:
    - Dividends received credits such as the US dividends – received deduction or "DRD"
    - 15 percent US tax rate on dividends to retail investors for qualifying dividend income or "QDI" (available only in taxable years beginning on or before December 31, 2010)
    - Tax free or deferred income on capital gains
    - Withholding tax or stamp duty avoidance or credits (*e.g.*, through the use of American Depositary Receipts or "ADR" facilities or orphan repackaging special purpose vehicles or "SPVs")
    - Avoidance of phantom income or gain
  - A transaction structure that investors can easily understand
  - Simple tax reporting
    - Form 1099 for certain trusts and corporations versus Form K-1 for partnerships

- Avoid issuers that are foreign trusts for US federal income tax purposes
- Avoid issuers that are passive foreign investment companies or "PFICs" for US federal income tax purposes
- Minimize complicated tax disclosure and tax reporting compliance requirements

Issuer tax benefits such as:

- Efficient allocation of available investor tax credits
- Coupon tax deductibility
- Coupon payments out of pre-tax dollars (*e.g.*, by a tax exempt vehicle such as a real estate investment trust or "REIT," or tax haven vehicle, or an off-balance-sheet income stream)
- Net operating loss or "NOL" absorption
- Tax deconsolidation

A transaction structure that can be established and operated in a cost efficient manner

- **Selected Product Development Tools**

  Subsidiaries and other on-balance-sheet vehicles, including trusts, partnerships, limited liability companies, corporations and tax haven vehicles

  Orphan vehicles, such as hat check trusts, charitable trusts, investment companies and depositary arrangements

  Guarantees (hard and soft), support agreements and exchange agreements

  Stapling and pairing

  Swaps, options, puts, calls, warrants, forwards, repurchase agreements, etc.

  Shifting, withering, optional and mandatory deferral and subordination features

  Coupon, currency, redemption and liquidation preference conversion features

  Stock settlement features

  Capital replacement features

Features that drop away if certain thresholds are met (*e.g.*, dividends becoming cumulative if an instrument no longer qualifies as Tier 1 capital)

Pledge and collateral arrangements

- **Legal, Regulatory and Accounting Issues**

  Capital regulations of the applicable primary regulator

  Tax and stamp duty regulations – maximize issuer and investor tax benefits, minimize transaction costs

  - Jurisdiction(s) where the bank wants tax benefits
  - Investors' jurisdictions
  - Conduit issuer and instrument jurisdictions

  Accounting

  - Whether an entity is a subsidiary or not for consolidated minority interest treatment
  - Shareholders' equity, mezzanine capital or debt treatment for the instrument
  - Regulatory treatment impact
  - Hedge accounting issues

  Corporate, partnership and trust laws and regulations

  Corporate authority

  - Product flexibility
  - Tax matters
  - Compliance costs
  - Rating agency impact

  Securities laws and regulations

  - Registration, prospectus delivery, marketing, trading and disclosure requirements
  - Ongoing reporting requirements

Mutual fund laws and regulations, including the US Investment Company Act of 1940 or "1940 Act"

Commodities and futures laws and regulations

Secured transactions laws, such as the Uniform Commercial Code or "UCC"

Legal investment laws and guidelines, such as ERISA, bank, insurance and other regulatory and NAIC investment guidelines, gambling and bucket shop laws, etc.

Foreign exchange, foreign investment and licensing laws and regulations

Stock exchange listing requirements for listed securities and conduit instruments

CHAPTER 2

PRODUCT DEVELOPMENT PRIOR TO THE 1988 BASEL ACCORD

- **Adjustable Preferred Stock**
  - Early floating rate preferred security

- **Auction, Remarketed and other Money Market Preferred Stock**
  - First sold in United States in 1984 by American Express
  - Main features
    - Reduced pricing volatility of fixed and floating rate preferred through:
      - issuer creditworthiness based repricing at regular intervals and
      - regular liquidity points for investors
    - Often functional equivalent of commercial paper
    - Voting and non-voting
    - Note negative impact of investment bank's decisions in late 2007 and 2008 to cease submitting backstop bids

    Different uses

    - Lower coupons through tax credits such as the DRD or lower tax buckets such as QDI
    - Lower effective cost of dividends by using up NOLs
    - Deconsolidating income or income producing assets for tax purposes
    - Leveraging the returns on closed end funds and pension funds
      - Under the 1940 Act, 2 to 1 preferred/common permitted leverage versus 3 to 1 debt/common permitted leverage

- **Stapled or Paired Shares**
  - Auction, remarketed, adjustable, fixed rate and participating products
  - Different uses
    - Saving domestic tax credits for domestic taxpayers
    - Paying dividends in pre-tax dollars
    - Paying dividends out of lower tax jurisdictions (*e.g.*, Hong Kong and Australia pairing)
    - Shifting interest payment deductions to the most useful jurisdiction

CHAPTER 3

THE BASEL FRAMEWORK

The 1988 Basel Accord

The 1988 Basel Accord ("Basel I") went into effect in March 1989 for all G10[12] central banks and required banks to maintain capital equal to 8 percent of "risk adjusted assets" by the end of 1992. The major impetus for Basel I was the concern that the capital of the world's major banks had become dangerously low after persistent erosion through competition. The goals of Basel I were to tailor regulatory capital adequacy requirements to the risk inherent in a bank's portfolio and to create incentives to hold more low risk assets. Further, Basel I sought to remove competitive inequalities in international banking that could result if different countries imposed varied regulatory capital standards.

Under Basel I, for the first time, capital was divided into Tier 1, or core capital, and Tier 2, or supplementary capital. The definition of Tier 1 capital in Basel I was as follows:

- permanent shareholders' equity (common stock and perpetual non-cumulative preferred);
- disclosed reserves (created or increased by appropriations of retained earnings or other surplus, *e.g.*, share premiums, retained profit, general reserves and legal reserves); and
- in the case of consolidated accounts, minority interests in the equity of subsidiaries which are less than wholly owned.

This definition of Tier 1 capital did not include cumulative preferred. Also, prior to the 1998 Basel Release (as defined below), the Basel Committee took the position that only minority interests in operating subsidiaries should count as Tier 1 capital.

The 1998 Basel Release

In an October 1998 press release entitled "Instruments Eligible for Inclusion in Tier 1 Capital" (the "1998 Basel Release"), the Basel Committee announced that it would consider it acceptable for banks to issue certain "innovative capital instruments," such as minority interests in equity accounts of consolidated subsidiaries that take the form of SPVs, that could be included in Tier 1 capital as long as their underlying instruments satisfy certain criteria. The Basel

[12] The countries that make up the G10 are Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the UK and the US.

Committee encouraged each local regulator to develop specific criteria for instruments that it would count as Tier 1 capital and affirmed that it expects banks to meet the Basel minimum capital ratios without undue reliance on innovative instruments. In the 1998 Basel Release, the Basel Committee limited inclusion of "non-common equity Tier 1 instruments with any explicit feature – other than a pure call option – which might lead to the instrument being redeemed" to a maximum of 15 percent of a bank's Tier 1 capital. This 15 percent basket is known in the market as the "innovative" Tier 1 capital basket.

In approving non-operating subsidiary preferred as Tier 1 capital, the 1998 Basel Release represented a change in the position of the Basel Committee under Basel I. This change was prompted by pressure from the banking community, which sought a level playing field among national bank regulators, several of which had at the time of the 1998 Basel Release already approved such non-operating subsidiary preferred as Tier 1 capital, as well as a level playing field within their own countries, where issuers from other industries were benefiting from the tax and other benefits of innovative preferred instruments.

In order to qualify as Tier 1 capital, the 1998 Basel Release required minority interest Tier 1 instruments to have the following equity-like characteristics:

- issued and fully paid;
- non-cumulative;
- ability to absorb losses within the bank on a going-concern basis;
- junior to depositors, general creditors and subordinated debt of the bank;
- permanent;
- neither secured nor covered by a guarantee of the issuer or related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis bank creditors; and
- callable at the initiative of the issuer only after a minimum of five years with supervisory approval and under the condition that it will be replaced with capital of same or better quality unless the supervisor determines that the bank has capital that is more than adequate to its risks.

In addition, to qualify as Tier 1 capital, the minority interest instruments must fulfill the following:

- the main features of the instruments must be easily understood and publicly disclosed;
- proceeds must be immediately available without limitation to the issuing bank or, if proceeds are immediately and fully available only to the issuing SPV, they must be made available to the bank (*e.g.*, through conversion into a direct issuance of the bank that is of higher quality or of the same quality at the same terms) at a

predetermined trigger point, well before serious deterioration in the bank's financial position;

- the bank must have discretion over the amount and timing of distributions on the instrument, subject only to prior waiver of distributions on the bank's common stock, and banks must have full access to waived distributions; and

- distributions can only be paid out of distributable items, and where distributions are pre-set, they may not be reset based on the credit standing of the issuer.

According to the 1998 Basel Release, moderate step-ups in instruments issued through SPVs are permitted in conjunction with a call option only if the moderate step-up occurs at a minimum of ten years after the issue date and if it results in an increase over the initial rate that is no greater than, at national supervisory discretion, either: (i) 100 basis points, less the swap spread between the initial index basis and the stepped-up index basis; or (ii) 50 percent of the initial credit spread, less the swap spread between the initial index basis and the stepped-up index basis.

The terms of the instrument should provide for no more than one rate step-up over the life of the instrument. The swap spread should be fixed as of the pricing date and reflect the differential in pricing on that date between the initial reference security or rate and the stepped-up reference security or rate.

Basel II

In June 2004, the Basel Committee published "International Convergence Capital Measurement and Capital Standards: A Revised Framework" ("Basel II"); a "comprehensive version" was published in June 2006. Basel II replaced Basel I. Basel II establishes a set of guidelines intended to provide new incentive for good risk management practices and is based on the following three guideline principles or "pillars" that are meant to create incentives for banks to enhance the quality of their control processes:

- minimum capital requirements ("Pillar 1")

- supervisory review process ("Pillar 2")

- market discipline and disclosure ("Pillar 3")

Pillar 1 represents a significant strengthening of the minimum capital requirements set out in Basel I. Under Basel II, banks that engage in less complex forms of lending and credit underwriting would be permitted to use a method of assessing the credit quality of their borrowers based on external measures of credit risk ("Standardized Method"). Banks, however, that engage in more sophisticated risk-taking and that have developed advanced risk measurement systems may rely on methods of assessing the credit quality of their borrowers based on such bank's own measures of risk, subject to strict data, validation and operational requirements ("Advanced Method"). By aligning capital charges more closely to a bank's own measures of its exposure to credit and operational risk, Pillar 1 encourages banks to refine those measures and, at the same time, provides incentives in the form of lower capital requirements for

banks to adopt more comprehensive and accurate measures of risk. Highlights of the minimum capital requirements of Pillar 1 are:

- 15 percent limit on Tier 1 innovative instruments, with similar qualification standards as in the 1998 Basel Release;
- 35 percent risk-weighting on claims secured by mortgages on residential property;
- 100 percent risk-weighting on claims secured by mortgages on commercial property;
- 75 percent risk-weighting on retail claims (in general);
- a sliding scale of risk weights for past due loans depending on specific provisions for loan losses; and
- new treatment of operational risk which, depending on the use of the Standardized Method or the Advanced Method, could result in an institution having to hold between 10 percent to 18 percent of the annual gross income of a business unit.

Pillar 2 recognizes the necessity of exercising effective supervisory review over banks' internal risk assessments. Supervisors evaluate the activities and risk profiles of individual banks to determine whether those organizations should hold higher levels of capital than the minimum requirements set by Pillar 1 and whether there is the need for remedial actions. Supervisors and banks are to engage in a "dialogue" about the banks' processes for measuring and managing risk, and supervisors will create implicit incentives for banks to develop sound control structures and improve such processes.

Pillar 3 uses market discipline and disclosure to motivate prudent management by enhancing the degree of transparency in banks' public reporting. Under Pillar 3, banks are required to make specific public disclosures in order to allow for greater transparency into the adequacy of their capitalization.

In July 2009, the Basel Committee issued three new releases aimed at strengthening the Basel II capital framework. The enhancements aim to ensure that the risks inherent in banks' portfolios related to trading activities, securitizations and exposures to off-balance sheet vehicles are better reflected in minimum capital requirements, risk management practices and accompanying disclosures to the public. The changes address: (i) trading book exposures, including securitizations and complex and illiquid credit products; (ii) "resecuritizations" (*e.g.*, collateralized debt obligations of ABS); and (iii) heightened Pillar 3 disclosures for securitizations and sponsorship of off-balance sheet vehicles. The changes should be implemented no later than December 31, 2010. The Committee also agreed to keep in place the Basel I capital floors beyond the end of 2009.

Implementation of Basel II

United States

Since 2003, the FRB, the Office of the Comptroller of the Currency ("OCC"), the FDIC, and the Office of Thrift Supervision ("OTS") (collectively, the "Agencies") have collaborated on establishing the implementation process for the Basel II three-pillar framework in the United States. In that regard, the Agencies issued a joint proposed rule on September 25, 2006, which was later superseded by the final rule published on December 7, 2007 ("Basel II Final Rule") setting forth a new risk-based regulatory capital framework for US banks adopting the advanced IRB approach for credit risk and the advance measurement approach for operational risk (the "advanced approaches") based on Basel II. The Basel II Final Rule is intended to produce capital requirements that are more closely aligned with actual risks than the existing general risk-based capital rules, which are based on Basel I.

The Basel II Final Rule is only mandatory for large, internationally active banking organizations with at least US$250 billion in total consolidated assets or at least US$10 billion in foreign exposure ("Core Banks"). While Basel II includes several methods for calculating risk-based capital requirements, the Core Banks are required to use the advanced internal ratings-based approach to determine credit risk and the advanced measurement approach to determine operational risk. Other banks may voluntarily decide to adopt the advanced approaches ("Opt-In Banks"). The term "banks" includes banks, savings associations and bank holding companies. Both Core Banks and Opt-In Banks must first meet certain qualification requirements to the satisfaction of their primary regulators before they can apply the advanced approaches.

The Basel II Final Rule maintains the Basel I minimum risk-based capital ratio requirements and the elements of Tier 1 and Tier 2 capital also generally remain unchanged. The primary difference is in the methodologies used to calculate risk-weighted assets. Under the Basel II Final Rule, banks generally use their internal risk measurement systems to determine the inputs for calculating the risk-weighted asset amounts for (1) general credit risk (includes wholesale and retail exposures), (2) securitization exposures, (3) equity exposures and (4) operational risk. However, in some cases, the bank must use external ratings or supervisory risk weights for risk-weighted asset amounts. Banks are also subject to a supervisory review process under Pillar 2 and certain disclosure requirements under Pillar 3 of the Basel II framework.

The Basel II Final Rule adopts a number of safeguards, including the requirement that a bank satisfactorily complete at least a four consecutive calendar-quarter parallel run period, beginning no sooner than January 1, 2008, before operating under the Basel II framework. Following a successful parallel run, a bank would progress through three transitional periods, each lasting at least one year during which there would be floors on potential declines in risk-based capital requirements relative to the current rules under Basel I (5 percent during the first period, 10 percent during the second period and 15 percent during the third period). The Basel II Final Rule also retains the existing leverage ratio and prompt correction action ("PCA") requirements. Therefore, during the transitional floor periods, a bank would report five regulatory capital ratios: two floor-adjusted risk-based capital ratios, two advanced approaches risk-based capital ratios and one leverage ratio. A bank would need approval from its primary

federal supervisor to move to each new transitional period, and at the end of the three transition periods, to fully operate under Basel II risk-based capital rules.[13]

Since the Basel II Final Rule became effective on April 1, 2008, the Agencies have issued a joint statement on July 8, 2008, outlining the qualification process for banking organizations that are required or planning to implement the advanced approaches risk-based capital framework in the United States. The qualification process consists of three major stages: (1) adoption of an implementation plan approved by the bank's board of directors; (2) completion of a satisfactory parallel run; and (3) advancement through three distinct transitional floor periods. In addition, the statement sets forth other matters that banks may need to address with their primary Federal supervisor such as validation of bank models and systems, exemptions from the advanced approaches, mergers and acquisitions, and supervisory approval for use of specific processes or methodology.

On July 31, 2008, the Agencies published guidance on the supervisory review process for capital adequacy (*i.e.*, Pillar 2 of the Basel II advanced approaches in the Basel II Final Rule). The guidance outlines Agencies' standards in considering, among other things, whether each institution: (1) satisfies the qualification requirements for implementing the advanced approaches, (2) addresses the limitations on the minimum risk-based capital requirements for credit risk and operational risk, (3) adopts a rigorous process for assessing its overall capital adequacy in relation to risk profile and a comprehensive strategy for maintaining appropriate capital levels (internal capital adequacy assessment process or ICAAP), and (4) maintains a satisfactory risk management and control structure. As a result of the supervisory review process, a bank's primary Federal supervisor may require the bank to address identified supervisory concerns such as holding additional capital commensurate with the bank's risk profile, to modify or enhance risk-management and internal control processes, reduce the bank's risk exposure or take any other action deemed necessary by the supervisor.

For banks that do not adopt the advanced approaches, in 2006 the Agencies issued a proposed rule for public comment that proposed modifications to the general risk-based capital rules for US banks under Basel I in order to better align the capital requirements with risk (the "Basel IA NPR"). After considering the comments, the Agencies decided not to finalize the Basel IA NPR. Instead, on July 29, 2008 the Agencies published a proposed rule for public comment to implement the standardized approach for credit risk and the basic indicator approach for operational risk based on the Basel II framework (the "Basel II Standardized NPR").

Generally, the Basel II Standardized NPR is consistent with the standardized approach and basic indicator approach set forth in the Basel II framework, but in some cases it incorporates a more risk sensitive treatment, most notably in the treatment of residential mortgages and equity exposures. The framework under the proposed rule ("standardized framework") is optional for banks that do not use the advanced approaches subject to prior written notification to their federal primary supervisor. If these banks do not adopt the standardized framework, they may opt to remain under the general risk-based capital rules. Additionally, if these banks opt to use the standardized framework, they may return to the general risk-based capital rules but only after prior written notification to their Federal primary

[13] See Appendix A (*Basel Committee and US Regulatory Innovative Tier 1 Capital Requirements*).

supervisor. As with the general risk-based capital rules for bank holding companies, small bank holding companies with total consolidated assets of less than US$500 million in assets are exempt from applying the standardized framework at the parent company level.

The Basel II Standardized NPR seeks to enhance risk sensitivity compared to Basel I without imposing an undue burden on the banks. The primary difference between the Basel II Standardized NPR and the general risk-based capital rules is in the method for calculating the risk-weighted assets. Under the Basel II Standardized NPR, banks would determine risk-weighted asset amounts for general credit risk, unsettled transactions, securitization exposures, equity exposures and operational risk. Banks that use the market risk rule would factor their market risk-equivalent assets into their total risk-weighted assets. All banks would continue to be subject to applicable Tier 1 leverage ratio requirements and each depository institution would continue to be subject to prompt corrective action thresholds.

The Basel II Standardized NPR also increases the number of risk-weight categories, expands the use of external ratings, uses loan-to-value ratios to weight most residential mortgages to enhance the risk sensitivity of the capital requirement, provides a capital charge for operational risk using the basic indicator approach under Basel II, emphasizes the importance of a bank's assessment of its overall risk profile and capital adequacy, and provides for supervisory review of capital adequacy (Pillar 2) and market discipline through enhanced public disclosure requirements (Pillar 3).

On September 3, 2009, the US Treasury Department issued a policy statement (the "Policy Statement") entitled "Principles for Reforming the US and International Regulatory Capital Framework for Banking Firms," which contemplates changes to the existing United States regulatory capital regime that would involve substantial revisions of major parts of the Basel I and Basel II frameworks. Among other things, the Policy Statement calls for stronger capital requirements for all banking firms and suggests that changes in the regulatory capital framework be phased in over several years. The recommended schedule provides for a comprehensive international agreement by December 31, 2010, with implementation by December 31, 2012.

European Union

EU-Banks. The EU has implemented the Basel II framework via the Banking Consolidation Directive (2006/48/EC) and the Capital Adequacy Directive (2006/49/EC) (together the Capital Requirements Directive or "CRD"). Each EU Member State was required to have the CRD implemented into national law by January 1, 2007, with the "advanced" approach having to be implemented by January 1, 2008. Most or all EU Member States have implemented the CRD as required.

Further to the Basel II implementation process, the European Commission began to undertake a review of the definition of "own funds" with the aim of achieving convergence across EU Member States. In June 2005, the European Commission issued a call for advice to the CEBS.

On April 3, 2008, CEBS published its advice on a common definition of Tier 1 hybrids. In their proposal document, CEBS reiterated that the objective was not to create a new definition for eligible Tier 1 capital instruments but to provide guidelines for a common EU interpretation of Tier 1 eligibility criteria and to advise the European Commission with regard to the implementation of these criteria into EU legislation. In its advice, CEBS proposed that hybrid capital instruments should only be eligible if they are issued and fully paid up, publicly disclosed and easily understandable. They must also be permanent, able to absorb losses in liquidation and on a going concern basis, and allow for the cancellation of payments. In stress situations, the instrument should help prevent its insolvency and make the recapitalization of the issuer more likely.

In November 2009, amendments to the CRD were adopted and published in the Official Journal of the EU. The amendments cover several areas, including hybrid capital, large exposures, 5 percent risk retention, due diligence and disclosure for securitisation transactions. In relation to hybrid capital, the amendments seek to improve the quality of bank's capital by specifying clear EU-wide criteria for assessing whether hybrid capital is eligible to be counted as part of a bank's overall capital. The changes take effect from December 31, 2010, but there is a general grandfathering (for 30 years) for capital instruments issued up until that date. Unlike Basel III, which is discussed below and requires that Tier 1 instruments be perpetual and have no incentives to redeem, the amendments to the CRD allow for 30 year instruments with "moderate" incentives to redeem (after the tenth year). Depending on the result of the Basel consultation, there is a possibility that the CRD in the EU may be amended again in order to be consistent with the Basel position. That may raise questions as to how grandfathered transactions under the CRD will be treated (*e.g.* whether the grandfathering should be revoked).

The amendments to the CRD require CEBS to elaborate guidelines for the convergence of supervisory practices with regard to hybrid capital instruments, and monitor their application. As a result, on December 10, 2009, CEBS published the CEBS Guidelines. The paper is structured in five main parts, covering the topics of permanence, flexibility of payments, loss absorbency, limits and hybrid instruments issued through special purpose vehicles. Regarding permanence, guidance is provided on incentives to redeem, the approval process for redemptions and the buy-back of hybrid instruments.

Notable elements of the CEBS Guidelines are as follows:

- Maturity: Shall be undated (or perpetual) or have an original maturity of at least 30 years. Undated or dated instruments may be redeemed only with the prior consent of the relevant regulator.

- Call Option / Redemption: Dated instruments may not provide for any incentive to redeem. Undated instruments may provide for a "moderate" incentive to redeem, arising not earlier than 10 years after issuance. Both dated instruments and undated instruments with an incentive to redeem are, in aggregate, limited to a maximum of 15 percent of a bank's Tier 1 capital. To call or redeem either a dated or undated instrument requires the prior consent of the relevant regulator. So long as the request is made by the issuer and the issuer's financial condition and solvency would not be affected by doing so, the consent may be granted. A

regulator must require the issuer to suspend redemption of a dated instrument if the issuer is not in compliance with its regulatory capital obligations.

- Coupon/Dividend Payments: The instrument, whether dated or undated, must allow the issuer the discretion to cancel coupons/dividend payments, when necessary, on a non-cumulative basis. Regulator intervention to cancel coupons/dividend payments is mandatory where the institution is not complying with its regulatory capital requirements. Dividend pushers or stoppers may be acceptable if the issuer has a large degree of flexibility to cancel payments.

- Loss Absorption: Principal, unpaid interest or dividends must be designed to help prevent an institution's insolvency and not hinder the recapitalization of the issuer. In preventing insolvency, the most important factors are redemption of principal not being permitted in stress situations, flexibility to cancel coupon/dividend payments, principal write-down features, convertibility into higher forms of capital and the instrument must not be taken into for purposes of determining whether the issuer is insolvent.

- Ranking on bankruptcy or liquidation: Subordinated to all non-subordinated creditors.

- Limits: To be eligible beyond the 35 percent limit on innovative Tier 1 instruments, there must be a mandatory conversion into equity at least in the event of a breach by the issuer of its required capital ratio, and perhaps also in other "emergency situations," which CEBS does not intend to define.

CEBS expects its members to transpose the CEBS Guidelines into their national law and apply them by December 31, 2010. CEBS intends to revisit the CEBS Guidelines if necessary, due to the possible future changes in the global regulatory framework with regard to the definition of capital instruments.

By way of illustration as to the divergent approaches taken throughout the EU as to hybrid capital and thus the need for a consistent approach in the EU as the CRD changes hope to achieve, CEBS published in March 2007 a quantitative analysis of the characteristics of hybrids eligible as Tier 1 (original own funds) in the EU. A table setting out each Member State's approach to hybrid instruments is set out below:

	Supervisory limit on innovative hybrids with an incentive to redeem (*e.g.* a step-up)	**Supervisory limit on hybrids excluding non-cumulative preference shares** (includes the limit of the first column unless otherwise stated)	**Limit on non-cumulative preference shares as defined under national company law** (in percent of ordinary shares)	**Maximum supervisory limit on hybrids** (innovative instruments, non-innovative instruments, non-cumulative perpetual shares; including the limits of all the preceding columns unless otherwise stated)
Austria	15 percent	30 percent	33 percent	30 percent
Belgium	15 percent	33 percent	33 percent[14]	33 percent

[14] No issuance.

	Supervisory limit on innovative hybrids with an incentive to redeem (*e.g.* a step-up)	**Supervisory limit on hybrids excluding non-cumulative preference shares** (includes the limit of the first column unless otherwise stated)	**Limit on non-cumulative preference shares as defined under national company law** (in percent of ordinary shares)	**Maximum supervisory limit on hybrids** (innovative instruments, non-innovative instruments, non-cumulative perpetual shares; including the limits of all the preceding columns unless otherwise stated)
Bulgaria	Not eligible as original own funds		Does not exist in the legislation	
Cyprus	15 percent	15 percent	No limit	15 percent[15]
Czech Republic	Not eligible as original own funds		Does not exist in the legislation	
Denmark	15 percent	15 percent	No limit	15 percent[16]
Estonia	Not eligible as original own funds		No limit	Not eligible
Finland	15 percent	15 percent[17]	No limit	50 percent
France	15 percent	25 percent	25 percent[1819]	50 percent
Germany	15 percent	50 percent	Does not exist[20]	50 percent
Greece	10 percent[21]	25 percent[22]	No limit[23]	25 percent[24]
Hungary	Not eligible as original own funds	15 percent	No limit	
Iceland	15 percent	33 percent	No defined	33 percent
Ireland	15 percent	49 percent	No limit	49 percent
Italy	15 percent	20 percent[25]	50 percent	20 percent[26]
Latvia	Not eligible as original own funds		No limit[27]	Not eligible
Liechtenstein	Not eligible as original own funds		Does not exist[28]	Not eligible
Lithuania	Not eligible as own funds		33 percent[29]	No limit[30]
Luxembourg	15 percent	15 percent	Does not exist	15 percent
Malta	15 percent	Not eligible as original own funds	No limit[31]	15 percent[32]
Netherlands	15 percent	50 percent	No limit	50 percent
Norway	15 percent	15 percent[33]	No limit[34]	15 percent
Poland	Not eligible as original own funds		Does not exist in the legislation	
Portugal	20 percent	20 percent	50 percent[35]	20 percent[36]
Romania	Not eligible as original own funds			

[15] Does not cover non-cumulative preference shares as they are not hybrids in the law.
[16] Does not cover non-cumulative preference shares as they are not hybrids in the law.
[17] This limit was valid as of January 1, 2007. Until December 31, 2006, the limit was 15 percent.
[18] No issuance.
[19] For publicly listed companies.
[20] Preference shares can only be cumulative and therefore only eligible as additional own funds.
[21] Limits valid for new issues of hybrids as of January 1, 2006. Until December 31, 2005, the limits were respectively 15 percent and 30 percent.
[22] Limits valid for new issues of hybrids as of January 1, 2006. Until December 31, 2005, the limits were respectively 15 percent and 30 percent.
[23] No issuance.
[24] Does not cover non-cumulative preference shares as they are not hybrids in the law.
[25] This limit was valid as of January 1, 2007. Until December 31, 2006, the limit was 15 percent.
[26] This limit does not take into account the limit on non-cumulative preference shares indicated in the third column.
[27] No issuance.
[28] Preference shares can only be cumulative and therefore only eligible as additional own funds.
[29] The New Regulations which come into force in 2008 foresee a limit on perpetual non-cumulative preference shares of 15 percent of original own funds.
[30] The New Regulations which come into force in 2008 foresee a limit on perpetual non-cumulative preference shares of 15 percent of original own funds.
[31] No limit so far. In the near future this position is going to be analysed in detail to check if there is any need to include a limit.
[32] Does not cover non-cumulative preference shares as they are not hybrids in the law.
[33] No issuance.
[34] No issuance.
[35] Issuance is unusual.
[36] This limit does not take into account the limit on non-cumulative preference shares indicated in the third column.

	Supervisory limit on innovative hybrids with an incentive to redeem (*e.g.* a step-up)	**Supervisory limit on hybrids excluding non-cumulative preference shares** (includes the limit of the first column unless otherwise stated)	**Limit on non-cumulative preference shares as defined under national company law** (in percent of ordinary shares)	**Maximum supervisory limit on hybrids** (innovative instruments, non-innovative instruments, non-cumulative perpetual shares; including the limits of all the preceding columns unless otherwise stated)
Slovakia	Does not exist in the legislation			
Slovenia	15 percent	15 percent	No limit	49 percent
Spain	15 percent	30 percent	30 percent	50 percent
Sweden	15 percent	15 percent	No limit[37]	15 percent[38]
UK	15 percent	15 percent	UK	50 percent

On February 26, 2010, the European Commission released a consultation paper on yet further amendments to the CRD. This package of amendments is known as "CRD IV", and deals with many of the issues raised by Basel III.

EU – Insurance Companies. The capital adequacy regime for the European insurance industry is also undergoing a fundamental review in the context of the proposed Solvency II framework directive. Solvency II is intended to establish a revised set of EU-wide capital requirements including provisions on the definition of capital for insurers. Solvency II was formally adopted in May 2009 and must be implemented by Member States by October 31, 2012. Solvency II is likely to adopt a similar approach to the CRD in relation to the constituents of capital and thus hybrid capital.

Rest of the World

It is estimated that up to 100 countries have adopted some or all of Basel II. There are, however, several inconsistencies with regards to the approach and timing of implementation. Furthermore, it is also expected that Basel II will have a similar pattern of implementation as Basel I, which initially was applied only to internationally active banks in the G10 countries and quickly became acknowledged as a benchmark measure of a bank's solvency and is believed to have been adopted in some form in more than 100 countries.

Basel III

On December 17, 2009, the Basel Committee issued a consultative document ("Strengthening the Resilience of the Banking Sector"), colloquially known as "Basel III", containing proposals to strengthen the global regulation of banks' capital.[39] The proposals are aimed at:

[37] Issuance is unusual.

[38] Does not cover non-cumulative preference shares as they are not hybrids in the law.

[39] Concurrently with the capital proposals, the Basel Committee issued a consultative document entitled "International Framework for Liquidity Risk Measurement, Standards and Monitoring" containing a number of proposals relating to liquidity. The liquidity proposals have three key elements (i) a "liquidity coverage ratio" designed to ensure that a bank maintains an adequate level of unencumbered high-quality assets sufficient to meet the bank's liquidity needs over a 30-day time horizon under an acute liquidity stress scenario, (ii) a "net stable funding ratio" designed to promote more medium and long-term funding

- raising the quality, consistency and transparency of the capital base;
- strengthening the risk coverage of the capital framework;
- introducing a non-risk adjusted leverage ratio as an international standard; and
- introducing a series of measures to promote the build-up of capital buffers in good times, to be drawn on in periods of stress.

The proposal to raise the quality, consistency and transparency of the capital base aims to strengthen the Tier 1 capital base in particular so that it is fully available to absorb losses on a going concern basis, therein contributing to a reduction of systemic risk. The proposal seeks to simplify the capital requirements, including by emphasizing that common equity should be the predominant component of Tier 1 capital, simplifying Tier 2 (removing the distinction between Upper Tier 2 and Lower Tier 2) and removing Tier 3 altogether. Significantly, the proposal would disqualify certain innovative hybrid capital instruments (including trust preferred securities), from Tier 1 capital. The justification for this change is the Basel Committee's goal to strengthening the quality and consistency of the instruments to be included as Tier 1 capital outside of common equity and its belief that certain innovative features which have been introduced in an effort to reduce costs have been added at the expense of quality. This approach is generally more strict than that introduced in the European Union in 2009 through amendments to the EU Capital Requirements Directive, which would allow 30 year instruments with "moderate" incentives to redeem (after the tenth year) to qualify as hybrid capital for Tier 1 purposes.

To further emphasize that common equity should be the predominant component of Tier 1 capital, the proposals would add a minimum common equity to risk-weighted assets ratio and require that goodwill, general intangibles and certain other items that currently are deducted from Tier 1 capital instead be deducted from common equity as a component of Tier 1 capital. The proposals do not specify the percentage requirements for the new ratio of common equity to risk-weighted assets. In addition, they leave open the possibility that the Basel Committee will recommend changes to the minimum Tier 1 capital and total capital ratios, which currently are 4% and 8%, respectively.

While the following criteria may be subject to change, Basel III identifies 14 factors that must be satisfied in order for a non-common equity product to be considered as Tier 1 additional going concern capital:

(1) issued and paid-in;

(2) subordinated to depositors, general creditors and subordinated debt of the bank;

(3) neither secured nor covered by a guarantee of the issuer or related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis bank creditors;

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of the assets and activities of banks over a one-year time horizon, and (iii) a set of monitoring tools that the Basel Committee indicates should be considered as the minimum types of information that banks should report to supervisors.

(4) perpetual, *i.e.*, there is no maturity date and there are no incentives to redeem;

(5) may be callable at the initiative of the issuer only after a minimum of five years:

(a) to exercise a call option a bank must receive prior supervisory approval;

(b) a bank must not do anything which creates an expectation that the call will be exercised; and

(c) banks must not exercise a call unless:

(i) they replace the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the bank; or

(ii) the bank demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised;

(6) any replacement of principal (*e.g.*, through repurchase or redemption) must be with prior supervisory approval and banks should not assume or create market expectations that supervisory approval will be given;

(7) dividend/coupon discretion:

(a) the bank must have full discretion at all times to cancel (and not merely defer) distributions/payments (*i.e.*, cumulative dividends would be prohibited)[40];

(b) cancellation of discretionary payments must not be an event of default;

(c) banks must have full access to cancelled payments to meet obligations as they fall due; and

(d) cancellation of distributions / payments must not impose restrictions on the bank except in relation to distributions to common stockholders.

(8) dividend /coupons must be paid out of distributable items;

(9) the instrument cannot have a credit sensitive dividend feature, that is a dividend/coupon that is reset periodically based in whole or in part on the banking organization's current credit standing;

(10) the instrument cannot contribute to liabilities exceeding assets if such a balance sheet test forms part of national insolvency law;

[40] This would disqualify cumulative perpetual preferred stock (which under current US capital guidelines may count as Tier 1 capital for bank holding companies, subject to certain limitations) and US- style trust preferred securities from Tier 1 capital.

(11) instruments classified as liabilities must have principal loss absorption through either (i) conversion to common shares at an objective pre-specified trigger point or (ii) a write-down mechanism which allocates losses to the instrument at a pre-specified trigger point. The write-down will have the following effects:

(a) reduce the claim of the instrument in liquidation;

(b) reduce the amount re-paid when a call is exercised; and

(c) partially or fully reduce coupon / dividend payments on the instrument.

(12) neither the bank nor a related party over which the bank exercises control or significant influence can have purchased the instrument, nor can the bank directly or indirectly have funded the purchase of the instrument;

(13) the instrument cannot have any features that hinder recapitalization, such as provisions that require the issuer to compensate investors if a new instrument is issued at a lower price during a specified time frame; and

(14) if the instrument is not issued out of an operating entity or the holding company in the consolidated group (*e.g.*, a special purpose vehicle), proceeds must be immediately available without limitation to an operating entity or the holding company in the consolidated group in a form which meets or exceeds all of the other criteria for inclusion in Tier 1 additional going concern capital.[41]

The Basel Committee proposes to introduce these changes in a manner that does not prove disruptive for the capital instruments that are currently outstanding, *i.e.*, through grandfathering provisions, although there is no clarity yet as to what those provisions would be.[42] The Basel Committee intends to discuss specific proposals at its meeting in July 2010 on the role of contingent capital, convertible capital instruments and instruments with write-down features. Comments on the consultation are due by April 16, 2010, with the expectation that the Basel Committee will release a comprehensive set of proposals by December 31, 2010 and that final provisions will be implemented by December 31, 2012. The final provisions would have to be implemented by regulations and guidelines adopted by member jurisdictions, which could differ from the final provisions adopted by the Basel Committee.

[41] While the 14 factors listed largely quote what is included in "Strengthening the resilience of the banking sector" (see pp. 20-21), please see the document for further explanation on why this criteria was chosen.

[42] The consultative document contains language which suggests that grandfathering may only be appropriate for securities issued prior to its publication. Whether this was its intention is not entirely clear.

CHAPTER 4

HYBRID CAPITAL PRODUCT DEVELOPMENT

Since Basel I, the banking sector has assumed a leading role in the development of innovative capital products. Basel I and the 1998 Basel Release contributed significantly to the pace in the development of subsidiary preferred Tier 1 capital and alternatives that are less complex or provide more benefits to banks or both. The hybrid capital products that have been developed since Basel I can be broken down into the following categories:

- tax deductible non-operating subsidiary preferred;
- pre-tax operating subsidiary preferred;
- multiple tax benefit subsidiary preferred;
- capital instruments issued by a bank;
- capital instruments issued by a bank linked to another instrument;
- mandatory convertible or exchangeable securities; and
- other products.

Hybrid capital product development historically has focused primarily on non-dilutive, fixed income, non-voting securities that raise capital at a lower cost than traditional common equity and, to the extent available to the issuer, preferred shares. It should be noted, however, that the issuer's strategic requirements and/or particular tax situation are instrumental in hybrid product selection and development. For example, the issuer might need "upper" or "non-innovative" hybrid capital to obtain more equity credit from Moody's in connection with an acquisition or due to recent significant losses. Another issuer may need "upper" or "non-innovative" Tier 1 capital because it is a regulated entity and its 15 percent innovative capital basket is full. Also, the issuer may want an income tax deduction in a high tax jurisdiction where a branch or subsidiary has significant taxable income, may have capital needs at a particular branch or subsidiary or may find it otherwise more capital or tax efficient to raise capital through a particular branch or subsidiary. Regulators such as the FSA, the German central bank and the Australian Prudential Regulation Authority ("APRA") have been considering the parameters for "upper" or "non-innovative" Tier 1 capital. For instance, in July 2006 the APRA issued new guidance notes on the measurement of capital for banks and in September 2006 it published capital adequacy requirements for insurance companies.[43] All such approaches, however, are likely to change as from 2012 if the Basel Committee's proposals on Tier 1 capital in Basel III (discussed in the Chapter 3 above) are implemented. In addition, the rules in the EU will be changing from December 31, 2010 so that preference shares may no longer qualify as hybrid capital (although existing transactions will be grandfathered to a certain extent).

[43] See www.apra.gov.au. For another example, see Appendix C (*Tier 1 Capital Rules for Banks in the United Kingdom*).

One important benefit that subsidiary preferred and other hybrid capital instruments provide to many banks around the world is access to the potential benefits of preferred and similar contract equity – cheap, non-participating equity leverage for the bank's common shareholders – like income only or limited partners in a partnership. Importantly, virtually all banks can raise capital by issuing common or ordinary shares, which is not true with respect to preferred and similar equity securities. For example:

- the statutory regimes in some countries, such as the United States, UK, Ireland, Canada, Australia, New Zealand and Singapore, permit banks and other corporate entities established under the laws of those countries to issue preferred or similar equity securities that can be readily sold in the capital markets, although some of these regimes still may require voting or other features that the bank may not want to offer equity investors;
- the statutory regimes in many other countries, particularly civil code countries such as those in continental Europe, to the extent they authorize preferred or similar equity securities, may not provide banks and other corporate entities with sufficient flexibility to issue instruments that can be readily sold in the capital markets. Many countries who found themselves in this situation, particularly those in continental Europe, have amended their statutes in an attempt to address this problem. In 2003, France adopted a new law that permitted directly issued hybrid capital securities; and
- even where there is sufficient statutory flexibility, many banks and other corporate entities have not included in their charters provisions that authorize the issuance of preferred or similar equity securities, and to do so would require common shareholder approval that management may not want to obtain or time does not permit.

A primary purpose of hybrid capital products developed historically has been to lower the issuer's cost of capital, in particular by introducing features that make the securities offered more tax efficient. The cost of capital may apply to the instruments themselves (such as withholding tax on dividends paid to foreign investors) or to the institution that issues them (such as having to pay dividends out of profits after tax). Accordingly, the most important issues in the development of hybrid capital products arise as a result of these products having to satisfy both the loss absorption and other requirements of the regulators or rating agencies on the one hand and the tax, cost saving and other objectives of the issuer on the other. The tension between these two competing goals is exacerbated because issuers, regulators, rating agencies and investors in the capital markets, where most of the hybrid capital products are sold, all require tax and legal analyses with a high degree of certainty (for example, bank regulators, because, among other things, of the requirement that Tier 1 capital be permanent and investors because of the pricing of the product).

The complexity in the structure of a hybrid capital instrument is normally initiated by the tax or other transaction benefits that the bank requires. To achieve those benefits, however, the tax, securities and other laws and regulations, the accounting requirements and the investor incentives described above more often than not are the primary reasons for the complexity of a particular structure.

CHAPTER 5

BANK TAX DEDUCTIBLE NON-OPERATING SUBSIDIARY TIER 1 INSTRUMENTS

Tax deductible non-operating subsidiary instruments have traditionally been the most common form of innovative Tier 1 capital, particularly since the Basel Committee formally approved the treatment of non-operating subsidiary preferred as minority interest Tier 1 capital in the 1998 Basel Release. The popularity of this structure is largely due to the fact that, once set up, it is relatively easy to administer and the tax deductibility result for the bank is reasonably certain. If there is a downside, it is the tendency for the structure to become complicated and difficult for an investor to understand.

The archetypal tax deductible subsidiary preferred structure involves the sale of a bank debt obligation to a tax transparent subsidiary that provides the bank with an interest deduction for tax purposes and minority interest treatment for accounting purposes. Where this subsidiary is a partnership for US tax purposes and is either a US-domiciled subsidiary or a substantial amount of the investors are located in the United States, the partnership subsidiary's preferred securities may be issued to a trust, which in turn would issue its securities to investors, although recent US tax developments described below make this approach less attractive.

This type of preferred structure is often called "trust preferred" because a trust is typically, but not always, the issuer of the securities purchased by investors. The primary benefit in offering investors trust securities is to maximize the potential investor base. For example:

- a trust may enable investors to receive Form 1099 income tax reporting forms, rather than the more complicated Form K-1 required for entities (such as LLCs and general and limited partnerships) that are treated as or properly elect to be treated as partnerships for US federal income tax purposes; and

- Euroclear and Clearstream may not deliver Form K-1's to investors who hold through those clearing systems, whereas they will deliver Form 1099s.

The use of a trust by a foreign bank, however, implicates the "foreign trust" rules under the US Internal Revenue Code of 1986, which impose burdensome reporting obligations and significant penalties for non-compliance. Foreign banks have taken one of three approaches to avoid these rules:

- US subsidiary: All common securities of the trust are held by a US subsidiary (a US person) of a foreign bank and the majority of trustees are US persons;

- US branch: All the common securities of the trust are held by a US branch of a foreign bank (not a US person), but (1) all the trustees and the sponsor, if any, are US persons and (2) the interests in the trust are widely distributed for sale in the US to US persons; and

- Hat check trust: Use of totally offshore custodial or depository arrangements known as "hat check trusts." In a typical hat check structure, the underlying securities are held in a custodial or depository account and the beneficial owners (that is, investors) receive a "claim check" in the form of a custody receipt or certificate. The investors can remove the securities from the account at any time. This approach, however, is not appropriate where US investors would or could hold the securities.[44]

The use of a trust may also cause problems for the bank in its home country. For example, if the bank is domiciled in the UK and the trust is considered a subsidiary of the bank for UK tax purposes, the debt instrument of the bank may be considered equity and interest payments as dividends, and therefore not deductible by the bank, for UK tax purposes.

In February 2007, a notice by the IRS called into question the treatment of a trust as a grantor trust for U.S. Federal income tax purposes where the assets of the trust are interests in a tax partnership, a historically common approach for complex trust subsidiary Tier 1 structures since 1997. In the notice, the IRS announced that a fixed investment trust formed to hold interests in a tax partnership (e.g., a limited partnership, an LLC or a trust that elects to be treated as a tax partnership) which has the power to vary its investments will not be eligible to be classified as a trust for US federal income tax purposes. Instead, such investment trust will be classified as a tax partnership (unless it elects corporate status). As a result of this interpretation, such a trust will be required to issue annual tax information statements to its investors on IRS Schedule K-1, rather than on the preferable IRS Form 1099.

Foreign banks have been significantly more active than US banks in developing Tier 1 capital products. In December 2000, the OCC approved the first trust preferred issue as Tier 1 capital for any US bank – an internal, non-capital driven issuance by Banc One. The non-cumulative requirement of the Basel Accord makes structuring a tax deductible Tier 1 trust preferred significantly more difficult for US banks than many foreign banks because the US federal income tax requirements for qualifying an instrument as debt are more onerous than those of many other countries. Also, there has been less incentive for US banks to develop tax deductible subsidiary products because the Federal Reserve Board has permitted cumulative trust preferred securities to count as Tier 1 capital of bank holding companies since 1996.[45] US banks and bank holding companies, however, may become more interested in raising tax deductible bank subsidiary preferred or other bank level capital if all or some of the following occurs:

- as US bank holding companies approach the 15 percent or 25 percent limit on Tier 1 credit for trust preferred and other restricted core capital elements;

- as the rating agencies focus on double leveraging of bank equity at the bank holding company level; and

[44] See Appendix D (*Use of Trust Structures in Tier 1 Preferred Securities and Other Capital Markets Transactions – Foreign Trust Tax Issues*).
[45] See Appendix A (*Basel Committee on US Regulatory Innovative Tier 1 Capital Requirements*) for a discussion of the Federal Reserve Board's final rules on trust preferred securities and the definition of capital for UK bank holding companies.

- the continuing refinement of guidelines for crediting hybrid capital instruments for rating purposes by Moody's and, to a lesser extent, Standard & Poor's and Fitch that began in February 2005.

The loss absorption features of tax deductible non-operating subsidiary preferred transactions to date have included:

- dividends or similar payments that are either non-cumulative or effectively non-cumulative through a deferral feature;

- the subsidiary cannot wind up before the bank and, when it does, investors are only entitled to the amount they would be entitled to if they were holders of bank preferred – this is often used where the bank is not authorized to issue preferred at all or where the preferred the bank can issue is problematic (*e.g.*, cannot be publicly sold, cannot be denominated in a foreign currency, cannot be redeemed as required by the market or the issuer, etc.);

- the value of the indebtedness of the bank to the subsidiary is written down or the debt instruments themselves are transferred to the bank upon the occurrence of events specified by the bank's primary regulator, in which case, although the subsidiary may continue to be the source of dividends, investors are generally forced to rely on the bank's guarantee for payment upon the liquidation of the subsidiary and possibly dividends;

- the preferred securities of the non-operating subsidiary are mandatorily exchanged into preferred or common shares of the bank upon the occurrence of certain events specified by the bank's primary regulator; and

- in the case of "enhanced" transactions:

  – deferred interest that has accrued on the debentures must be paid by the bank holding company with the proceeds from the sale of its common stock and/or perpetual non-cumulative preferred stock (*i.e.*, if there is a stress event and the bank holding company defers, then there will be no impact on its liquidity);

  – unlike normal tax deductible non-operating subsidiary preferred, in enhanced transactions interest on the debentures can be deferred for as long as a total of 10 or 12 years, but must be paid after five or seven years if the deferral period has not yet ended with the proceeds from the sale of its common stock and/or perpetual non-cumulative preferred stock of the bank or non-bank issuer. If a "market disruption event" occurs, such that the bank or non-bank issuer is unable to sell a sufficient amount of its securities to fund the repayment of the deferred interest, then interest can be deferred for an additional five years without triggering an event of default; and

– certain enhanced issuances are deeply subordinated, *e.g.*, ranking junior to all debt and existing trust preferred.

Set forth below is an analysis of the Tier 1 trust preferred and other tax deductible non-operating subsidiary preferred securities that banks and bank holding companies have issued to date.

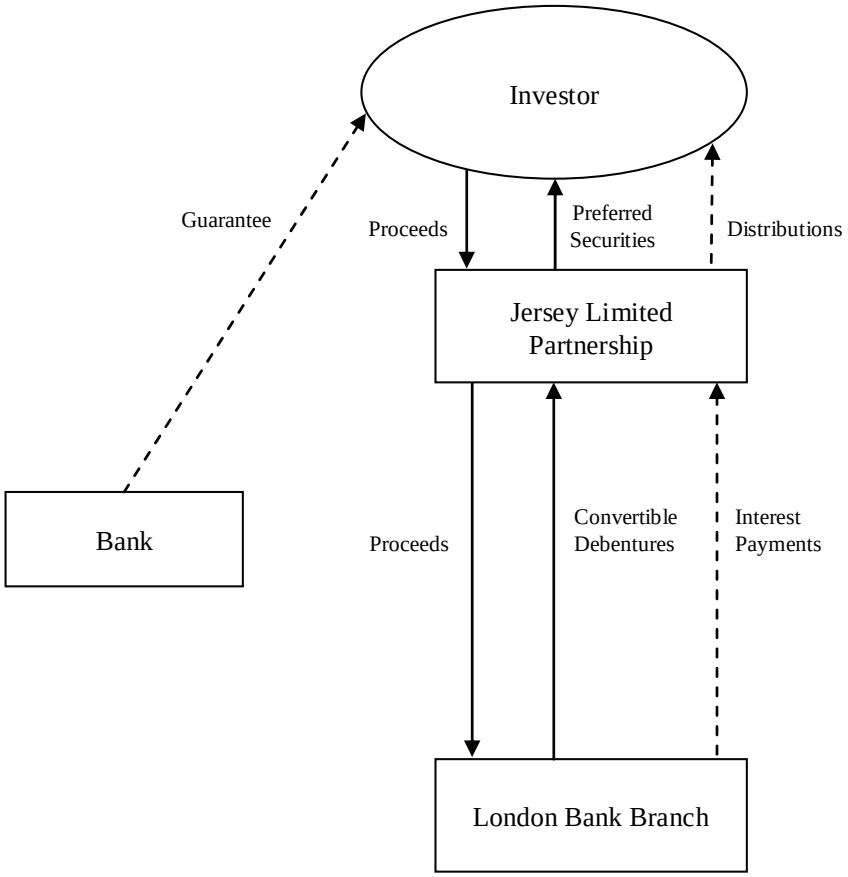
SIMPLE SUBSIDIARY STRUCTURES

Recently, we have seen a trend toward subsidiary preferred structures that are simpler and less complex in much the same way that we have seen a trend toward more direct issue Tier 1 capital securities. Some of this is due to the requirement by the Basel Committee in the 1998 Basel Release, as well as the world's bank regulators since, that hybrid Tier 1 capital instruments not be too complex. Some of this is also due to changing tax and financial regulatory regimes around the world and the current economic environment where investors are more reluctant to invest in complex products they may not entirely understand.

For the most part, the complexity of the subsidiary structure is primarily driven by the issuer's concerns, particularly as they relate to the tax efficiencies of the structure. However, investment and regulatory concerns of certain types of investors, such as insurance companies and US pension funds, and investor-driven tax reporting concerns (such as the K-1 partnership reporting issues and PFIC issues for US taxpayers) also impact the need for more complex solutions.

Like the more complex subsidiary structures, some banking regulators require that a subsidiary's securities be exchangeable into parent company Tier 1 preferred stock in the event that the parent's financial or regulatory capital position is under stress. In some cases, the existence of an exchangeable feature will give the issuer better quality regulatory capital and/or more equity credit from the rating agencies.

- ***Australian Bank Exchangeable Guaranteed Subsidiary Preferred (since 2004)***



- Selected issue
  - Macquarie (2004)
- Transaction benefits
  - Primary regulator capital treatment – bank level Tier 1.
  - Avoids withholding tax on distributions paid to foreign investors.
  - Avoids withholding tax under the guarantee.
- Features
  - The issuer partnership is established for the sole purpose of raising finance for the banking group.
  - Preference shares of the bank are perpetual securities paying non-cumulative dividends.

- Proceeds from the issue of the preferred securities are used to purchase convertible debentures issued by the bank.

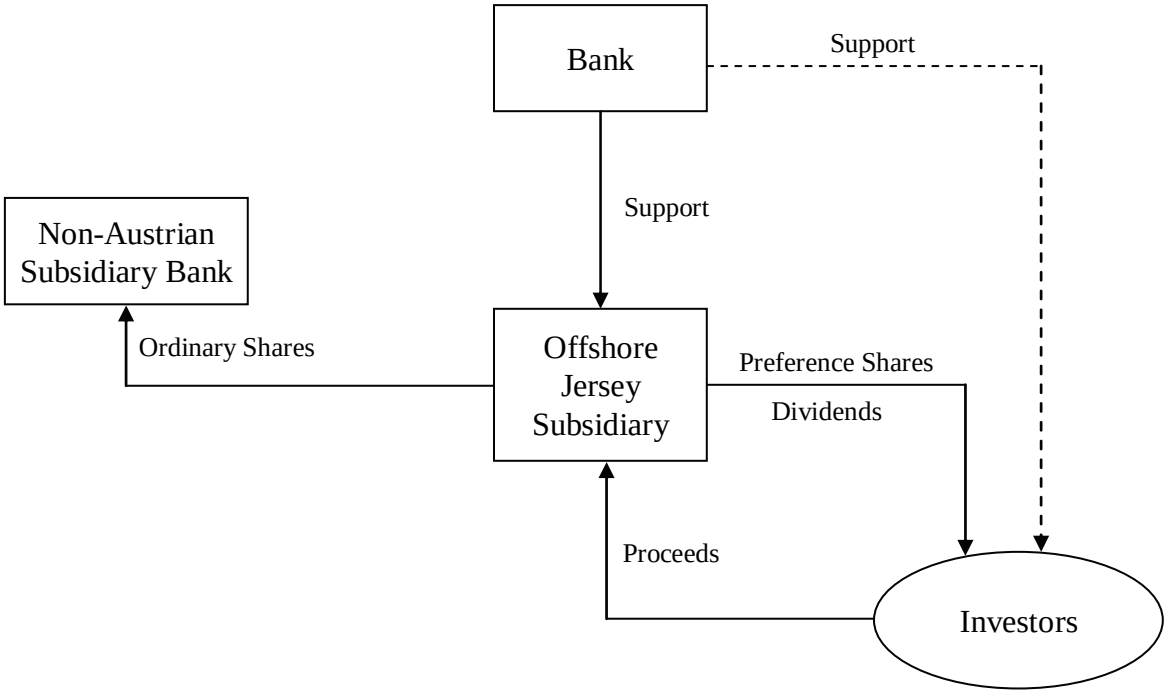
- The convertible debentures are mandatorily convertible 45 years after the issue date, and are convertible or exchangeable into preference shares issued by the bank at the option of the bank.

- The preferred shares are exchanged for the bank's preference shares upon the occurrence of certain regulatory capital, solvency and other triggering events.

- Distributions on the preferred securities depend on whether interest is paid on the convertible debentures. If distributions are made on the preferred securities, such distributions will be made through the issuing partnership to holders of the securities.

- The bank has the option to redeem the preferred securities upon a minimum of 30 days' notice to the holders.

- ***Austrian and Swiss Bank Support Agreement Backed Subsidiary Preferred (since 1999)***



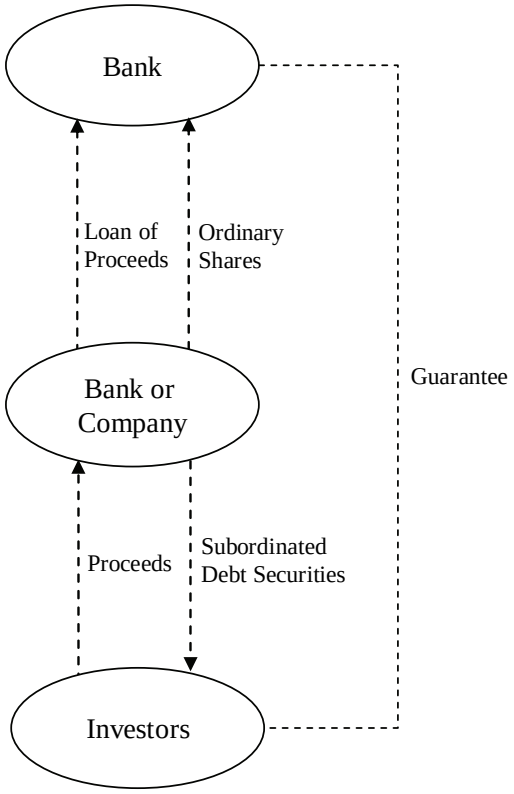
Selected issues

- RZB (Jersey) (1999)
- BAWAG (Jersey) (2000)
- Erste (Jersey) (2000)
- Hypo Alpe Adria (Jersey) (2001)
- RZB (Jersey) (2003)
- RZB (Jersey) (2004)
- Bank Austria Creditanstalt (Cayman) (2004)
- Bank Austria Creditanstalt (Cayman) (2005)
- Erste (Jersey) (2005)
- UBS (Jersey) (2005)
- UBS (Jersey) (2008)

Features

- Distributions not guaranteed, but the structures contain strong support arrangements with direct recourse to the bank by investors through the use of English Law Deed Polls.
- Use of wholly-owned or majority-owned intermediary subsidiary outside Austria, most typically Malta.
- Potential for use of direct ownership and other lending arrangements.
- Payments are non-cumulative and are only made out of distributable returns. Notwithstanding this, payments must be made if paid on other *pari passu* securities of the bank.

- ***Belgian, Dutch and Luxembourg Bank or Financial Services Company Guaranteed Subsidiary Instruments (since 2006)***



Selected issues

- Fortis (Belgian & Dutch) (Luxembourg subsidiary) (2006)
- Dexia (Belgian) (Belgian subsidiary) (2006)
- KBC (Belgian) (Belgian subsidiary) (2007)
- Espírito Santo Financial Group S.A. (Luxembourg) (Cayman Islands subsidiary) (2007)
- Fortis (Belgian & Dutch) (Belgian subsidiary) (2007)
- Fortis (Belgian & Dutch) (Luxembourg subsidiary) (2008 – two issues)

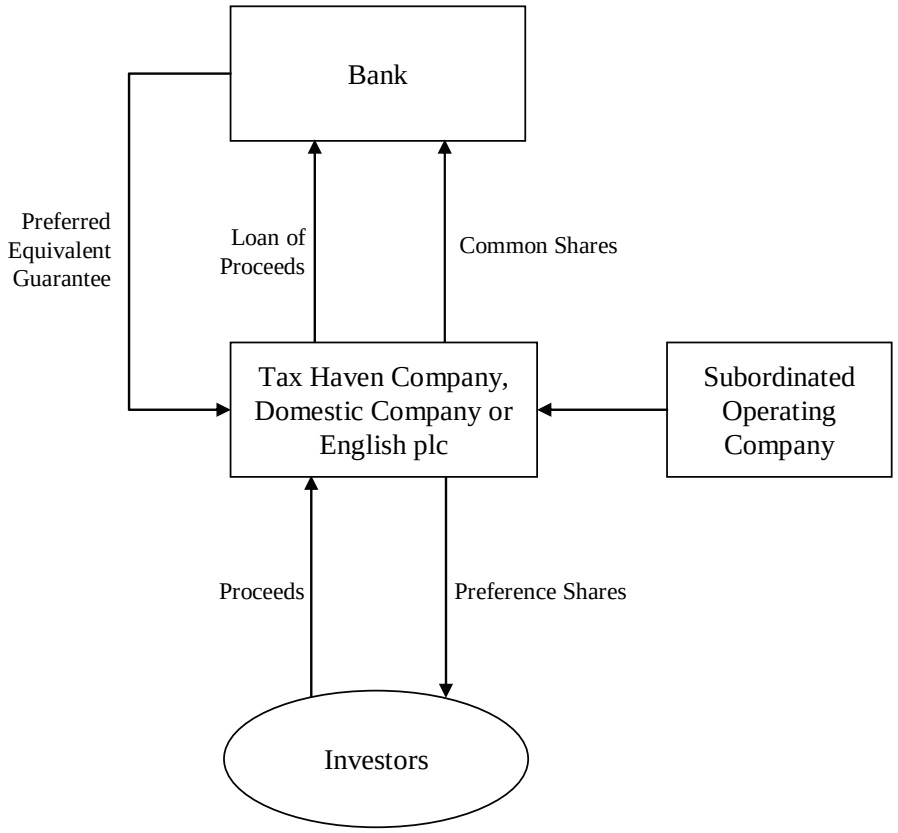
Transaction benefit

- The interest on the subordinated debt securities is tax deductible.

Features

- The subordinated debt securities, which have been perpetual notes, are issued by a finance subsidiary of the parent bank or financial services company.
- The assets of the subsidiary consist of loans to the parent and, in some cases, the parent's other subsidiaries.
- The subordinated debt securities are guaranteed on a subordinated basis by the parent. In the case of Fortis, for Dutch law purposes, the subordinated debt securities also have the benefit of a support agreement.
- Distribution rates on the subordinated debt securities are non-cumulative and are generally fixed for a period of time (*e.g.*, 10 years) and thereafter will be payable at the sum of a fixed rate and an internationally recognized floating rate (such as EURIBOR or LIBOR).
- Distributions on the subordinated debt securities are not payable if a trigger event occurs and the parent does not raise additional funds to permit the payment to be made.
- The trigger event typically includes such situations as where: (i) the parent's assets are less than its liabilities; (ii) the parent's regulatory capital falls below required minimums; or (iii) the parent's regulatory prohibits the payment.
- The subordinated debt securities are not redeemable at the option of the holders. The subordinated debt securities may be redeemed at the option of the subsidiary either after a fixed period of time or if certain events occur (such as a change of law that changes the tax status of the securities held by each of the entities in connection with this type of transaction or changes in capital treatment).
- Neither the subordinated debt securities nor the guarantee have a provision that would prevent the parent or any subsidiaries from making payments on any other securities if and so long as coupon payments are waived or other payments are not made when due. If a payment is due in connection with a redemption and not paid, holders only have the right to proceed if the parent is in bankruptcy or liquidation proceedings.

- ***French, Greek, Portuguese and Spanish Bank Guaranteed Subsidiary Preferred (since 1991)***



Selected issues

- Banco Santander (Spanish) (1991)
- Banco Bilbao Vizcaya Argentaria (Spanish) (1991)
- Banque Indosuez (French) (1991)
- Crédit Lyonnais (French) (1993)
- Banco Comercial (Portuguese) (1993)
- Banco Espirito Santo (Portuguese) (1993)
- Banco Totta (Portuguese) (1993)
- Banco Bilbao Vizcaya Argentaria (Spanish) (1997)
- Banco Santander Central Hispano (Spanish) (2000)

- Banco Espirito Santo (Portuguese) (2000)
- Banco Bilbao Vizcaya Argentaria (Spanish) (2001)
- Banco Espirito Santo (Portuguese) (2003)
- National Bank of Greece (Greek) (2003)
- Banco BPI, S.A. (Portuguese) (2003)
- Banco Popular Español (Spanish) (2003)
- Alpha Group (Greek) (2003)
- Caja de Ahorros de Salamanca y Soria (Caja Duero) (Spanish) (2003)
- Banco Espirito Santo (Portuguese) (2004)
- Banco Popular Español (Spanish) (2004)
- Banco Santander Central Hispano (Spanish) (2004)
- Banco Commercial (Portuguese) (2004)
- Caixa Geral de Depositos (Portuguese) (2004)
- Piraeus Bank (Greek) (2004)
- National Bank of Greece (Greek) (2004)
- Banif Banc Internacional Do Funchal (Portuguese) (2004)
- Alpha Bank AE (Greek) (2005)
- Banco Pastor (Spanish) (2005)
- Caixa Geral de Depositos (Portuguese) (2005)
- EFG Eurobank (Greek) (2005)
- Caixa D'Estalvis del Penedes (Spanish) (2006)
- Banco Bilbao Vizcaya Argentaria (Spanish) (2006)
- National Bank of Greece (Greek) (2006)
- Banco Santander Central Hispano (Spanish) (2006)
- Banco Santander Central Hispano (Spanish) (2007 – three issues)

- Banco Popular Español (Spanish) (2007)
- Caja de Ahorros de Galicia (Spanish) (2007)
- Banco Bilbao Vizcaya Argentaria (Spanish) (2007 – two issues)
- Banco Santander Central Hispano (Spanish) (2008)
- Banco Bilbao Vizcaya Argentaria (Spanish) (2008)

Selected 2009 issues

- *Banco Santander Central Hispano (Spanish) (January 2009, two issues in March 2009, one issue in July 2009 and two issues in September 2009)*[46]
- *EFG Eurobank Ergasisas S.A. (Greek) (July 2009)*
- *Banco Bilbao Vizcaya Argentaria (Spanish) (October 2009)*[47]

This structure has also been used by non banks.

The French deals ceased in the early 1990's due to tax law changes.

Transaction benefits

- Primary regulator capital treatment – bank minority interest Tier 1.
- The interest paid by the bank on its loans from the issuer is deductible for Spanish, French, Greek and Portuguese tax purposes, as the case may be.
- Enables the bank to issue preferred equivalents.

Features

- The issuer for the Spanish issues had historically been a tax haven-domiciled company that is a subsidiary of the bank for accounting purposes. A 2003 change in Spanish law allows issuers to use a Spanish corporate subsidiary instead of an offshore vehicle to achieve the same tax result, although structuring the terms of the securities and related documentation and clearance procedures remains a significant structuring challenge.[48]
- National Bank of Greece issues through an English corporate subsidiary.

[46] Securities issued in September 2009 offered pursuant to an exchange offer, see page 308, Chapter 17 (*Liability Management Transactions*).

[47] Securities issued pursuant to an exchange offer, see page 309, Chapter 17 (*Liability Management Transactions*).

[48] See discussion below under the heading *Spanish Tax Law*.

- Bank loans generally are the issuer's only assets.
- The bank loans are debt for the bank's domestic tax purposes but sufficiently equity-like to avoid the US tax payment and reporting requirements for PFICs.
- Preferred dividends are non-cumulative and discretionary in the case of Spanish and Portuguese banks and non discretionary in the case of French banks. In the Greek transactions, dividends on the preferred are mandatorily payable if the bank pays dividends on any of its securities that rank equally with or junior to the preferred, in which case it must pay dividends on the company preferred for one year following such payment.
- The bank guarantees the preferred in a manner that makes it the functional equivalent of preferred issued by the bank itself. Accordingly, guarantee payments include:
  - dividend payments if its prior year distributable profits are sufficient to pay such dividend payments and dividends on instruments ranking equally with or senior to the preferred, but only if the bank would not be limited in making payments under capital adequacy regulations if it had itself issued the preferred;
  - the redemption price, subject to the foregoing with respect to any dividend component; and
  - the liquidation amount payable on the preferred.
- The guarantee ranks junior to all indebtedness of the bank and equal to the most senior preferred or preference shares of the bank.
- The preferred's liquidation payment is determined based on the assets of the issuer provided that, if the bank is being wound up at the same time, it is instead based on the assets of the bank.
- The issuer must be wound up if the bank is wound up.
- The issuer is 1940 Act exempt pursuant to Rule 3a-5 (finance subsidiary).
- In the Caixa General de Depositos' 2004 transaction, the Caixa's French operating subsidiary provided the guarantee of the securities.

Spanish Tax Law

In 2003 and 2004, the Spanish government enacted a series of new laws and regulations that were designed to curb the use of tax haven structured finance and otherwise put in place additional protections against money laundering. The laws and regulations had the effect of establishing an entirely new tax regime for certain capital market transactions (including the

exemption from Spanish taxes on any income derived by non-Spanish investors – except those resident in, or acting through, a tax haven territory – from the relevant securities and the tax deductibility for the Spanish issuer of any distribution payment or other financial income arising from the issuance of securities) and certain tax disclosure requirements.

During 2008, a new set of legal provisions aimed at modifying the existing tax regime applicable to certain issuances of Spanish preferred shares and debt instruments were adopted.

First, Royal Decree-Law 2/2008, of April 21, extended to all non-Spanish residents acting in Spain without a permanent establishment (including those resident in, or acting through, a tax haven jurisdiction) the tax exemption applicable to income deriving from Spanish listed preferred shares and other debt instruments governed by Additional Provision Two of Law 13/1985, of May 25, on investment ratios, own funds and information obligations of financial intermediaries.

Second, as a follow up of this first step taken to improve the competitiveness of the Spanish debt markets, on Christmas Day 2008 the Official National Gazette published Law 4/2008, of December 23, which, among other tax changes, reduced the universe of investors for whom certain information will have to be submitted to the Spanish tax authorities, which covers residents in Spain for tax purposes (as opposed to the previously existing regime where information concerning non-Spanish tax resident investors had to be collected and delivered to the Spanish tax authorities by Spanish issuers or guarantors).

Pursuant to this new law, the submission of the above referred information will have to be made in a form to be further developed in accordance with future regulations, which are still awaiting approval. Until the Spanish government passes regulations developing this new legal framework, Spanish issuers and guarantors of preferred shares and debt instruments governed by Law 13/1985 will continue applying the procedures to identify investors that have been utilized since 2005.

These so called "relief at source" procedures are designed to facilitate the collection of certain information concerning the identity and country of tax residence of beneficial owners who are entitled to receive payments in respect of the securities free and clear of Spanish withholding taxes, namely (i) corporations resident in Spain for tax purposes; or (ii) individuals or entities not resident in Spain for tax purposes, which do not act with respect to the securities through a permanent establishment in Spain. These procedures apply in transactions made by Spanish issuers in the US market cleared through The Depositary Trust Company ("DTC") when the beneficial owners entitled to the exemption from Spanish withholding tax are participants in DTC or hold their interests through participants in DTC, provided that in each case, the relevant DTC participant is a central bank, another public institution, an international organization, a bank, a credit institution or a financial entity, including collective investment institutions, pension funds or insurance entities, and is resident either in an Organisation of Economic Co-operation and Development country (including the United States) or in a country with which Spain has entered into a double taxation treaty subject to a specific administrative registration or supervision scheme (each, a "Qualified Institution").

In order to allow for "relief at source" procedures to work for book-entry securities, a third party intermediary is needed to liaise between the issuer and DTC. The introduction of a third party intermediary has led to the following acceptable tax information procedures with DTC and the Spanish tax authorities in regards to preferred securities issued by Spanish entities:

- At least five New York business days prior to each relevant record date (each, a "Distribution Record Date") preceding a cash distribution payment date on the security (each, a "Distribution Payment Date"), the Spanish issuer will provide DTC with an announcement which will form the basis for the creation of a DTC "Important Notice" regarding the relevant cash distribution and Spanish withholding tax exemption entitlement information. The "Important Notice" will be printed on DTC's website and will include a summary of the relevant beneficial owner information collection procedures;

- Beginning on the first New York business day following each relevant Distribution Record Date through and including the close of business on the fourth New York business day prior to each relevant Distribution Payment Date ("Standard Deadline"), DTC participants must enter information into the system of the third party intermediary regarding the beneficial owners holding interests in the securities through such participants. In addition, direct participants in DTC that have submitted beneficial owner information in accordance with the preceding sentence must make an election via the DTC Elective Dividend Service ("EDS") confirming their aggregate positions that are exempt from Spanish withholding tax;

- Once complete beneficial owner information in respect of a participant's holding in the securities has been entered into the system of the third party intermediary, such third party intermediary will produce fully completed forms of certificates as required by the Spanish law. Each DTC participant will then be required to (i) print, (ii) review, (iii) sign and (iv) fax or send a PDF copy of the duly signed paper certificate to the third party intermediary by the Standard Deadline. The third party intermediary will submit all confirmed certifications to the Spanish issuer on the Distribution Payment Date;

- Participants in DTC must ensure that beneficial owner data entered into the system of the third party intermediary and EDS elections are synchronized and updated to reflect any changes to beneficial ownership or DTC positions occurring prior to the relevant Distribution Payment Date. For this purpose, the third party intermediary will accept revisions to beneficial owner information until 9:45 a.m. (New York time) on the Distribution Payment Date and DTC will accept requests for changes to EDS elections at the request of DTC participants until 9:45 a.m. (New York time) on the Distribution Payment Date. If at 9:45 a.m. (New York time) on the Distribution Payment Date, the beneficial owner information supplied by a DTC participant to the third party intermediary concerning that DTC participant's EDS elections and its DTC positions are inconsistent in any respect, payments will be made net of Spanish taxes on the entire position held by such DTC participant;

- DTC and the third party intermediary will reconcile beneficial owner information, EDS elections and DTC positions on the morning of each relevant Distribution Payment Date. Based on this reconciliation, and acting on a best efforts basis, the staff at the third party intermediary will (until 9:45 a.m. (New York time) on such relevant Distribution Date) warn DTC participants of any inconsistencies. DTC participants will have the opportunity to revise the beneficial owner information they have submitted to the third party intermediary and submit new or amended tax certifications and request DTC to amend EDS elections until 9:45 a.m. (New York time) on the relevant Distribution Payment Date in order to correct any inconsistencies; and

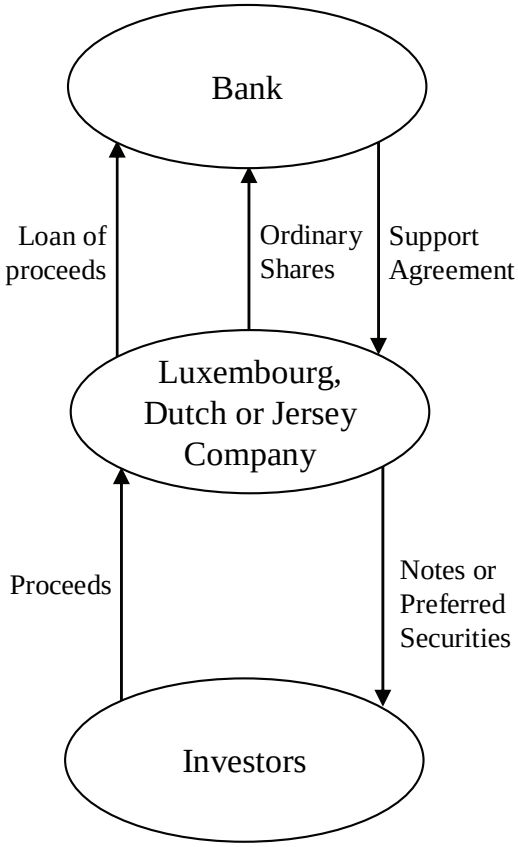
- The Spanish issuer will make interest payments on the securities (net or gross of withholding, as the case may be) in accordance with the final paying agent report provided by DTC and the third party intermediary unless the issuer determines that there are inconsistencies with the tax certifications provided or that any of the information set forth therein is, to the issuer's knowledge, inaccurate.

Beneficial owners who are entitled to receive distribution payments in respect of the securities free of any Spanish withholding taxes, but who do not hold their securities through a Qualified Institution and holders of securities who hold certificated securities will have Spanish withholding tax withheld from distribution payments and other financial income paid with respect to their securities at the then-applicable rate (currently, 19 percent). The same applies to DTC participants who are Qualified Institutions holding securities on behalf of beneficial owners entitled to exemption from Spanish withholding tax but who fail to timely comply with the "relief at source" procedures. Such beneficial owners, holders of certificated securities or DTC participants will have to follow, in order to obtain a refund of the amounts withheld, either the so-called "quick refund" procedures (when refund is sought from the issuer) or the so-called "direct refund" procedures (when refund is sought from the Spanish tax authorities), as applicable.

In 2003 and 2004, a number of Spanish issuers issued either Spanish domestic issuances or Eurozone-only issuances. No transactions, however, were executed where the securities were issued into the United States in book-entry form. The problem was the inability of DTC to carry out tax certification procedures at the time of each payment date. In 2005, Banco Santander Central Hispano made the first issuance of book-entry securities under the new regime into the United States pursuant to Rule 144A.

Finally, whatever the nature and residence of the holder of Spanish Tier 1 securities, the acquisition and transfer of those securities will be exempt from indirect taxes in Spain, *i.e.*, exempt from Transfer Tax and Stamp Duty, in accordance with the Consolidated Text of such tax promulgated by Royal Legislative Decree 1/1993, of September 24, and exempt from Value Added Tax, in accordance with Law 37/1992, of December 28, regulating such tax.

- ***German and Kazakhstan Bank Support Agreement Backed Subsidiary Instruments (since 2005)***



Selected issues

- Kazkommertsbank (2005)
- BankTuranAlem (Kazakhstan) (Luxembourg corporate subsidiary) (2006)
- DZ Bank (German) (Jersey subsidiary) (2006 – three issues)
- Bank CenterCredit (Kazakhstan) (Dutch subsidiary) (2006)
- Alliance Bank (Kazakhstan) (Dutch corporate subsidiary) (2006)
- ATFBank (Kazakhstan) (Dutch corporate subsidiary) (2006)

Transaction benefit

- The interest on the subordinated notes is tax deductible.

Features

- The Tier 1 capital securities, which have been perpetual notes and perpetual preferred securities, are issued by an offshore finance subsidiary of the parent.

- The assets of the subsidiary consist of loans to or debt securities of the parent and, in some cases, the parent's other subsidiaries.

- The subordinated loans rank equally with present and future, direct, unsecured perpetual and subordinated obligations of the parent or the relevant subsidiary and with any Tier 1 capital of the parent (other than equity, including preference shares, which rank junior).

- Typically, the parent will provide a support agreement under which the parent ensures that the subsidiary will always have a positive net worth and sufficient liquidity to make payments when required under Tier 1 capital securities. The rights against the parent under the support agreement are subordinated. Tier 1 capital security holders have an indirect right to enforce the support agreement against the parent if the subsidiary fails to do so.

- Distribution rates on the Tier 1 capital securities are non-cumulative and are generally fixed for a period of time (*e.g.*, 10 years) and thereafter will be payable at the sum of a fixed rate and an internationally recognized floating rate (such as EURIBOR or LIBOR).

- In the case of equity instruments, such as the instruments issued by the German owned subsidiaries, distributions are only payable if declared by the Jersey subsidiary.

- Distributions on the Tier 1 capital securities are not payable if the parent does not satisfy certain regulatory (including regulatory capital), distributable profits and financial tests and normally may be prohibited by the parent's primary regulator.

- The Tier 1 capital securities are not redeemable at the option of the holders. The Tier 1 capital securities may be redeemed at the option of the subsidiary either after a fixed period of time or if certain events occur (such as a change of law that changes the tax status of the securities held by each of the entities in connection with this type of transaction or changes in capital treatment).

- In the case of the Belgian and German issues, the terms of the Tier 1 capital securities have a "pusher provision" that requires the issuer to pay a dividend if its parent or any affiliate has, during specified periods of time, made a dividend payment on another security ranking equal to the Tier 1 capital securities.

- In the case of the Kazakhstan issues, the subordinated loan has a "stopper provision" that prevents the parent from (i) declaring or paying most types of dividends in respect of its share capital, (ii) effecting the redemption of any of its share capital or (iii) making any proposal to its shareholders or voting or allowing any of its subsidiaries to vote in favor of any of the actions in A or B if the parent mandatorily defers payment of interest on the subordinated loan (and therefore distributions are not paid on the Tier 1 capital securities).

- In the case of the German issues, there are no events of default. In the case of the Kazakhstan issues, the following constitute events of default under the subordinated loan: (i) failure to pay principal or interest (other than interest that is mandatorily deferred) within ten days of the applicable payment date; (ii) a winding-up of the parent; or (iii) breach by the parent of the capital payment stopper. An event of default triggers automatic repayment of the subordinated loan and redemption of the Tier 1 capital securities.

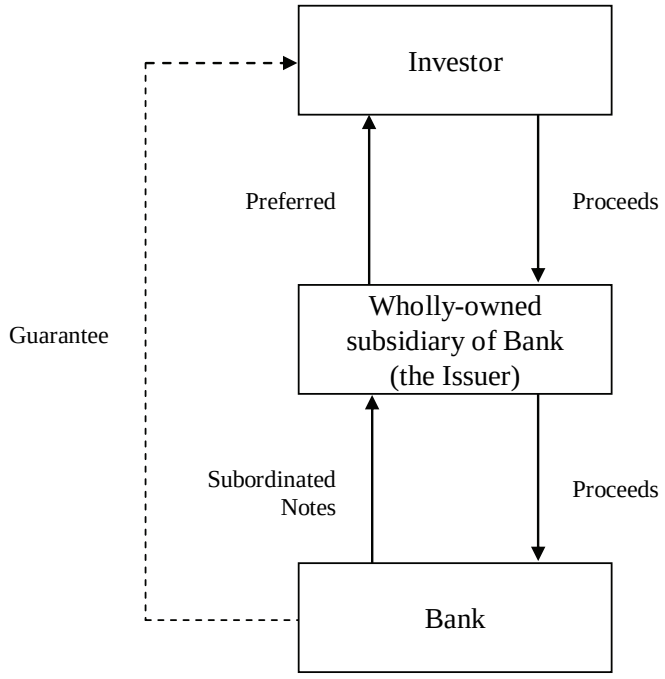
- An investment in the Tier 1 capital securities is intended to provide holders with rights to payments that are as similar as possible to those to which they would have been entitled if they had purchased non-cumulative, non-voting perpetual preference shares issued directly by the parent with economic terms equivalent to the Tier 1 capital securities and the support agreement taken together.

Kazakhstan Regulations

In November 2005, the National Bank of Kazakhstan adopted several new banking regulations, which, among other things, approved hybrid subordinated debt obligations, issued either directly by a bank or through a non-operating subsidiary, as Tier 1 capital. The first Kazakhstan bank to take advantage of the new regulations was Kazkommertsbank, which issued support agreement subsidiary subordinated debt securities in 2005.[49]

[49] For further information on the regulations issued by the National Bank of Kazakhstan, please see the following link: www.nationalbank.kz.

- ***Korean Bank Guaranteed Subsidiary Preferred (since 2002)***



Selected issue

- Hana Bank (2002)

Primary regulator capital treatment – bank level Tier 1.

Product name

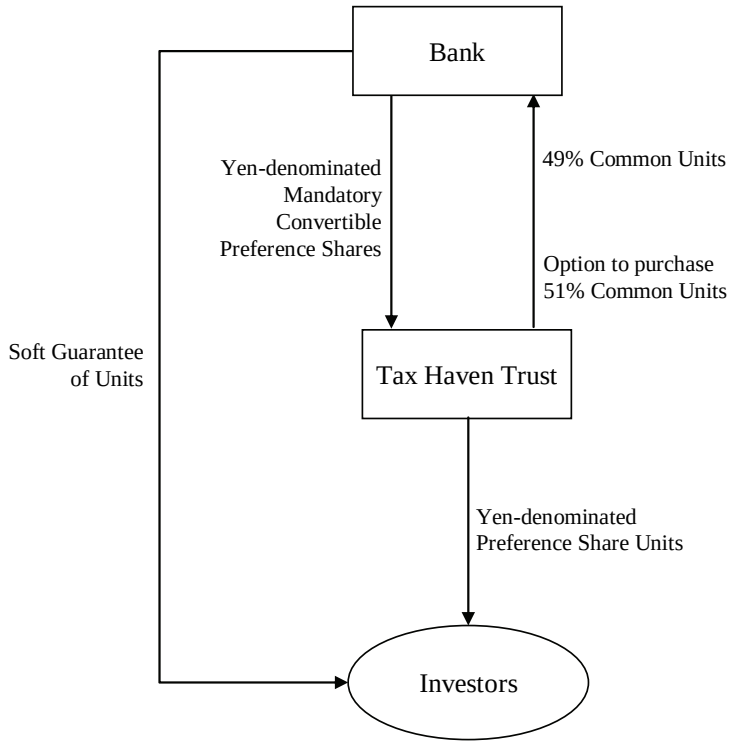
- Tier One Preferred Securities or "TOPS."

Features

- Designed primarily for Asian offerings.
- Preferred securities are issued from a wholly-owned subsidiary of the bank and are non-cumulative, perpetual preferred securities.
- The issuer's activities are limited to (i) issuing the preferred securities, (ii) acquiring subordinated notes issued by the bank with the proceeds from the TOPS and (iii) other activities reasonably incidental thereto.
- Fixed dividend rates convert to floating dividend rates after 10 years.

- Dividend payment obligations are deferred if payment would cause the bank to be insolvent or if the bank is a "distressed financial institution."
- On certain dates, the preferred may be redeemed for cash at the option of the issuer.
- The bank guarantees that if the issuer fails to make payment in full of any payments due in respect of the preferred securities, the bank will make the payment.
- The subordinated notes issued by the bank to the issuer will mature in 100 years, but maturity will automatically extend for another 99 years so long as the preferred securities have not been redeemed.
- Investors under the bank guarantee and the subordinated notes rank junior to all other debt holders and senior to ordinary share holders upon liquidation.

- ***Japanese Bank Exchangeable Subsidiary Preferred (1994 and 1996)***



Selected issues

- Sakura Bank (1994 and 1996)

Transaction benefits

- Primary regulator capital treatment – bank Tier 1 capital.
- Conversion feature results in a lower dividend rate on the bank preference shares than would otherwise be the case.
- The preferred securities delay dilution of the common shares until the conversion date.

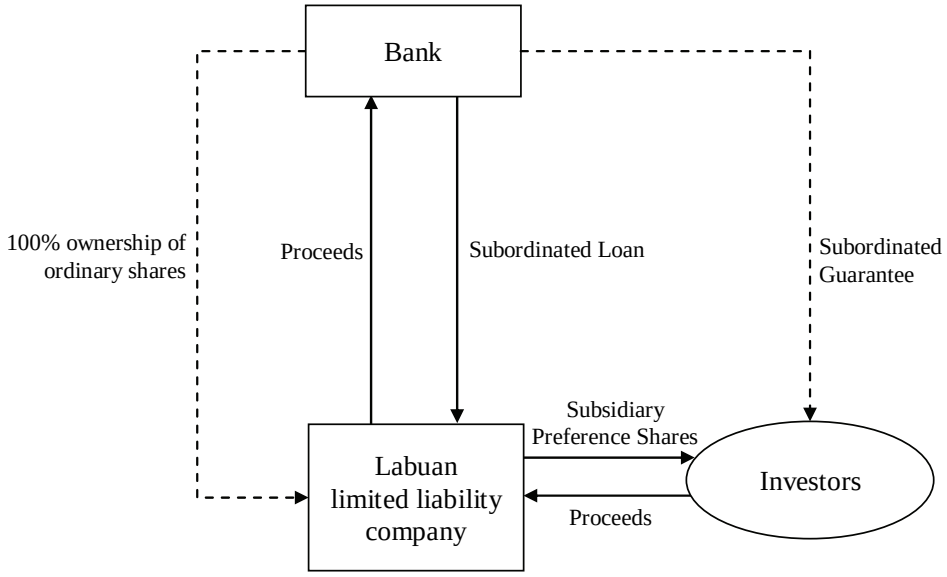
Features

- The issuer is a tax haven-domiciled trust that is a subsidiary of the bank for certain purposes.
- Bank convertible preference shares are the issuer's only assets.

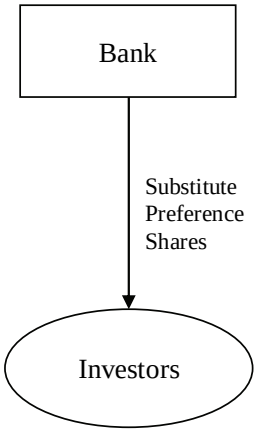
- The bank preference shares are mandatorily convertible into bank common stock on or after a specified period of time and are convertible at the option of the investor into bank common stock prior to such time.
- Dividends on the bank preference shares are subject to Japanese withholding tax.
- The dividend withholding tax rate for US holders was 15 percent, which could be used by a US holder as a foreign tax credit subject to certain limitations.
- The trust preferred are pass-through trust interests.
- Soft guarantee – to the extent of legally available funds held by the issuer.
- Dividends on the convertible bank preference shares are non-cumulative, subject to bank board of directors (interim dividend) or shareholder (annual dividend) approval, and may be declared or paid only to the extent of distributable profits of the bank.
- Liquidation payment on the bank preference shares and, therefore, the trust preferred is determined by reference to the bank's available assets.
- The issuer is 1940 Act exempt pursuant to Rule 3a-5 (finance subsidiary).

- ***Malaysian Bank Exchangeable Guaranteed Subsidiary Preferred (since 2005)***

Before Substitution Event



After Substitution Event



Selected issues

- Southern Bank Berhad (2005)
- AmBank (M) Berhad (2006)

Transaction benefits

- Primary regulator capital treatment – bank Tier 1 capital.

- The interest paid by the bank to the issuer on its subordinated loan is deductible for Malaysian tax purposes.

Features

- The issuer of the subsidiary preference shares is a company incorporated with limited liability in Labuan and is a wholly-owned subsidiary of the bank.

- The issuer loans the proceeds from the sale of its subsidiary preference shares on a subordinated basis to the bank.

- The subsidiary preference shares pay a fixed dividend rate for ten years and then convert to a floating dividend rate (three-month LIBOR) with a step-up thereafter.

- Non-cumulative dividends on the subsidiary preference shares are payable on each dividend payment date if then declared due and payable by the board of directors of the issuer, unless the bank is restricted from making payments on its parity obligations (or under the subordinated guarantee) under Malaysian banking regulations (*e.g.*, if such payments would breach the capital adequacy requirements applicable under Malaysian banking regulations or if the bank's distributable profits and distributable reserves would not be sufficient to enable the bank to make such payments in full).

- If the bank makes a payment on its ordinary shares or parity obligations, then the issuer is required, subject to applicable law, to pay an amount equal to the unpaid amount (if any) of dividends in respect of dividend periods (or part thereof) falling in the 12 months immediately preceding the date of such payment (or, in the case of AmBank, the next two or, after the first call date, four scheduled dividend payments). If the bank and the issuer are restricted by Malaysian banking regulations from making payments in respect of the subsidiary preference shares or the subordinated guarantee, then the bank cannot make payments on, or effect the redemption of, any of its ordinary shares or parity obligations.

- If the issuer pays only a partial dividend or part of the liquidation payment (or the bank only makes a partial payment of such amounts under the subordinated guarantee) as a result of Malaysian banking regulations, but the bank has distributable reserves as of the relevant dividend determination date, then holders are entitled to receive the relevant proportion (*i.e.*, the amount of distributable reserves divided by the sum of the full scheduled dividend to be paid and the full amount of distributions scheduled to be paid on parity obligations during the then-current fiscal year) of a guaranteed payment.

- The bank guarantees, on a subordinated basis and subject to the same limitations on payment as the issuer, all dividends and amounts payable on

redemption and liquidation of the issuer. An investment in the subsidiary preference shares is intended to provide holders with rights to dividends and liquidation preference as similar as possible to those to which they would have been entitled if they had purchased non-cumulative, non-voting perpetual preference shares issued directly by the bank with economic terms equivalent to the subsidiary preference shares and the subordinated guarantee, taken together.

- The subsidiary preference shares are not redeemable at the option of the holders. The subsidiary preference shares may be redeemed at the option of the issuer and with the consent of Bank Negara Malaysia ("BNM") either after a fixed period of time or if certain events occur (such as a change of law that impedes the ability of the bank to obtain deductibility of interest payments on the subordinated loan or that affects the capital treatment of the subsidiary preference shares under Malaysian banking regulations). A cash redemption by the issuer must be funded with the proceeds from an issue of its ordinary shares (or the subsidiary preference shares must be purchased from holders by the bank).

- There is a mandatory substitution of bank preference shares ("substitute preference shares") for the subsidiary preference shares upon the first occurrence of any of the following "substitution events":

  – the bank's Tier 1 capital ratio falls below the then applicable minimum ratio;

  – the board of director's of the bank has notified BNM that the bank's Tier 1 capital ratio is expected to fall below the then applicable minimum ratio in the near term;

  – proceedings have been commenced for a winding-up of the bank;

  – BNM has assumed control of the bank under applicable Malaysian banking regulations; or

  – in the case of Southern, the subsidiary preference shares have not been redeemed in full on or prior to the maturity date of the subordinated loan or, in the case of AmBank, an administrator of the bank has been appointed.

- In addition, in lieu of redeeming the subsidiary preference shares for cash following a tax or regulatory event, at the option of the issuer, substitute preference shares may be substituted for the subsidiary preference shares as if the tax or regulatory event constituted a substitution event.

- Following a breach by the bank of its payment obligations under the subordinated guarantee, a holder of subsidiary preference shares can bring

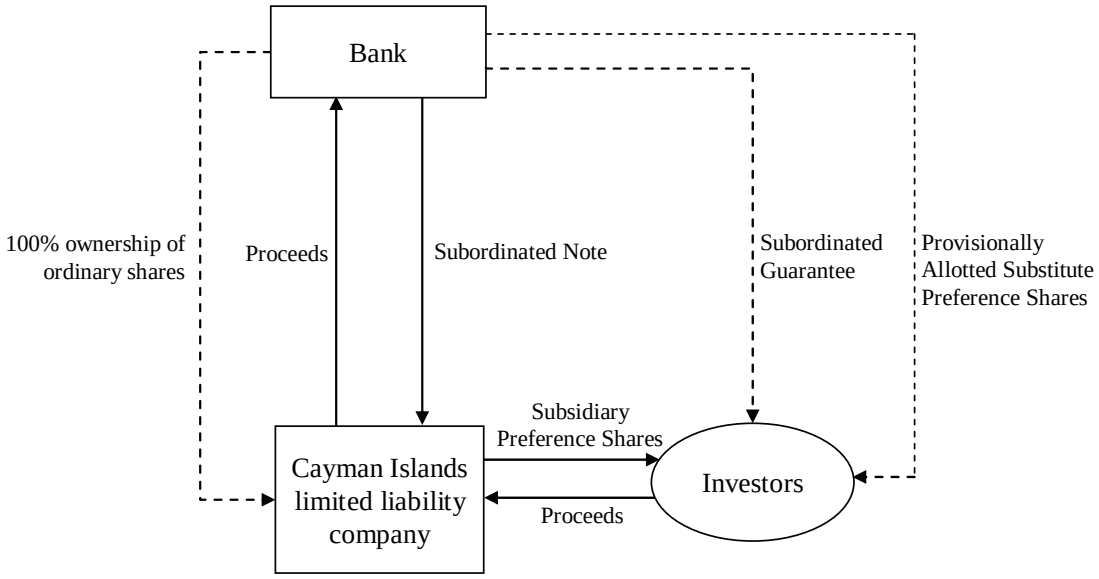
a direct action against the bank to enforce the bank's payment obligations under the subordinated guarantee.

- Upon a winding-up of the bank, the subordinated guarantee and the subordinated loan rank as subordinated indebtedness of the bank (and *pari passu* with the parity obligations).

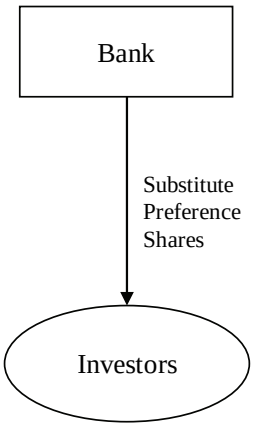
- The issuer is 1940 Act exempt pursuant to Rule 3a-5 (finance subsidiary).

- ***Singapore Bank Exchangeable Guaranteed Subsidiary Preferred (since 2001)***

Before Substitution Event



After Substitution Event



Selected issues

- The Development Bank of Singapore Ltd (2001 and 2004 subordinated notes issuances)
- Oversea-Chinese Banking Corporation (2005)

- United Overseas Bank Limited (2005)

Transaction benefits

- Primary regulator capital treatment – bank Tier 1 capital.
- The interest paid by the bank to the issuer on its subordinated note is deductible for Singapore tax purposes.

Features

- The issuer of the subsidiary preference shares is a company incorporated with limited liability in the Cayman Islands and is a wholly-owned subsidiary of the bank.
- The issuer loans the proceeds from the sale of its subsidiary preference shares on a subordinated basis to the bank.
- The subsidiary preference shares pay a fixed dividend rate for ten years and then convert to a floating dividend rate (three-month LIBOR) with a step-up thereafter.
- Non-cumulative dividends on the subsidiary preference shares are payable on each dividend payment date if then declared due and payable by the board of directors of the issuer, unless the bank is restricted from making payments on its parity obligations (or under the subordinated guarantee) under Singapore banking regulations (*e.g.*, if such payments would breach the capital adequacy requirements applicable under Singapore banking regulations or if the bank's distributable profits and distributable reserves would not be sufficient to enable the bank to make such payments in full).
- The bank, as guarantor under the subordinated guarantee, can give notice to the issuer stating that the issuer shall pay no, or less than full, dividends in respect of a dividend payment date, in which case no, or less than full, dividends shall become due and payable (in the DBS transaction, notice can only be delivered if the bank does not intend to pay its next ordinary dividend).
- If the issuer pays only a partial dividend or part of the liquidation payment (or the bank only makes a partial payment of such amounts under the subordinated guarantee), but the bank has distributable reserves as of the relevant dividend determination date, then holders are entitled to receive the relevant proportion (*i.e.*, the amount of distributable reserves divided by the sum of the full scheduled dividend to be paid and the full amount of distributions scheduled to be paid on parity obligations during the then-current fiscal year) of a guaranteed payment.

- The bank guarantees, on a subordinated basis and subject to the same limitations on payment as the issuer, all dividends and amounts payable on redemption and liquidation of the issuer. An investment in the subsidiary preference shares is intended to provide holders with rights to dividends and liquidation preference as similar as possible to those to which they would have been entitled if they had purchased non-cumulative, non-voting perpetual preference shares issued directly by the bank with economic terms equivalent to the subsidiary preference shares and the subordinated guarantee, taken together.

- The subsidiary preference shares are not redeemable at the option of the holders. The subsidiary preference shares may be redeemed at the option of the issuer and with the consent of the Monetary Authority of Singapore ("MAS") either after a fixed period of time or if certain events occur (such as a change of law that impedes the ability of the bank to obtain deductibility of interest payments on the subordinated note or that affects the capital treatment of the subsidiary preference shares under Singapore banking regulations). The subsidiary preference shares may be repurchased from holders by the issuer at the direction of the bank.

- There is a mandatory substitution of bank preference shares ("substitute preference shares") for the subsidiary preference shares upon the first occurrence of any of the following "substitution events":

  – the bank's Tier 1 capital ratio falls below the then applicable minimum ratio;

  – the board of director's of the bank has notified the MAS that the bank's Tier 1 capital ratio is expected to fall below the then applicable minimum ratio in the near term;

  – proceedings have been commenced for a winding-up of the bank;

  – the MAS has assumed control of the bank under applicable Singapore banking regulations;

  – the MAS has exercised its powers to effect an exchange of the subsidiary preference shares for substitute preference shares; or

  – the bank no longer controls the issuer.

- In addition, in lieu of redeeming the subsidiary preference shares for cash following a tax or regulatory event, at the option of the issuer, substitute preference shares may be substituted for the subsidiary preference shares as if the tax or regulatory event constituted a substitution event.

- Each of the bank's substitute preference shares is "provisionally allotted" on the issue date and forms a unit with each subsidiary preference share

such that the securities cannot be transferred or assigned separately prior to the occurrence of the substitution event.

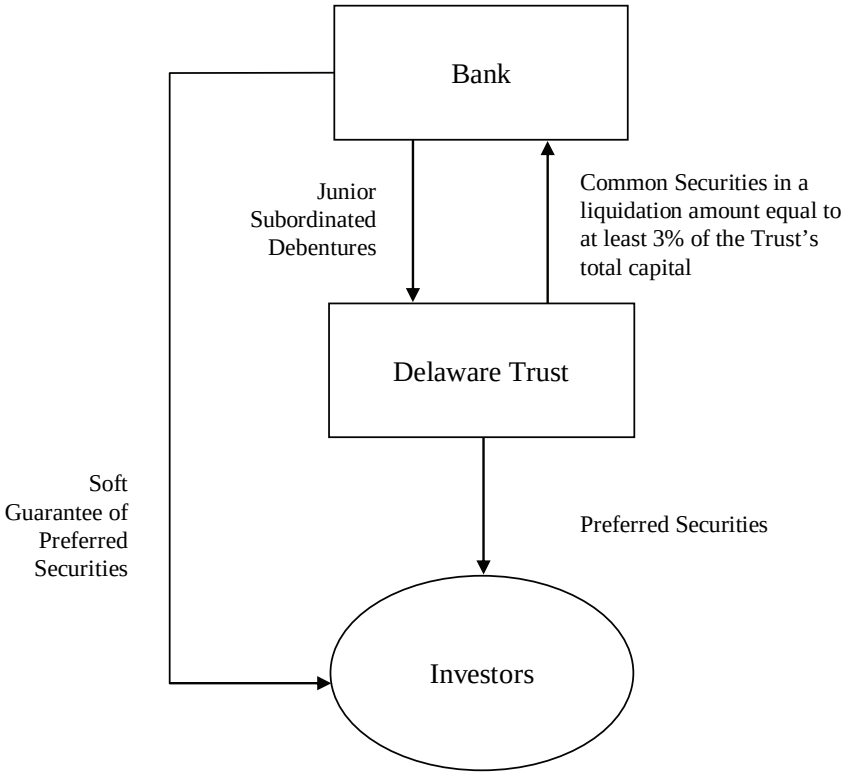
- Upon the occurrence of the substitution event, the provisionally allotted substitute preference shares are deemed to have been automatically issued.

- Following a breach by the bank of its payment obligations under the subordinated guarantee, a holder of subsidiary preference shares can bring a direct action against the bank to enforce the bank's payment obligations under the subordinated guarantee.

- Upon a winding-up of the bank, the subordinated guarantee and the subordinated loan rank as subordinated indebtedness of the bank (and *pari passu* with the parity obligations).

- The issuer is 1940 Act exempt pursuant to Rule 3a-5 (finance subsidiary).

- ***US Bank Holding Company Guaranteed Subsidiary Preferred (normal issues since 1996; enhanced issues since 2005)***



Since March 2009 and to date in 2010, six US BHCs registered trust preferred and other capital security transactions with the SEC. In 2008 over four, in 2007 over 46, in 2006 over 18, in 2005 over 29, in 2004 over 25, in 2003 over 20, in 2002 over 40 and in 2001 over 20 US BHCs registered trust preferred and other capital security transactions with the SEC. These transactions included normal issues and issues that were enhanced to obtain additional equity credit from the rating agencies.[50]

Prior to 2009, the most significant Tier 1 product developments resulted from enhancements to existing trust preferred products following Moody's revised rating categories for hybrids that were announced in February 2005 and were initiated in the US banking sector by US Bancorp with respect to enhanced trust preferred securities in December 2005. The US Bancorp transaction structure largely resembled that of a standard trust preferred deal but contained certain additional equity-like features (*e.g.*, 60-year maturity, mandatory deferral of distributions if US Bancorp is not in compliance with various financial covenants,

[50] In addition, see Chapter 13 (*Bank and Insurance Company Instrument CDOs*) for a description of securitization transactions involving CDOs backed primarily by pools of bank trust preferred securities and other bank and insurance company capital instruments.

deferred interest must be paid with the proceeds from the sale of common stock and/or perpetual non-cumulative preferred stock, deeper subordination than a standard trust preferred deal, etc.) that allowed US Bancorp to obtain tax deductibility, bank holding company minority interest Tier 1 treatment and 75 percent equity credit from Moody's.

Transaction benefits

- Primary regulator capital treatment – bank holding company minority interest Tier 1.
- The interest on the bank holding company debentures held by the trust is deductible by the bank holding company for US tax purposes.

The Federal Reserve Board has treated this structure as Tier 1 capital for bank holding companies since 1996. As a result of FIN 46(R), trust preferred securities may no longer be regarded under US GAAP and is no longer regarded by the SEC as a minority interests. The Federal Reserve Board announced on March 2, 2005 that trust preferred securities will continue to be considered as Tier 1 capital as long as certain requirements are met. As discussed below under "FASB Interpretation No. 46," in June 2009, the FASB amended FIN 46(R) by issuing Statement of Financial Accounting Standards No. 167, which, among other things, changed the test regarding consolidation of variable interest entities in a manner that does not appear to change the position under FIN 46(R) that trust preferred securities may no longer be regarded as minority interests.

This structure had been used by US non-banking institutions, particularly insurance and finance companies, utility companies, oil & gas and other industrial companies, prior to the Federal Reserve Bank's approval of the structure as Tier 1 capital.

The cumulative and limited life features of this preferred structure are not favored by the Basel Committee under Basel I or the 1998 Basel Release.

Features of normal and enhanced issues

- The issuer is a US-domiciled trust that is a subsidiary of the bank for accounting purposes and qualifies as a pass-through grantor trust for US tax purposes.
- Bank holding company debentures are the issuer's only assets.
- The preferred securities are pass-through trust interests.
- Soft bank holding company guarantee – to the extent of amounts paid on the bank holding company debentures.
- The interest on the debentures is deferrable for up to five years.

- The debentures are junior subordinated indebtedness, but generally not an instrument that would qualify as upper Tier 2 capital.

- The debentures have a maturity of 20 to 45 years.

- Preferred distributions are cumulative, non-discretionary and tied to the income of the issuer, not the bank holding company.

- The preferred liquidation payment is determined by reference to the issuer's available assets.

- Preferred holders have the right to proceed directly against the bank under the debentures for their *pro rata* claim if the bank defaults on its payment obligations under the debentures.

- The issuer is 1940 Act exempt pursuant to Rule 3a-5 (finance subsidiary).

Additional features of enhanced issues (starting in 2005)

- Interest on the debentures can be deferred for as long as a total of 10 or 12 years, but must be paid after five years (or, in some the cases, seven years) if the deferral period has not yet ended with the proceeds from the sale of its common stock and/or perpetual non-cumulative preferred stock of the bank or non-bank issuer. If a "market disruption event" occurs, such that the bank or non-bank issuer is unable to sell a sufficient amount of its securities to fund the repayment of the deferred interest, then interest can be deferred for an additional five years without triggering an event of default.

- Interest on the debentures, in the case of a non-bank issuer, is mandatorily deferred if the issuer is not in compliance with certain financial covenants (*e.g.*, if the issuer's retained cash flow to total debt ratio falls below 15 percent for the most recent fiscal quarter).

- Deferred interest that has accrued on the debentures must be paid by the bank holding company with the proceeds from the sale of its common stock and/or perpetual non-cumulative preferred stock.

- The debentures have a maturity of between 30 and 60 years (for certain structures, after a fixed period, Moody's equity credit shifts to 25 percent).

- Replacement capital covenant – the bank holding company or non-bank issuer contractually commits to one or more classes of its existing note holders not to redeem the preferred securities or the debentures (and, in certain structures, not to allow the maturity of the debentures) unless, within 180 days prior to the date of redemption, it has first issued and sold securities that (i) have equity-like characteristics that are the same as, or more equity-like than, the debentures at that time and (ii) in the case of a

bank holding company, qualify as Tier 1 capital of the bank holding company under the capital guidelines of the Federal Reserve.

- Certain enhanced issuances are deeply subordinated, *e.g.*, the Tier 1 securities US Bancorp issued in 2005 rank junior to all debt and existing trust preferred.

- Some issues involve the use of an intermediate LLC that holds the debentures and issues its preferred securities (which have the benefit of a soft guarantee from the ultimate credit) to the trust.

- Issuer can obtain 50 to 75 percent equity credit from Moody's.

- The Capital One transaction in 2005 was the first of a "new generation" hybrid for banks and was innovative on two accounts: First, by having a 30-year scheduled maturity rather than a 60 year non-call five or 60 year non-call 10 like other "C" basket bank hybrids had up until that time, the Tier 1 securities take all the extension risk after 30 years out of the structure. The structure also solved the mystery of how to get "D" basket treatment on a bank holding company hybrid without imposing a mandatory deferral trigger that is onerous to both issuers and regulators like the Federal Reserve. Until this deal, optional deferral language made the structures seem cumulative in Moody's eyes and therefore not equity-like enough to make it into the "D" basket. The deal tweaked that language to make it non-cash cumulative and therefore "D" basket eligible, by ensuring the company issues equity to pay for deferred dividend payments rather than cash.

FASB Interpretation No. 46

In January 2003, the Financial Accounting Standards Board ("FASB") issued interpretation No. 46 ("FIN 46") that interprets Accounting Research Bulletin No. 51. FIN 46 addresses the consolidation of "variable interest entities"(VIEs") by business enterprises and requires companies that control another entity to consolidate the controlled entity for financial purposes. FIN 46 also implies, however, that a bank holding company's trust preferred issuing trust subsidiary should be de-consolidated from its parent for accounting purposes. This de-consolidation means that the bank holding company and its trust subsidiary have a relationship based exclusively on a debt interest. As a result of this new relationship, the junior subordinated debentures issued to the trust in a trust preferred transaction (which were previously eliminated in consolidation) are treated as a liability on the bank holding company's consolidated balance sheet, in contrast to the equity treatment given to the trust preferred securities prior to de-consolidation, and the "related expense is recorded as an interest expense on the income statement rather than as a minority interest in the income of its trust subsidiary."

In December 2003, the FASB revised FIN 46 (as revised "FIN 46(R)), stating that trust preferred securities issued by trust subsidiaries of bank holding companies must be de-consolidated as of December 31, 2003.

In June 2009, the FASB further revised FIN 46 by issuing Statement of Financial Accounting Standards No. 167 ("SFAS 167") which, among other things, changed the test for determining whether a VIE should be consolidated with another entity from a quantitative test to a more qualitative test that focuses on identifying which enterprise has the power to direct the activities of a VIE that most significantly impacts the VIE's economic performance and (1) the obligation to absorb losses of the entity or (2) the right to receive benefits from the VIE. This change, however, does not appear to have changed the position under FIN 46(R) that a bank holding company's trust preferred issuing trust subsidiary should be de-consolidated from its parent for accounting purposes.

The Federal Reserve Board's Trust Preferred Regulations

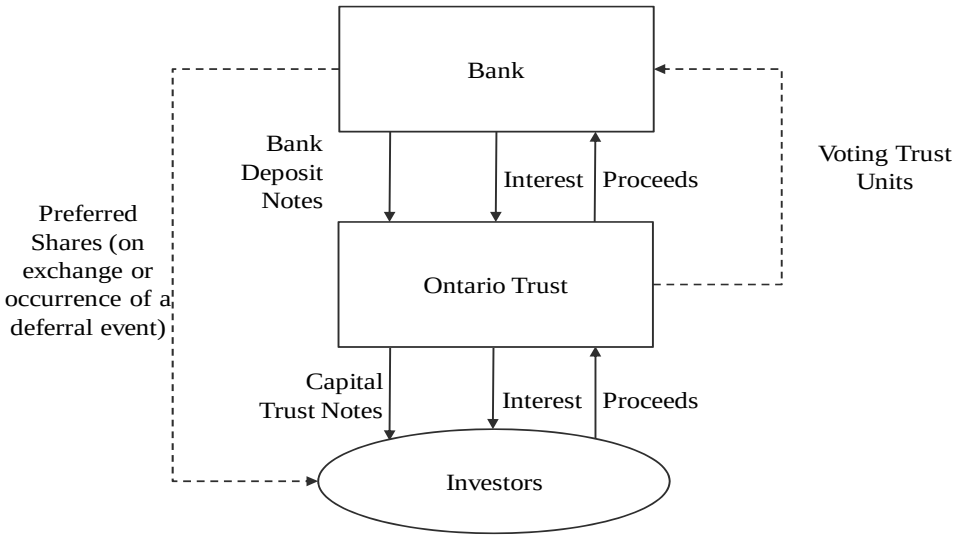
By no longer permitting trust preferred securities to be counted as minority interests, FIN 46 had the effect of undercutting a fundamental premise for the Federal Reserve Board's treatment of trust preferred securities as innovative Tier 1 capital of bank holding companies. In May 2004, the Federal Reserve Board reacted to the adoption of FIN 46 by proposing new regulations on the treatment of trust preferred securities as regulatory capital and the definition of capital for bank holding companies.

On March 1, 2005, the Federal Reserve Board approved final regulations that allow trust preferred securities of US bank holding companies to be treated as Tier 1 capital, notwithstanding that they are no longer treated as minority interests under US GAAP as a result of FIN 46. The regulations require no significant changes to existing bank holding company trust preferred securities structures in order to achieve Tier 1 treatment. Trust preferred securities and other "restricted core capital elements" may not exceed 25 percent (15 percent in the case of internationally active banking organizations) of a bank holding company's core capital elements, net of goodwill less any associated deferred tax liability. Restricted core capital elements include cumulative preferred stock, minority interests in non-banking subsidiaries and qualifying trust preferred securities. In addition to restricted core capital elements, core capital elements include common stock and perpetual non-cumulative preferred stock (including related surplus) and minority interests in banking subsidiaries. Interestingly, mandatory convertible preferred securities are specifically exempted from the 15 percent limitation for internationally active banking organizations, but are included in a separate 25 percent limitation for those institutions.[51]

In light of the continued stress of the financial markets, the FRB in March 2009 announced the adoption of a rule that delays until March 31, 2011, the effective date of new limits on the inclusion of trust preferred securities and other restricted core capital elements in the Tier 1 capital of BHCs. The new limits were scheduled to take effect on March 31, 2009, pursuant to the final rule adopted by the Federal Reserve Board on March 10, 2005. As a result of delaying implementation of the new limits and until the new effective date in 2011, all BHCs may include cumulative perpetual preferred stock and trust preferred securities in their Tier 1 capital up to 25 percent of total core capital elements.

[51] See Chapter 10 (*Bank Mandatory Convertible or Exchangeable Tier 1 Instruments*) for a discussion of the WITS transaction, which was structured to obtain Tier 1 treatment and fall outside the 15 percent limitation on restricted core capital elements applicable to internationally active banks.

- ***Canadian Bank Subsidiary Instruments (since 2009)***



Selected 2009 issues

- *Toronto-Dominion Bank (January 2009)*
- *Canadian Imperial Bank of Commerce (March 2009)*
- *Scotiabank (April 2009)*

Transaction benefits

- Primary regulator capital treatment – bank Tier 1 capital.

Features

- Toronto-Dominion Bank (or "TDB") transaction involved a trust established under the laws of Ontario, paying interest on capital trust notes in equal semi-annual installments.
- The interest rate on the capital trust notes is pegged to the Government of Canada Yield plus a margin.
- The proceeds of the issue were used to purchase bank deposit notes issued by TDB on the closing date.

- The capital trust notes will be exchanged automatically for newly issued preferred shares of TDB if: (i) there is an application for winding up in respect of TDB; (ii) the Office of the Superintended in Bankruptcy Canada takes control of TDB or its assets; (iii) TDB has a Tier 1 Capital ratio of less than 5 percent or a risk-based total capital ratio of 8 percent; or (v) the Office of the Superintended in Bankruptcy Canada directs TDB to increase its capital or provide additional liquidity, and TDB does not comply with this.

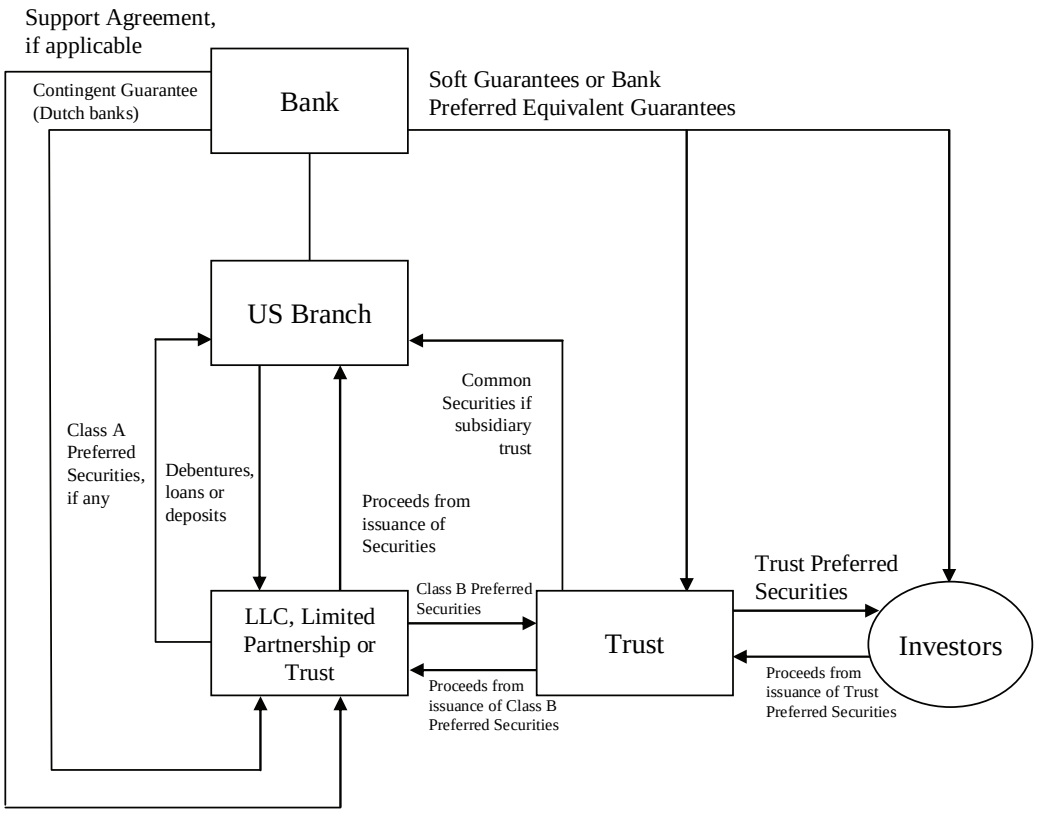
- On each interest payment date the holders of the capital trust notes may be required to invest interest paid on the capital trust notes in preferred shares of TDB. This will happen if: (i) TDB fails to declare cash dividends on all outstanding preferred shares (or common stock if no preferred shares are outstanding) in accordance with its ordinary dividend practice; (ii) interest is not paid on the capital trust notes; or (iii) TDB elects for holders of the capital trust notes to invest interest in its preferred shares. Collectively, events (i)-(iii) are called deferral events.

- No guarantee or support agreement.

- The capital trust notes and the bank deposit notes have a long maturity of over 100 years.

COMPLEX SUBSIDIARY STRUCTURES (SINCE 1997)

- ***Basic Structure***



- The first transactions were 1997 Australian and 1998 Japanese Tier 1 capital non-operating US LLC subsidiary structures, neither of which used a trust.

  In many respects, this structure is similar to that used for the Spanish and Portuguese non-operating tax haven corporate subsidiary non-cumulative preferred. For example, like the Spanish and Portuguese preferred, in many cases the US trust/intermediate subsidiary preferred has the benefit of a guarantee that is the functional equivalent of bank preferred.

  Since the 1998 Basel Release, this format has been used by many banks because the intermediate vehicle and the bank guarantee in the structure provide sufficient flexibility for banks from a number of countries to satisfy the Tier 1 capital requirements of their primary regulator and to achieve the tax benefits they seek.

- The most popular intermediate subsidiary is a US-domiciled LLC. For tax and accounting reasons discussed below, UK banks use a partnership rather than an LLC and, if the US is not a significant market, a Jersey partnership instead of a trust.

Australian banks have also used this structure, but used a trust instead of an LLC for tax reasons; the trust, as the intermediate subsidiary, was treated as a US tax partnership.

Transaction benefits

- Primary regulator capital treatment – bank-consolidated and sometimes solo minority interest Tier 1 capital.
- The interest or other payments on the instrument held by the intermediate subsidiary are deductible by the branch issuing the instrument for applicable income tax purposes.
- The instrument provides a US dollar denominated capital hedge against the bank's US dollar denominated assets.
- Avoidance or minimization of withholding tax.

Features

- A US-domiciled trust:
  - If the trust is a subsidiary of the bank for accounting purposes, generally the common securities of the trust are held directly or indirectly by the bank and the trust qualifies as a pass-through grantor trust for US tax purposes.
  - If the trust is a hat check trust (*i.e.*, not a subsidiary of the bank for accounting purposes), all the trust's securities are held by investors and the trust qualifies either as a pass-through grantor trust or a depositary arrangement for US tax purposes.
  - While the hat check trust can be used in any of the transactions, the hat check trust is more likely to be used if:
    - a US subsidiary trust would present a problem under the bank's domestic tax or other laws, as is the case with UK and Irish banks as described below; or
    - it is difficult for the bank to avoid characterization of the trust as a foreign trust for US federal income tax purposes.
- The only assets of the trust are the preferred securities of the intermediate subsidiary and the guarantee of the partnership securities by the bank.
- The trust is a non-discretionary conduit which distributes everything it receives to investors.

- If the trust is a subsidiary of the bank, in many cases, upon the occurrence of certain tax, 1940 Act or bank regulatory events that create a problem at the trust level, the bank may liquidate the trust and distribute the partnership preferred securities to investors.

- If the trust is a hat check trust, investors may withdraw the preferred securities of the intermediate subsidiary underlying their trust preferred securities at any time.

■ Whether the intermediate subsidiary is an LLC, a partnership, a trust or another vehicle that can elect to be a partnership for US tax purposes, treatment of the intermediate subsidiary as a partnership for US federal income tax purposes is generally sought in order to provide the flexibility required to achieve Tier 1 capital treatment and the applicable tax benefits.

■ The intermediate subsidiary is US-domiciled if it is an LLC or a trust, and may be either US- or tax haven-domiciled if it is a partnership.

■ The intermediate subsidiary and the bank guarantee, if any, of the preferred securities of the intermediate subsidiary provide:

- synthetic bank preferred (*i.e.*, together they generally put investors in the place they would be if they owned bank preferred); and

- the flexibility necessary for the bank's group to issue non-cumulative preferred securities with the loss absorption characteristics required by the bank's primary regulator while obtaining an interest deduction on the instruments of the bank that are held by the intermediate subsidiary.

■ The applicable tax laws where the bank seeks a tax deduction, the ability of the bank itself to issue preferred or similar securities, foreign exchange issues and other considerations will affect the mechanics of the intermediate subsidiary and the related subsidiary to accomplish the non-cumulative and loss absorption features required by the bank's primary regulator. For example:

- Whether and the extent to which the intermediate subsidiary is required to have assets other than the bank's instruments will depend primarily upon the substance that the intermediate subsidiary is required to have under the tax analysis of the jurisdiction where the bank seeks a tax deduction.

- The non-cumulative requirement for the preferred securities may be accomplished by, among other things:

- causing the interest on the debt to be non-cumulative, deferrable (perpetually or with all deferred interest payable to the common

security holder of the intermediate subsidiary) or payable in a bank equity security upon the occurrence and during the continuance of events specified by the bank's primary regulator;

– giving the appropriate directors or officers of the intermediate subsidiary the discretion to declare dividends on its preferred securities, with a requirement that any income not distributed to preferred security holders be distributed to common security holders; or

– requiring dividends to be paid on the preferred of the intermediate subsidiary generally, but prohibiting such dividends upon the occurrence and during the continuance of events specified by the bank's primary regulator, with a requirement that any income not distributed to preferred security holders be distributed to common security holders.

■ The loss absorption requirement for the preferred securities may be achieved, upon the occurrence of events required by the bank's primary regulator, by:

– writing down the bank instrument held by the intermediate subsidiary;

– giving the bank, as direct or indirect holder of the common or another class of securities of the intermediate subsidiary, the right to receive the bank instrument held by the intermediate subsidiary or any proceeds from the disposition thereof either upon the occurrence of such an event or upon the winding-up of the intermediate subsidiary (this approach requires a provision that the intermediate subsidiary may only wind-up if the bank winds-up); or

– exchanging the intermediate subsidiary's preferred for preferred of the bank with similar characteristics.

■ The bank guarantees of the trust and intermediate company preferred securities, if any, can be soft or hard.

– The hard guarantee transactions generally focus investors on the guarantee, with all required dividends, redemption and liquidation payments payable to investors guaranteed or sourced through the guarantee.

– The soft guarantees are essentially performance guarantees. The guarantee depends on the availability of funds at the subsidiary level, and focus investors on the underlying assets of the trust or the intermediate subsidiary, as the case may be.

- It is possible to have a soft guarantee for the trust preferred and a hard guarantee for the intermediate subsidiary's preferred as the intermediate subsidiary is the focus of the Tier 1 capital structuring.

- Rule 3a-5 under the 1940 Act only requires bank guarantees for public offerings by US finance subsidiaries. Thus, non SEC-registered and hat check trust preferred securities, which are simply not investment companies and do not require the exemption afforded by Rule 3a-5, need not be guaranteed by the bank. Private transactions may also have the benefit of Rule 3a-7 under the 1940 Act (issuers of asset-backed securities).

- Since many of the trust preferred transactions have been private, a guarantee is not required for purposes of Rule 3a-5. Nevertheless, a guarantee is often used because it is a convenient method of providing investors with the bank preferred equivalent features that they expect with the additional comfort of the bank's enforceable obligation to guarantee payments or performance on or in respect of a bank preferred equivalent security.

■ The characteristics of the bank instruments in which the intermediate subsidiary invests depends to a large extent upon the tax regime in the jurisdiction where the bank seeks a tax deduction and the laws that apply to the bank instruments. Accordingly, the instruments might be:

- debentures, loans, deposits, repurchase agreements, silent partnerships, etc.;

- perpetual, limited life, withering, convertible from one currency into another, etc.;

- cumulative or non-cumulative; and

- in ranking upon a winding-up of the bank or other borrower, equal or junior to senior debt, junior debt, senior preferred or junior preferred.

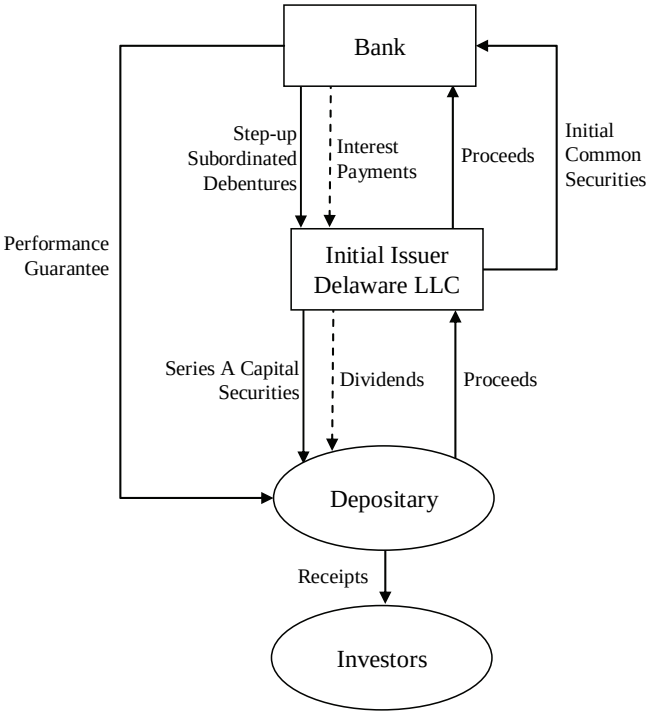
■ If the bank wants capital in a currency that is different from the currency that it can raise through the issuance of the trust preferred, the intermediate subsidiary may enter into a swap so the bank debt would be denominated in the appropriate currency.

■ If the intermediate subsidiary invests in assets other than securities or other investments in the bank or the bank's subsidiaries, those assets must satisfy the requirements of Rule 3a-5 under the 1940 Act to the extent applicable.

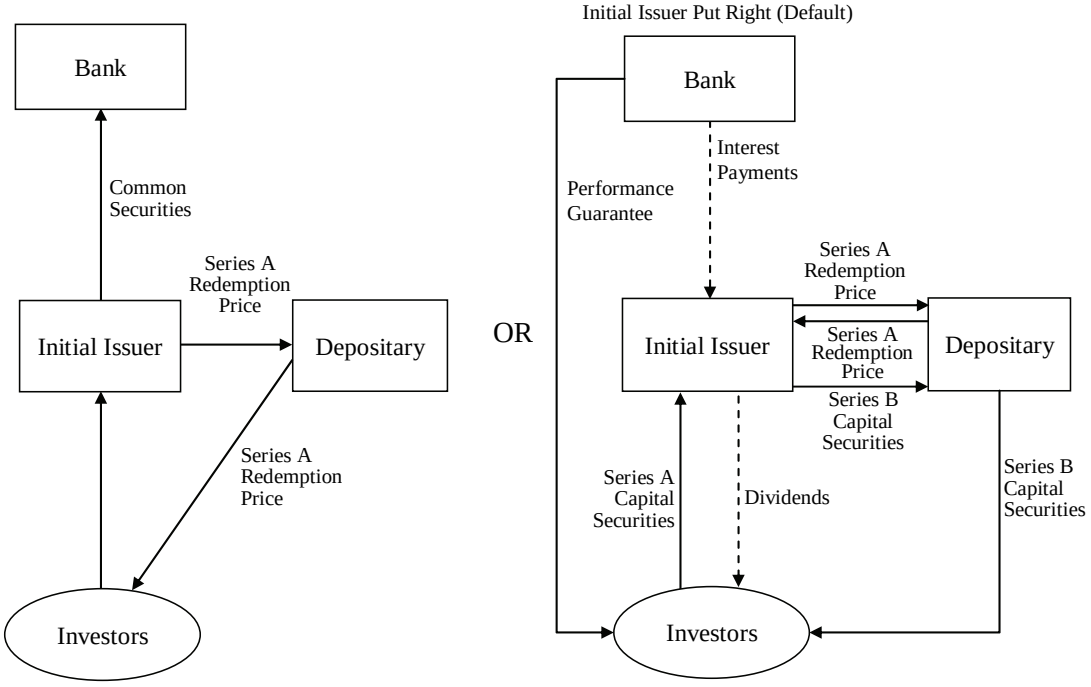
- The trust and the intermediate subsidiary are 1940 Act exempt pursuant to Rule 3a-5 (finance subsidiary). They may also be exempt pursuant to Rule 3a-7 under the 1940 Act (issuers of asset back securities) or Section 3(c)(7) of the 1940 Act (sales only to qualified purchasers).

- ***Australian Bank Exchangeable Guaranteed Subsidiary Preferred (since 1997)***

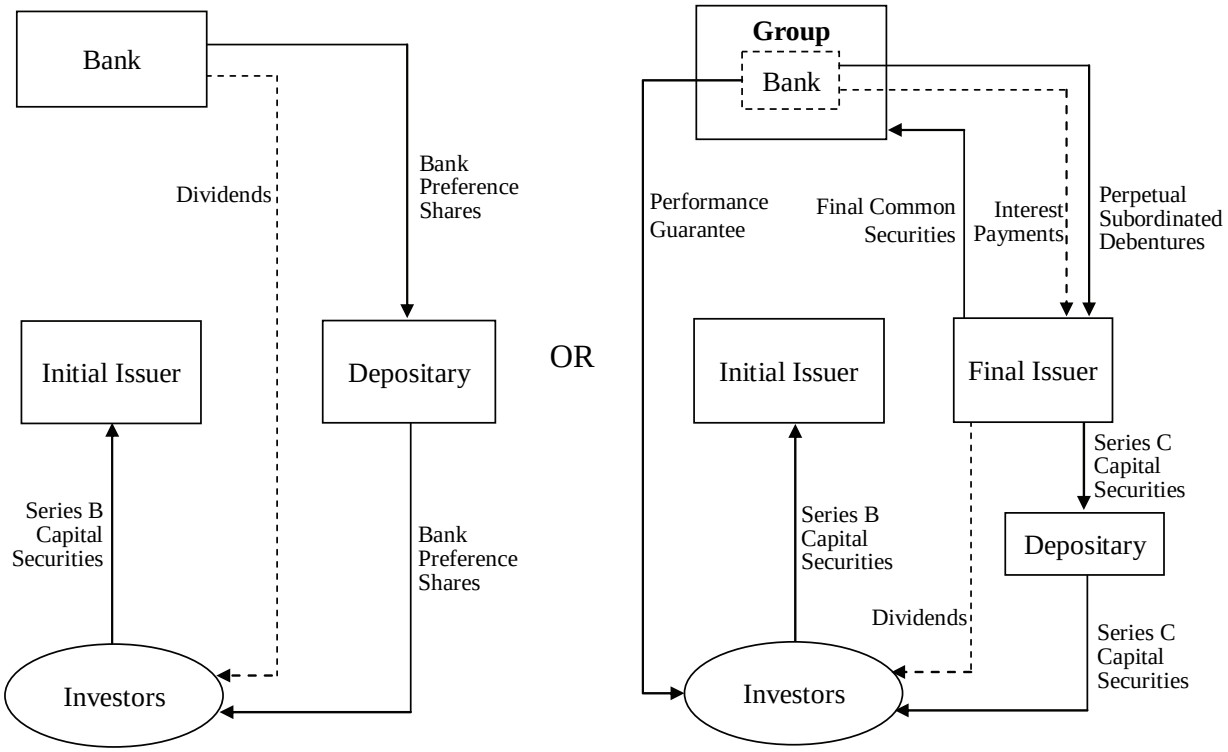
Issue Date



Year 20



Year 25



Selected issue

- St. George Bank (1997)

Transaction benefits

- Primary regulator capital treatment – bank minority interest Tier 1.
- The interest on the bank debentures held by the LLC is deductible by the bank for Australian tax purposes.

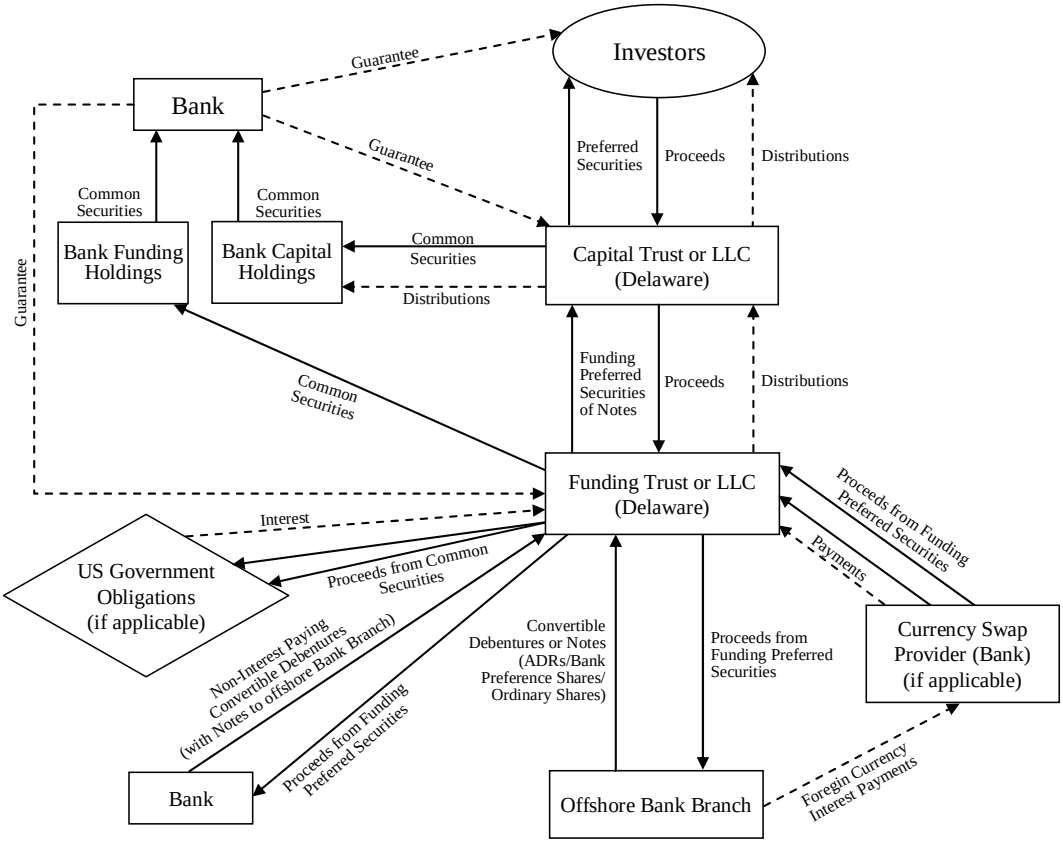
Features

- There are two issuers, each of which is a US-domiciled limited liability company that is a subsidiary of the bank and qualifies as a partnership for US tax purposes.
- The preferred securities of the initial issuer are replaceable upon mandatory redemption after 20 years with a second series of preferred securities of the initial issuer unless the bank, with the applicable regulator's approval, elects to distribute the cash proceeds to investors and terminate the structure. After 25 years, the second series of preferred

securities will be exchangeable, at the bank's option, into bank preference shares or preferred securities issued by the second issuer.

- The preferred securities are issued in the form of depositary receipts to minimize investor disruption that might be caused as the preferred securities are replaced through the life of the structure.
- The preferred dividend rate is a fixed rate that steps up in years 20 and 25.
- Preferred dividends must be paid if the issuer has legally available funds, but only:
  - to the extent of the bank's consolidated net income for the immediately preceding fiscal year, less any dividends on bank shares or group *pari passu* shares during the current fiscal year; and
  - if the payment is prohibited or limited by applicable law or regulation, by the provisions of any group *pari passu* security or other instruments or agreements to which the issuer or the bank is a party.
- The preferred liquidation payment is determined by reference to the bank's available assets provided that, if the bank is being wound up at the same time, it is instead based on the assets of the bank.
- Bank subordinated debentures are the issuer's only assets.
- The interest rates and dates and the redemption dates and prices of the debentures are the same as the dividend rates and dates and the redemption dates and prices of the debentures.
- Soft bank guarantee of payments on the preferred securities, to the extent the applicable issuer has legally available funds and has failed to make such payments.
- Under the guarantees, the bank agrees that if any dividend is not paid, no dividend or other payment may be made on any share capital of the bank or its subsidiaries until such time as the issuer or the bank shall have paid full dividends for at least two semi annual dividend periods.
- The debentures are upper Tier 2 subordinated debt.
- The debentures held by the initial issuer have a maturity of 25 years. The debentures held by the second issuer have no maturity.
- Each issuer is 1940 Act exempt pursuant to Rule 3a-5 (finance subsidiary exemption).

- ***Australian Bank Exchangeable Guaranteed Subsidiary Preferred (since 1999)***



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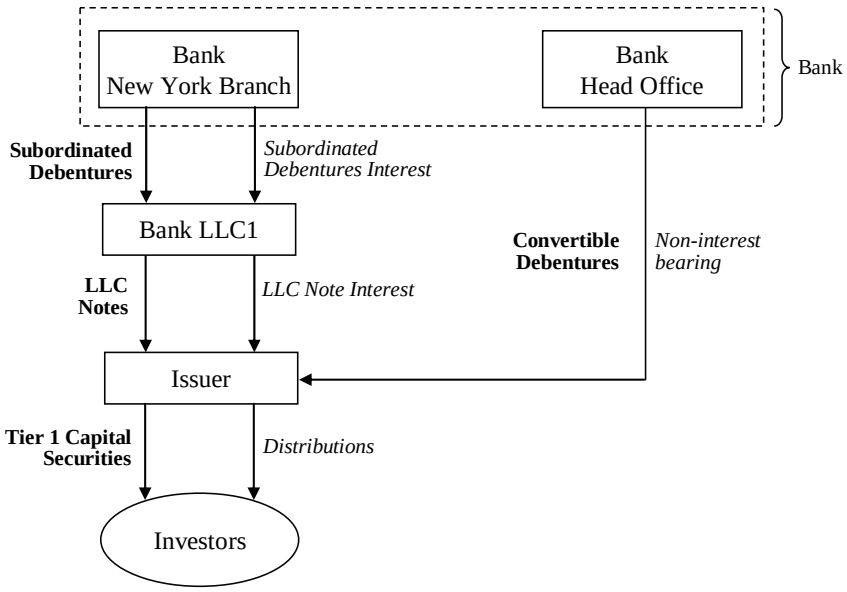


Selected issues

- Westpac (1999)
- Commonwealth Bank of Australia (2003)
- Westpac (2003)
- National Australia Bank (2003)
- Westpac (2004)
- National Australia Bank (2005)
- National Australia Bank (2006)

Transaction benefits

- Primary regulator capital treatment – minority interest Tier 1 capital.
- The interest on the convertible debentures held by the funding trust is deductible by the bank's branch or subsidiary for income tax purposes or, in the case of notes issued by an offshore branch, will obtain branch tax credits for the interest payments.
- Enables the bank branch or subsidiary to issue preferred securities in US dollars or pounds sterling and hedge the US dollar or pounds sterling foreign exchange risk at head office.
- Saves tax credits for the bank's Australian shareholders.
- Avoids withholding tax on dividends paid to foreign investors.

Features

- The issuer is a US-domiciled trust or LLC that is a US subsidiary of the bank and qualifies as a grantor trust or partnership for US tax purposes.
- The intermediate subsidiary is a US-domiciled trust or LLC that is a trust or partnership for Australian tax purposes and a subsidiary of the bank. It qualifies as a partnership or trust for US tax purposes.
- The common securities of the issuer, if any, are held by a US corporate subsidiary of the bank.
- The common securities of the intermediate trust subsidiary are held by an Australian or US corporate subsidiary of the bank.

- The issuer, whose only role is *pro rata* distributions from its assets, holds the preferred securities or notes issued by the intermediate trust or LLC subsidiary and any bank guarantee thereof.

- The intermediate trust or LLC subsidiary's primary assets are convertible debentures issued by the bank's branch or the bank itself and, in the case of National's 2005 and 2006 issues, subordinated notes of the bank's subsidiary and New York branch, respectively, in both instances the principal amount of which is equal to the liquidation preference of the intermediate subsidiary's trust preferred or the principal amount of its notes, as the case may be. In some transactions, such as Westpac, the intermediate trust subsidiary also holds a nominal amount of other assets.

- The convertible debentures, if any, are mandatorily convertible 50 years after the issue date into bank preference shares or depositary receipts representing bank preference shares with similar terms.

- If the bank wants capital in a currency that is different from the currency that it raises through the issuance of the trust or LLC preferred, the intermediate subsidiary may enter into a swap so the bank debt is denominated in the appropriate currency.

- If the intermediate trust or LLC subsidiary issues preferred securities, distributions are non-cumulative and are mandatorily payable unless interest on the convertible debentures or the subordinated notes is deferred. Interest may be deferred if:

  – the value of the US dollars (i) if there is a currency swap, to be exchanged pursuant to the currency swap or (ii) to be paid on the convertible debentures, or, in the case of National's 2005 and 2006 issues, the subordinated notes, together with the aggregate amount of distributions paid or payable on or before that interest payment date during the current fiscal year of the bank on (i) the intermediate trust subsidiary preferred or LLC subordinated notes other than distributions or interest payable on the date corresponding to that interest payment date, (ii) any capital securities of the bank or any of its subsidiaries to the extent of distributions on such securities funded by instruments of the bank ranking equal with the convertible debentures and (iii) any other share capital of the bank would exceed the consolidated earnings of the bank and its subsidiaries for the immediately preceding fiscal year of the bank; or

  – the payment of the interest payable on the convertible debentures or the subordinated notes or the exchange of US dollars pursuant to the currency swap, if any, on any interest payment date, or the corresponding distributions, would be prohibited or limited by

applicable law, regulation or administrative decree or by the provisions of any bank instruments ranking equally with the convertible debentures or any other instruments or agreements to which the bank is subject.

- If the intermediate trust or LLC subsidiary issues notes, interest on the notes is deferrable but cumulative.

- Interest not paid to the trust or LLC or other intermediate trust or LLC subsidiary security holders as a result of the above are paid as a distribution to the common holder (or is otherwise recycled to the bank).

- The intermediate trust subsidiary preferred's liquidation payment is determined by reference to the issuer's assets.

- The intermediate trust subsidiary preferred or notes mandatorily convert into bank preference shares or depositary receipts representing bank preference shares upon the conversion of the convertible debentures. In addition, the bank preference shares become dividend paying and are distributed to the holders of the trust subsidiary preferred in redemption thereof upon the occurrence of an assignment event, which will, in either case, occur in the following circumstances:

  - on the 50th anniversary of the issue date;

  - any date that the bank selects in its absolute discretion;

  - distributions, interest and/or dividends are not paid when due and payable (which may be after an applicable grace period);

  - the bank branch defers any interest payment on the convertible debentures or the subordinated notes;

  - due to a change in law or regulation, the currency swap becomes illegal, if applicable;

  - the bank fails to exchange US dollars pursuant to the terms of the currency swap, if applicable;

  - the bank ceases to wholly own the issuer or the intermediate trust subsidiary;

  - certain events relating to the bank's primary regulator, including:

    - the bank's primary regulator determines in writing that the bank has a Tier 1 capital ratio of less than 5 percent (or such lesser percentage as required by the bank) or a total risk-based capital ratio of less than 8 percent (or such lesser

percentage as required by the bank) on a Level 1 or Level 2 basis, as applicable;

– the bank's primary regulator issues a written directive to the bank under applicable banking regulations, legislation or guidelines for the bank to increase its capital;

– the bank's primary regulator appoints a statutory manager to the bank or assumes control of the bank under Australian banking law or proceedings are commenced for the winding-up of the bank; or

– the retained earnings of the bank fall below zero;

– an event of default occurs under the subordinated notes or the convertible debentures; or

– the trust or the intermediate trust subsidiary is wound up.

- The bank's capital contribution to each of the issuer and the intermediate trust subsidiary is a nominal amount, *e.g.*, US$1,000, or there may not be a capital contribution.

- The bank guarantees the trust preferred securities or LLC notes and intermediate trust subsidiary preferred securities to the extent each has legally available US dollar, pounds sterling or foreign currency funds available.

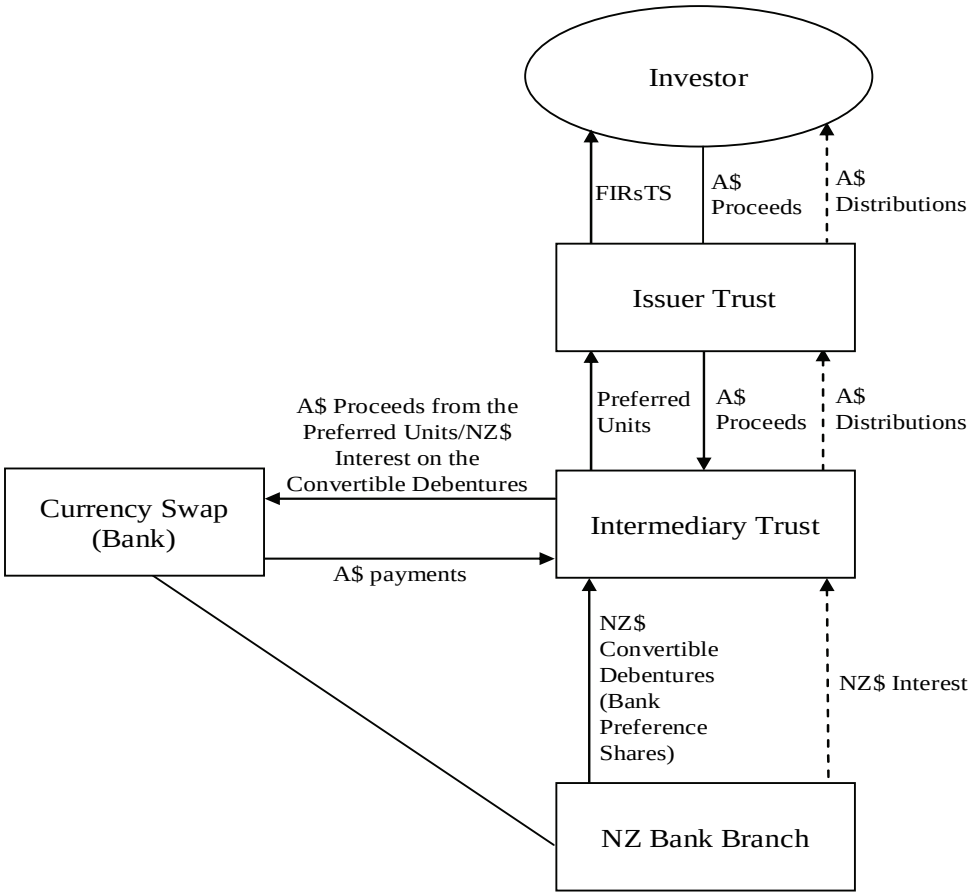
- In some transactions, such as Commonwealth Bank's 2003 issue, on the tenth anniversary following issuance, the holders may elect to exchange their trust preferred securities, whereupon the issuer will either deliver ordinary shares in exchange or cause a third party to purchase the trust preferred securities from the investors for the cash value of those shares.

- Upon a winding-up of the bank, the guarantee and the convertible debentures rank as junior subordinated indebtedness of the bank (or *pari passu* with the bank's preference shares).

- Capital trust preferred and intermediate trust preferred holders may have the right to proceed directly against the bank under the guarantees and the convertible debentures and any subordinated notes if the bank defaults on its payment obligations under the guarantees or the convertible debentures or any subordinated notes, as the case may be.

- The issuer and the intermediate trust subsidiary are 1940 Act exempt by virtue of Rule 3a-5 (finance subsidiary).

- ***Australian Bank Exchangeable Guaranteed Subsidiary Preferred, Australian Market only (since 2002)***



Selected issue

- Westpac (2002)

Transaction benefits

- Primary regulator capital treatment – bank level Tier 1.
- Avoids withholding tax on dividends paid to foreign investors.
- Avoids withholding tax on distributions paid to non-resident holders, who are not subject to Australian tax.
- Enables the bank branch to issue preferred securities in Australian dollars and hedge the Australian dollar foreign exchange risk at head office.

- Ordinary share settlement features upon redemption or conversion.

Product Name

- Fixed Interest Resettable Trust Securities or "FIRsTS."

Designed primarily as domestic Australian offering.

Features

- The issuer trust is established for the sole purpose of issuing securities and acquiring the preferred units issued by the intermediary trust.
- The intermediary trust is established solely for the purpose of holding the convertible debentures issued by the bank, entering into the currency swap with the bank, issuing the preferred units to the issuing trust and issuing an ordinary unit to a subsidiary of the bank.
- A bank subsidiary holds one ordinary unit of the intermediary trust at the issue price of A$100 per unit.
- Distribution payment dates and the next rollover date (the first rollover date is the fifth anniversary of the issue date) are reset on each rollover date to match the interest payment dates and rollover date notified by the bank as having been reset on the convertible debentures or, if the convertible debentures have converted into preference shares or alternative securities of the bank, the equivalent dates and rollover date reset by the bank on the bank's preference shares or alternative securities.
- The convertible debentures are mandatorily convertible 50 years after the issue date, or where the bank fails to pay interest on the convertible debentures within 21 days of an interest payment date, into preference shares with similar terms.
- The convertible debentures convert automatically into the bank's ordinary shares upon the occurrence of certain regulatory events that trigger regulatory actions affecting the bank or on an event of default.
- If interest is not paid on an interest payment date because the specially constituted committee appointed by the board of directors fails to declare the interest payable or because of a deferral condition, a calculation of that interest together with compound interest is made.
- Preference shares of the bank are perpetual securities paying non-cumulative dividends.
- Distributions on the securities issued and capital invested in the securities are not guaranteed by the bank.

- Distributions on the securities depend on whether interest is paid on the convertible debentures and the distribution of that interest through the intermediary trust and the issuing trust to holders of securities.

- Holders of securities may elect to exchange some or all of its securities for cash or ordinary shares of the bank on each rollover date or upon a takeover of or scheme of arrangement involving the bank.

- The bank has the option to redeem the securities it acquires from a holder on any rollover date or a takeover of or scheme of arrangement involving the bank.

- The bank may elect to exchange the bank's preference shares for cash or for the bank's ordinary shares. The bank's preference shares are automatically exchanged for the bank's ordinary shares on certain regulatory events or on an event of default.

- The bank may exchange all or a portion of the securities for cash subject to the following conditions and the approval of the bank's regulator:

  – at any time upon the occurrence of a tax event or regulatory event;

  – after the first rollover date, at least 21 business days prior to any distribution payment date, provided at that time a floating rate basis applies to the market rate;

  – at any time where holders request a meeting to approve an amendment to the constitution or a change of the trustee and the bank has not given its consent;

  – at any time when the ability of the intermediary trust trustee to redeem the securities and the bank's ability to acquire securities is or will be impaired or removed; or

  – at least 21 business days prior to any rollover date.

- The bank may exchange all, or a portion of the securities, for ordinary shares of the bank subject to the following conditions:

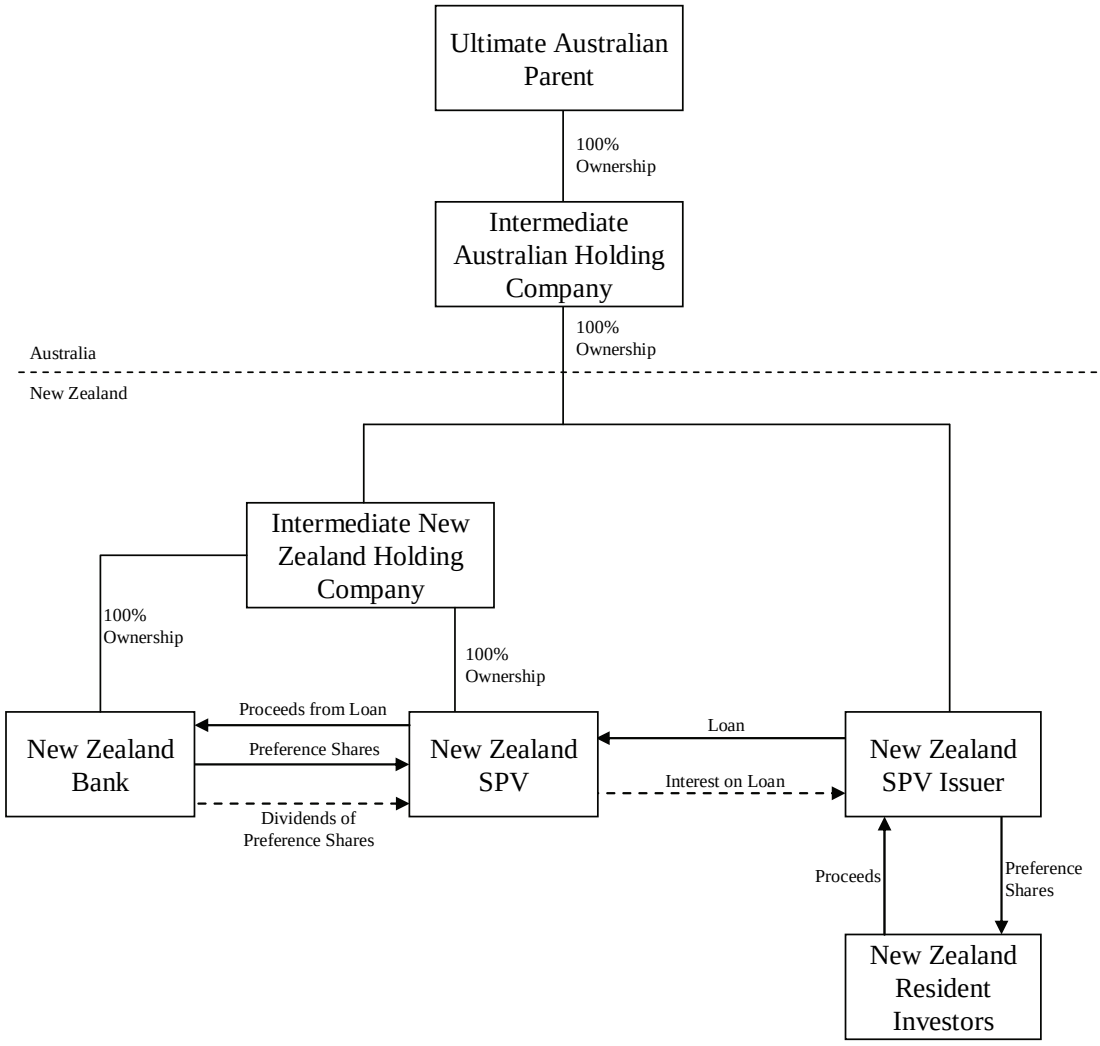
  – at any time upon the occurrence of a tax event or a regulatory event;

  – after the first rollover date, at least 21 business days prior to any distribution payment date, provided at that time a floating rate basis applies to the market rate;

- at any time where holders request a meeting to approve an amendment to the constitution or a change of the trustee and the bank has not given its consent;
- at any time when the ability of the intermediary trust trustee to redeem the securities and the bank's ability to acquire securities is or will be impaired or removed; or
- at least 21 business days prior to any rollover date.

- The bank may require the issuing trust to redeem any securities that the bank acquires as a result of an exchange of securities.
- Securities will be automatically redeemed for ordinary shares of the bank upon certain regulatory events or on an event of default.
- Holders of securities will have all of their securities redeemed by the intermediary trust trustee where (i) the bank has exercised its redemption right to exchange convertible debentures for cash, (ii) the bank redeems the preference shares or alternative securities for cash or (iii) convertible debentures, preference shares or alternative securities are converted into ordinary shares.
- The Australian dollar funds received by the intermediary trust on the issue of preferred units are swapped with the bank into New Zealand dollars.
- Upon the winding-up of the bank, the convertible debentures and any preference shares into which they have been converted will rank equally with the bank's ordinary shares.

- ***New Zealand Bank Subsidiary Preferred (since 2008)***



Selected issue

- Bank of New Zealand (2008)

Transaction benefits

- Primary regulator capital treatment – bank level Tier 1.
- The issuer is a Portfolio Listed Company in terms of the new Portfolio Investment Entity regime. As a result, natural persons and most trustee investors are not required to include the dividend in their income tax return.

Features

- The issuer is a SPV established for the sole purpose of issuing the perpetual non-cumulative securities issued in connection with the transaction.

- The preference shares made available by the issuer are only being offered to New Zealand residents.

- Under the terms of the transaction, the issuer will lend the proceeds of the preference shares to the New Zealand SPV. The New Zealand SPV will then invest the proceeds of the loan in perpetual non-cumulative preference shares issued by the New Zealand Bank. The proceeds will be used within the New Zealand Bank Group for general business purposes, including making distributions to the Bank of New Zealand's ultimate Australian parent.

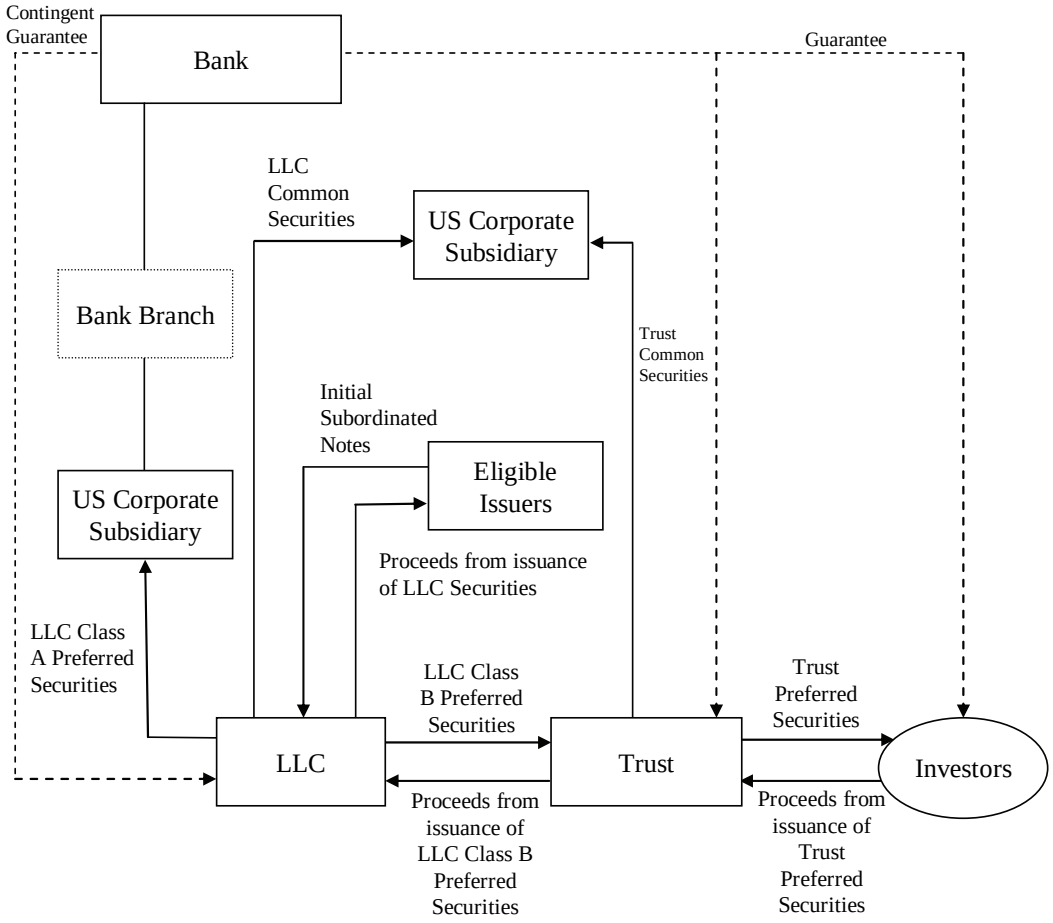
- The issuer will be able to pay dividends in respect of the preference shares only to the extent that the New Zealand bank makes payments to the New Zealand SPV, and the New Zealand SPV makes payments to the issuer under the loan agreement.

- The dividends payable on the preference shares rank after all creditors of, and in priority to the ordinary shareholders of, the issuer.

- The obligations in respect of the preference shares are not guaranteed.

- On the initial call date (or on any dividend payment date thereafter) or at any time after the occurrence of certain specified events and subject to all necessary governmental or regulatory consents or approvals, the ultimate Australian parent (*i.e.*, National Australia Bank Limited) has the right to purchase the preference shares from investors for the aggregate issue price plus an amount equal to dividends accrued from the last dividend payment date (to the extent unpaid).

- ***Dutch and Belgian Bank Guaranteed Subsidiary Preferred (since 1998)***



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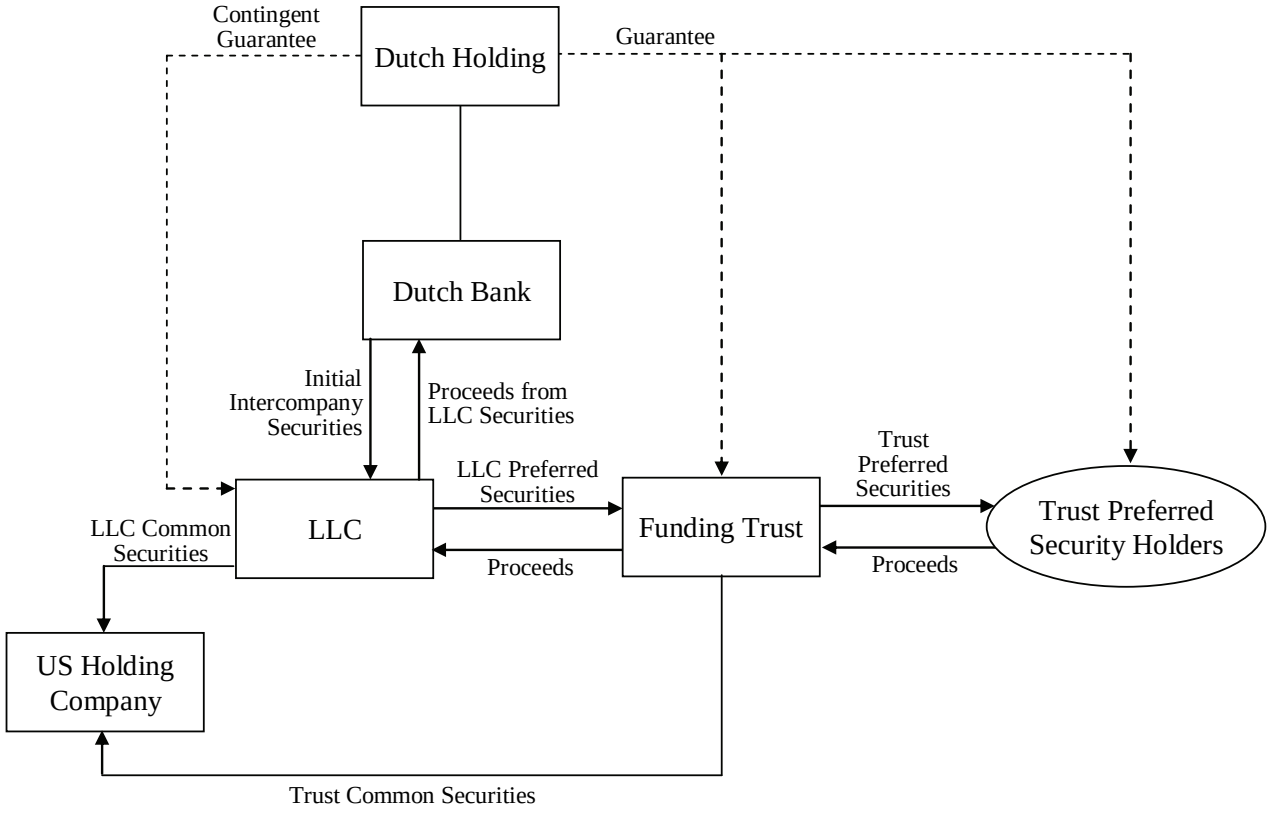


- Selected issues
  - ABN AMRO (Dutch) (1998)
  - ABN AMRO (Dutch) (1999)
  - Rabobank (Dutch) (1999)
  - KBC Bank (Belgian) (1999)
  - ING Bank (Dutch) (2000)
  - ABN AMRO (Dutch) (2002)
  - ABN AMRO (Dutch) (2003)
  - ABN AMRO (Dutch) (2004)
  - Rabobank (Dutch) (2004)

Transaction benefits

- Primary regulator capital treatment – minority interest Tier 1 capital.
- The interest on the bank debentures held by the LLC is deductible by the bank in the jurisdiction of the issuer of the debentures.
- Enables the bank to issue preferred equivalent in US dollars.

Features

- The issuer is a US-domiciled trust that is either a US subsidiary of the bank or a hat check trust.
- The intermediate subsidiary is a US-domiciled limited liability company that is a subsidiary of the bank and qualifies as a partnership for US tax purposes.
- In the case of US subsidiary trusts, the common securities are held by a US-domiciled direct wholly-owned subsidiary of the bank.
- The common securities and class A preferred securities of the intermediate LLC subsidiary (which, except in the case of the winding-up of the intermediate LLC subsidiary, rank junior to the class B preferred securities held by the trust for the benefit of investors) are held by subsidiaries of the bank.
- The issuer, whose only role is *pro rata* distributions from its assets, holds the class B preferred securities issued by the intermediate LLC subsidiary and the bank's guarantee thereof.
- The intermediate LLC subsidiary's primary assets are debentures issued by the New York branch of the bank or other eligible issuers, as the case may be, the principal amount of which initially is, in each case, at least equal the liquidation preference of the class B preferred securities. The initial debentures mature in 20 years.
- Dividends on the class B preferred securities are non-cumulative and are mandatorily payable if:
  - the group's approved annual accounts reflect that the group has earned group distributable profits for the preceding year; or
  - the bank or any other member of the group pays dividends on or redeems any securities that rank equally with, or junior to, the preferred securities,

provided, notwithstanding the foregoing, such dividends are not payable if prohibited by applicable Netherlands banking regulations.

- Dividends not paid to the trust or other class B preferred holders as a result of the above are paid as a dividend to the common holder.

- The class B preferred's liquidation payment is determined by reference to the intermediate LLC subsidiary's assets, which could be depleted because, upon the winding-up of the intermediate LLC subsidiary, the intermediate LLC subsidiary's assets – including the debentures or deposits issued by the New York branch or other eligible issuers – are distributed to the class A preferred holders.

- The bank's capital contribution to the trust is nominal (€1,000), and to the intermediate LLC subsidiary varies from nominal to substantial, depending upon the tax analysis.

- The intermediate LLC subsidiary's primary assets are subordinated debentures issued by the New York branch and other legal eligible issuers, which has similar interest payment and redemption features as the class B preferred and the trust preferred.

- The bank guarantees the class B preferred and, if the trust is a subsidiary trust, the trust preferred in a manner that makes the guarantee the functional equivalent of preferred issued by the bank itself. Accordingly, guarantee payments include:

  – dividend payments that the issuer or the intermediate LLC subsidiary, as the case may be, is required to pay;

  – the redemption price, subject to the foregoing with respect to any dividend component; and

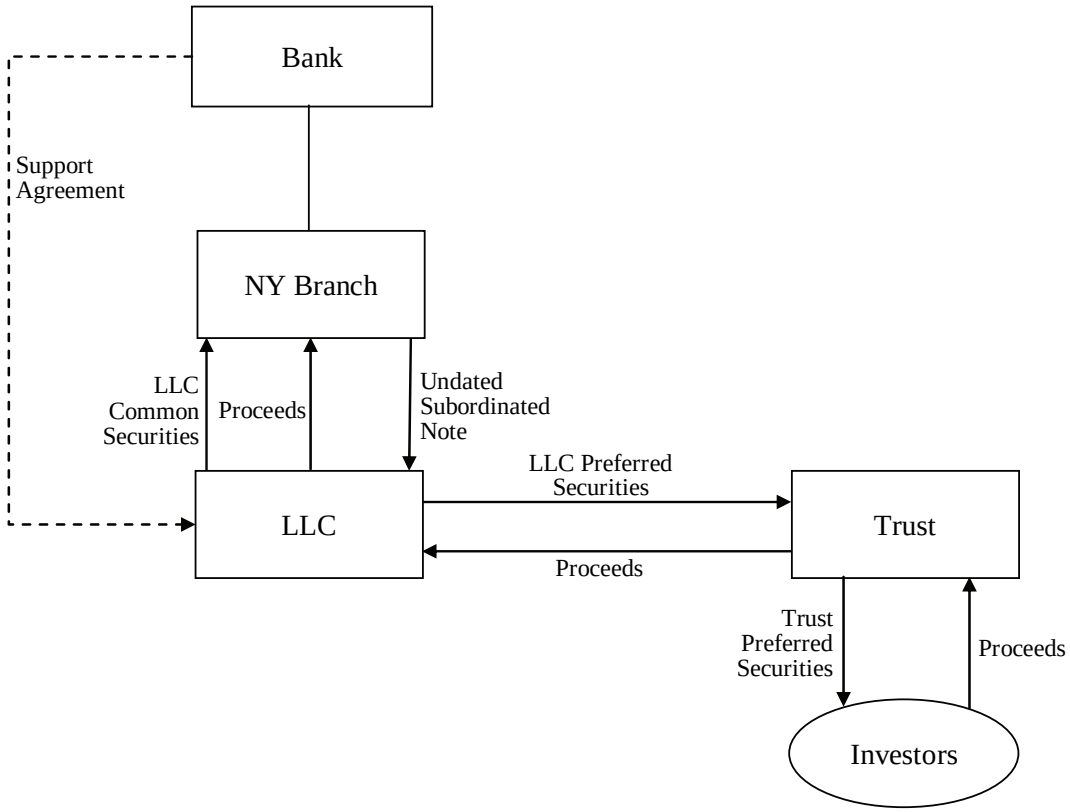
  – the liquidation amount payable on the class B preferred and, if applicable, the trust preferred.

- The contingent guarantee exists due to some uncertainty under Dutch law about the enforceability of the guarantee.

- Upon the winding-up of the bank, the guarantee ranks junior to all indebtedness of the bank and equal with the bank's obligations under the contingent guarantee and, effectively, with the most senior preferred of the bank.

- The issuer must be wound up if the bank is wound up.

- ***French Bank Guaranteed Subsidiary Preferred (since 2000)***



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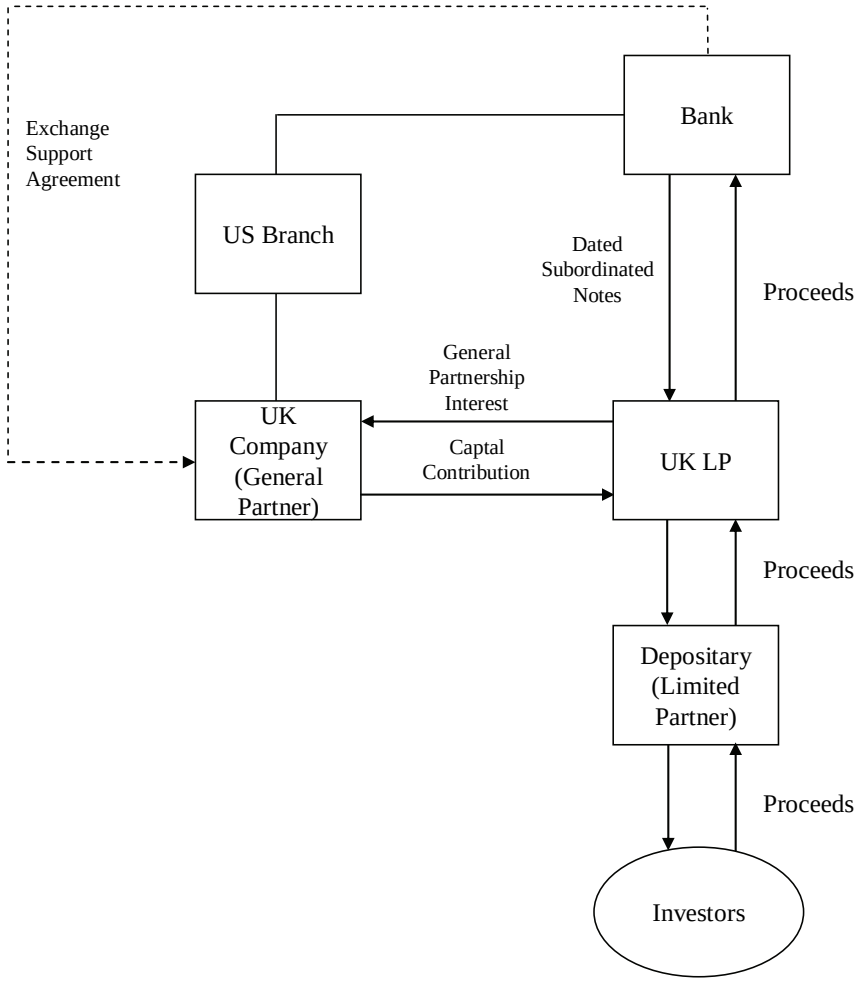


Selected issues

- Société Générale (2000)
- Natexis Banque Populaires (2000)
- BNP Paribas (2001)
- Crédit Lyonnais (2002)
- BNP Paribas (2002)
- BNP Paribas (2003)
- Crédit Agricole (2003)
- Société Générale (2003)

- Natexis Banque Populaires (2003)
- Confinoga (2003 and 2004)
- Crédit Agricole (2005)

Transaction benefits

- Primary regulator capital treatment – minority interest Tier 1 capital.
- The interest on the bank debentures held by the non-operating subsidiary is deductible by the bank for US and French tax purposes, as the case may be.
- Enables the bank to issue preferred equivalent in US dollars or UK pounds sterling, as the case may be.

Features – US Trust/LLC Structure

- The issuer is a US-domiciled trust that is a hat check trust.
- The intermediate subsidiary is a US-domiciled limited liability company that is a subsidiary of the bank and qualifies as a partnership for US tax purposes.
- The common securities of the intermediate LLC subsidiary (which rank junior to the company preferred securities held by the trust for the benefit of investors) are held by the New York branch.
- The issuer, whose only role is *pro rata* distributions from its assets, holds the preferred issued by the intermediate LLC subsidiary.
- The intermediate LLC subsidiary's primary assets are debentures issued by the bank or its New York branch, the principal amount of which is at least equal to the liquidation preference of the company preferred.
- Dividends on the company preferred are only mandatorily payable if the bank pays dividends on any of its securities that rank equally with or junior to the preferred; notwithstanding the foregoing, it must pay dividends on the company preferred for one year.
- Dividends not paid to the trust or company preferred holders as a result of the above are paid as a dividend to the common holder.
- The company preferred's liquidation payment is determined by reference to the company's assets.
- The bank's capital contribution to the intermediate LLC subsidiary varies from nominal to substantial, depending upon the tax analysis.

- The subordinated debentures issued by the bank have the same interest payment and redemption features as the company preferred.

- The bank enters a support agreement relating to the company preferred in a manner that makes the support agreement the functional equivalent of preferred issued by the bank itself. Accordingly, the payments under the support agreement include:

  – dividend payments that the intermediate LLC subsidiary is required to pay;

  – the redemption price, subject to the foregoing with respect to any dividend component; and

  – the liquidation amount payable on the company preferred.

- Upon the winding-up of the bank, the support agreement ranks junior to all indebtedness of the bank and equal with the most senior preferred of the bank, if any, and senior to all other share capital of the bank.

- The issuer and the intermediate LLC subsidiary must be wound up if the bank is wound up.

- One or more independent directors acting on behalf of preferred holders must approve certain actions, including the winding-up of the intermediate LLC subsidiary that is not concurrent with the winding-up of the bank.

- Holders of a majority (by liquidation preference) of trust preferred securities and company preferred securities have the right to bring suit to enforce the support agreement if the bank defaults on its payment obligations under the debentures.

- The issuer and the intermediate LLC subsidiary are 1940 Act exempt by virtue of Rule 3a-5 (finance subsidiary).

- The subordinated debentures are undated and unsecured and rank *pari passu* with most other unsecured obligations of the New York branch, and will be cancelled or forgiven if a capital deficiency or bankruptcy event occurs.

Features – UK Limited Partnership/UK Limited Company Structure

- The issuer is a UK-domiciled limited partnership that is classified as a partnership for UK tax purposes.

- The general partner of the issuer is a UK-domiciled private limited company that is a subsidiary of the bank.

- 10 year fixed term floating rate.
- The general partnership interests of the issuer are held by a UK subsidiary of the bank.
- The depositary, who is the sole limited partner of the issuer, holds the partnership preferred securities of the limited partnership.
- The limited partnership's primary assets are debentures issued by the bank, the principal amount of which is at least equal to the liquidation preference of the partnership preferred securities.
- Dividends on the partnership preferred securities are only mandatorily payable if the bank pays dividends on any of its securities that rank equally with or junior to the preferred, in which case it must pay dividends on the company preferred for one year following such payment.
- The subordinated debentures issued by the bank have the same interest payment and redemption features as the company preferred.
- The bank enters an exchange and support agreement with the general partner relating to the partnership preferred securities in a manner that makes the exchange and support agreement the functional equivalent of preferred issued by the bank itself. Accordingly, the payments under the exchange and support agreement include:
  - mandatory distributions that the limited partnership is required to pay;
  - the redemption price, on the redemption date; and
  - the liquidation amount payable on the partnership preferred securities.
- Upon the occurrence of one of the events described below, known as a "Shift Event," the bank will be entitled to call the bank debentures held by the limited partnership and, pursuant to the exchange and support agreement, the bank will pay to the limited partnership the amounts necessary to enable the limited partnership to make distributions on the partnership preferred securities or pay the redemption price thereof:
  - as a result of losses incurred by the bank, the total risk-based capital ratio of the bank as reported by the bank or determined by the primary regulator falls below the minimum requirements of the primary regulator;
  - proceedings are commenced for the winding-up of the bank; or

- the primary regulator determines that one of the events mentioned above will occur in the near term.

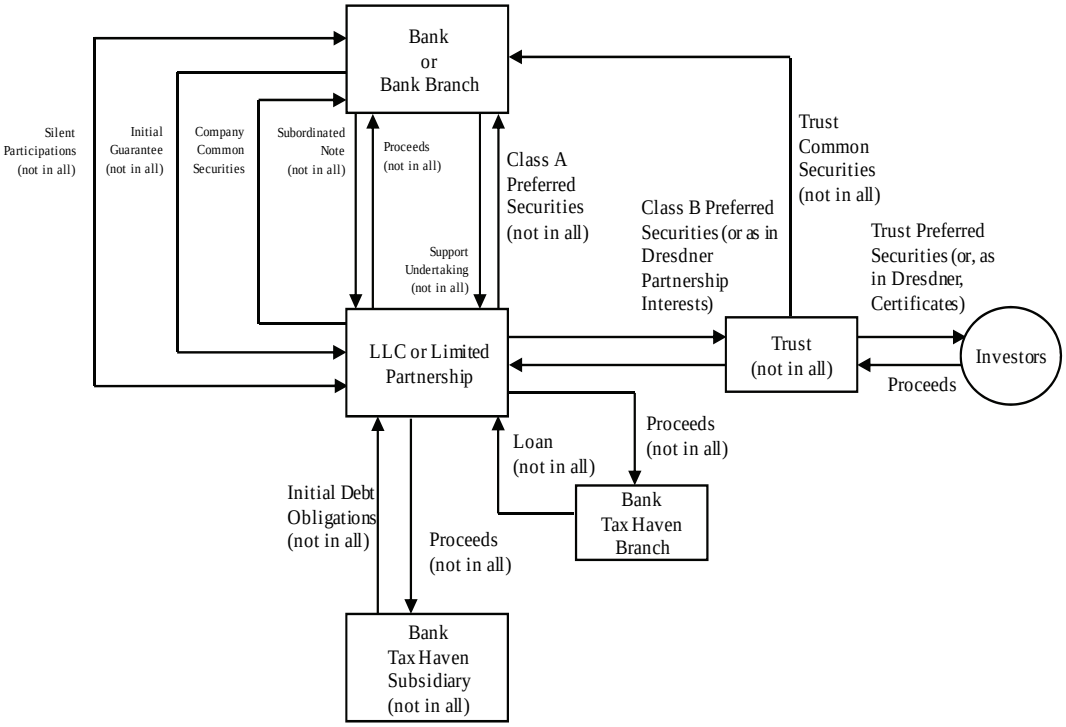
- Upon the winding-up of the bank, the support agreement ranks junior to all senior indebtedness of the bank and senior to all other share capital of the bank.

- The issuer and the general partner must be wound up if the bank is wound up.

- Pursuant to an enforcement agreement, an enforcement agent is appointed to bring suit and take other action to enforce the limited partnership rights if the general partner fails to do so within 15 days of such enforcement rights arising.

- The subordinated debentures are undated and unsecured and rank *pari passu* with most other unsecured obligations of the bank.

- ***German Bank Subsidiary Preferred (since 1999)***



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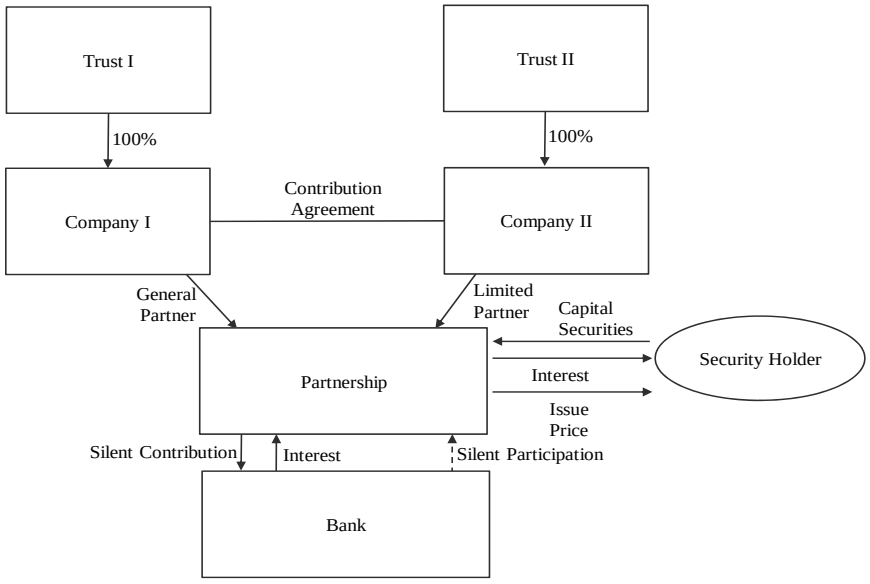


Selected issues

- Dresdner Bank (1999)
- Deutsche Bank (1999)
- Hypo- und Vereinsbank AG (1999)
- DePfa Deutsche Pfandbrief Bank (2000)
- Hypo und Vereinsbank AG (2002)
- EuroHypo AG (2003)
- Deutsche Bank (2003)
- LB Kiel (RESPARC) (2003)
- IKB Deutsche Industrie Bank (2004)
- Postbank (2004)
- Deutsche Bank (2005)
- Postbank (2005)
- Deutsche Bank (2006 – two issues)
- Commerzbank (2006 – two issues)
- Bayerische Landesbank (2007)
- DZ Bank AG (2007)
- IKB Deutsche Industriebank AG (2007)
- Deutsche Bank Aktiengesellschaft (2007 – three issues)
- Hypo Real Estate Bank International AG (2007)
- Deutsche Postbank AG (2007)
- Deutsche Bank (2008 – three issues)

Selected 2009 issues

- *Deutsche Bank (September 2009)*
- *Münchener Hypothekenbank eG (November 2009)*

Transaction benefits

- Primary regulator capital treatment – minority interest Tier 1 capital.
- The interest on the bank debentures or deposits held by the non-operating subsidiary is deductible by the bank for German (in the case of head office debentures) purposes or the non German jurisdiction where the branch is located.
- Enables the bank to issue preferred equivalent in US dollars in the United States or offshore capital markets like Hong Kong.

Features

- In the case of the Münchener Hypothekenbank eG transaction, the issuer is a Jersey limited partnership. The issuer issued perpetual capital securities.
- The proceeds of the issue were intended to be used to acquire a silent capital interest in Münchener Hypothekenbank eG pursuant to a partnership agreement. Payment of principal and interest under the capital securities is conditional on the issuer receiving profit participation payments under the partnership agreement and loan advances from Münchener Hypothekenbank eG.
- In some cases, the issuer can be a US-domiciled trust that is either a US subsidiary of the bank or a hat check trust.
- The non-operating subsidiary has been a US-domiciled limited liability company, or either a Hong Kong limited partnership or a German limited liability company, both of which would be a subsidiary of the bank and either of which would qualify as a partnership for US tax purposes.
- Generally, in the case of US subsidiary trusts, the common securities are held by the bank or a subsidiary or branch of the bank.
- The common securities and class A preferred securities of the non-operating subsidiary (the class A preferred securities rank senior and the common securities rank junior to the class B preferred securities held by the trust for the benefit of investors) can be held by the US branch if the bank has a US branch or, if not, by the bank or a subsidiary or branch of the bank. In some cases, such as Dresdner, there are no class A preferred securities and the common securities have the attributes discussed herein for the class A securities. In the LB Kiel transaction, the general partner was a Hong Kong joint venture comprising of the Bank (51 percent) and a Hong Kong charitable trust and the limited partner was a German limited liability company, which was not affiliated with the bank.

- Where a hat check trust is used, the issuer, whose only role is *pro rata* distributions from its assets, holds the class B preferred securities issued by the non-operating subsidiary.

- The non-operating subsidiary's primary assets are debentures issued by a non German branch of the bank, or in the case of the 2003 LB Kiel deal, the primary assets were silent partnerships issued by the German bank, a support undertaking issued by a Luxembourg branch of the bank, and debentures issued by a non German branch of the bank to provide funding if there is loss absorption in the silent partnership interests; the initial principal amount of any of these is at least equal to the liquidation preference of the class B preferred securities.

- Dividends on the class B preferred securities are generally mandatorily payable unless:

  – the bank does not have available distributable profits for the most recent preceding fiscal year;

  – in some transactions, such as DePfa and Deutsche Bank, the bank is otherwise prohibited by order of the bank's primary regulator under applicable German banking laws from making any distributions of its profits;

  – in some transactions, such as DePfa and Deutsche Bank, the intermediate LLC subsidiary does not have operating profits at least equal to the amount of such dividends;

  – in some transactions, such as Dresdner, the current notional value of each class B preferred is not equal to the liquidation preference of such preferred; or

  – in some transactions, such as Dresdner, a Shift Event, as defined below, has occurred and is continuing,

  provided that, if the bank or any of its subsidiaries pays dividends on any securities that rank equally with or junior to the preferred, notwithstanding the foregoing, it must pay dividends on the class B preferred.

- Dividends not paid to the trust or other class B preferred holders as a result of the above are paid as a dividend to the common holder.

- The class B preferred's liquidation payment is determined by reference to the intermediate LLC subsidiary's assets, which generally will be depleted because the intermediate LLC subsidiary's assets – including debentures of a non German branch of the bank – will have been distributed to the class A preferred holder.

- In some transactions, such as Dresdner, upon the occurrence of one of the Shift Events below, the intermediate subsidiary waives its right to payments under the debentures if:
  - the board of managing directors of the bank determines that either the total or Tier 1 capital ratio of the bank has fallen below the minimum requirements of the German Banking Act or the bank's non-compliance with the foregoing capital ratio requirements is immediately imminent;
  - the bank is declared insolvent or over-indebted and insolvency proceedings are to be commenced; or
  - the German Banking Supervisory Authority either exercises its extraordinary supervisory powers under the German Banking Act or announces its intention to take such measures.
- The bank or a non German branch of the bank's capital contribution to the trust, if there is a subsidiary trust, is nominal (*e.g.*, €100) and to the non-operating subsidiary varies from nominal to substantial, depending upon the tax analysis.
- In some transactions, such as Deutsche Bank and DePfa, the bank enters a support undertaking relating to the class B preferred securities that is the functional equivalent of preferred issued by the bank itself. Accordingly, the support undertaking covers:
  - dividend payments that the intermediate LLC subsidiary is required to pay;
  - the redemption price, subject to the foregoing with respect to any dividend component (in DePfa but not in Deutsche Bank); and
  - the liquidation amount payable on the class B preferred.
- In DePfa and Deutsche Bank, upon the winding-up of the bank, the support undertaking ranks junior to all indebtedness of the bank and equal with the most senior preference shares of the bank, if any, and senior to all other share capital of the bank. In LB Kiel, payments under the support undertaking are subordinated and rank *pari passu* with payments by the Bank under the silent partnership participation agreement.
- In some transactions, such as Dresdner, the issuer must be wound up if the bank is wound up.
- In some transactions, such as Dresdner, one or more independent directors acting on behalf of preferred holders must approve certain actions,

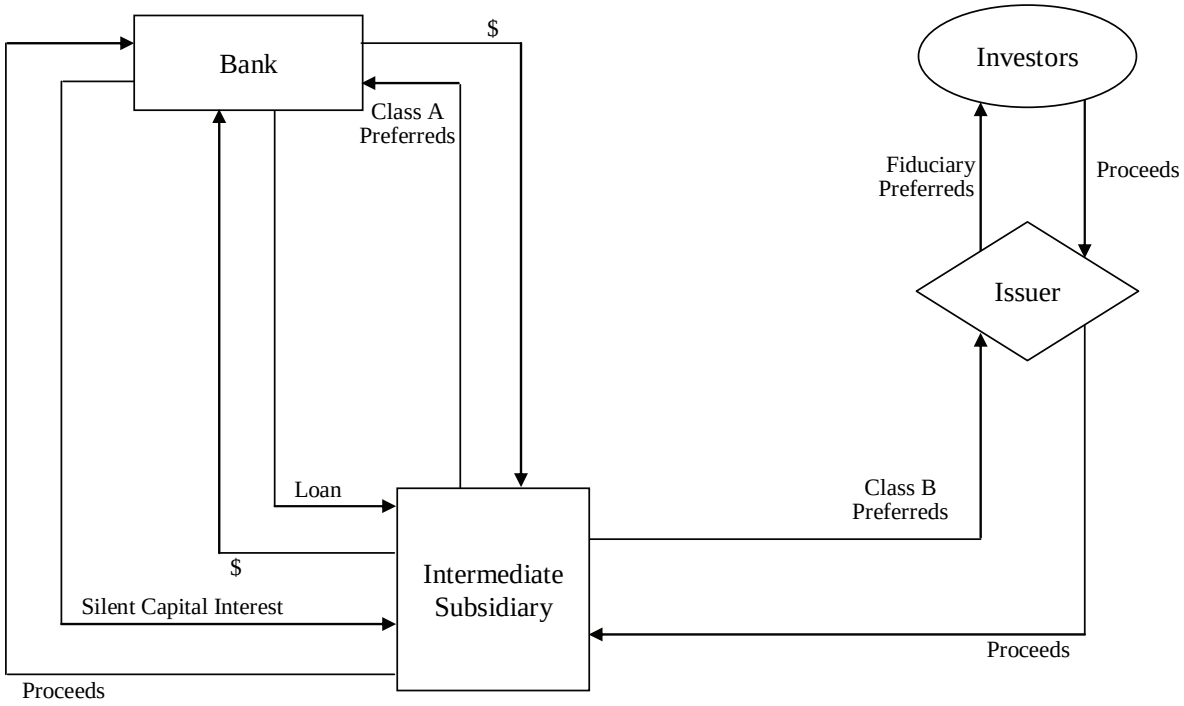
including the winding-up of the intermediate LLC subsidiary that is not concurrent with the winding-up of the bank.

- Trust preferred and class B preferred holders generally do not have the right to proceed directly against the bank under the debentures if the bank defaults on its payment obligations under the debentures.

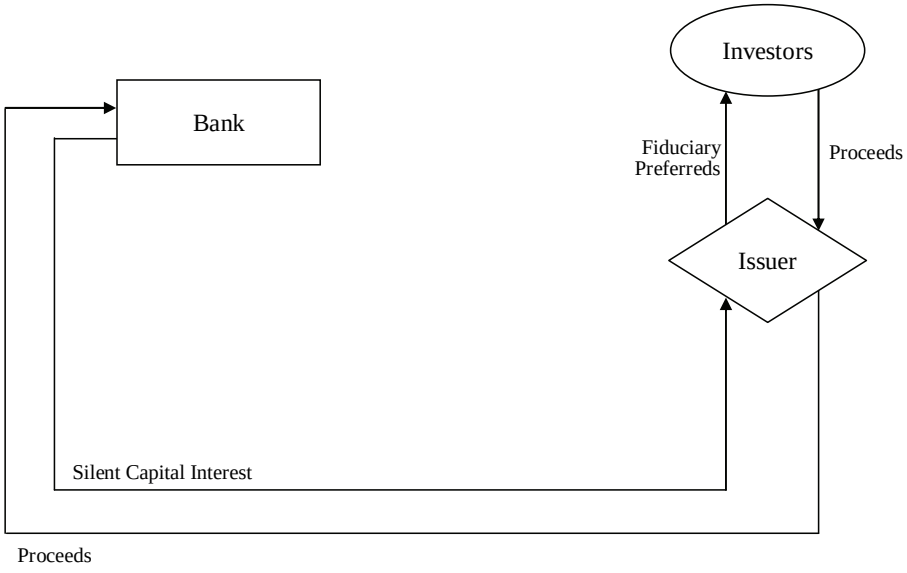
- The issuer and the intermediate subsidiary (if any) may be 1940 Act exempt by virtue of Rule 3a-5 (finance subsidiary).

- ***German, Luxembourg, Austrian and Swiss Bank Subsidiary Instruments Issued through a Fiduciary Agreement (since 2002)***

The following diagram outlines the relationship between the bank, the intermediate subsidiary, the issuer and the investors prior to transfer:

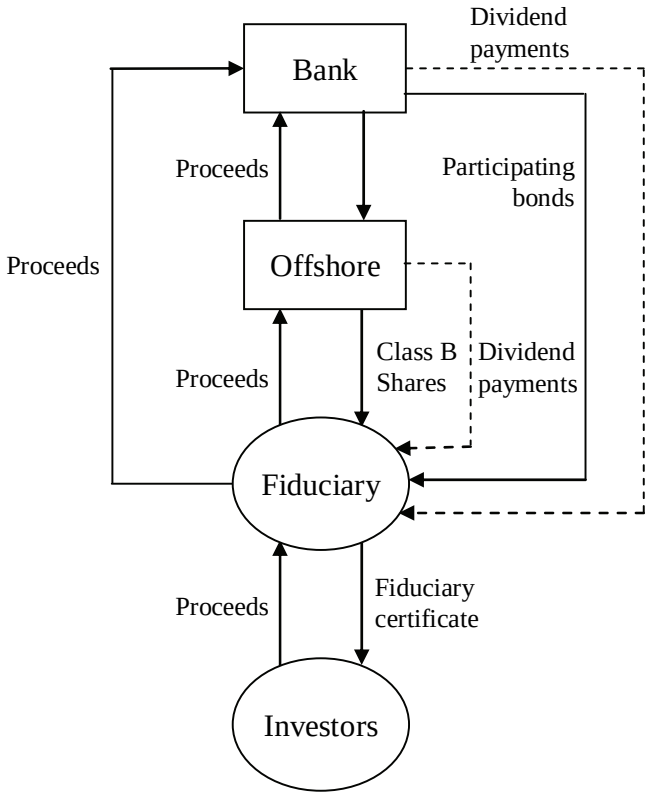


The following diagram outlines the relationship between the bank, the intermediate subsidiary and the issuer after transfer:



OR

Alternatively, in the 2008 Credit Suisse transaction, the following diagram outlines the relationship between the bank, the intermediate subsidiary, the Fiduciary and the investors:



Selected issues

- LB Kiel (SPARC) (German) (2002)
- EFG Private Bank (Swiss) (2004)
- Helaba (German) (2005)
- West LB (German) (2005)
- Nord LB (German) (2005)
- Helaba (German) (via a Jersey SPV) (2006)
- Credit Suisse (Swiss) (2008 – two issues)
- Österreichische Volksbanken-Aktiengesellschaft (via Banque de Luxembourg) (Austrian) (2008 – two issues)

Transaction benefits

- Primary regulator capital treatment – solo Tier 1 capital.
- Interest payments paid on the loan (prior to transfer) are deductible by the bank for German or Swiss tax purposes.
- No withholding tax on dividend payments prior to transfer.
- Enables the bank to issue preferred equivalent in US dollars and euros.

Features

- The issuer is a fiduciary institution incorporated in Luxembourg or an institution that is unaffiliated with the bank raising Tier 1 capital, and it issues securities to investors in an investment structure under which the issuer purchases and holds class B preferred shares of a subsidiary of the bank and, in the case of the EFB Private Bank deal, directly of the bank, each on a fiduciary basis, as the case may be.
- In many instances, the subsidiary of the bank is an exempted company with limited liability registered and incorporated in an offshore jurisdiction, such as the Cayman Islands or Guernsey.
- The ordinary shares and class A preferred securities of the intermediate subsidiary (the class A preferred securities rank senior, and the ordinary shares rank junior, to the class B preferred securities held by the bank subsidiary) are held by the bank.
- In some cases (*e.g.*, Helaba), the issuer is a Jersey limited partnership that holds the silent partnership interest directly.
- In the German context, the issuer's primary assets are either (prior to transfer of the silent partnership interest to the fiduciary in exchange for the class B preferred) the class B preferred securities issued by the bank subsidiary or (after transfer of the silent partnership interest to the fiduciary in exchange for the class B preferred) a silent partnership interest in the bank, in the form of a Stille Gesellschaft.
- The issuer makes *pro rata* distributions out of the dividends on the class B preferred securities or the profit participation relating to the silent capital interest, as the case may be.
- In the Swiss context, the issuer's primary asset is the class B preferred securities from both the intermediate subsidiary and the bank and the issuer makes *pro rata* distributions out of the dividend on both class B preferred securities.

- Dividend payments on the fiduciary securities will only be paid to the extent of available profits of the bank, which limit the dividend amounts payable on the assets held by the issuer.

- The fiduciary securities represent the assets held by the issuer, which are either (prior to transfer) a *pro rata* interest in the class B preferred securities or (after transfer) a *pro rata* interest in the silent capital interest.

- The bank subsidiary's primary assets are (i) a loan to the bank, which has the same interest payments as the class B preferred securities and is funded with the proceeds of the class A preferred securities purchased by the bank and (ii), in the German context, a silent partnership interest in the bank.

- The bank enters an undertaking agreement relating to the class B preferred securities that is the functional equivalent of preferred issued by the bank itself. Accordingly, pursuant to the agreement, the bank undertakes to:

  – ensure that the bank subsidiary is in a position to pay the dividends on the class B preferred securities;

  – ensure that the bank subsidiary is in a position to pay an extraordinary dividend to the issuer in the event that the bank redeems the silent capital interest prior to a certain date; and

  – if a transfer occurs and the bank redeems the silent capital interest prior to a certain date, pay investors an amount equal to what the extraordinary dividend would have been if no such transfer had occurred.

- The profit participation relating to the silent capital interests accrues unless:

  – the bank's annual unconsolidated balance sheet does not have, or the payment of the profit participation would cause the bank to not have, a balance sheet profit for the fiscal year to which the relevant profit participation relates;

  – a "reduction" has occurred that has not yet been fully restored;

  – there is a regulatory intervention; or

  – payment thereof would lead to or increase an annual loss if the bank's solvency ratio is less than 9 percent on a solo or consolidated basis.

- The holders of fiduciary securities generally do not have the right to proceed directly against (prior to transfer) the bank subsidiary if it defaults on its payment obligations under the class B preferred securities, or (after transfer) the bank if it defaults on its payment obligations under the silent

capital interest. However, if the fiduciary becomes obligated to take legal action against the bank subsidiary (prior to transfer) or the bank (after transfer) and fails to do so within a reasonable time, the holders may be entitled to institute a legal action against the bank subsidiary or the bank, as the case may be, in the fiduciary's stead.

- The issuer will redeem the fiduciary securities when (prior to transfer) the class B preferred securities are redeemed or (after transfer) the silent capital interest is redeemed. The bank subsidiary will, unless the silent capital interest has already been redeemed, redeem the class B preferred securities by way of a transfer of the silent capital interest to the issuer. The bank may redeem the silent capital interest after 10 years, but only after it gives at least 2 years' prior notice and only if the solvency ratio consistently exceeds 9 percent.

- Silent partnerships (*Stille Beteiligungen*) are a specific form of capital contribution existing under German and Luxembourg law, similar to the concept of preference shares. The basic features of a silent partnership include:

  – Dated, perpetual and subordinated;

  – Senior to common equity in any winding-up proceedings;

  – Payments on silent partnership interests are, under certain circumstances, tax deductible; and

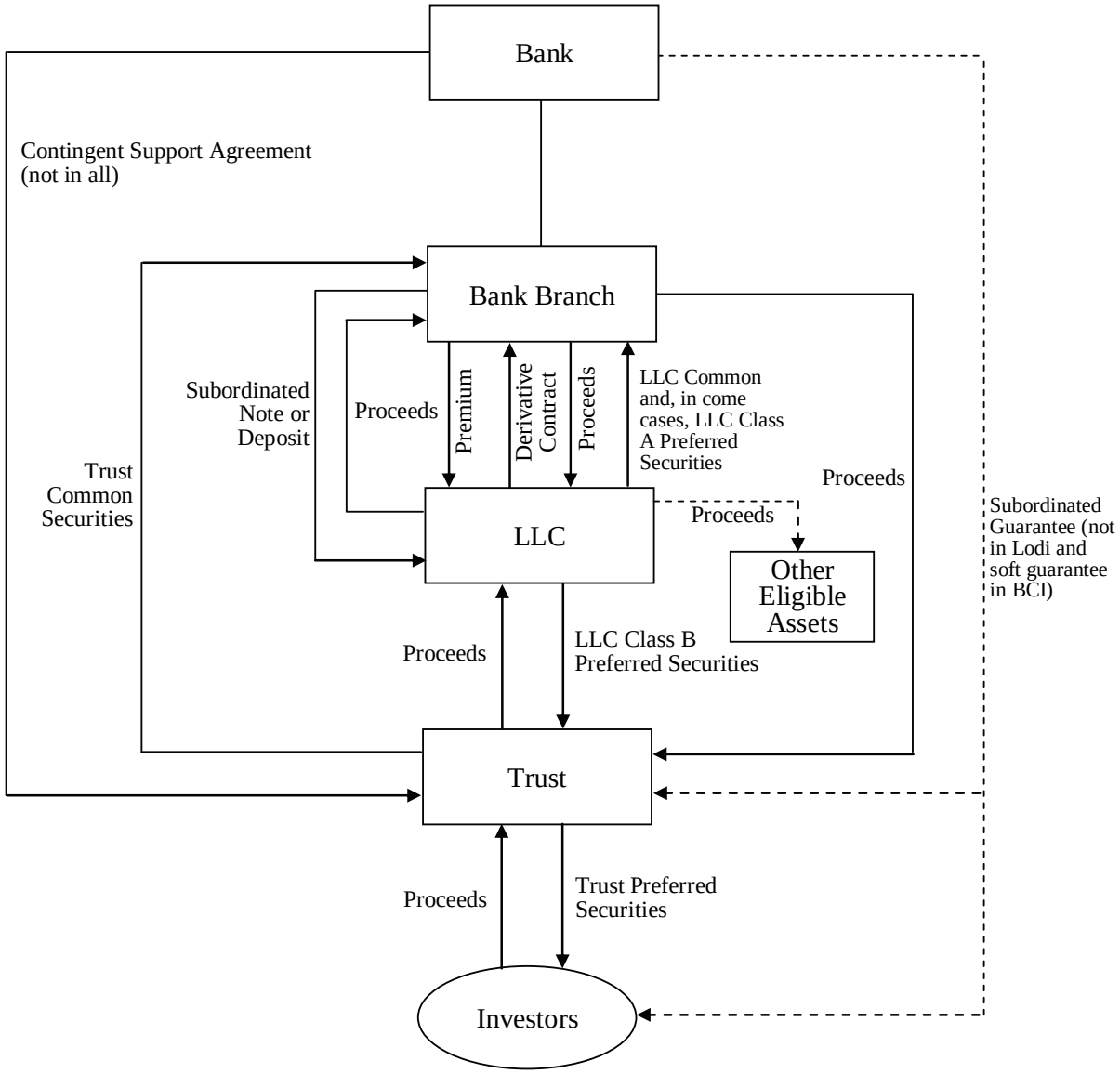
  – Silent partnership interests are also subject to interest cancellation depending on the performance of the issuer.

- Section 10 of the German Banking Act permits the inclusion of silent partnership contributions in Tier 1 capital provided that the interest deferral is non-cumulative and the instrument can absorb losses (*i.e.*, principal write-down). Indeed, loss absorption ranking *pari passu* with ordinary share capital of an issuer is a dispositive feature of any silent partnership Tier 1 issue. In contrast, equity is written down before Tier 1 preferred in the United Kingdom, Netherlands, Italy and Spain.

- Despite heightened activity in the Tier 1 markets caused by the BIS clarification in October 1998, German Tier 1 requirements have largely remained unchanged for some time. Even following the Bank of International Settlements ("BIS") clarification, the German regulators still allowed Tier 1 preferred to have a maturity date. German regulators were able to develop a compromise with BIS so that instead of Tier 1 products being referred to as "perpetual," they will be referred to as "permanent," which under German law interpretive releases by the German banking regulators effectively means having a maturity of five years or more.

- Prior to the LB Kiel transaction, German withholding tax issues made a direct issue of non-innovative Tier 1 instruments impossible outside of the German domestic market. This was because, as public institutions, German Landesbanks could not issue shares. So the only means to raise Tier 1 capital was through silent partnerships/participations. Such instruments are subject to German withholding tax, which is unattractive for international investors. The need for German Landesbanks to raise capital internationally, however, became more acute once the German government abolished state aid to state owned banks (*i.e.*, Landesbanks). After the abolition of state aid to the German Landesbanks, raising finance in capital markets became more expensive. As a result, German Landesbanks needed to develop a way to issue inexpensive Tier 1 securities without international investors being subject to German withholding tax.
- The LB Kiel issue was the first transaction that allowed a German state owned Landesbank to raise Tier 1 capital in the international capital markets. It was also the first presumed non-innovative deal sold to individual investors. The issuer was able to get around the withholding tax issue by postponing the withholding tax for up to 12 years (10 years plus 2 years' notice as mentioned above). This means that after the call date, there is an incentive for the issuer to either call the securities or refinance.
- The EFG Private Bank issue is principally the same as the LB Kiel issue with the following notable exceptions:
  - no withholding tax gross-up by the issuer;
  - the issuer's sole assets are participating bonds directly issued by the bank (and which qualify for Core Tier 1 treatment) and class B preferred issued by a wholly-owned offshore subsidiary of the bank. This subsidiary's sole asset is a subordinated note issued by the bank (on which the bank is able to receive its tax deductions);
  - the participating bonds have loss absorption (to qualify for Core Tier 1); and
  - the bank can convert the participating bonds into other forms of Tier 1 qualifying securities or common shares.
- In the Helaba transaction, the "profit participation payments" and replenishments of the "silent contribution" were subject to German withholding tax plus a solidarity surcharge withheld and transferred to the German tax authorities. To the extent such profit participation payments and to the extent such replenishments were attributable to the issuer's limited partner as taxable profit under German tax laws, such withholdings would be counted as a prepayment towards the German income tax owed by the issuer's limited partner.

- ***Italian Bank Subsidiary Preferred (since 1998)***



Selected issues

- Banca Commerciale Italiana (1998)
- Intesa (1998)
- Banca Lombarda (2000)
- Banca Popolare di Lodi (2000)
- UniCredito (2000)

- Sanpaolo IMI (2000)
- Banca Popolare Commercia e Industria (2001)
- Intesa BCI (2001)
- Banca Popolare di Bergamo (2001)
- Banca Popolare di Milano (2001)
- Banca Monte dei Paschi di Siena (2001)
- Banca Monte dei Paschi di Siena (2003)
- Banca Popolare di Lodi (2005)
- Unicredito (2005)
- Banca Italease (2006)

Transaction benefits

- Primary regulator capital treatment – minority interest Tier 1 capital.
- The interest on the bank debentures or deposits held by the LLC is deductible by the bank for Italian (in the case of head office debentures or deposits) tax purposes or, in the case of a branch, where the branch is located.
- Enables the bank to issue preferred equivalent in US dollars.

Features

- The issuer is a US-domiciled trust that is either a US subsidiary of the bank or a hat check trust.
- The intermediate subsidiary is a US-domiciled limited liability company that is a subsidiary of the bank and qualifies as a partnership for US tax purposes.
- Generally, in the case of US subsidiary trusts, the common securities are held by:
  - the US branch or subsidiary of the bank if the bank has a US branch or subsidiary; or
  - if the bank does not have a US branch or subsidiary, the intermediate LLC subsidiary.

- The common securities and class A preferred of the intermediate LLC subsidiary (which rank senior to the class B preferred held by the trust for the benefit of investors) are held by the US branch if the bank has a US branch or, if not, by the bank or a subsidiary of the bank. In some cases, such as Banca Commerciale Italiana, Intesa and Lodi, there are no class A securities and the common securities have the attributes discussed herein for the class A securities.

- 10 year fixed then floating dividend rate.

- The issuer, whose only role is *pro rata* distributions from its assets, holds the class B preferred issued by the intermediate LLC subsidiary and the bank's guarantee thereof.

- The intermediate LLC subsidiary's primary assets are debentures or deposits issued by the head office or a non Italian branch, as the case may be, of the bank, the principal amount of which is, in each case, at least equal the liquidation preference of the class B preferred. Depending on the US or Italian tax position, the intermediate LLC subsidiary may have additional assets that are eligible assets for purposes of Rule 3a-5 under the 1940 Act.

- Dividends on the class B preferred are mandatorily payable unless:

  – according to the most recently prepared and approved set of unconsolidated annual accounts for the bank, the bank does not have net profits available for paying a dividend on any class of its share capital and/or the bank has not declared or paid dividends on any of its securities for the then current financial year;

  – the bank is otherwise prohibited under applicable Italian banking laws from declaring a dividend on any of its share capital; or

  – a Shift Event, as defined below, has occurred and is continuing,

  provided that, if the bank pays dividends on any of its securities that rank equally with or junior to the preferred, notwithstanding the foregoing, it must pay dividends on the class B preferred for one year.

- Dividends not paid to the trust or other class B preferred holders as a result of the above are paid as a dividend to the common holder.

- The class B preferred's liquidation payment is determined by reference to the intermediate LLC subsidiary's assets, which, following a Shift Event, other than, in some cases, the contingent support agreement, will be depleted because the intermediate LLC subsidiary's assets – including the bank's debentures or the intermediate LLC subsidiary's deposits with the bank – will have been distributed to the class A preferred holders.

- Following a Shift Event, class B preferred holders can rely on either the hard guarantee or contingent support agreement for payment.

- Upon the occurrence of one of the Shift Events below, the class A securities are redeemed for the bank debentures held by the intermediate LLC subsidiary or the intermediate LLC subsidiary's deposits in the bank, as the case may be:

  – as a result of losses incurred by the bank, the total risk-based capital ratio of the bank as reported by the bank or determined by the Bank of Italy falls below the minimum requirements of the Bank of Italy;

  – proceedings are commenced for the winding-up of the bank; or

  – the Bank of Italy determines that one of the events mentioned above will occur in the near term.

- The bank's capital contribution to the trust, if it is a subsidiary trust, is nominal (*e.g.*, US$1,000), and to the intermediate LLC subsidiary varies from nominal to substantial, depending upon the tax analysis.

- The intermediate LLC subsidiary's primary assets are subordinated debentures issued by or on deposit with the bank, which has the same interest payment and redemption features as the class B preferred and the trust preferred. In the 1998 Intesa offering, the deposits in the bank held by the intermediate LLC subsidiary were credit-linked like the Japanese non-operating subsidiary deals.

- The 1998 transactions and Lodi transaction use a soft or no guarantee approach and a support agreement that provides the intermediate LLC subsidiary's cash flow after a Shift Event to pay dividends and redemption and liquidation payments. The other transactions use a hard guarantee (Sanpaolo uses a hard guarantee and a support agreement).

- Each of the hard guarantees and the support agreements attempt to put holders of the intermediate LLC subsidiary preferred in the position they would be in if they were preferred holders of the bank.

- In the hard guarantee, the bank guarantees the class B preferred and, generally, if the issuer is a subsidiary trust, the trust preferred in a manner that makes the guarantee the functional equivalent of preferred issued by the bank itself. Accordingly, guarantee payments include:

  – dividend payments that the issuer or the intermediate LLC subsidiary, as the case may be, is required to pay;

- the redemption price, subject to the foregoing with respect to any dividend component; and
- the liquidation amount payable on the class B preferred and, if applicable, the trust preferred.

- In the soft guarantee, the bank guarantees payments on the class B preferred to the extent of available funds at the issuer or the intermediate LLC subsidiary, as the case may be.
- Upon the winding-up of the bank, the guarantee ranks junior to all indebtedness of the bank and either senior to all share capital of the bank or equal with the most senior preferred of the bank, if any, or senior to all other share capital of the bank.
- The intermediate LLC subsidiary must be wound up if the bank is wound up.
- One or more independent directors acting on behalf of preferred holders must approve certain actions, including the winding-up of the intermediate LLC subsidiary that is not concurrent with the winding-up of the bank.
- Trust preferred and class B preferred holders generally have the right to proceed directly against the bank under the guarantees and the debentures or deposits if the bank defaults on its payment obligations under the debentures.
- The issuer and the intermediate LLC subsidiary are 1940 Act exempt by virtue of Rule 3a-5 (finance subsidiary).

Italian Regulatory Capital Developments

On December 27, 2006, the Bank of Italy issued prudential regulations (such regulation, as amended from time to time, the "Circolare 263/2006") that, among other things, have an impact of the hybrid instrument that Italian banks can issue.

The hybrid instruments, in order to be deemed as "*strumenti innovativi di capitale*" for the purposes of the Circolare 263/2006 and therefore be included in the Tier 1 regulatory capital (*patrimonio base*) of the bank, shall comply with the requirements set forth in Title I, Chapter II, paragraph 3 of the Circolare 263/2006.[52]

[52] In particular (i) the issuing entity shall be incorporated in the EU or in a state belonging to the "Group of 10"; (ii) the instruments shall be irredeemable. The possibility to repay the instruments by the issuer shall not be allowed before 10 years from their issuance, and the repayment shall be previously authorised by the Bank of Italy; (iii) any step-up clauses can not operate before 10 years from the issuance of the instruments, and the amount of the step-up may not exceed, alternatively, 100 basis points or the 50 percent of the spread relating to the reference base, net of the difference between the initial reference base and the reference base on which the upgrade of the interest rate is calculated; (iv) the agreement shall provide for the possibility not to pay interest to the holders of the instruments if,

Hybrid instruments complying with such requirements may be included in the Tier 1 regulatory capital (*patrimonio base*) within the 20 percent of such capital. Those with a redemption incentive are includable up to 15 percent.

These changes in Italy's regulatory capital guidelines, together with a 2004 change that permits interest on perpetual debt instruments as a deduction for Italian income tax purposes and the need to issue bond-like securities in order to enable foreign investors to be eligible for an exemption from Italy's withholding taxes, provide interesting structuring opportunities and challenges.

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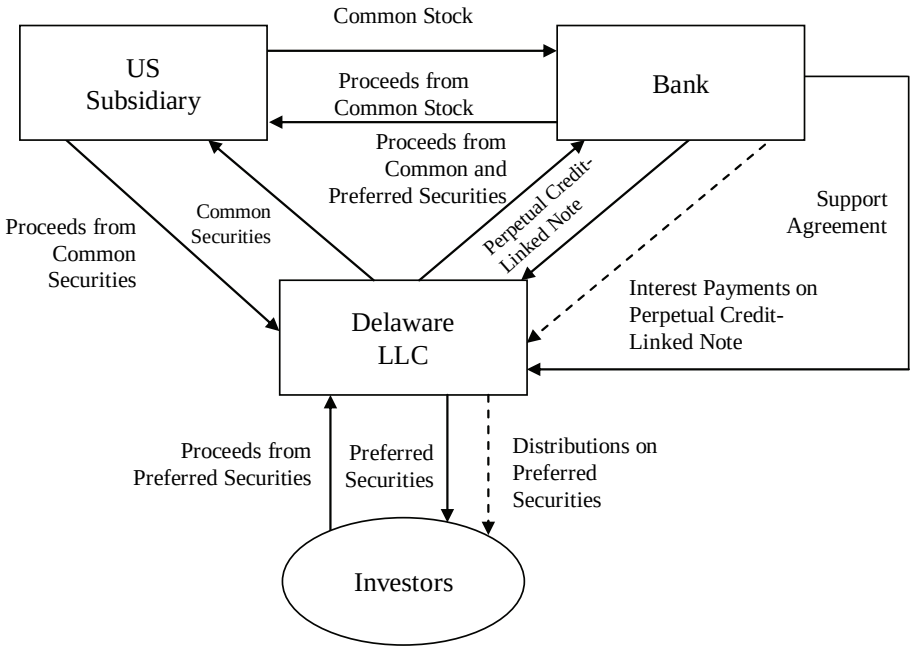
in the previous fiscal year, the bank controlling directly or indirectly the issuing entity, has not had any distributable profits and/or has not paid any dividends to its shareholders. The payment of interest shall be suspended in case the aggregate capital ratio (*coefficiente patrimoniale collettivo*) of the bank falls below 5 percent due to losses and the bank has not paid dividends to the shareholders; (v) the interest may not be cumulated. Once interest has been paid, there is no right for further remuneration; (vi) the agreement shall provide that the amounts deriving from the issuance of the instruments are totally disposable by the issuing bank, in the event the aggregate capital ratio (*coefficiente patrimoniale collettivo*) of the bank falls below 5 percent due to losses; (vii) in case of winding up of the bank, the holders of the instruments, who have priority vis-à-vis the shareholders, shall be subordinated to all other creditors; (vii) in case the instruments are issued by a non Italian subsidiary, an agreement providing the transfer of the sums received by the bank on the same terms and conditions of those set out for the issuance of the instruments, shall be in place.

- ***Japanese Bank Subsidiary Preferred (since 1998)***



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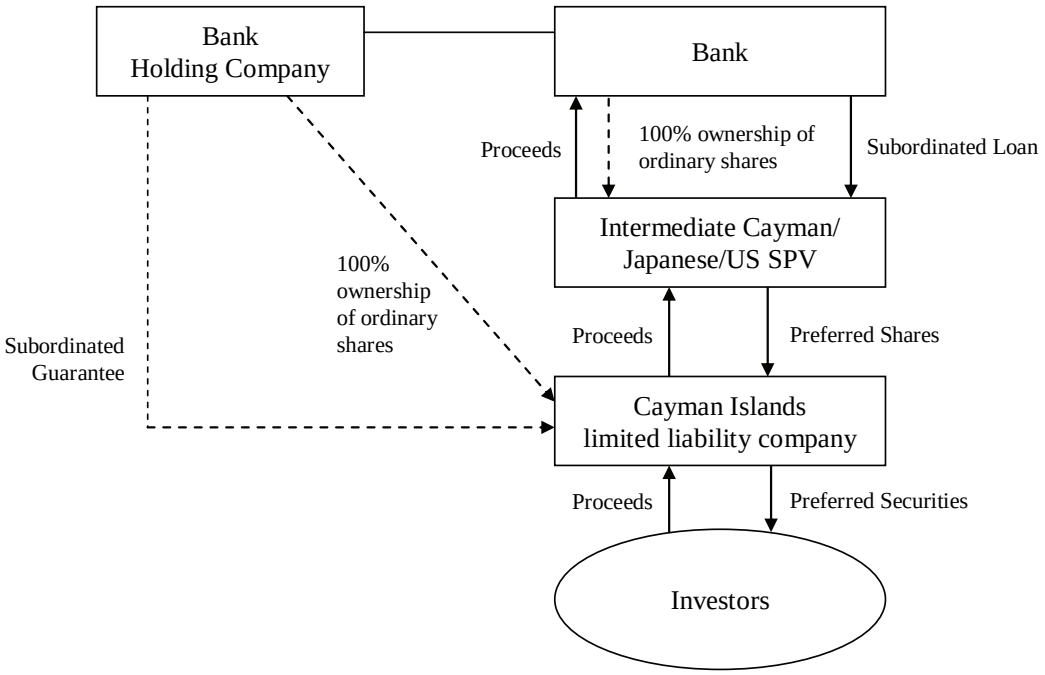

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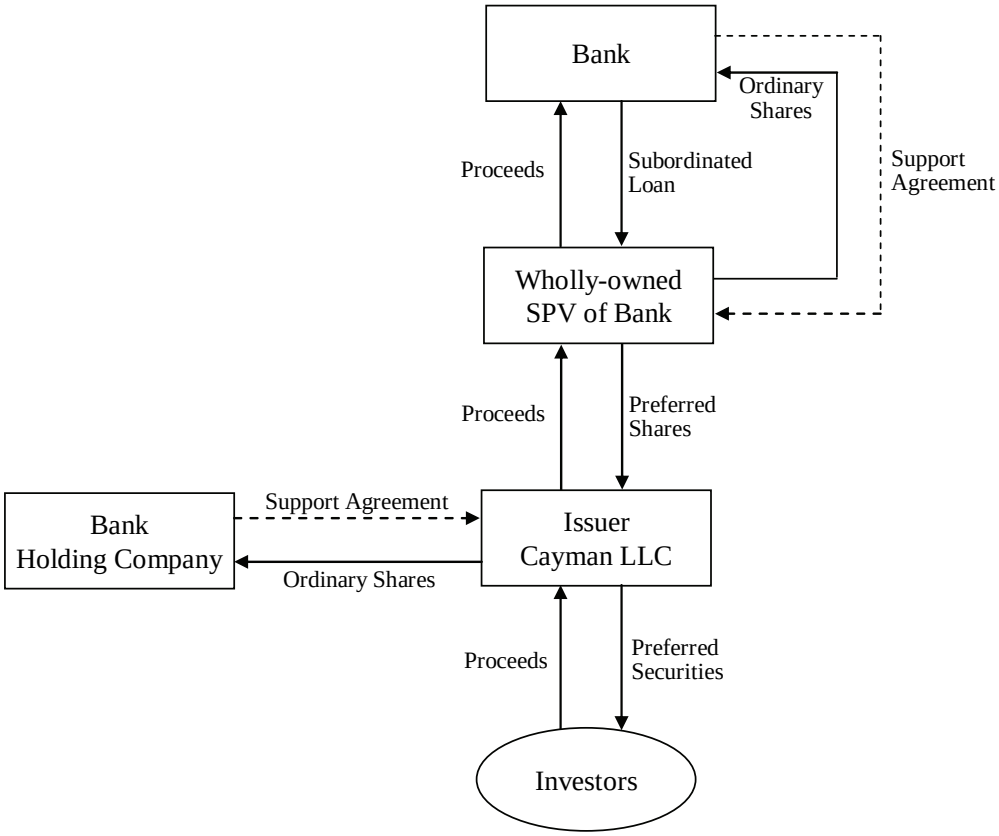


Selected issues

- The Industrial Bank of Japan, Limited (1998)
- The Fuji Bank, Limited (1998)
- Resona Holdings, Inc. (2005)
- Shinsei Bank, Limited (2006)
- Mitsubishi UFJ Financial Group, Inc. (2006 – three issues)
- Mizuho Financial Group, Inc. (2006)
- Mitsubishi UFJ Financial Group, Inc. (2007 – two issues)
- Mizuho Financial Group, Inc. (2007)
- Chuo Mitsui Trust Holdings, Inc. (2007)
- The Sumitomo Trust & Banking Co., Ltd. (2007)

- Mitsubishi UFJ Financial Group, Inc. (2008)
- Sumitomo Mitsui Financial Group, Inc. (2008 – four issues)
- Mizuho Financial Group. Inc (2008 – three issues)
- Chuo Mitsui Trust Holdings, Inc. (2008 – two issues)
- The Sumitomo Trust & Banking co., Ltd. (2008 – two issues)

Selected 2009 issues

- *Sumitomo Mitsui Financial Group, Inc. (January, September and October 2009)*
- *Mizuho Financial Group, Inc. (February, June, August and September 2009)*
- *Mitsubishi UFJ Financial Group, Inc. (March and July 2009)*
- *Shinsei Bank, Limited (March and October 2009)*

Transaction benefits

- Primary regulator capital treatment – minority interest Tier 1 capital.
- The interest on the bank instrument or loan held by the LLC or other intermediate SPV is deductible by the bank for Japanese tax purposes.
- Enables the bank to issue preferred equivalent.

Early transaction features

- The issuer is a US-domiciled limited liability company that is a subsidiary of the bank and qualifies as a partnership for US tax purposes.
- The issuer's common securities are held by the bank through a US-domiciled subsidiary.
- 10 year fixed then floating dividend rate.
- Dividends on the securities preferred are mandatorily payable unless:
  - the bank's total or Tier 1 risk-based capital ratio declines below minimum percentages required by Japanese banking regulations;
  - a liquidation proceeding is brought against the bank; or

– the bank has suspended dividend payments on outstanding bank preferred Tier 1 securities,

provided that, if the bank pays dividends on any of its capital stock, notwithstanding the foregoing, it must pay dividends on the preferred for two consecutive dividend periods thereafter, but only to the extent that interest payments are due on the credit-linked note held by the issuer.

- Dividends not paid to preferred holders as a result of the above are paid to the common holder.
- The preferred's liquidation payment is determined by reference to the issuer's assets, *i.e.*, the credit-linked note.
- The bank's capital contribution to the issuer is more than 10 percent of the issuer's assets.
- The issuer's primary asset is a credit-linked note, which it purchases from the bank with the proceeds from the sale of its preferred to investors and its common to a subsidiary of the bank.
- If the Japanese government (until year 10) or the US treasury (after year 10) defaults on its payment obligations under the applicable reference security, no interest is payable on the credit-linked note unless and until such default is cured.
- The bank does not issue a guarantee for the preferred securities. A guarantee is not required for Rule 3a-5 purposes because the transaction was not SEC-registered. Also, until 1998, Japanese banks generally did not guarantee securities issued by offshore subsidiaries because to do so required the banks, under Japan's foreign exchange laws, to provide prior notification to the Ministry of Finance. That requirement was rescinded effective April 1, 1998.
- Under a support agreement, the bank agrees to provide funds to the issuer for the payment of dividends if the bank pays dividends to the holders of its capital stock, but only to the extent of the bank's obligation to pay interest under the credit-linked note.
- Upon liquidation of the bank, the credit-linked note will entitle the issuer to such amount of the assets of the bank as if the credit-linked note were the bank's most senior preferred.
- One or more independent directors acting on behalf of preferred holders must approve certain actions and can enforce the support agreement and the credit-linked note on behalf of the issuer upon the winding-up of the bank. The independent directors must approve the winding-up of the

issuer other than a winding-up in conjunction with the winding-up of the bank.

Later transaction features

- The issuer of the subsidiary preference securities is a company incorporated with limited liability in the Cayman Islands and is a wholly-owned subsidiary of the bank holding company. The intermediate subsidiary is a SPV that is wholly-owned by the bank.

- The issuer uses the proceeds from the sale of its preferred securities to purchase preferred shares of the intermediate subsidiary. The intermediate subsidiary loans the proceeds from the sale of its preferred shares on a subordinated basis to the bank. The proceeds from such subordinated loans are used to strengthen the capital of the bank.

- The preferred securities pay a fixed dividend rate for ten years and then convert to a floating dividend rate (*e.g.*, three- or six-month LIBOR or EURIBOR) with or without a step-up thereafter.

- Non-cumulative dividends on the preferred securities will be deemed due and payable on each dividend payment date unless a mandatory suspension event or an optional suspension event has occurred.

  – Mandatory Suspension Events: If (i) the bank holding company winds up or is liquidated (or a similar event occurs) or if its capital ratios fall below the regulatory minimum levels, then the bank holding company will deliver a notice to the issuer and the intermediate subsidiary and such vehicle will pay no dividends with respect to the preferred securities on that dividend payment date, and (ii) if a distributable profits limitation or dividend limitation (*i.e.*, if distributable profits are less than the applicable dividend or if the bank holding company makes a final and conclusive declaration to pay less than full dividends on its preferred shares) is in effect, then the bank holding company will deliver a suspension notice to the issuer and the intermediate subsidiary and such vehicle will pay no dividends or reduced dividends with respect to the preferred securities on that dividend payment date.

  – Optional Suspension Events: If the bank holding company (i) has no outstanding preferred shares and (ii) has not paid and has declared that it will not pay dividends on any of its common stock for the most recently ended fiscal year, then the bank holding company may, at its sole discretion, deliver a suspension notice to each of the issuer and the intermediate subsidiary that such vehicle

pay no dividends or reduced dividends with respect to the preferred securities on the relevant dividend payment date.

- If the issuer receives payments on the preferred shares after the occurrence of a mandatory suspension event or an optional suspension event, then such payments will be paid to the holder of its ordinary shares (*i.e.*, the bank holding company) and not the holders of its preferred securities.

- If the bank holding company makes a final and conclusive declaration to pay less than the full amount of dividends on its preferred shares with respect to any fiscal year, then the amount of dividends the issuer and the intermediate subsidiary pay on its preferred securities on the dividend payment date in July of the calendar year in which that fiscal year ends and the next succeeding January will (to the extent not limited or prohibited by the distributable profits limitation and subject to the effect of any mandatory suspension event, if, and to the extent, applicable) be equal to an amount that represents the same proportion of full dividends on the preferred securities as the amount of dividends so declared on the bank holding company preferred shares with respect to that immediately preceding fiscal year bore to full dividends on the bank holding company preferred shares. For this purpose, full dividends will be treated as having been paid for a particular fiscal year even if no interim dividend is paid on the bank holding company preferred shares if a full dividend is paid after the end of the particular fiscal year. If the bank holding company makes a final and conclusive declaration not to pay dividends on its preferred shares with respect to a fiscal year, no dividends will be paid on the preferred securities on the dividend payment dates that occur in July of the calendar year in which that fiscal year ends and the next succeeding January.

- The bank holding company guarantees, on a subordinated basis, all dividends and amounts payable on redemption and liquidation of the issuer (unless a mandatory suspension event has occurred or a suspension notice has been properly delivered with respect to an optional suspension event).[53]

- The preferred securities are not redeemable at the option of the holders. The preferred securities may be redeemed at the option of the issuer and with the consent of regulatory authorities either after a fixed period of time or if certain events occur (such as a change of law that requires the issuer, the intermediate subsidiary or the bank to pay additional amounts or that affects the capital treatment of the preferred securities under Japanese

[53] According to an announcement issued by the Financial Services Agency of Japan on March 27, 2006, preferred securities issued by off-shore SPVs are required to be unsecured to qualify as a Tier 1 asset. Whether a preferred security with a subordinated guarantee would satisfy this requirement is a determination that is based on a facts and circumstances analysis of the guarantee. Japanese counsel should be consulted in advance in connection with this determination.

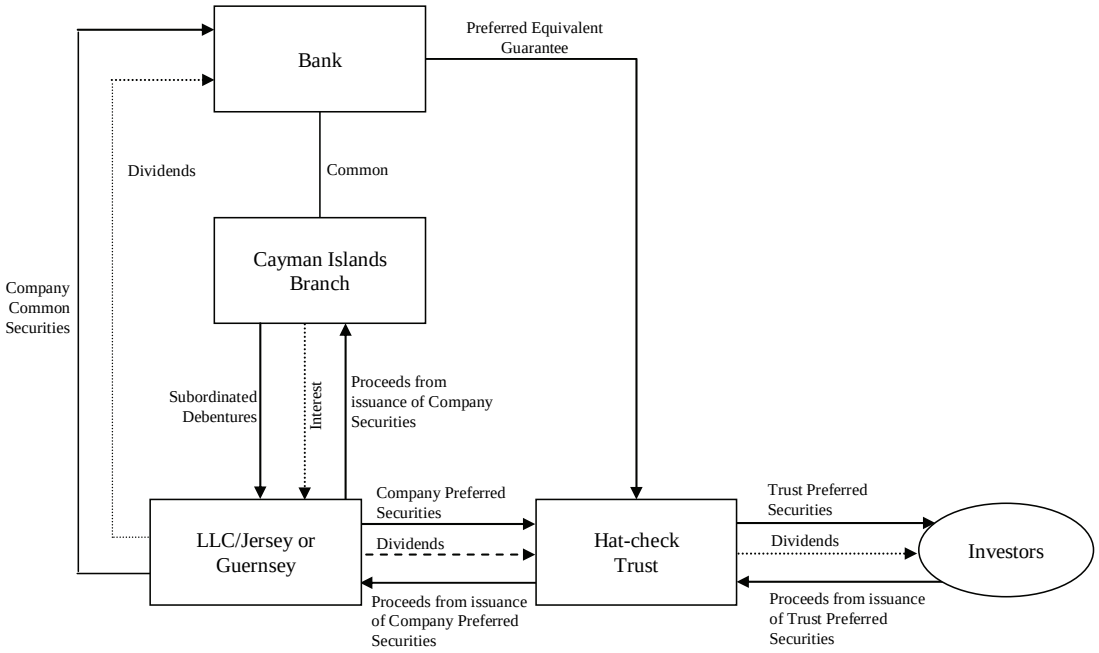
banking regulations). The preferred securities may be repurchased from holders by the issuer at the direction of the bank.

- Upon a winding-up of the bank, the subordinated guarantee (and therefore the preferred securities) effectively ranks equally in a liquidation with the most senior ranking preference shares of the bank holding company (and senior to the subordinated loan).

- The issuer and the intermediate subsidiary are 1940 Act exempt pursuant to Rule 3a-5 (finance subsidiary).

- The Mizuho Financial Group 2006 issue represented a development in hybrid issuance by using a non step-up structure for the first time among Japanese banks.

- ***Swiss Bank or Financial Services Company Guaranteed Subsidiary Preferred (normal issues since 2000; enhanced issues since 2006)***



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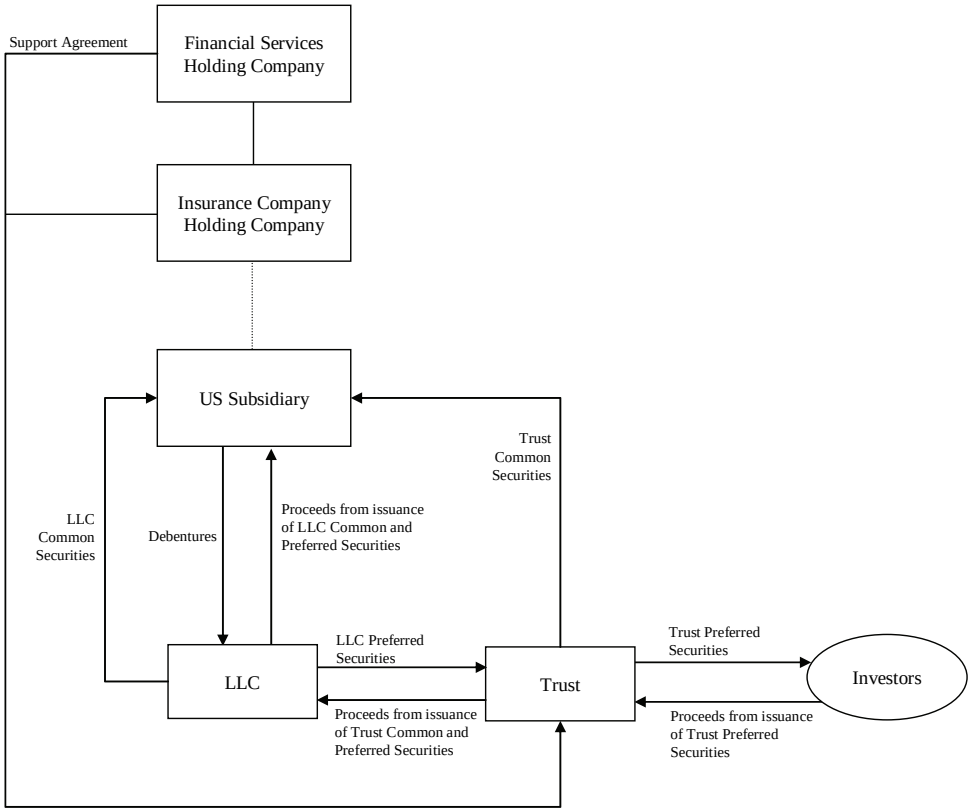


Selected issues

- UBS (2000)
- Credit Suisse (2000)
- UBS (2001)
- Credit Suisse (2001)
- Zurich Financial Services (2006)
- UBS (2006)

Transaction benefits

- Primary regulator capital treatment – minority interest Tier 1 capital.
- The interest on the debentures is deductible by the bank.

Features of normal and enhanced issues

- The issuer is a US-domiciled hat check trust.
- The intermediate subsidiary is a US-domiciled limited liability company that is a subsidiary of the bank and qualifies as a partnership for US tax purposes.
- The common securities of the intermediate LLC subsidiary (which rank senior to the class B preferred securities held by the trust for the benefit of investors), are held by the Cayman Islands branch of the bank.
- The issuer, whose only role is *pro rata* distributions from its assets, holds the company preferred issued by the intermediate LLC subsidiary and the bank's guarantee thereof.
- The intermediate LLC subsidiary's primary assets are debentures issued by the Cayman Islands branch of the bank, the principal amount of which is at least equal to the liquidation preference of the company preferred.
- Dividends on the company preferred are mandatorily payable if the bank pays dividends on any securities that rank equally with or junior to the preferred unless:
  - the bank is not in compliance with the Swiss Banking Commission's minimum capital adequacy requirements, or would not be in compliance because of payment of dividends on the company preferred securities;

- the bank does not have available distributable profits; or
- the bank delivers a notice limiting dividends.

- Dividends on the company preferred securities and, therefore, those on the trust preferred securities may, at the bank's option, shift to the company's common securities when no mandatory dividend payment amount is required to be paid on the company preferred securities.
- The class B preferred securities liquidation payment is determined by reference to the issuer's assets.
- The subordinated debenture issued by the Cayman Islands branch of the bank has the same interest payment and redemption features as the company preferred and the trust preferred.
- The bank guarantees the company preferred in a manner that makes the guarantee the functional equivalent of preferred issued by the bank itself. Accordingly, guarantee payments include:
  - dividend payments that the intermediate LLC subsidiary is required to pay;
  - the redemption price, subject to the foregoing with respect to any dividend component; and
  - the liquidation amount payable on the class B preferred and, if applicable, the trust preferred.
- Upon the winding-up of the bank, the guarantee and the debentures rank junior to all indebtedness of the bank, equal with the most senior preferred of the bank, if any, and senior to all other share capital of the bank.
- The issuer must be wound up if the bank is wound up.
- The intermediate LLC subsidiary is 1940 Act exempt by virtue of Rule 3a-5 (finance subsidiary). The issuer is not an investment company for purposes of the 1940 Act.

Additional features of enhanced issues

- Issuer is a US-domiciled trust that is a subsidiary of the US holding company, which is a subsidiary of the Swiss financial services holding company.
- Intermediate issuer is a US-domiciled subsidiary LLC of the US holding company.

- Distributions on the LLC preferred can be deferred for five years at the option of the issuer.

- Distributions on the LLC preferred are mandatorily deferred if the issuer is not in compliance with certain financial covenants (*e.g.*, negative net income for a four-fiscal quarter period).

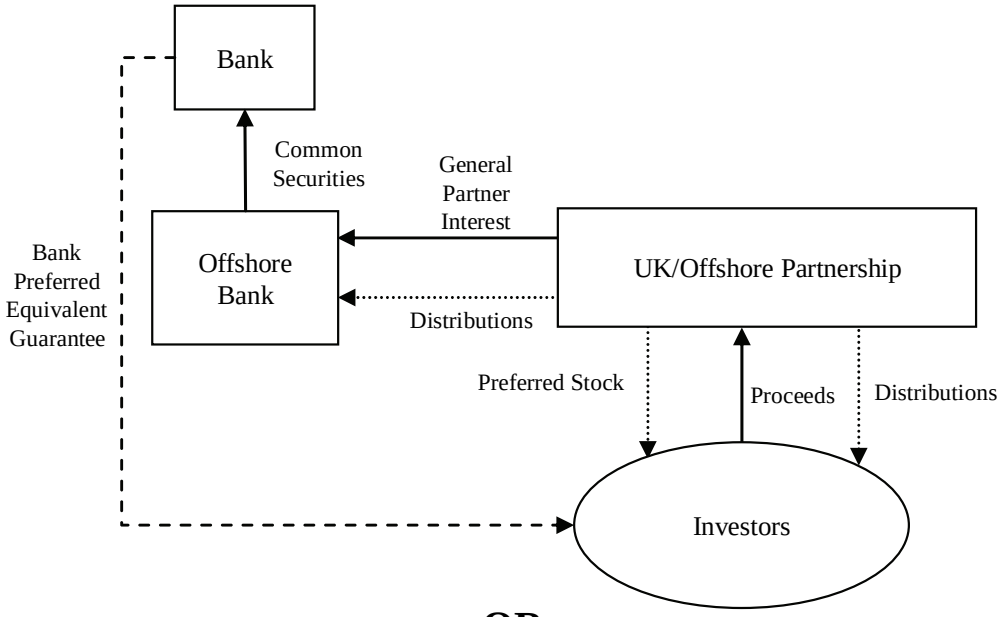
- Deferred distributions on the LLC preferred must be paid by the financial services holding company with the proceeds from the sale of its common stock.

- The debenture has a maturity of 30 years, but the LLC can reinvest the proceeds from the debenture in other eligible debt securities of its parent or of a third party.

- Replacement capital covenant – the managing member of the LLC commits not to redeem the LLC preferred without first having issued and sold securities that have equity-like characteristics that are the same as, or more equity-like, than the LLC preferred and the trust preferred securities (at the time of redemption).

- Issuer can obtain equity credit from Moody's.

- ***UK, Irish and South African Bank Guaranteed Subsidiary Instruments (since 1999)***



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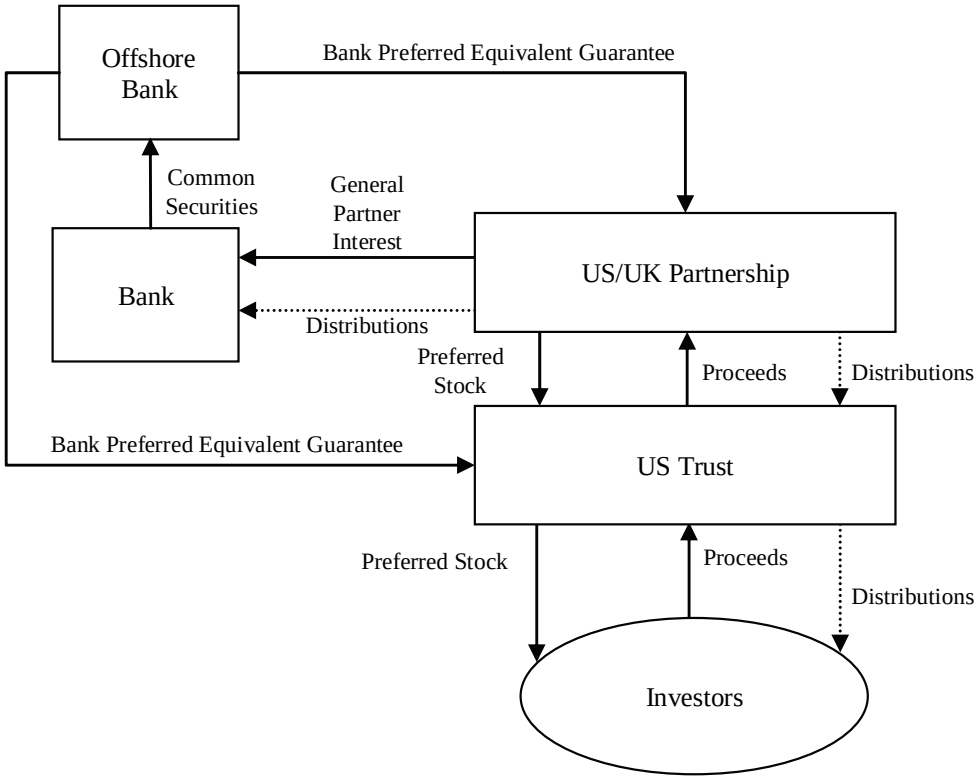

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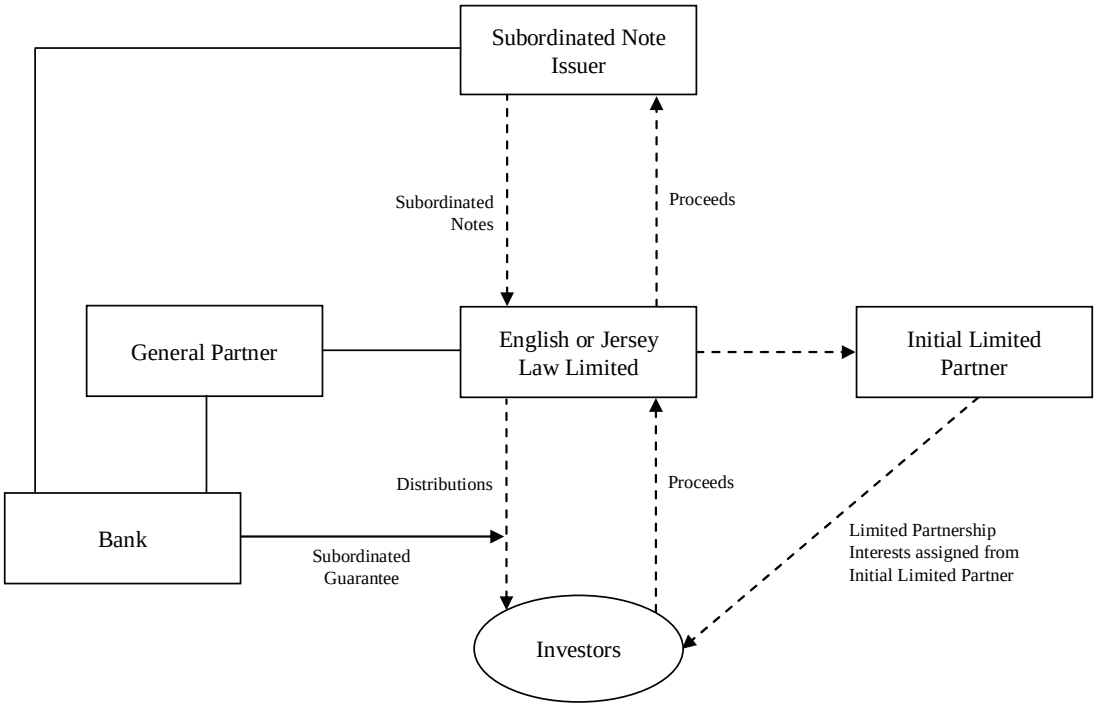
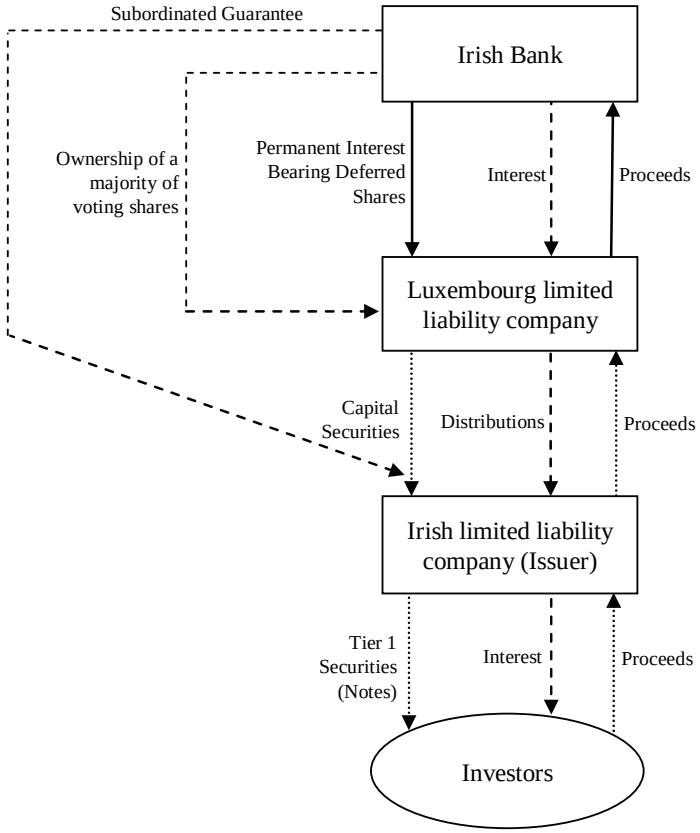

Subordinated Note Issuer
Subordinated Notes
Proceeds
General Partner
English or Jersey Law Limited
Initial Limited Partner
Distributions
Proceeds
Bank
Subordinated Guarantee
Limited Partnership Interests assigned from Initial Limited Partner
Investors

OR


Subordinated Guarantee
Irish Bank
Ownership of a majority of voting shares
Permanent Interest Bearing Deferred Shares
Interest
Proceeds
Luxembourg limited liability company
Capital Securities
Distributions
Proceeds
Irish limited liability company (Issuer)
Tier 1 Securities (Notes)
Interest
Proceeds
Investors

Selected issues

- Halifax (UK) (Jersey partnership) (1999)
- Abbey National (UK) (US trust/partnership) (2000)
- Lloyds (UK) (Jersey partnership) (2000)
- Standard Chartered Bank (UK) (US trust/partnership) (2000)
- HSBC (Jersey partnership) (UK) (2000 – three issues)
- Bank of Scotland (UK) (2000)
- HBOS (UK) (2001)
- Bradford & Bingley (UK) (2002)
- Royal Bank of Scotland (UK) (2002)
- HBOS (Jersey partnership) (2003)
- HSBC (Jersey partnership) (2003)
- Royal Bank of Scotland (UK) (US trust/partnership) (2003)
- HSBC (UK) (Jersey partnership) (2003)
- DePfa Bank (Irish) (English and Welsh LP) (2003)
- DePfa (Irish) (English and Welsh LP) (2004)
- HSBC (UK) (Jersey partnership) (2004)
- HBOS (UK) (Jersey partnership) (2004)
- Royal Bank of Scotland (UK) (US trust/partnership) (2004)
- Allied Irish Bank (Irish) (English and Welsh LP) (2004)
- DePfa Bank (Irish) (English and Welsh LP) (2005)
- Investec (South Africa) (English and Welsh LP) (2005)
- Anglo Irish Bank Corporation plc (Irish bank/Irish limited liability company) (2005)
- EBS Building Society (Luxembourg limited liability company/Irish bank guarantor/Irish limited liability company) (2005)

- Royal Bank of Scotland (UK) (US trust/partnership) (2005)
- Bank of Ireland (Irish) (English and Welsh LP) (2006 – three issues)
- Lehman Brothers UK (UK) (English and Welsh LP) (2006)
- HBOS (UK) (Jersey partnership) (2006)
- Allied Irish Bank (Irish) (English and Welsh LP) (2006 – two issues)
- Anglo Irish Bank (Irish) (English and Welsh LP) (2006)
- Royal Bank of Scotland (UK)(Delaware statutory trust/Delaware LP) (2006)
- DePfa Bank (Irish) (English and Welsh LP) (2007)
- Anglo Irish Bank (Irish) (English and Welsh LP) (2007)
- EBS Building Society (Irish) (Irish PLC) (2007)
- Lehman Brothers UK (UK) (English and Welsh LP) (2007 – two issues)
- HBOS (UK) (Jersey partnership) (2008)

Transaction benefits

- Primary regulator capital treatment – minority interest Tier 1 capital.
- The interest on the subordinated notes is tax deductible.

Features

- If a trust is used, the trust preferred securities are issued from a special purpose trust vehicle. Each trust preferred security represents an undivided beneficial interest in the assets of the trust, which are non-cumulative, perpetual preferred securities issued by a separate partnership. The assets of the partnership will initially consist of subordinated notes of the bank.
- The partnership holds subordinated notes issued by the bank and other eligible investments. If a trust is used, the holders of the trust preferred securities are not typically entitled to hold or enforce the subordinated notes or other eligible investments. Distributions on the partnership preferred securities are funded out of amounts received on the subordinated notes or other eligible securities.
- Typically, the bank will provide a guarantee, on a subordinated basis, as to the distributions and amounts payable on redemption and liquidation of

the trust or the partnership, depending on which structure is used. An investment in the trust or partnership preferred securities is intended to provide holders with rights to distributions and liquidation preference as similar as possible to those to which they would have been entitled if they had purchased non-cumulative, non-voting perpetual preference shares issued directly by the bank with economic terms equivalent to the trust or partnership preferred securities and the subordinated guarantees, taken together.

- If a trust is used, the distributions on the trust preferred securities are made to the extent the partnership makes corresponding distributions on the same dates on the partnership preferred securities. Distributions on the partnership preferred securities are payable on each distribution payment date unless the bank notifies the general partner of the partnership that distributions will not be paid as a result of certain limitations on distributions under UK banking regulations (*e.g.*, if distributions by the partnership would breach the capital adequacy requirements applicable under UK banking regulation or if the bank's distributable profits and distributable reserves would not be sufficient to enable the bank to pay full dividends or other distributions).

- Distribution rates on the partnership preferred securities are generally fixed for a period of time and thereafter will be payable at the sum of a fixed rate or an internationally recognized floating rate (such as EURIBOR or LIBOR).

- The bank will agree in the subordinated guarantees that if any distribution payable on the trust preferred securities or the partnership preferred securities has not been paid in full on the most recent distribution payment date, no dividends will be declared or paid on any junior share capital (typically meaning the ordinary shares of the bank, together with any other securities of any member of the bank as a group expressed to rank junior as to the right to dividends to the subordinated guarantees), unless and until distributions on the partnership preferred securities and the trust preferred securities have been paid in full.

- The bank will further agree in the subordinated guarantees that if any distribution payable on the trust preferred securities or the partnership preferred securities for the most recent distribution period has not been paid in full, the bank will not redeem, purchase, reduce or otherwise acquire any share capital of the bank or any securities of any subsidiary of the bank ranking, as to the right of repayment of capital, equal with or junior to the subordinated guarantees, nor may it set aside a sinking fund for that purpose, unless and until distributions on the partnership preferred securities and the trust preferred securities have been paid in full.

- The partnership preferred securities and the trust preferred securities are not redeemable at the option of the holders. Partnership preferred securities may be redeemed at the option of the partnership and with the consent of the FSA either after a fixed period of time or if certain events occur (such as a change of law that changes the tax status of the securities held by each of the entities in connection with this type of transaction or changes in capital treatment under UK banking regulation).

- If a trust is used, the holders of the trust preferred securities may be given a right, at the end of a certain specified period, to require the bank to exchange the partnership preferred securities for the cash proceeds generated through a sale of ordinary shares of the bank.

- The rights under the subordinated guarantees are subordinated to the rights and claims of all creditors (including, typically, depositors, general creditors and subordinated debt holders) of the bank and rights and claims of holders of shares or securities of the bank ranking senior to the subordinated guarantees.

- The trust preferred securities, the partnership preferred securities and the subordinated guarantees taken together do not entitle the holders thereof to receive more than they would have been entitled to receive had they been the holders of directly issued non-cumulative, non-voting preference shares of the bank.

- The ranking of the partnership preferred securities is ordinarily senior to the general partnership interest and the priority limited partnership interest as to payment of distributions. To the extent that distributions are not payable on the partnership preferred securities, the excess amount of the interest received by the partnership on the subordinated notes or other eligible investments is distributed to the priority limited partner as holder of the priority limited partnership interest.

- Upon dissolution of the partnership or trust, holders of the partnership preferred securities are typically entitled to receive a liquidation preference equal to their initial investment together with any due and accrued distribution and any additional amounts out of the assets of the partnership available for distribution under applicable law. If, at the time of a liquidation distribution of the partnership, an order is made or an effective resolution is passed for the winding-up of the bank, the liquidation distribution payable per partnership preferred security will not exceed the amount per security that would have been paid as a liquidation distribution out of the assets of the bank had the partnership preferred securities been non-cumulative, non-voting preference shares issued directly by the bank with rights of participation in the capital of the bank equivalent to the partnership preferred securities and the subordinated guarantees, taken together.

- Some transactions (*e.g.*, Royal Bank of Scotland, DePfa and Bank of Ireland) allow the partnership preferred securities to be replaced with directly issued capital securities or preference shares of the bank guarantor.

- The Bank of Ireland's Tier 1 transactions in 2006 allowed the issuer to take advantage of both innovative and non-innovative (or core) capital issuances. The key difference between the two types of transactions was that the non-innovative deal, unlike the innovative deal, did not allow a tax call, had a lower step-up after the ten year no-call period and limited the bank's ability to redeem the limited partnership interests after the no-call period. One further interesting point on this transaction structure is that the preferred securities had to be issued to an initial limited partner and subsequently assigned to investors at the time of closing due to the fact that Cede & Co. would not be a direct party to any of the transaction documents, including the limited partnership agreement.

- Features of the 2005 Anglo Irish and EBS transactions

  – The notes are perpetual securities and are secured by capital securities issued by a Luxembourg limited liability company and the subordinated guarantee in respect thereof (or, in the Anglo Irish transaction, by capital securities issued by the bank directly) and an assignment of the issuer's rights to payment in respect thereof.

  – In EBS, the capital securities of the Luxembourg limited liability company, which is a subsidiary of the bank, are issued in exchange for permanent interest bearing deferred shares of the bank.

  – Interest on the notes is non-cumulative and is only payable to the extent the issuer receives a distribution under the capital securities or, in EBS, in respect of the subordinated guarantee.

  – Deferral Conditions: Neither the Luxembourg limited liability company nor the bank guarantor will make a payment in respect of the capital securities:

    – if such payment, together with the amount of any distributions scheduled to be paid to holders of parity securities, would exceed adjustable distributable reserves; or

    – even if adjustable distributable reserves are sufficient:

      • if such payment in respect of the capital securities and/or the subordinated guarantee and/or the parity securities would cause a breach of applicable capital adequacy requirements;

- to the extent the bank is not meeting minimum capital requirements and solvency ratios as determined by the bank in its sole discretion;
- if the bank resolved that no distribution should be made on an applicable distribution payment date; or
- if the applicable bank regulator has instructed the bank or the Luxembourg limited liability company not to make such payment.

– Subject to certain exceptions, the issuer may not, without the consent of the trustee, incur other indebtedness or engage in any business other than those generally related to the transaction (in EBS, the Luxembourg limited liability company also may not incur additional indebtedness).

– The capital securities have a distribution and capital stopper provision, whereby the bank, as guarantor or issuer of the capital securities, as applicable, is prevented from declaring or paying distributions on, or effecting the redemption of, instruments ranking *pari passu* with or junior to the subordinated guarantee or the capital securities, as applicable, if the bank fails to make a payment in respect of the subordinated guarantee or on the capital securities, as applicable (other than proportionate payments on securities ranking *pari passu* in the case of a partial payment on the notes).

– If (i) the Luxembourg limited liability company or the bank is obliged to redeem the capital securities but fails to do so, (ii) proceedings for the liquidation, winding-up or dissolution of the Luxembourg limited liability company or the bank are commenced, (iii) the Luxembourg limited liability company or the bank fails to make payments on or in respect of the capital securities (in Anglo Irish, for a period of 14 days; in EBS, other than if such failure to pay is due to the existence of one of the deferral conditions listed above), (iv) the Luxembourg limited liability company or the bank breaches the distribution and capital stopper or (v) the Luxembourg limited liability company or the bank breaches any other provision of the capital securities or the subordinated guarantee in a manner that, in the opinion of the trustee, is materially prejudicial to the note holders, then the issuer shall notify the trustee, the paying agent and the note holders and redeem the notes.

- The issuer shall also redeem the notes if it is subject to withholding or other tax in respect of its income that it cannot otherwise reasonably avoid.

- The capital securities are redeemable at the option of the Luxembourg limited liability company or the bank on any distribution payment date ten years after the issue date.

- In the case of EBS, the capital securities can be substituted for substitute capital securities (having the same general economic terms as the capital securities) if the capital adequacy ratio of the bank falls below the minimum required level.

- The issuer has no direct or indirect relationship with the Luxembourg limited liability company or the bank.

- The notes pay interest at a fixed rate for the first ten years and then convert to a floating rate (there is a step-up at year ten).

- The Anglo Irish securities count as core Tier 1 capital, while the EBS securities were included as innovative Tier 1.

■ Features of Depfa Bank transactions

- The notes are preferred securities that will entitle holders to receive non-cumulative preferential cash distributions. Distributions will be payable out of the Issuer's own legally available resources annually in arrear.

- Notwithstanding the existence of such resources legally available for distribution by the Issuer, subject to certain conditions, the issuer will not pay any distributions to the holders and the guarantor will not make any payment in respect of distributions under the subordinated guarantee.

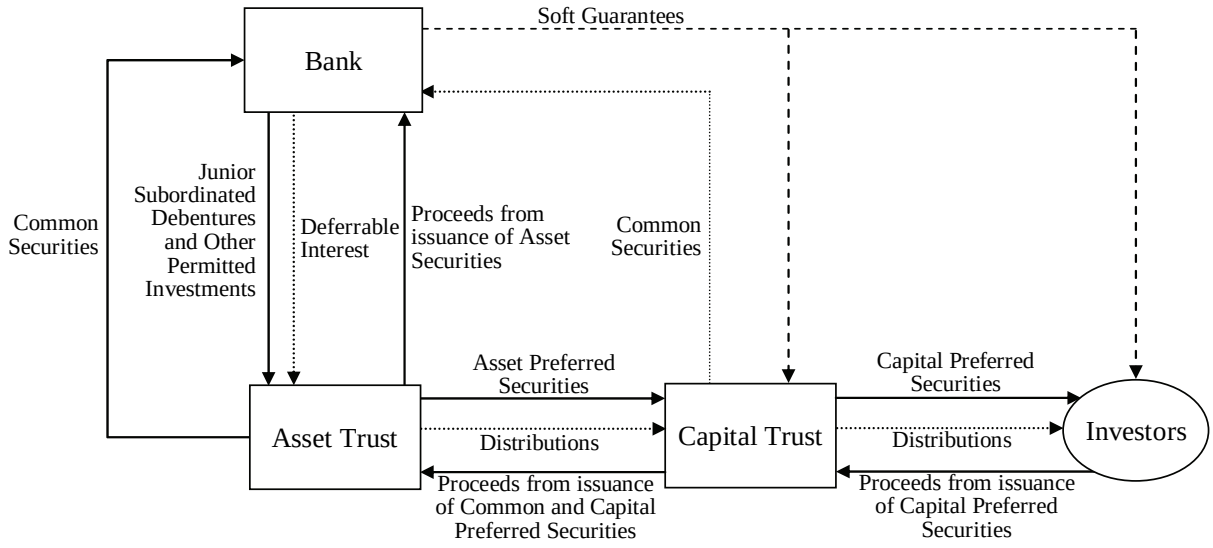
- The discretion of the guarantor's board of directors to resolve that a distribution should not be paid is unfettered, except that the guarantor's board of directors will exercise such discretion not to pay if the guarantor or any of its subsidiaries has suspended payment of, deferred or not paid the most recent payment or foresees suspension of the next payment on any of its preference shares (unless such payment is the last payment in the dividend stopper period) or Tier 2 securities (unless prior to the relevant distribution payment date of the preferred securities all the deferred and accrued arrears of interest in respect of such Tier 2 securities have been paid in full).

- To the extent that a distribution is not paid by reason of the limitations described above, no payment under the subordinated guarantee will be paid, or may be claimed in respect thereof.

- The guarantor will undertake in the subordinated guarantee that, in the event that any distribution is not paid it will not: (a) declare or pay any distribution or dividend and, where applicable, will procure that no distribution or dividend is declared or paid on any junior share capital or parity securities, until the then applicable dividend stopper period has expired; or (b) (if permitted) repurchase or redeem junior share capital or parity securities until the then applicable dividend stopper period has expired.

- The preferred securities will be perpetual securities and are not subject to any mandatory redemption provisions. The preferred securities will, however, be redeemable on a call date or any distribution payment date thereafter, in whole but not in part, at the option of the general partner and subject to the satisfaction of certain conditions.

- ***US Bank Holding Company and Irish Bank Guaranteed Subsidiary Preferred (since 1999)***



Selected issue

- Allfirst (formerly First Maryland) (1999)

Transaction benefits

- Primary regulator capital treatment – minority interest Tier 1 capital.
- The interest on the bank debentures or deposits held by the LLC is deductible by the bank for Irish (in the case of head office debentures or deposits) or US (in the case of New York branch debentures) tax purposes.
- Enables the bank to issue preferred equivalent in US dollars.

Features

- The issuer is a US-domiciled trust that is a US subsidiary of the bank or a hat check trust.
- The intermediate subsidiary is a US-domiciled trust that is a subsidiary of the bank and qualifies as a partnership for US tax purposes.
- The common securities of the capital trust subsidiary are held by the bank.
- The common securities of the intermediate trust subsidiary (which rank senior to the preferred held by the trust for the benefit of investors) are held by the bank.

- The issuer, whose only role is *pro rata* distributions from its assets, holds the class B preferred issued by the intermediate trust subsidiary and the bank's guarantee thereof.

- The intermediate trust subsidiary's primary assets are debentures issued by the bank, the principal amount of which is greater than the liquidation preference of the preferred. The intermediate trust subsidiary has additional assets that are eligible assets for purposes of Rule 3a-5 under the 1940 Act. Interest on the debentures is deferrable for up to 20 quarters at the issuer's discretion. The initial debentures mature in 30 years. The junior subordinated debentures are subordinate to all indebtedness of the bank.

- Dividends on the preferred are non-cumulative and payable only if interest is not deferred.

- Dividends not paid to the trust or other class B preferred holders as a result of the above are paid as a dividend to the common holder.

- The preferred's liquidation payment is determined by reference to the issuer's assets.

- The bank's capital contribution to the trust is nominal (US$1,000), and to the intermediate LLC subsidiary was substantial for purposes of the US tax analysis.

- The bank guarantees the preferred and trust preferred only to the extent funds are legally available in the respective vehicles.

- Upon the winding-up of the bank, the guarantee ranks junior to all indebtedness of the bank and equal with the debentures.

- Trust preferred and class B preferred holders have the right to proceed directly against the bank under the guarantees and the debentures if the bank defaults on its payment obligations under the guarantees or the debentures.

- The issuer and the intermediate LLC subsidiary are 1940 Act exempt by virtue of Rule 3a-5 (finance subsidiary).

- ***US National Bank Guaranteed Subsidiary Preferred (since 2000)***

  Selected issue

  - Bank One (2000)

  This was not a public transaction. It was approved by the OCC in a letter to Bank One Corporation dated December 22, 2000, which was published in January 2001.

CHAPTER 6

BANK OPERATING SUBSIDIARY TIER 1 INSTRUMENTS

Operating subsidiary preferred or "OpCo preferred" was originally developed to address the Basel Committee's position prior to the 1998 Basel Release that, in order to count as Tier 1 capital, the subsidiary that issued equity securities to investors had to be an operating company. To date, US banks have used this product over non-operating subsidiary preferred for a number of reasons, including:

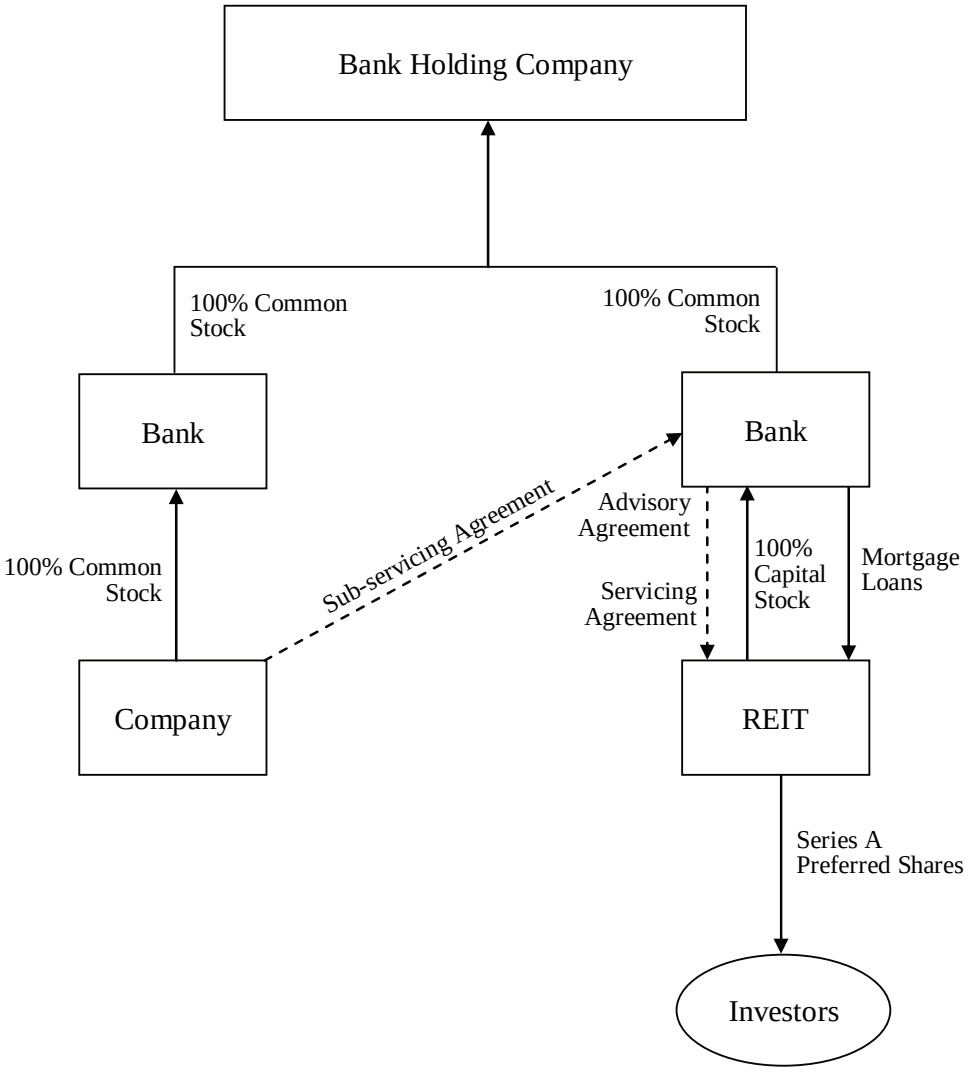
- in addition to paying preferred dividends out of pre tax profits, which is the result if the subsidiary qualifies as a REIT for US federal income tax purposes, some banks save state tax on their income or assets by moving income earning assets to subsidiaries established in low or no state tax jurisdictions; and

- the tax analysis for this product is considered more certain.

On the other hand, the ongoing administration of the subsidiaries is complicated because they have assets that require significant management. This may be particularly problematic for foreign banks with US branches who are required to manage the US based portfolio of its subsidiary.

With the exception of an early transaction, the loss absorption mechanism in the US OpCo preferred transactions is exchanging the subsidiary preferred for bank preferred or dividending or otherwise transferring the subsidiary's assets to the bank in the event that an event specified by the bank's primary regulator occurs.

- ***US Bank Holding Company and Bank REIT Subsidiary Preferred (since 1996)***



There is now less need for this structure due to the approval by the Federal Reserve Bank of bank holding company non-operating trust subsidiary preferred as Tier 1 and a revised Tier 1 analysis by US bank regulators.

Selected issue

- Chase Manhattan (1996)

Transaction benefits

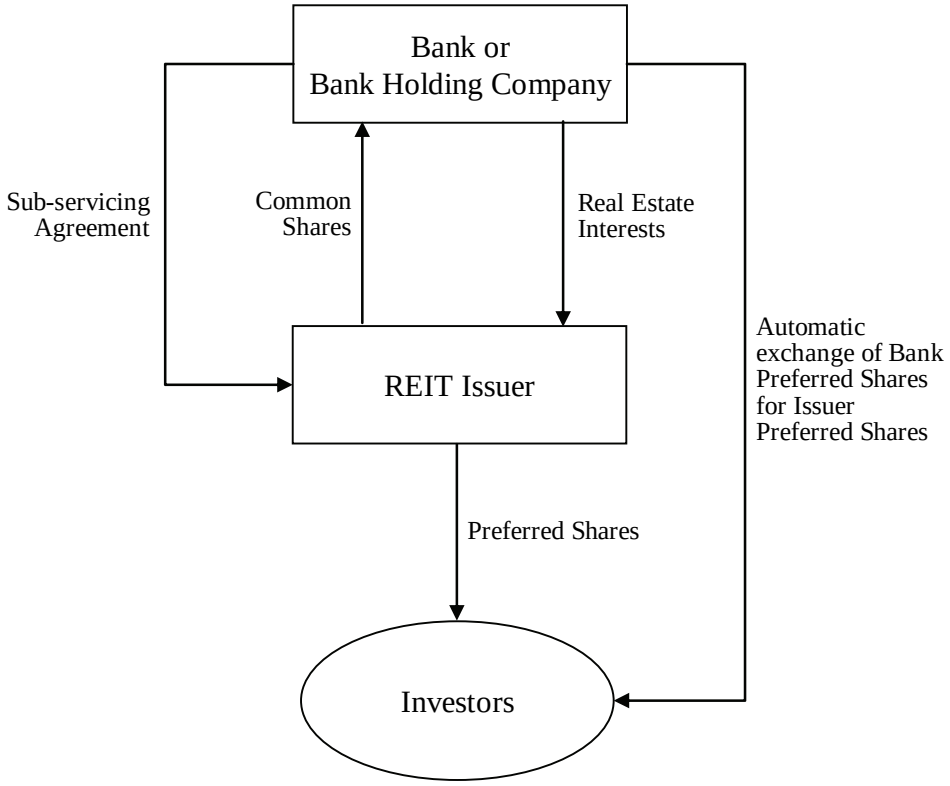
- Primary regulator capital treatment – bank and bank holding company minority interest Tier 1 under early transaction structure; core bank capital under the recent transaction structure.

- The issuer is not required to pay tax on income it distributes to shareholders. Accordingly, by contributing a portion of the bank's assets to the issuer, the bank pays less tax because the preferred dividends are paid out of profits before tax.

Transaction features

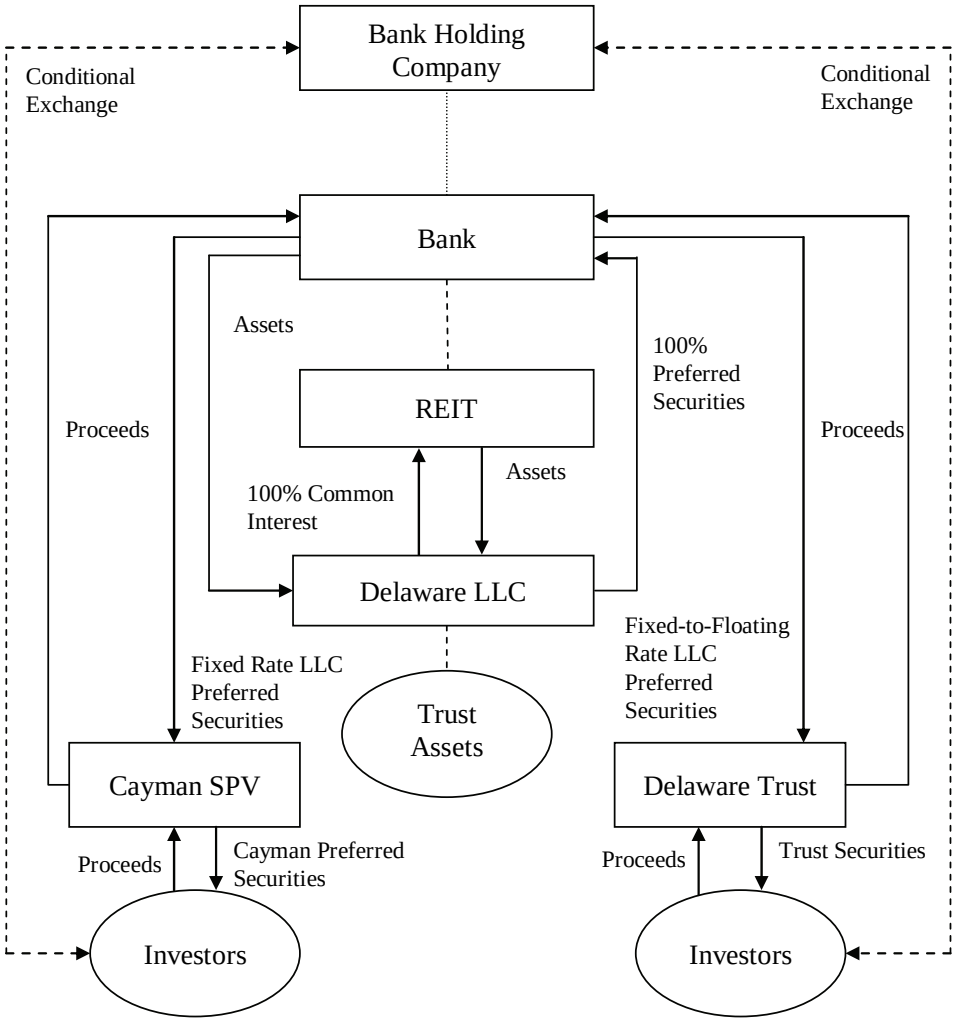
- The issuer is a US-domiciled corporation that is a subsidiary of the bank for accounting and tax purposes and qualifies as a REIT for US tax purposes.
- Real estate interests are the issuer's only assets.
- The preferred dividends are cumulative, discretionary and tied to distributable profits of the issuer, not the bank or the bank holding company.
- No guarantee or support agreement.
- The preferred securities liquidation payment is determined by reference to the issuer's available assets, not the bank's.
- The issuer is 1940 Act exempt pursuant to Section 3(c)(5)(C) (companies holding primarily interests in real estate).

- ***US and Canadian Bank REIT Subsidiary Exchangeable Preferred (normal since 1996; enhanced since 2006)***



OR

(since 2006)



This structure now holds less appeal for US banks following the Federal Reserve Bank's approval of bank holding company non-operating subsidiary cumulative trust preferred as Tier 1.

May be more appealing to US banks if the Federal Reserve Bank limits or controls Tier 1 treatment of bank holding company non-operating subsidiary cumulative trust preferred following adoption of FIN 46 and subsequent accounting treatment as a liability, not minority interest.

Increased appeal for US banks in recent years due to double leveraging and innovative capital basket limitations at the bank holding company level.

Selected issues

- Chevy Chase (US) (1996)
- D&N Bank (US) (1997)
- National Bank of Canada (Canada) (1997)
- Bank of Nova Scotia (Canada) (1997)
- SunTrust (US) (2000)
- Huntington Preferred Capital (US) (2001)
- First Republic (US) (2002)
- Washington Mutual (US) (2002)
- New York Community Bank (US) (2003)
- First Republic (US) (2003)
- Wachovia (US) (2003)
- Roslyn Bank (US) (2003)
- Novastar Financial (US) (2004)
- Capital Crossing (US) (2004)
- Washington Mutual (US) (2006 – two issues)
- PNC Bank (US) (2006)
- Royal Bank of Canada (Canada) (2008)
- National Bank of Canada (Canada) (2008)
- Toronto-Dominion Bank (Canada) (2008)

Transaction benefits

- Primary regulator capital treatment – bank minority interest Tier 1.
- The issuer is not required to pay tax on income it distributes to shareholders. Accordingly, by contributing and maintaining a portion of the bank's assets at the issuer level, the bank pays less tax because the preferred dividends are paid out of profits before tax.

- By moving assets to a low or no tax state, a US bank in a higher tax state may avoid state income and other taxes on the assets contributed to the issuer and profits thereon.

Features

- The issuer is a US-domiciled corporation that is a subsidiary of the bank or, in the case of Wachovia in its 2003 transaction, a bank holding company for accounting purposes and qualifies as a REIT for US tax purposes.
- Real estate interests, initially mortgages contributed directly or indirectly by the bank, are the issuer's only assets.
- Preferred dividends are non-cumulative, discretionary and tied to the distributable profits of the issuer, not the bank.
- No guarantee or support agreement.
- The preferred's liquidation payment is determined by reference to the issuer's available assets.
- The US bank preferred is mandatorily exchangeable into bank preferred with similar dividend, redemption and liquidation preference terms if:
  - the bank becomes undercapitalized under the applicable regulator's prompt corrective action regulations;
  - the bank is placed in bankruptcy, reorganization, conservatorship or receivership; or
  - the applicable federal regulator anticipates the bank becoming undercapitalized in the near term.
- The Canadian bank preferred is mandatorily exchangeable into bank preferred with similar dividend, redemption and liquidation preference terms if:
  - the bank fails to declare or pay dividends on any of its preferred shares;
  - the bank's Tier 1 risk-based capital ratio falls below percent or, in some cases, Tier 1 and total Tier 1 capital falls below 5 percent and 8 percent, respectively;
  - the Superintendent of Financial Institutions of Canada takes control of the bank or proceedings for the winding-up of the bank are commenced; or

- the Superintendent anticipates the bank becoming undercapitalized in the near term.

- The issuer is 1940 Act exempt pursuant to Section 3(c)(5)(C) (companies holding primarily interests in real estate).

- The 2006 Washington Mutual transaction involved two tranches of preferred securities, one issued by a Cayman Islands SPV and one issued by a Delaware statutory trust, that were mandatorily and conditionally exchangeable into depositary shares representing shares of preferred stock of Washington Mutual. The assets of both issuers were instruments that ultimately fed off an indirect US-domiciled corporate subsidiary of Washington Mutual that was a REIT for US tax purposes. The structure resembled a standard exchangeable REIT preferred structure with additional equity-like features (perpetual, non-cumulative, redemption only with replacement capital, etc.) that allowed Washington Mutual to pay investors out of pre-tax income, obtain holding company minority interest Tier 1 treatment and obtain enhanced equity credit from Moody's.

Enhanced transaction features

- There are two issuers – a Cayman Islands SPV and a Delaware statutory trust – that invest the proceeds from the sale of their perpetual non-cumulative preferred securities in perpetual non-cumulative preferred securities of an intermediate finance subsidiary. The Cayman SPV and Delaware trust preferred securities are not exchangeable for one another.

- The intermediate finance subsidiary is a Delaware LLC, which holds asset trust certificates. The asset trust certificates are backed by indirect interests in mortgages and mortgage-related assets (*e.g.*, home equity loans) that have been placed in the asset trust, which were originated by the bank and held by the bank and an indirect, US-domiciled corporate subsidiary that qualifies as a REIT for US tax purposes. In exchange for receiving the assets, the Delaware LLC issues its preferred securities to the bank and its common securities to the REIT. The bank then sells the LLC's preferred securities to the Delaware trust and the Cayman Islands SPV for cash.

- The trust preferred securities pay a fixed dividend rate for five years and then convert to a floating dividend rate (three-month LIBOR) with a step-up thereafter. The Cayman preferred securities pay only a fixed dividend rate.

- Non-cumulative dividends on the LLC's preferred securities are payable out of legally available funds on each dividend payment date if then declared due and payable by the board of managers of the LLC. Under certain circumstances, the OTS can choose to restrict the LLC's ability to

pay dividends on its preferred securities (thereby limiting the ability of the Cayman SPV and Delaware trust to pay dividends on their preferred securities) if it determines that the bank is operating with an insufficient level of capital.

- If the LLC, the Cayman SPV or the Delaware trust fails to pay dividends on its preferred securities, then holders of the Cayman SPV and Delaware trust preferred securities can vote to remove the independent manager of the LLC.

- The bank holding company also covenants that if full dividends on the Cayman SPV or Delaware trust preferred securities are not paid, then it will not declare or pay dividends with respect to, or redeem, purchase or acquire, any of its equity capital securities during the next succeeding dividend period (except for dividends paid in connection with employee benefits or shareholders' rights plans).

- Automatic exchange – at the direction of the OTS, the Cayman SPV and Delaware trust preferred securities are automatically exchangeable for depositary shares representing 1/1000th of a share of the bank holding company's Series I perpetual non-cumulative preferred stock. Conditional exchange – following certain events (*e.g.*, if the bank becomes "undercapitalized" under applicable OTS regulations or is placed in receivership or if the OTS directs such exchange in anticipation of the bank becoming "undercapitalized"), the preferred securities are also automatically exchangeable, except for depositary shares representing a different series of the bank holding company's perpetual non-cumulative preferred stock. The bank holding company covenants not to issue any preferred stock that would rank senior to the preferred stock issuable on exchange for the Cayman SPV or Delaware trust preferred securities.

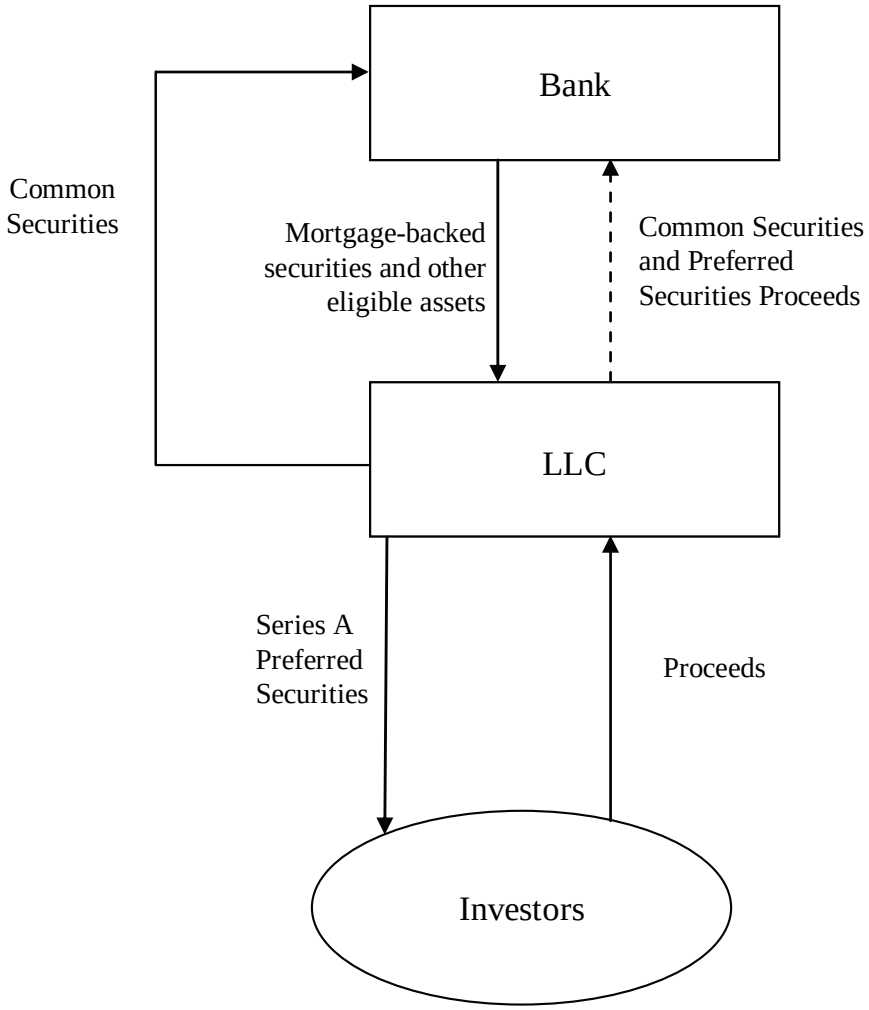
- The Cayman SPV and Delaware trust preferred securities are redeemable upon redemption of the LLC preferred securities. The LLC preferred securities are redeemable on any dividend payment date after five years at par, or earlier at a make-whole redemption price following the occurrence of a tax event (*e.g.*, if the LLC, the Cayman SPV or the Delaware trust is required to withhold amounts from payments), a 1940 Act event (*i.e.*, if there is significant risk that the LLC, the asset trust, Cayman SPV or Delaware trust is or will be considered an investment company that is required to register under the 1940 Act) or a regulatory capital event (*i.e.*, if there is significant risk that the LLC preferred securities will no longer constitute core capital of the bank for purposes of the OTS' capital regulations).

- Replacement capital covenant – the bank holding company contractually commits to its existing debt holders not to redeem or repurchase, or permit a subsidiary to redeem or repurchase, the Cayman SPV or Delaware trust

preferred securities, the LLC preferred securities or, after a conditional exchange, the depositary shares, unless, within 180 days prior to the date of redemption, the bank holding company or its subsidiaries issue equity securities and use the proceeds from such issuance to fund the redemption or repurchase.

- No guarantee or support agreement.
- The liquidation payment on the LLC's preferred securities is determined by reference to the LLC's available assets, not the bank's.
- The REIT is 1940 Act exempt pursuant to Section 3(c)(5)(C) (companies holding primarily interests in real estate); the issuer and the intermediate LLC subsidiary are 1940 Act exempt by virtue of Rule 3a-5 (finance subsidiary).

- ***French Bank Operating Subsidiary Preferred (since 1997)***



Selected issues

- Société Générale (1997)
- Banque Nationale de Paris (1997)
- Natexis Banque Populaires (1998)

Transaction Benefits

- The issuer is not required to pay tax on income it distributes to shareholders. Accordingly, by contributing a portion of the assets of a US-domiciled branch of the bank, the bank pays less US tax because the preferred dividends are paid out of profits before tax.

- Primary regulator capital treatment – bank minority interest Tier 1.

Features

- The issuer is a US-domiciled limited liability company that is a subsidiary of the bank and qualifies as a partnership for US tax purposes.
- Mortgage backed securities and other eligible investments, which may include US treasuries and short term investments, are the issuer's primary assets.
- The issuer's common securities are held by a US-domiciled branch of the bank.
- Preferred dividends are non-cumulative, discretionary and are tied to the distributable profits of the issuer or, following and during the continuance of a supervisory or Shift Event, to the payments made to the issuer by the bank under a support agreement between them.
- The preferred's liquidation payment is determined by reference to the issuer's available assets or, following a supervisory or Shift Event, the bank's available assets.
- The issuer must be liquidated if the bank is liquidated.
- Upon the occurrence of a supervisory or Shift Event, assets of the issuer are paid to the branch of the bank, as holder of the issuer's common securities. Supervisory or Shift Events include:
  - the bank's total risk-based capital ratio or Tier 1 risk-based capital ratio declines below the minimum percentages required by French banking regulations;
  - the bank becomes subject to insolvency, receivership or similar proceedings under French law; or
  - the French Banking Commission determines that either of the foregoing would apply in the near term.
- The issuer is 1940 Act exempt pursuant to Rule 3a-7 (asset-backed securities) in the case of Banque Nationale de Paris or Section 3(c)(7) (sales only to qualified institutional purchasers) in the case of Société Générale

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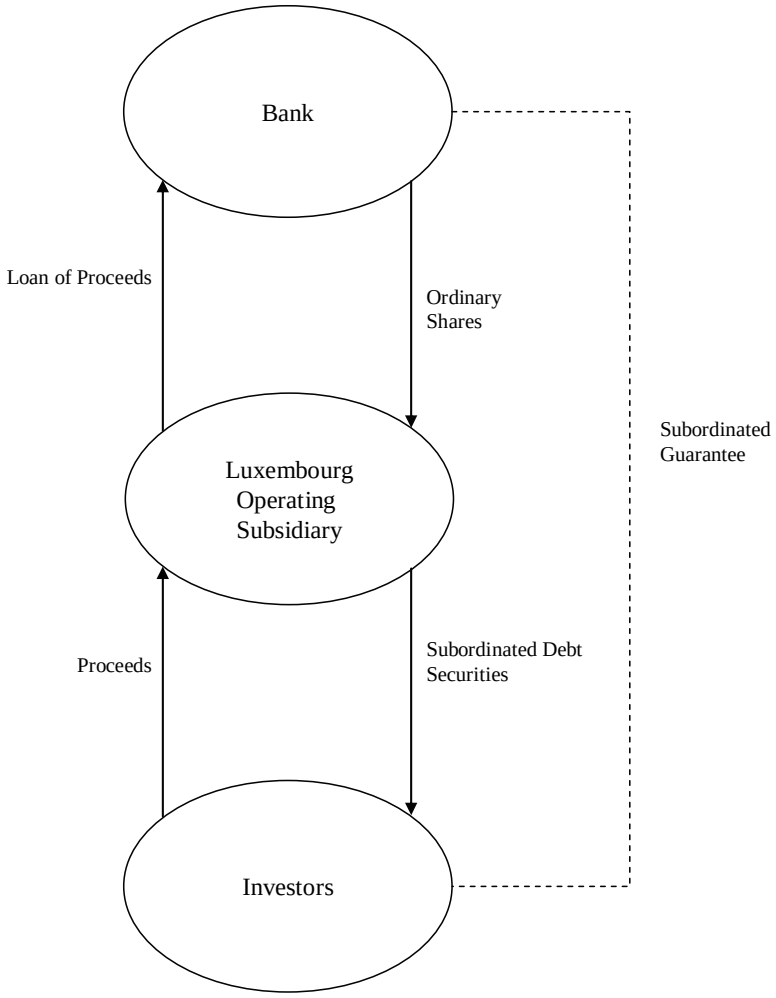
- ***Italian Bank Guaranteed Subsidiary Instruments (since 2008)***



Select Issue

- Unicredit International Bank (Luxembourg) S.A. as issuer and Unicredit S.p.A. as guarantor (2008)

Select 2009 issue

- *Unicredit International Bank (Luxembourg) S.A. as issuer and Unicredit S.p.A. as guarantor (December 2009)*

Transaction benefits

- Primary regulator capital treatment – bank level Tier 1.

Features

- Notes constitute direct, unsecured and subordinated obligations of the issuer ranking subordinate and junior to all indebtedness of the issuer (other than any instrument or contractual right expressed to rank *pari passu* with the notes), *pari passu* with the most senior non-cumulative preference shares of the issuer, if any, and senior to the other share capital of the issuer.

- Notes will bear interest on a non-cumulative basis at a fixed rate payable semi-annually to and including the interest reset date, and from and including the interest reset date to the date of redemption, at a floating rate.

- The issuer may elect not to pay all of the interest or to make a partial payment of the interest accrued to an interest payment date if (i) the guarantor does not have distributable profits and/or (ii) since the guarantor's annual shareholders' meeting in respect of the financial statements for the financial year immediately preceding the year in which such interest payment date falls, the guarantor has not declared or paid dividends on any junior securities.

- The obligations of the guarantor under the guarantee constitute direct, unsecured and subordinated obligations of the guarantor, ranking subordinate and junior to all indebtedness of the guarantor (other than any instrument or contractual right expressed to rank *pari passu* with the guarantee), *pari passu* with the most senior non-cumulative preference shares of the guarantor, if any, and senior to the other share capital of the guarantor.

- Notes will mature and be redeemed on the date on which voluntary or involuntary winding-up proceedings are instituted in respect of the guarantor.

- The issuer may, at its option, redeem the notes in whole, but not in part, on the interest reset date and on any interest payment date. In addition, the issuer may, at its option, redeem the notes in whole, but not in part, at any time before the interest reset date following the occurrence of a regulatory event or a tax deductibility event.

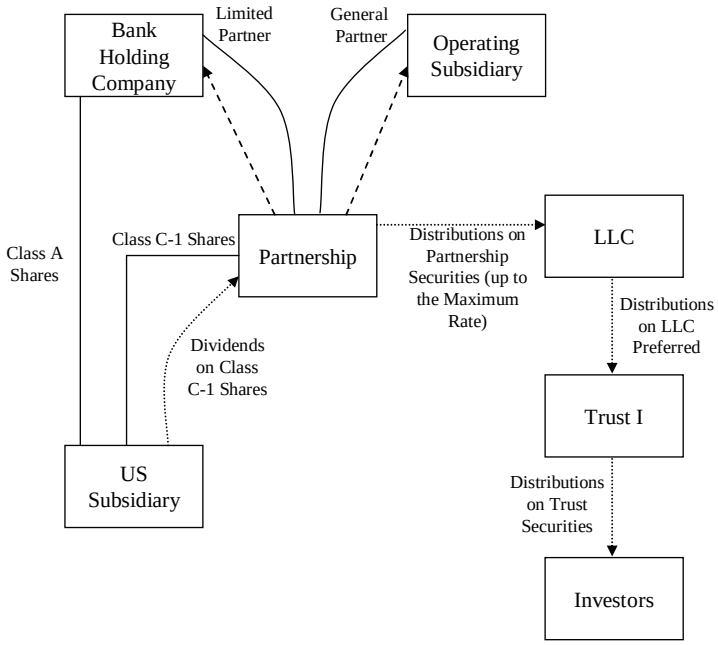
- Notes governed by English law, except the subordination provisions are governed by the laws of the Republic of Italy.

CHAPTER 7

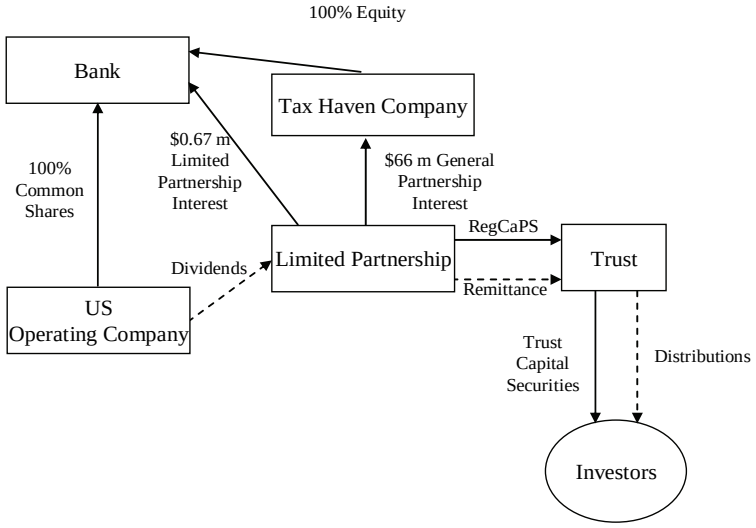
BANK MULTIPLE TAX BENEFIT SUBSIDIARY TIER 1 INSTRUMENTS

- ***US Trust/Limited Partnership Non-Operating Subsidiary Guaranteed DRD Preferred (since 2000)***

Fortis and Zurich



ABN AMRO



Selected issues

- Fortis (Belgian & Dutch) (2000)
- ABN AMRO (Dutch) (2000)
- Zurich (Swiss) (2001)
- Société Générale (French) (2001)

Transaction benefits

- Primary regulator capital treatment – Tier 1.
- The holders of the trust preferred that are US corporations benefit from a 70 percent dividends received deduction with respect to distributions on such securities.
- The bank is entitled to an interest deduction or pre tax payment benefit in its home country.

Features

- The trust preferred are marketed only to US corporations.
- The issuer is a US-domiciled trust.
- One of the intermediate entities is a US-domiciled partnership that qualifies as a partnership for US tax purposes.

- The issuer of the trust preferred, whose only role is to pay *pro rata* distributions from its assets, holds directly or indirectly the class C preferred securities issued by the partnership.

- The partnership's primary assets are the class C preferred issued by a US operating subsidiary of the bank. Dividends paid on the class C preferred securities are entitled to a dividends received deduction.

- Distributions on the class C preferred are non-cumulative and payable only to the extent that they do not cause the US operating subsidiary's net worth to be less than a specified dollar amount, which is adjusted by any amounts received for the issuance and sale of, or paid to purchase or redeem, any of its capital stock ranking *pari passu* with or senior to the class C preferred.

- If distributions are not paid, the US operating subsidiary cannot pay dividends on any securities ranking junior to the class C preferred.

- If distributions are not paid in full, the US operating subsidiary may only pay dividends ranking *pari* passu with the class C preferred and only in the same proportion as a partial dividend on the class C preferred.

- The securities are redeemable for cash or exchangeable for class C preferred upon the occurrence of certain events.

- No guarantee or support agreement.

- The class C preferred securities rank junior to indebtedness of the US subsidiary.

- The trust preferred are perpetual and dividends thereon are non-cumulative.

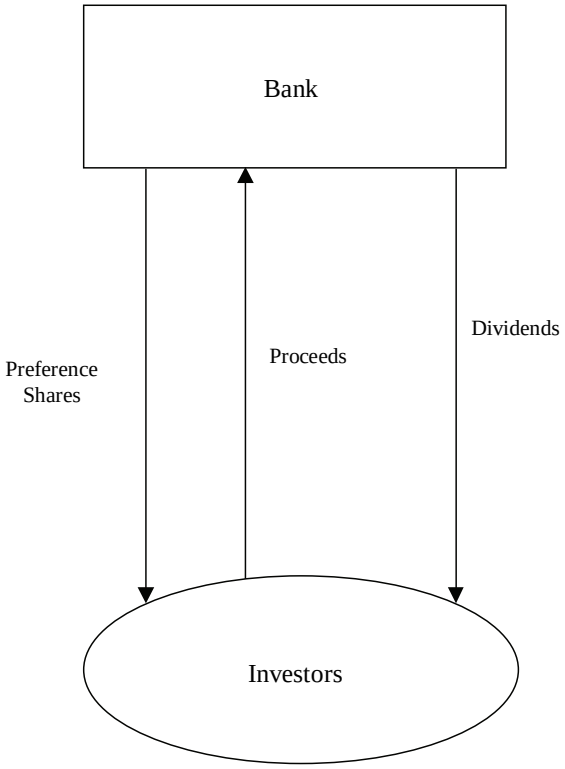
- In order to be exempt from Swiss withholding tax, in the case of Swiss companies, an investor must satisfy certain criteria and submit Swiss tax forms to the custodian holding the trust preferred on its behalf.

CHAPTER 8

BANK AND BUILDING SOCIETY DIRECT ISSUE TIER 1 INSTRUMENTS

The simplest of non-common equity Tier 1 capital is preferred stock, preference shares, perpetual subordinated debt instruments or other similar instruments issued by a bank. Many jurisdictions do not afford tax deductibility to dividend, interest or similar payments on these instruments, although an increasing number do. As a result, these products have been developed to take advantage of other benefits, tax and otherwise. Also, increasingly, bank and insurance regulators, without detracting from the Basel Committee's position that common shareholders' funds should be the key element of capital, are including these instruments in a regulated institution's 15 percent innovative and, in some areas, non-innovative Tier 1 capital basket. As noted in Chapter 4 above, however, preference shares may no longer qualify as hybrid capital under the latest Basel proposals in December 2009 and the EU's amendments to the Capital Requirements Directive in 2009 (although existing transactions will be grandfathered to a certain extent).

- ***UK and Irish Bank Preference Shares (since 1989)***



Selected issues

- Barclays Bank (UK) (1989)
- Allied Irish Bank (Irish) (1989)
- Royal Bank of Scotland (UK) (1989)
- Royal Bank of Scotland (UK) (2000)
- Royal Bank of Scotland (UK) (2001)
- Anglo Irish Bank (Irish) (2001)
- Standard Chartered Bank (UK) (2001)
- Lloyd's Bank (UK) (2002)
- Royal Bank of Scotland (UK) (2004)
- Barclays Bank (UK) (2004)

- Barclays Bank (UK) (2005)
- Alliance & Leicester (UK) (2006)
- HBOS (UK) (via an orphan Irish repackaging SPV) (2006)
- Northern Rock (UK) (via an orphan Irish repackaging SPV) (2006)
- Lloyds TSB Group (UK) (via an orphan Irish repackaging SPV) (2006)
- Standard Chartered Bank (UK) (2006)
- Royal Bank of Scotland Group (UK) (2006)
- HBOS (UK) (2007)
- Standard Chartered PLC (UK) (2007)
- Northern Rock PLC (UK) (2007)
- Royal Bank of Scotland Group (UK) (2007 – four issues)
- Standard Chartered PLC (UK) (2008 – two issues)
- Lloyds TSB Group (UK) (2008)

Transaction benefits

- Primary regulator capital treatment – bank level Tier 1.
- At one time, the dividend rate on the preference shares was lower because foreign investors were entitled to the UK Associated Tax Credit or the Irish Imputed Tax Credit, as the case may be, resulting in a higher net cash dividend than would otherwise be the case plus a foreign tax credit in respect of UK or Irish withholding tax.

Developments that have affected issuance of UK dividend tax credit preferred:

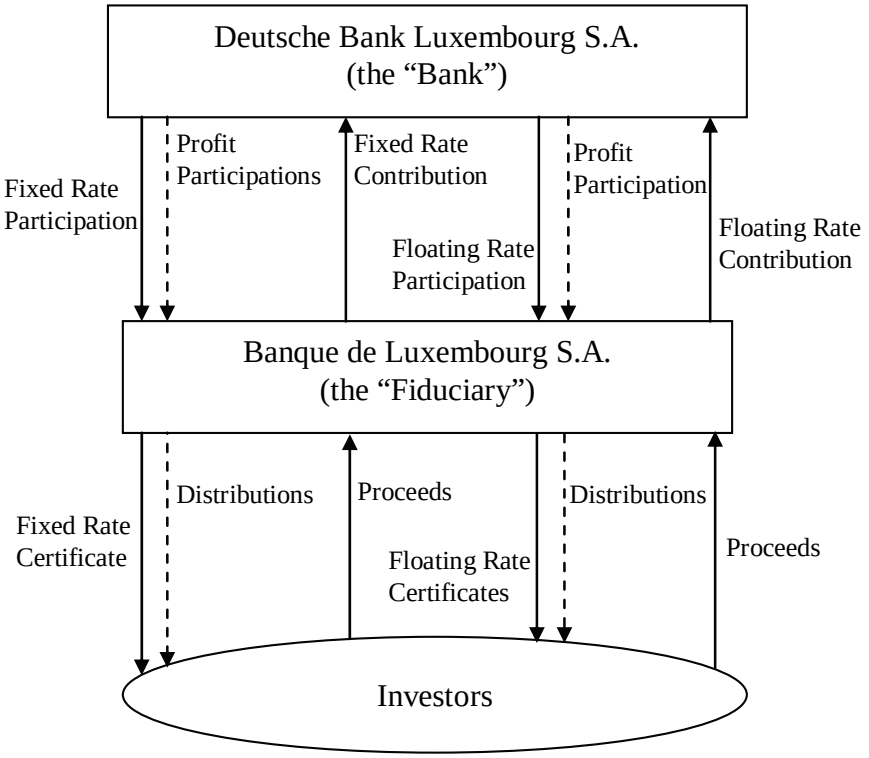
- UK Associated Tax Credit phased out by the UK Inland Revenue.
- FSA policy that a bank can only redeem a non-hybrid Tier 1 capital instrument with the proceeds from another non-hybrid Tier 1 capital instrument.

Initially, the preference shares were issued in the form of ADRs to avoid UK or Irish stamp duty. ADRs are no longer required to avoid such stamp duty.

Features

- Dividends are non-cumulative, but generally mandatorily payable by the bank:
  - to the extent of the bank's distributable profits and reserves; and
  - so long as payment does not result in breach of the bank's capital adequacy requirements.
- In older issues, the dividend rate is adjusted for changes in the UK Associated Tax Credit.
- The dividend withholding tax rate for US holders was 15 percent, which could be used by a US holder as a foreign tax credit subject to certain limitations.
- Liquidation payment on the bank preference shares is determined by reference to the bank's available assets.

- ***Luxembourg Bank Silent Partnership Securities (since January 1998)***



Selected issues

- Deutsche Bank Luxembourg (1998)
- Hypo und Vereinsbank AG (1998)

Transaction benefits

- Primary regulator capital treatment bank level Tier 1 and bank holding company Tier 1.
- Interest deduction at the bank level for distributions on the securities.
- No Luxembourg withholding tax on dividend payments.

10 year maturity.

Distributions are non-cumulative and payable to the extent of available distributable profits for the fiscal year.

Available distributable profits for a fiscal year means the bank's total profits or losses for that year, and, at the bank's discretion, distributable reserves.

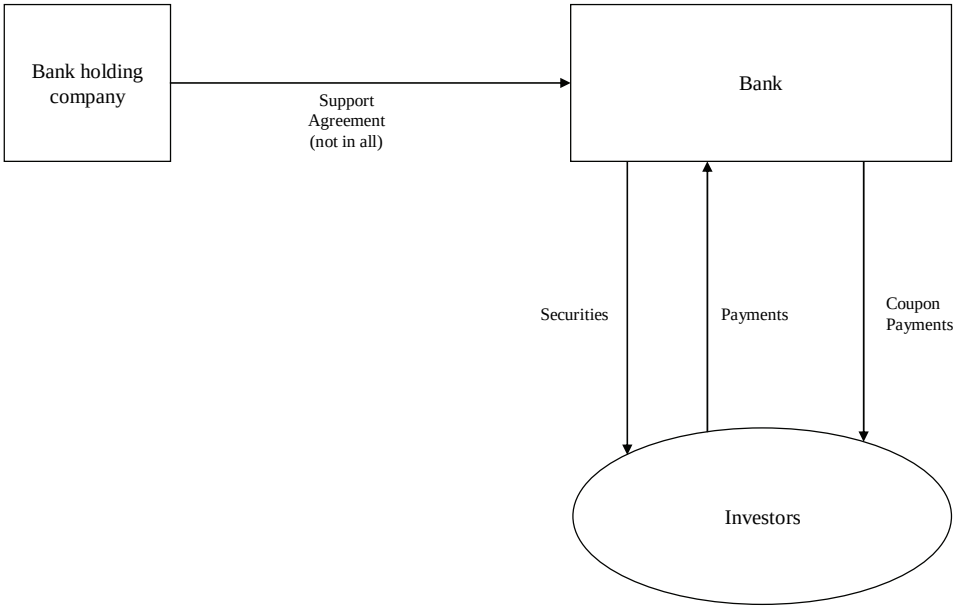
If distributions are not paid in full, the bank cannot pay cash distributions on its capital stock unless it pays four semi-annual distributions on the securities.

The securities participate in the losses and, to the extent the participations have been written down, the profits of the bank.

The securities can be redeemed early upon a regulatory event, but only at their initial contribution amount.

The securities rank junior to creditors, equal with other silent partnership interests and senior to the share capital of the bank.

- ***Austrian, German, French, Norwegian, Luxembourg, Dutch, Belgian, Danish, Icelandic, Swedish, Korean, Finnish, Philippine, New Zealand, Taiwanese, Italian, Mexican, Indian, Swiss, Slovenian, Guatemalan, Brazilian, Australian and Hong Kong Bank Instruments (since 1997)***



Selected issues

- Meritabanken (Finnish) (1997)
- Nordbanken (Swedish) (1999)
- Skandinaviska Enskilda Banken (Swedish) (1999)
- Den Norske Bank (Norwegian) (2001)
- Union Bank of Norway (Norwegian) (2002)
- Eksportfinans (Norwegian) (2003)
- ING Group (Dutch) (2003)
- AB Svensk Exportkredit (Swedish) (2003)
- SNS Bank (Dutch) (2003)
- Caisse Nationale des Caisses d'Epargne (French) (2003)
- KBC Bank (Belgian) (2003)
- NIB (Dutch) (2003)

- Korea First Bank (Korean) (2004)
- Skandinaviska Enskilda Banken (Swedish) (2004)
- Swedbank (Swedish) (2004)
- Kaupthing Bank (Icelandic) (2004)
- Jyske Bank (Danish) (2004)
- Danske Bank (Danish) (2004)
- ING Group (Dutch) (2004)
- Compagnie Financiere du Credit Mutual (French) (2004)
- Caisse Nationale des Caisse d'Epargne (French) (2004)
- Nordea Bank (Swedish) (2004)
- Caisse Federale du Credit Mutuel Nord Europe (French) (2004)
- Banesto (Spanish) (2004)
- Sydbank (Danish) (2004)
- Banque Federative Credit Mutual (French) (2004)
- Natexis Banques Populaires (French) (2005)
- Société Générale (French) (2005)
- Danske Bank (Danish) (2005)
- Shinhan Bank (Korea) (2005)
- Swedbank (Swedish) (2005)
- DLR Kredit A/S (Danish) (2005)
- ING Group (Dutch) (2005)
- IF Skadeförsäkring (Swedish) (2005)
- BNP Paribas (French) (2005)
- Dexia (Belgian) (2005)
- Crédit Agricole (French) (2005)

- Chinatrust Commercial Bank (Taiwanese) (2005)
- Danske Bank (Danish) (2006)
- Caisse Nationale des Caisses D'Epargne et de Prévoyance (French) (2006 – two issues)
- Crédit Agricole (French) (2006 – two issues)
- Landisbanki Islands HF (Icelandic) (2006)
- Metropolitan Bank & Trust Company (Philippine) (2006)
- Credit Logement (French) (2006 – two issues)
- ING Groep NV (Dutch) (2006)
- ABN AMRO Bank (Dutch) (2006)
- Sydbank (Danish) (2006)
- Kommunalkredit Austria (Austrian) (via a Luxembourg fiduciary that issued participation interests) (2006)
- BNP Paribas (French) (2006 – four issues)
- Erste Bank (Austrian) (via two Jersey cell companies) (2006)
- ICICI Bank, Bahrain branch (Indian) (2006)
- Glitnir Banki hf (Icelandic) (2006)
- Development Bank of the Philippines (Philippine) (2006)
- NIBC Bank NV (Dutch) (2006)
- Argenta Spaarbank (Belgian) (2006)
- Cofidis (French finance company) (2006)
- Shinhan Bank (Korean) (2006)
- Rizal Commercial Banking Corporation (Philippine) (2006)
- Danske Bank (Danish) (2007 – two issues)
- DnB NOR Bank ASA (Norwegian) (2007)

- Abanka Vipa (Slovenian) (via an unaffiliated bank and Dutch repackaging vehicle that issued perpetual loan participation notes to investors) (2007)
- State Bank of India (Indian) (2007)
- Kommunalkredit Austria AG (Austrian) (2007)
- Ixe Banco, S.A. (Mexican) (2007)
- Sydbank (Danish) (2007)
- Bank of India (Indian) (2007)
- The Bank of East Asia, Limited (Hong Kong) (2007)
- Société Générale (French) (2007 – two issues)
- Credit Suisse (Swiss) (2007)
- Svenska Handelsbanken AB (Swedish) (2007 – two issues)
- Wing Hang Bank, Limited (Hong Kong) (2007)
- Woori Bank (Korean) (2007)
- BBVA Bancomer, S.A. (Mexican) (2007)
- BNP Paribas (French) (2007 – four issues)
- La Compagnie Financière Edmond de Rothschild Banque (French) (2007)
- Roskilde Bank (Danish) (2007)
- Banco Popolare di Verona e Novara (Italian) (2007)
- Kaupthing Bank (Icelandic) (2007)
- Swedbank (Swedish) (September 2007)
- Crédit Agricole S.A. (French) (2007 – two issues)
- OKO Bank plc (Finnish) (June 2007)
- ING Groep N.V. (Dutch) (2007 – two issues)
- SNS REAAL N.V. (Dutch) (2007)
- Caisse Nationale des Caisses d'Epargne et de Prévoyance (French) (2007)
- Natixis (French) (2007)

- Rabobank Nederland (Dutch) (2007)
- Landsbanki Islands HF (Icelandic) (2007)
- Skandinaviska Enskilda Banken AB (Swedish) (2007)
- Swedbank (Swedish) (2008)
- Wing Hang Bank, Limited (Hong Kong) (2008)
- Credit Suisse (Swiss) (2008 – two issues)
- Intesa Sanpaolo S.p.A (Italian) (2008)
- Banco Popolare Di Milano (Italian) (2008)
- Crédit Agricole S.A. (French) (2008 – three issues)
- BNP Paribas (French) (2008 – two issues)
- KBC (Belgium) (2008 – two issues)
- Société Générale (French) (2008 – two issues)
- Natixis (French) (2008 – two issues)
- Rabobank Nederland (Dutch) (2008)
- Banco Industrial (Guatemalan) (2008 – two issues)
- Dexia Banque Internationale á Luxembourg, société anonyme (Luxembourg) (2008)
- ANZ National Bank Limited (New Zealand) (2008)

Selected 2009-2010 issues

- *Rabobank Nederland (Dutch) (May 2009)*[54]
- *Credit Agricole S.A. (French) (June, September and October 2009 – three issues)*
- *Société Générale (French) (August and September 2009)*
- *National Australia Bank Limited (acting through its New York branch) (Australian) (September 2009)*
- *Nordea Bank AB (Swedish) (September 2009)*

[54] Securities issued pursuant to an exchange offer, see page 311, Chapter 17 (*Liability Management Transactions*).

- *Skandinaviska Enskilda Banken AB (publ) (Swedish) (September 2009)*
- *Banco do Brasil (acting through its Grand Cayman branch) (Brazilian) (October 2009)*
- *BPCE (French) (October 2009 and March 2010)*
- *Intesa Sanpaolo S.p.A (Italian) (October 2009)*
- *Nykredit Realkredit A/S (Danish) (October 2009)*
- *SNS Bank N.V. (Dutch) (November 2009)*
- *Unicredit Bank AG* (*German*) *(November 2009)*

Transaction benefits

- Primary regulator capital treatment – bank level Tier 1.
- Interest deduction at the bank level for distributions on the securities.
- No withholding tax on dividend payments.

Features

- Perpetual maturity.
- Distributions are non-cumulative or are deferrable and are payable only to the extent of available distributable funds for that fiscal year.
- Some transactions use an Alternative Coupon Satisfaction Mechanism (as defined below) (in ordinary shares or hybrid capital securities or both) for deferred coupon payments.
- Available distributable funds means the amount shown on the latest published annual accounts of the bank, adjusted for any subsequent profit or loss of the bank.
- In most of these transactions, if distributions are not paid in full, the bank cannot pay cash distributions on its capital stock unless it pays four semi-annual distributions on the securities. In some cases, the issuer must pay distributions if it has made payments on its junior ranking securities.
- In some French transactions, dividends on the company preferred are only mandatorily payable if the bank pays dividends on any securities that rank equally with or junior to the preferred.

- In some of these transactions, the securities participate in the losses, and to the extent the participations have been written down, participate in profits of the bank by being written up pursuant to restoration allocations.

- The securities can be redeemed early upon certain events only at their principal amount.

- In some transactions, the shareholders of the bank can vote to convert the principal amount of the securities to satisfy losses at the bank, and to reinstate any reduction in the principal amount of the securities thereafter.

- The securities rank junior to creditors, equal with other silent partnership interests and senior to the share capital, including preferred, of the bank.

- In some transactions, the issuer issued non-cumulative perpetual step-up capital securities and Perpetual Capital Investments, respectively, under its Euro MTN program.

- The 2004 French transactions were issued off their Euro MTN programs and were deeply subordinated fixed rate notes convertible into floating rate notes after one year.

- In some transactions, the issuer bank receives the benefit of a support agreement from its parent holding company. The issuer is also able to convert the securities for upper Tier 2 securities upon the occurrence of certain events.

- Agenta Spaarbank, an intermediate holding company, had the benefit of a support agreement from its parent.

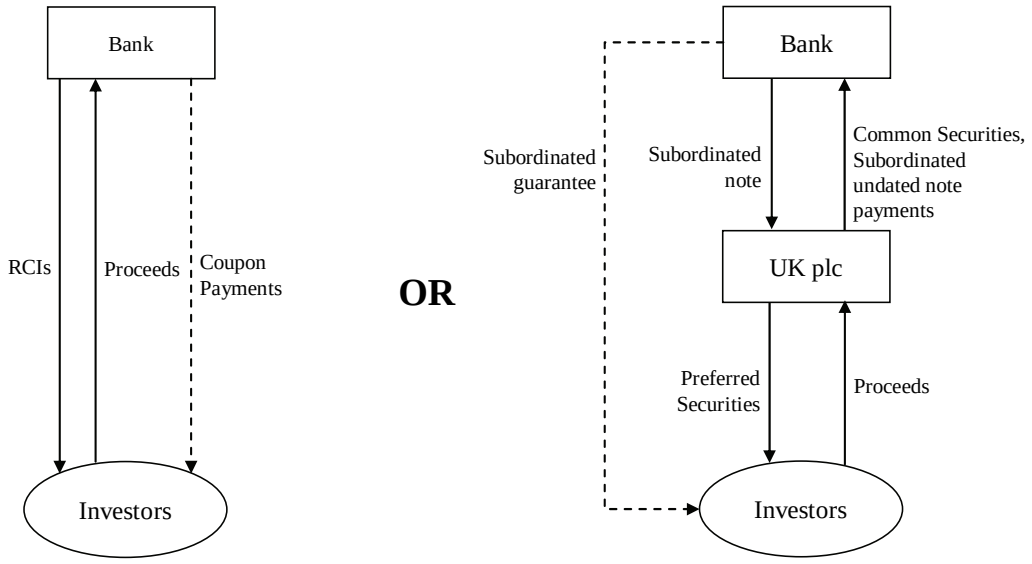
Guidelines in the Philippines

In December 2005, the Monetary Board of Bangko Sentral ng Philipinas approved guidelines based on the minimum features recommended by the Basel Committee regarding the recognition of hybrid Tier 1 capital instruments as eligible Tier 1 or core regulatory capital of a bank. The guidelines specify that the issuance of hybrid Tier 1 capital by a Philippine bank requires the prior approval of the Monetary Board and is subject to a maximum limit of 15 percent of total Tier 1 capital. Under the guidelines, the Monetary Board will not allow Philippine banks that issue peso denominated hybrid Tier 1, upper Tier 2 and lower Tier 2 instruments to swap the proceeds into a foreign currency for the purpose of investing in foreign currency denominated instruments. In February 2006, shortly after release of the guidelines, Metropolitan Bank & Trust Company became the first Philippine bank to use those guidelines with an offering of direct issue perpetual subordinated debt securities, followed thereafter by

Development Bank of the Philippines and Rizal Commercial Banking Corp, which issued direct issue perpetual subordinated debt securities in September and October 2006, respectively.[55]

[55] For further information on the guidelines issued by the Monetary Board of Bangko Sentral ng Philipinas, please see the following link: www.bsp.gov.ph.

- ***UK, Belgian and Irish Perpetual Settled Instruments (since 2000)***



Selected issues

- Barclays Bank (UK) (2000)
- Northern Rock (UK) (2000)
- Allied Irish Bank (Irish) (2001)
- Abbey National (UK) (2001)
- Bank of Ireland (Irish) (2001)
- Bank of Scotland (UK) (2001)
- Fortis (Belgian & Dutch) (2001)
- Royal Bank of Scotland (UK) (2001)
- Abbey National (UK) (TOPIC) (2002)
- Barclays Bank (UK) (TONs) (2002)
- Anglo Irish (Irish) (TONIC) (2002)
- Northern Rock (UK) (TONs) (2002)
- Lloyds TSB (UK) (RCIs) (2002)
- Anglo Irish Bank (Irish) (TONICS) (2003)

- Bank of Ireland (Irish) (2003)
- Alliance & Leicester plc (UK) (2004)
- Fortis (Belgian & Dutch) (2004)
- HBOS (UK) (2005)
- Royal Bank of Scotland (UK) (2005)
- Barclays Bank (UK) (2006)
- Yorkshire Building Society (UK) (2006)
- Derbyshire Building Society (UK) (2006 – two issues)
- Coventry Building Society (UK) (2006)
- Nationwide Building Society (UK) (2007 – three issues)
- Barclays Bank PLC (UK) (2007 – two issues)
- Kent Reliance Building Society (UK) (2007)
- Royal Bank of Scotland Group (UK) (2007 – two issues)
- Barclays Bank (UK) (2008 – two issues)
- Lloyds TSB Bank (UK) (2008)

Selected 2009 issues

- *Lloyds TSB Bank (UK) (January and December 2009)*
- *Standard Chartered Bank (UK) (June 2009)*
- *The Co-operative Bank plc (UK) (July 2009)*

Selected product names

- Reserve capital instruments or "RCIs."
- Perpetual Regulatory Tier 1 Securities or "PROs."
- Tier 1 Notes or "TONs."
- Tier 1 Preferred Income Capital Securities or "TOPICs."
- Tier 1 Non-Innovative Capital Securities or "TONICs."

Primary regulator capital treatment – bank level Tier 1.

- RCIs and PROs – Limited to 15 percent innovative Tier 1 basket.
- TONs, TOPICs and TONICs – At time of issue were limited to 35 percent non-innovative Tier 1 basket. Currently, other than grandfathered transactions, are subject to 15 percent innovative Tier 1 limit.[56]

Other transaction benefits

- Interest deduction at the bank level for distributions on the securities.
- No withholding tax on dividend payments.

In the Standard Chartered Bank June 2009 issue of perpetual preferred securities the coupon rate on the preferred securities for the first fixed period is equal to the gross redemption yield on United States treasury bills with a five year term plus a margin of 6.78 percent. The coupon rate then steps up to 150 percent above the margin.

Perpetual securities that have no maturity date are issued, in the case of a bank, directly by the bank pursuant to a trust deed or trust indenture. In the case of a building society, the Tier 1 securities may be issued as deferred shares pursuant to the organization instruments of the building society. Terms may vary from issue to issue but generally are as described below.

Redemption can only be in whole and not in part at the option of the issuer, subject to prior consent of the appropriate banking regulatory overseer and to certain solvency thresholds being met for the six months prior to the proposed redemption. Redemption can also occur following a change of control event or a change in tax status of the RCIs or PROs (see below).

Interest payments can vary from being a fixed rate for an initial period and then a variable rate thereafter to a fixed rate set above a published variable interest rate, such as LIBOR or EURIBOR. Other examples include a rate reset after a term of five years pegged to a published variable rate.

These securities are subordinated to the claims of senior creditors (including upper and lower Tier 2) and rank *pari passu* with holders of the most senior class of preference shares.

Interest payments, in the case of a bank, are effectively cumulative (provided they are paid only out of proceeds of the issue of ordinary shares as described below or in liquidation proceedings). Interest payments generally may be deferred by the bank subject to certain qualifications, as follows:

[56] See below and Appendix C (*Tier 1 Capital Rules for Banks in the United Kingdom*).

- payments will be mandatory to the extent that the bank pays on ordinary shares or *pari passu* preference shares;

- except in the case of a mandatory payment, payments may be deferred at the bank's election or option;

- deferral of payment may occur without any requirement to pay interest on the deferred amount if, and so long as, the bank determines that the bank was, or the payment would have resulted in the bank being, in non-compliance with applicable bank capital regulations or pre determined contractual insolvency thresholds;

- if the bank determines that it is not in compliance with applicable capital adequacy regulations, it must either defer payment or satisfy the payment with proceeds from the issuance of ordinary shares; and

- if the bank is not making payments on *pari passu* preference shares, then payments must be deferred, except in the case of a mandatory payment.

Deferral of interest payments can be at the option of the issuer, and does not require a trigger, although this is also true of many non-operating subsidiary trust preferred transactions. The issuer (in most cases the operating company subsidiary of the bank holding company) is able to defer coupons for any period of time, although neither the issuer nor its holding company is allowed to declare or pay a dividend during deferral, apart from final dividends already declared or a dividend paid by the issuer to the holding company. Deferral is in two forms:

- General Deferral – at the option of the issuer. Coupon so deferred accrues at the prevailing interest rate plus a premium (as in Barclays' original RCI deal, +2 percent) until paid.

- Exceptional Deferral – when the issuer does, or is about to, breach its capital requirements. Deferral is only for one coupon period (*i.e.*, one year) and there is no interest on interest. This exceptionally deferred payment has to be paid once the payment can be made without breaching the capital rules. Banking regulatory approval (such as the FSA) is required to make payment following exceptional deferral.

Deferred coupons must be settled by the proceeds from the sale of ordinary shares, and RCI holders always get paid in cash. This process is called the Alternative Coupon Satisfaction Mechanism (the "ACSM"). If there is an insufficiency of authorized, unissued shares to be sold, then the general deferred coupons bear interest at the coupon rate plus a premium (*i.e.*, 2 percent), until the shares are authorized. If a "market disruption event" occurs, then the issuer can defer payment using the ACSM. In this case, the deferred payment will accrue interest at the same rate as the coupon should the disruption continue for 14 days or more (*i.e.*, no 2 percent penalty). In the case of securities issued with a

guarantee (*e.g.*, Anglo Irish in 2003), there is an additional guarantee of the ACSM from the guarantor.

The issuer and the holding company are required to keep available for issue enough of its shares as it reasonably considers would be required to satisfy from time to time the next year's coupon payments using the ACSM.

In the case of a building society, interest is non-cumulative and the payment on any date may be cancelled or reduced to the extent necessary to ensure that the society will remain in compliance with the regulatory capital guidelines to which it is subject.

Some of these securities have a step-up upon the occurrence of certain tax or regulatory events at the option of the issuer.

These securities typically have a dividend stopper as well as a capital stopper feature. If the issuer defers payment for any reason, while any payment is deferred, neither the issuer nor the guarantor may (i) declare or pay a dividend or a distribution on any of their respective ordinary or preference shares or stock or other issued Tier 1 securities or (in the case of the guarantor) make any payment under a Tier 1 guarantee in respect of any such dividend or distribution (other than a final dividend declared by the holders of the ordinary stock of the guarantor before such payment is so deferred, or a dividend or a distribution or payment is made by the issuer to the guarantor, any holding company of the guarantor or to another wholly-owned subsidiary of the guarantor) or (ii) redeem, purchase or otherwise acquire any of their respective ordinary shares, ordinary stock or other Tier 1 securities (other than where such shares or stock are held by the issuer, the guarantor, any holding company of the guarantor or any wholly-owned subsidiary of the guarantor as well as certain other non material carve outs).

The FSA's Historic Approach to RCIs and PROs

- Prior to the first RCI issue, the FSA had agreed to allow stock settlement regarding repayment of principal at the call date on a number of other Tier 1 deals. It, therefore, had little scope to resist this feature for coupon payments, particularly since traditional UK preference shares have permitted payment in shares in lieu of deferral/suspension.

- The RCI deferral mechanism allows the issuer to eliminate cash interest payments if necessary and to ultimately capitalize these – coupons can be missed, and fresh equity has to be issued to satisfy the missed coupon payments, there is no depletion of the issuer's (*i.e.*, the bank's) own reserves. This meets the FSA requirement that if a dividend on Tier 1 preferred is non-cumulative, it is acceptable to pay the dividend in "scrip" to preserve the capital base of the bank. This is one reason why RCIs are allowed to count as regulatory Tier 1 capital. Another is that the FSA has

received an accountant's opinion on RCIs which states that the proceeds "feed straight into reserves" (discussed in more detail below).

- In terms of regulatory limits on innovative capital, the treatment of RCIs effectively depends on the coupon structure; tax deductibility alone does not make them innovative. RCIs with a step-up coupon are subject to the 15 percent limit for non-innovative Tier 1; callable RCIs without the step-up (such as retail preferred) would not automatically be subject to the 15 percent limit.

- When the RCIs were first issued, the FSA granted Tier 1 treatment to a direct issue only if it was accounted for within shareholders' funds of the issuing bank. In the case of the Barclays' issue, its auditors provided an opinion to the FSA that this was the case. Nevertheless, this approach came under the scrutiny of the UK Accounting Standards Board's ("ASB") Urgent Issues Task Force ("UITF"). Ultimately it was decided that these instruments should be accounted for as debt and not equity by the ASB and the FSA now will not treat an instrument accounted for as a liability or a prospective or contingent liability as core Tier 1 capital. Thus, direct issues are still allowed to be counted as Tier 1 capital, whether accounted for as equity or debt, so long the ratio of the securities to bank capital remains above 4 percent.

Selected RCI and PROs matters

- If at any time the securities cease to qualify as Tier 1 capital, the bank may, subject to the consent of the appropriate regulatory overseer, exchange the securities for or vary the term of the securities so they become Upper Tier 2 securities or, if such exchanged or varied securities do or would not qualify as Upper Tier 2 capital or certain other provisions apply and provided that certain solvency conditions are met, redeem all (but not some only) of the securities at their principal amount together with any outstanding payment obligations. The securities rank junior to creditors, equal with senior preference shareholders and senior to all other shareholders of the bank.

- In certain issues there can be a guarantor (*e.g.*, Bank of Ireland) whereby the investments are guaranteed on a subordinated basis by the guarantor. Payment of principal and/or interest in respect of the investments will be deemed to be due and payable in full for purposes of the guarantee notwithstanding that they are not in fact due and payable by the bank. This means that the rights and claims of the holders of the investments (including the guarantee provided thereunder) are subordinated to the claims of any senior creditors of the bank or the guarantor in that no payment in respect to the investments or the guarantee shall be due and payable except to the extent that the bank of the guarantor is solvent and could make such payment and still be solvent immediately thereafter.

- RCI coupons are paid by the bank directly out of pre-tax income and thus, RCIs are tax deductible instruments. This is so because although RCIs are issued directly out of the operating company, the UK tax authorities (HM Revenue & Customs) still allows the coupons to be paid out of pre-tax income. RCIs are treated as debt for tax purposes, as they are directly issued and economically have the same terms as Upper Tier 2 debt in that coupons are effectively cumulative.

- RCIs and PROs are service marked names given to this type of Tier 1 capital security. While there are subtle differences depending on the particular deal, RCIs and PROs for all extensive purposes are the same type of security. There is the possibility, however, that there will be more directly issued structures in the future under other names, when issues are lead managed by investment banks that were not part of either the RCI or PRO transactions.

Selected TONs, TOPICs and TONICs Matters

- Barclays Bank was the first to issue a non-innovative Tier 1 instrument to institutional clients. Although TONs have no step-up for the investor if the issue is not called at the first call date, Barclays is forced to issue equity to pay the coupon going forward, and thus faces its own step-up in financing costs. It should be noted that this only applies to the coupon and not the principal value of the TONs.

- The salient features of this product are as follows:

  – perpetual, with a call in 30 years;

  – directly issued by Barclays Bank and coupons are paid out of pre-tax income (*i.e.*, tax deductible to the issuer);

  – no step-up in coupon rate;

  – if the issue is not called at the first call date, the issuer has to issue new equity to raise enough cash to pay the coupon. Investors always receive cash coupons;

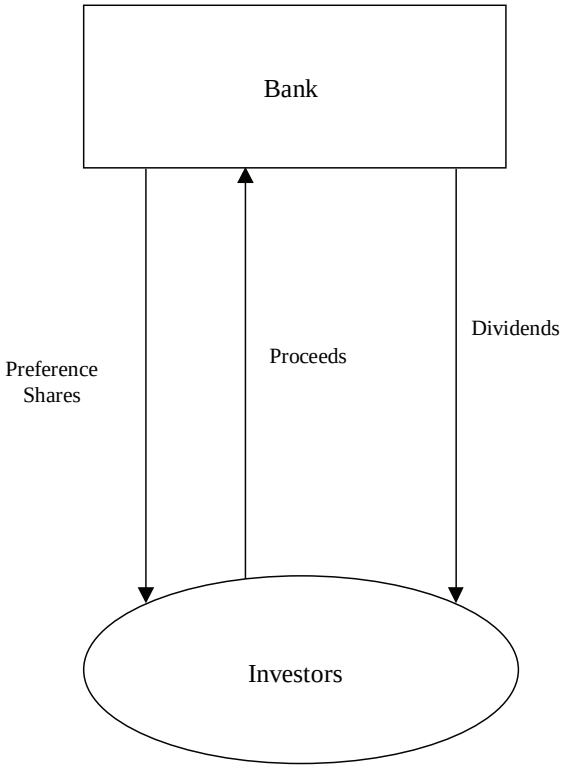
  – coupons can be deferred, but are cumulative under regulatory events (not liquidation), and are paid when the issue is ultimately called; and

  – in winding-up, TONs holders rank *pari passu* with other classes of preference shares and RCIs and PROs. The claim in a winding-up is limited to principal and not deferred coupons.

- Although there is no step-up in coupon rate at the call date, there still is a strong incentive to call the issue at the first call date. The rationale is that

(i) it will be an administrative nuisance for the issuer to have to issue equity at every coupon date after the first call date and (ii) this issuance will also be anticipated by the market. The cost of equity will always be higher than the cost of debt, so there will also be a cost incentive to the issuer to call the securities. Thus, whereas there is no explicit step-up, there is an implicit step-up built in. Another incentive for the issuer to call TONs is the general perception in the market of the issuer and its reputation in the market.

- ***Singapore, Malaysian and Thai Bank Instruments (since 2002)***



Selected issues

- Overseas – Chinese Banking Corporation (Singapore) (2002)
- Krung Thai Bank (Thai) (2006)
- Thai Military Bank (Thai) (2006)
- Public Bank Bhd (Malaysian) (2006 – two issues)

Primary regulator capital treatment – bank level Tier 1.

Designed primarily for Asian offerings.

Features

- The preference shares are non-cumulative, non-convertible perpetual securities issued by the bank that qualify as Tier 1 capital of the bank.
- The shares are redeemable at the option of the bank: (i) five years after the date of issuance thereof; (ii) ten years after the date of issuance thereof; and (iii) on each dividend date thereafter. In addition, the bank may

redeem the preference shares upon the occurrence of a specified tax event or the occurrence of a specified special event.

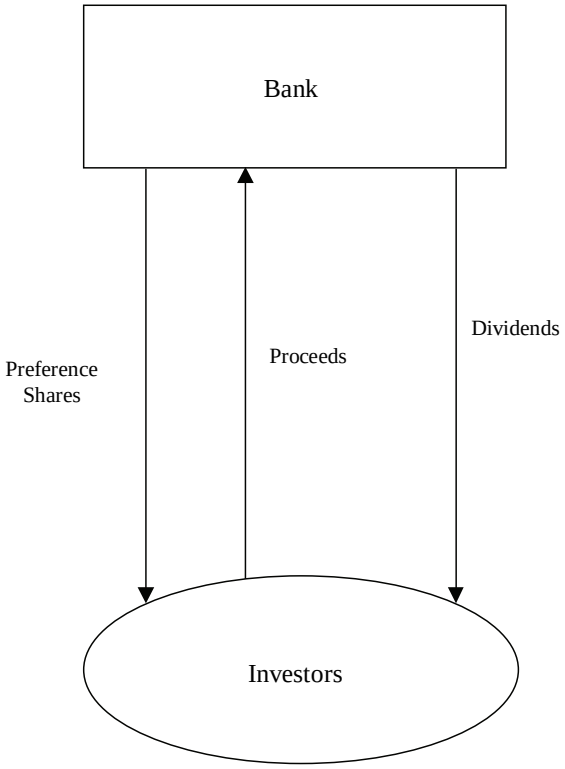
- Subject to certain limitations, each shareholder shall be entitled to receive a non-cumulative preferential cash dividend based on the liquidation preference.

Thai Regulatory Developments

In February 2006, the Bank of Thailand issued new rules that address the circumstances under which coupon payments on hybrid Tier 1 capital instruments issued by Thailand banks can be deferred. Under the rules, the bank must determine 30 to 60 days in advance of its fiscal year end (typically, December 31st) whether it will announce a loss for the full fiscal year and, if it determines to do so, the bank may defer coupon payments on its Tier 1 capital instruments. In April and October 2006, respectively, Thai Military Bank and Krung Thai Bank issued Thailand's first hybrid Tier 1 capital securities – direct issue perpetual subordinated debt securities.[57]

[57] For further information on the rules issued by the Bank of Thailand, please see the following link: www.bot.or.th.

- ***Australian and New Zealand Bank Convertible Preference Shares (since 2000)***



Selected issues

- Bank of Queensland (2000)
- Commonwealth Bank of Australia (2001)
- Suncorp Metway (2001)
- Commonwealth Bank of Australia (2003)
- Commonwealth Bank of Australia (2006)
- Bank of Queensland (2007)
- St.George Bank Limited (2007)
- Bank of New Zealand (2008)

Selected product names

- Preferred Exchangeable Resettable Listed Shares or "PERLS"

- Reset Preference Shares or "RePS"

Designed primarily for domestic Australian or New Zealand offerings.

Transaction benefits

- Primary regulator capital treatment – bank level Tier 1.

- Franked Dividend. If the dividend on the preference shares are not franked to the specified level (*e.g.*, 100 percent), investors will have the right to elect to exchange their preference shares on the next dividend payment date for ordinary shares or third party cash.

- After ten years, the issuer can reset the margin used in calculating the dividend rate and the dividend payment dates; the permission of the APRA may be required.

The preference shares are perpetual and non-cumulative.

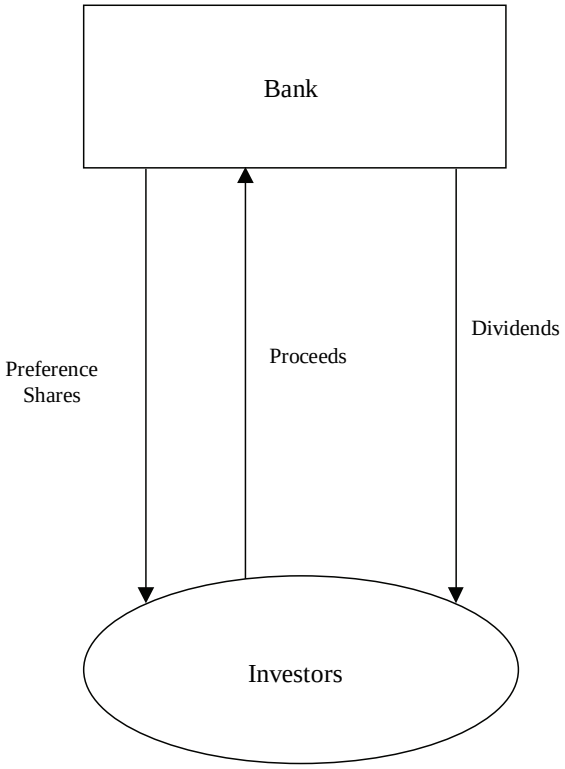
If dividends are not paid on the preference shares, no dividends can be paid on the bank's ordinary shares until four consecutive dividends (two in the case of Bank of New Zealand) are paid or an optional dividend is paid on the preference shares.

The dividend is non-cumulative and payable quarterly in arrears. The dividend payable for each quarter is calculated based on the issue price, the dividend rate and the number of days in that quarter. A floating dividend rate is set at a percentage and is adjusted every quarter to reflect market movements in the 90-day bank bill rate.

The preference shares may be converted into ordinary shares either automatically upon a takeover of or scheme of arrangement involving the issuer or at the bank's election upon the occurrence of a regulatory event, tax event or acceleration event.

Investors have the flexibility to exit their investments in the preference shares through an exchange election after five years upon a change in the margin used in calculating the dividend rate or, if the dividend is not fully franked, at the next dividend payment date, whereupon the issuer will either deliver ordinary shares in exchange or cause a third party to purchase the preference shares from the investors for the cash value of those shares.

- ***Spanish Preference Shares (since 2006)***



Selected issues

- Caja de Ahorros y Monte de Piedad or "Ibercaja" (2006)
- Banco Sabadell (2006)
- Caixa Manlleu (2007)

Selected 2009 issue

- *Banco de Sabadell, S.A. (January 2009)*

Transaction benefits

- Primary regulator capital treatment – bank level Tier 1.

Features

- The preference shares or participations are perpetual and dividends are non-cumulative.

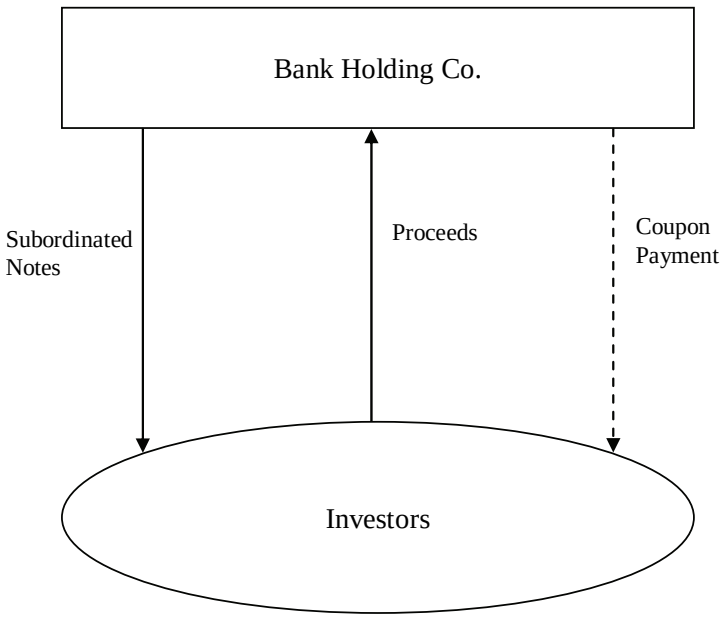
- Dividends for the first 10 years are payable at a fixed rate and thereafter at a floating rate.

- Dividends are non-cumulative and, subject to (i) the existence of sufficient distributable profits, and (ii) regulatory capital adequacy requirements, must be paid.

- If dividends are not paid on the preference shares, no dividends can be paid on the bank's share capital that ranks junior to the preference shares until dividends are paid on the preference shares for one annual or four quarterly dividend periods.

- The preference shares may be redeemed after 10 years at any time by the bank and, prior to 10 years, are redeemable in the case of certain tax law changes.

- ***US and Canadian Bank Instruments (since 2007)***



Selected issues

- CIT Group Inc. (US) (2007)
- Toronto-Dominion Bank (Canadian) (2007)

Transaction benefits

- Primary regulator capital treatment – bank level Tier 1.

Features

- Notes rank junior to subordinated debt, but senior to share capital.
- The notes have a maturity of between 30 and 60 years.
- Fixed rate coupons payable until the first call date, stepping-up to floating rate thereafter.
- Limited events of default only encompassing (i) default in the payment of interest in full for a period of 30 days after the conclusion of an interest deferral period, (ii) failure to pay principal on the final maturity date or upon a call for redemption, (iii) deferral of interest, whether optional, mandatory, or a combination of both, for more than ten consecutive years without payment of accrued interest being made in full, and (iv) and specified insolvency events.

- Optional interest deferral for one or more periods of up to 10 consecutive years. Deferred interest is cumulative. During a deferred interest period the issuer and its subsidiaries may not, except in limited circumstances: (i) declare or pay any dividends on, redeem, purchase, or acquire any capital stock; (ii) make any payment of principal, interest or premium, or repay or repurchase any *pari passu* or junior notes; nor (iii) make and guarantee payments on guarantees ranked *pari passu* or junior.

- Issuer optional redemption in whole, but not part (i) on, or at any time after, the first call date, at 100 percent of the principal amount plus accrued and unpaid interest, or (ii) before the first call date at the make-whole redemption amount plus accrued and unpaid interest, or (iii) upon occurrence of certain tax or rating agency events at the applicable make-whole redemption amount plus accrued and unpaid interest.

- An ACSM applies where deferred interest is payable, with the Issuer being required to (i) issue and/or sell new shares or treasury shares up to a specified maximum amount of the issuer's outstanding issued share capital; and/or (ii) issue certain eligible notes in a maximum aggregate amount of up to 25 percent of the aggregate principal amount of the notes. In some cases if the Issuer is unable to issue or sell new shares, treasury shares or eligible notes, sufficient to cover the full amount of accrued and unpaid interest the remaining amount will be mandatorily deferred.

- Replacement capital intention – the company states its intention not to redeem the notes (and, in certain structures, not to allow the maturity of the notes) unless, within 180 days prior to the date of redemption, it has first issued and sold notes that have equity-like characteristics that are the same as, or more equity-like than, the notes at that time.

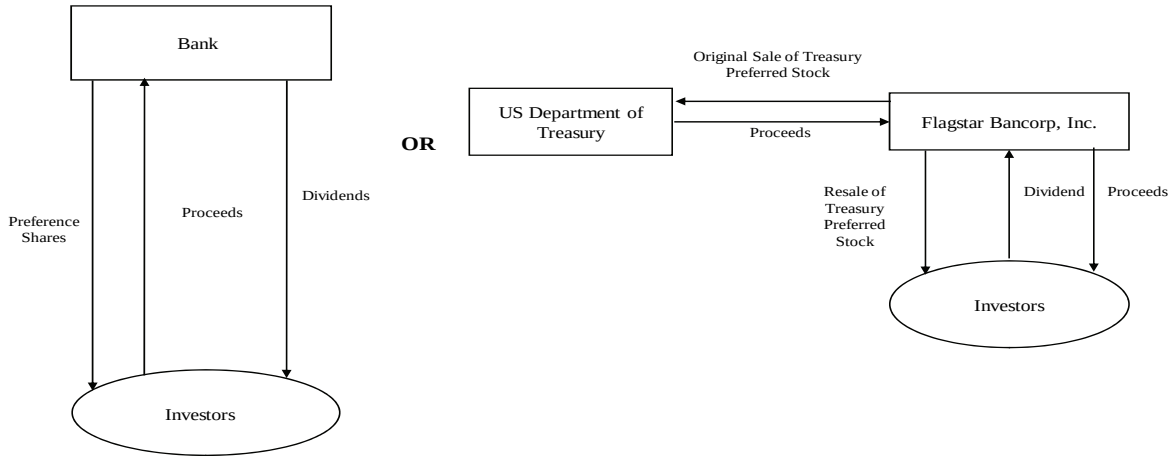
- Proceeds of issue stated to be used for general corporate purposes, redemption of notes or repurchase of stock.

- Some notes are not listed.

- US issues governed by New York law; Toronto Dominion Bank issued governed by the laws of the Province of Ontario.

- Notes classified as debt for IFRS purposes.

- ***US and Canadian Bank Holding Company Direct Issue Preferred Securities (since 2008)***



Selected issues

- Bank of America Corporation (US) (2008 – two issues)
- Citigroup Inc. (US) (2008 – three issues)
- Lehman Brothers Holding Inc. (US) (2008)
- JPMorgan Chase & Co. (US) (2008)
- The PNC Financial Services Group, Inc. (US) (2008)
- Wachovia Corporation (US) (2008)

Selected 2009 issues

- *Manulife Financial Corp. (Canada) (February 2009)*
- *Flagstar Bancorp, Inc. (US) (July 2009)*

Transaction benefits

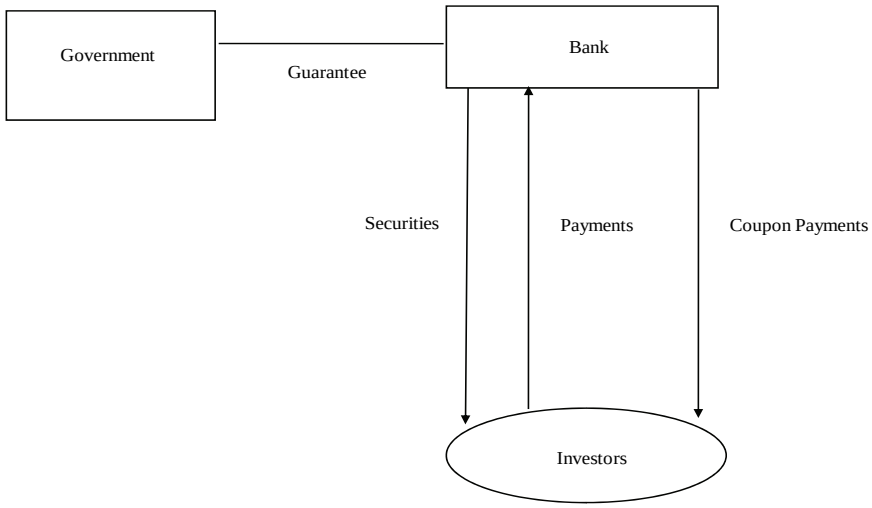
- Primary regulator capital treatment – bank level Tier 1.

Features

- Flagstar Bancorp, Inc. issued cumulative preferred stock (the "Treasury Preferred Stock") to the US Department of Treasury as part of the Treasury's Troubled Asset Relied Program Capital Purchase Program in January 2009. The July 2009 issue of the Treasury Preferred Stock was made on behalf of the US Department of Treasury.

- The Treasury Preferred Stock has a 5 percent annual coupon for the first five years and a 9 percent coupon thereafter.
- The Treasury Preferred Stock is redeemable at anytime after February 2012. Before 2012, the Treasury Preferred Stock is not redeemable unless Flagstar Bancorp, Inc. has received from one or more qualified equity offerings. In such a case, the Treasury Preferred Stock can be redeemed.
- In all other issues, securities are perpetual.
- Fixed rate or fixed rate stepping up to floating at the first call date.
- Ranks senior to common stock and may be senior, junior or equal with other preferred stock.
- Dividend payments are discretionary and may be cumulative or non-cumulative. There is a dividend stopper upon payment of dividends on, or repurchase of, junior stocks if dividends are not paid on the preferred stock.
- Redemption after the first call date is subject to prior approval by the relevant regulator.
- No events of default.
- If there is a failure to pay, or declare and set apart for payment, for a certain amount of dividend periods, whether or not consecutive, the preferred stock holders will be entitled to elect two additional directors at the first annual meeting thereafter. The holders will be entitled to continue to elect these additional directors at each subsequent annual meeting until, in the case of cumulative preferred stock, all past payable dividend payments have been made, and, in the case of non-cumulative preferred, a certain number of non-paid periods have been paid. In the case of the Bank of America L series conversion of the preferred stock will also terminate the right to elect the additional directors.
- The Bank of America L series is convertible, at any time, at the option of the holder, into common stock. It is convertible, in whole, or in part, at the option of the issuer from the first call date if the closing price of the common stock exceeds a certain ratio to the applicable conversion price of the preferred stock. It is also convertible upon the occurrence of certain "reorganization events," including merger and consolidation.
- The JPMorgan and Lehman issues are subject to a replacement capital covenant.
- Proceeds of issue for general corporate purposes.

- ***Bermudan Bank Instruments Fully and Unconditionally Guaranteed by the Government of Bermuda (since 2009***)



Selected 2009 issue

■ *The Bank of N.T. Butterfield & Son Limited (June 2009)*

Transaction benefits

■ Primary regulator capital treatment – bank level Tier 1.

Features

■ The preference shares are perpetual and pay a 8.00 percent coupon.

■ The payment of dividends and of the liquidation preference is guaranteed by the Government of Bermuda for up to 10 years from the date of issuance of the preference shares.

■ The preference shares rank junior to junior shares of The Bank of N.T. Butterfield & Son Limited, *pari passu* with its parity shares and junior to any of its senior shares. The issuance of any shares ranking senior to the preference shares require the vote or approval of holders of at least 66⅔ percent of the aggregate liquidation preference of preference shares, and the approval of the Government of Bermuda.

■ Dividends on the preference shares are non-cumulative and non-mandatory.

- The Bank of N.T. Butterfield & Son Limited may redeem the preference shares, subject to the approval of the Bermuda Monetary Authority, after the bank redemption date (10 days prior to 10 years from the date of issuance of the preference shares).
- Listing on the Bermuda Stock Exchange and Euro MTF Market.
- Governed by the laws of Bermuda.

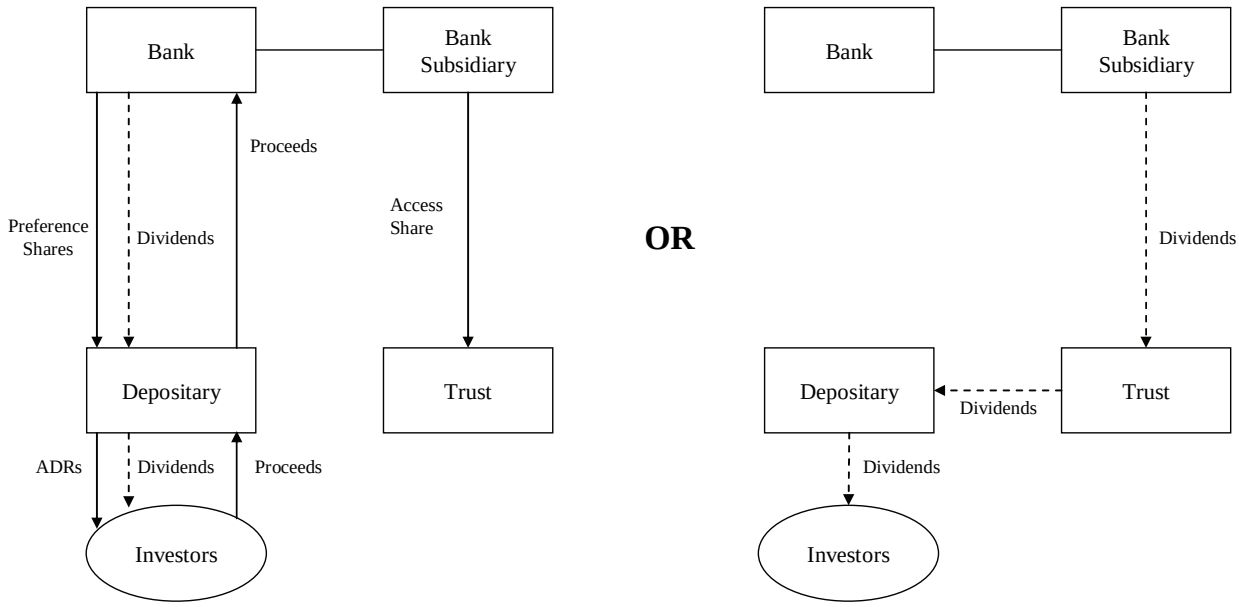
CHAPTER 9

BANK DIRECT ISSUE TIER 1 INSTRUMENTS LINKED TO ANOTHER INSTRUMENT

In these structures, the bank issues preferred securities to a third party, and satisfies the carrying charges on the preferred or the instruments issued to fund the purchase of the preferred with an instrument from another tax effective source. These securities provide bank level, not minority interest, Tier 1 and could be considered by the bank's primary regulator to fall outside the 15 percent innovative Tier 1 capital basket. While the tax benefits generated by such instruments are positive, the securities are difficult to structure in order to achieve such tax benefits.

The first two Australian structures referred to below illustrate how a change in tax laws can dramatically impact the complexity required to achieve the desired tax result in structuring a Tier 1 capital transaction.

- ***Australian Bank Non-Cumulative Preference Shares Stapled to Subsidiary Access Share (since 1989)***



Selected issue

■ Westpac (1989)

No other issues due to Australian tax law changes.

Transaction benefits

■ The dividends the bank pays to Australian taxpayers are tax exempt to the extent paid out of income on which the bank has paid Australian income tax. This structure enabled the bank to retain its Australian taxed income to pay dividends to its ordinary shareholders, who were predominantly Australian taxpayers, thereby reducing its cost of capital.

■ Primary regulator capital treatment – bank level Tier 1 capital.

The preference shares were issued in the form of ADRs listed on the New York Stock Exchange to avoid New South Wales, Australia stamp duty.

Features

■ Dividends are non-cumulative and payable if and when declared by the board of directors:

– to the extent of the bank's consolidated net income for the immediately preceding fiscal year, less any share dividends during the current fiscal year; and

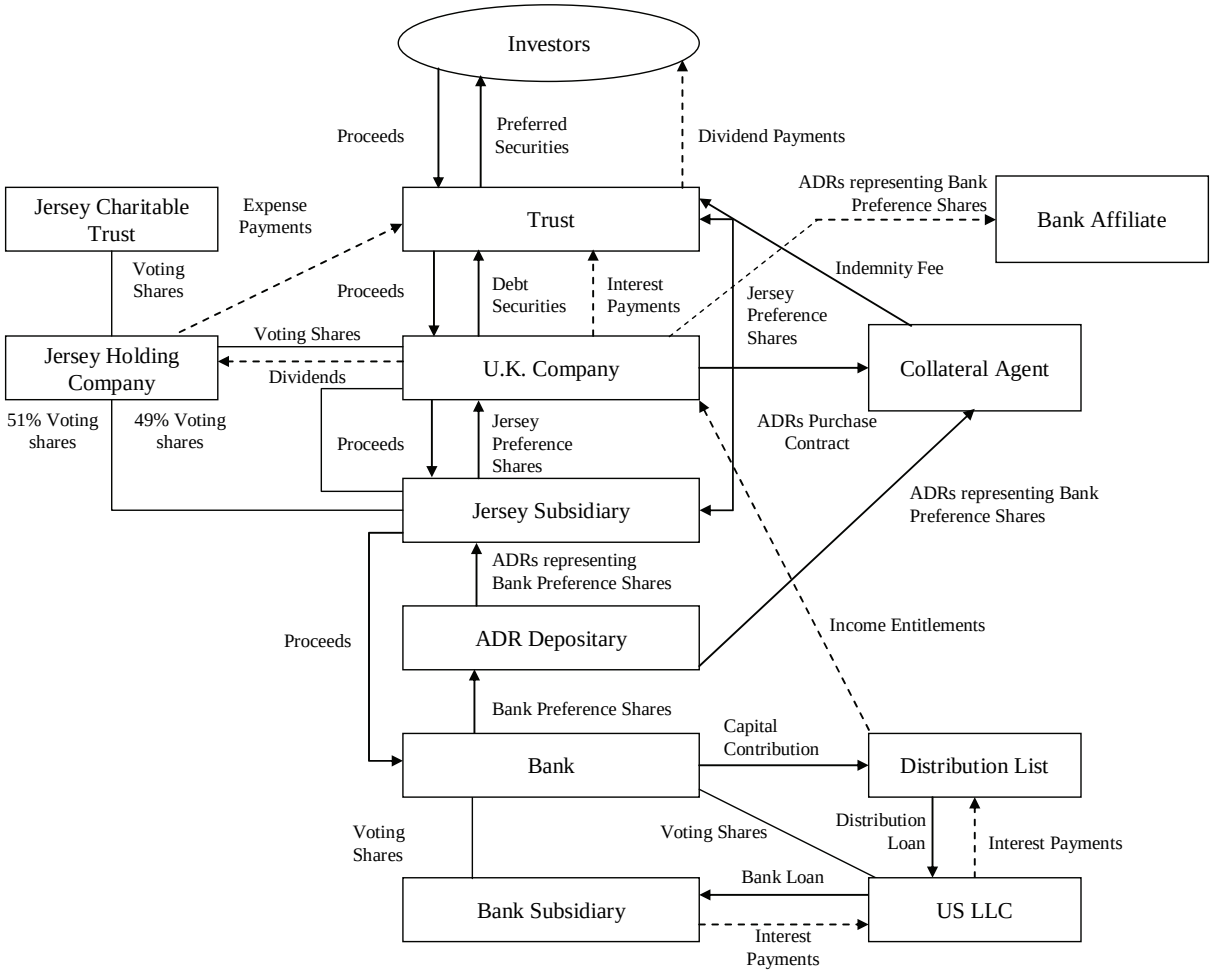
- so long as payment does not result in a breach of the bank's capital adequacy or other supervisory requirements.

- In lieu of declaring and paying dividends on the preference shares, the bank can pay dividends received on an access share issued by a subsidiary of the bank. The subsidiary had significant retained unfranked income (*i.e.*, real estate gains not subject to Australian taxation).

- The dividend withholding tax rate for US holders was 15 percent, which could be used by a US holder as a foreign tax credit subject to certain limitations.

- Liquidation payment on the bank preference shares is determined by reference to the bank's available assets.

- ***Australian Bank Non-Dividend Paying Preference Shares Linked to Subsidiary Debt Securities (since 1998)***



Selected issues

- Australia and New Zealand Banking (1998)
- National Australia Bank (1998)

Transaction benefits

- Primary regulator capital treatment – bank level upper Tier 1 capital.
- Interest payments to investors on preferred securities out of the Trust are deductible by the bank or its subsidiary.
- Available investor tax credits saved for Australian ordinary shareholders.
- Avoids Australian withholding tax on preference share dividends.

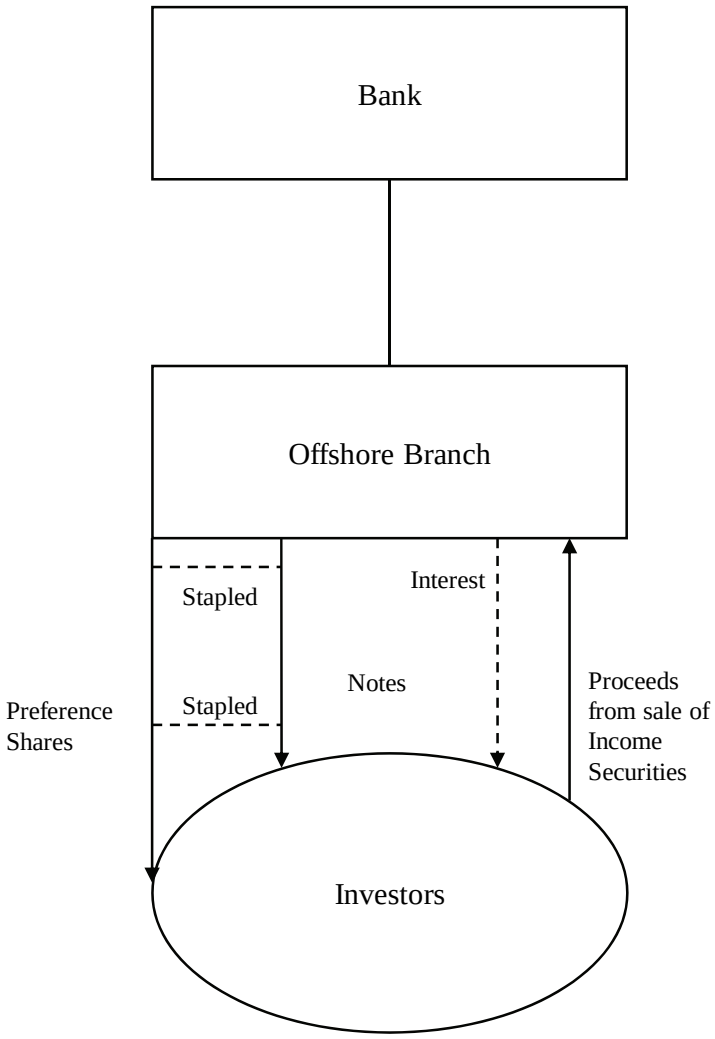
The trust is a registered investment company under the 1940 Act.

Bank preference shares convert into or are exchangeable for dividend paying preference shares and are distributed to investors upon the occurrence of any of the following events:

- 49 years after issuance;
- any time at the discretion of the bank;
- failure to receive dividends in full on any dividend payment date;
- any date when the Tier 1 or total capital adequacy ratios of the bank as reported by the bank or determined by its primary regulator falls below the statutory minimums and is not increased to such minimums within 90 days;
- specified changes affecting the integrity of the transaction structure;
- the winding-up of the bank or any of the other structure companies or certain proceeding in furtherance thereof; or
- the collateral agent fails to have a perfected security interest in the Jersey preference shares and ADRs representing the bank preference shares.

The preference shares are perpetual and non-cumulative.

- ***Australian Bank Non-Dividend Paying Preference Shares Stapled to Bank Debt Securities, Australian Market only (since 1999)***



Selected issue

- National Australia Bank (1999)

Selected 2009 issues

- *Westpac (February 2009)*
- *National Australia Bank (September 2009)*
- *Commonwealth Bank of Australia (October 2009)*

Selected product names

- Stapled Preferred Securities or "SPS"
- Perpetual Exchangeable Resaleable Listed Securities or "PERLS"

Transaction benefits

- Primary regulator capital treatment – bank level upper Tier 1 capital.
- The branch obtains an interest deduction on the notes, which are a legal form of debt for purposes of the branch tax rules.
- Available investor tax credits saved for Australian ordinary shareholders.
- Avoids Australian withholding tax on preference share dividends.

Features

- The notes and the preference shares are perpetual.
- Prior to the assignment or mandatory transfer of the notes to the bank, interest is payable on the notes and no dividends are payable on the preference shares. Distributions are non-cumulative and are generally not due and payable in a combination or all of the following circumstances:
  - the amount of distributions payable on the securities on the payment date would exceed the bank's distributable profits for the applicable period (or such other amount determined by the bank's primary regulator), less interest payments on the notes and dividend payments of any share capital of the bank during the applicable period;
  - the payment would result in the Tier 1 or total capital ratio of the bank falling below regulatory required minimums or the bank's primary regulator has stated that the payment would result in the securities not being treated as Tier 1 capital;
  - the bank's primary regulator objects to the payment; or
  - the bank's board resolves not to pay the distribution.
- If the bank fails to make a distribution, a dividend or capital stopper applies with respect to equal or junior ranking securities, including the bank's ordinary shares unless and until four consecutive distribution payments are made.
- In some cases, the preference shares are unpaid (National Australia Bank issues), while they are fully paid in other transactions. In the 1999

National Australia Bank issue, the preference shares become due and payable upon the occurrence of an event of default or upon the bank's election if certain other events occur. In that case, mandatory delivery of the notes to the bank is treated as constituting paying up the preference shares.

- The securities are subject to conversion, repurchase or redemption under certain circumstances. The securities may convert into ordinary shares, subject to conversion conditions. Alternatively, in some cases, on the initial mandatory conversion date, at the bank's election, the securities may be transferred to a nominated party or repurchased or redeemed by the bank for cash, subject to the approval of the regulatory authority. If such conversion, transfer, redemption or repurchase is not possible on an initial mandatory conversion date, such action may apply to the next possible conversion date.

- Certain events trigger the mandatory transfer or the assignment of the notes to the bank (*i.e.*, the un-stapling of the securities). These include:

  – failure to pay interest when due on the notes, after a 20 business days grace period;

  – the Tier 1 or total capital ratio of the bank (as determined by the bank or the bank's primary regulator) falls below the regulatory required minimum and is not restored to such required minimum within 90 days;

  – the bank's insolvency or certain events involving the liquidation or winding-up of the bank;

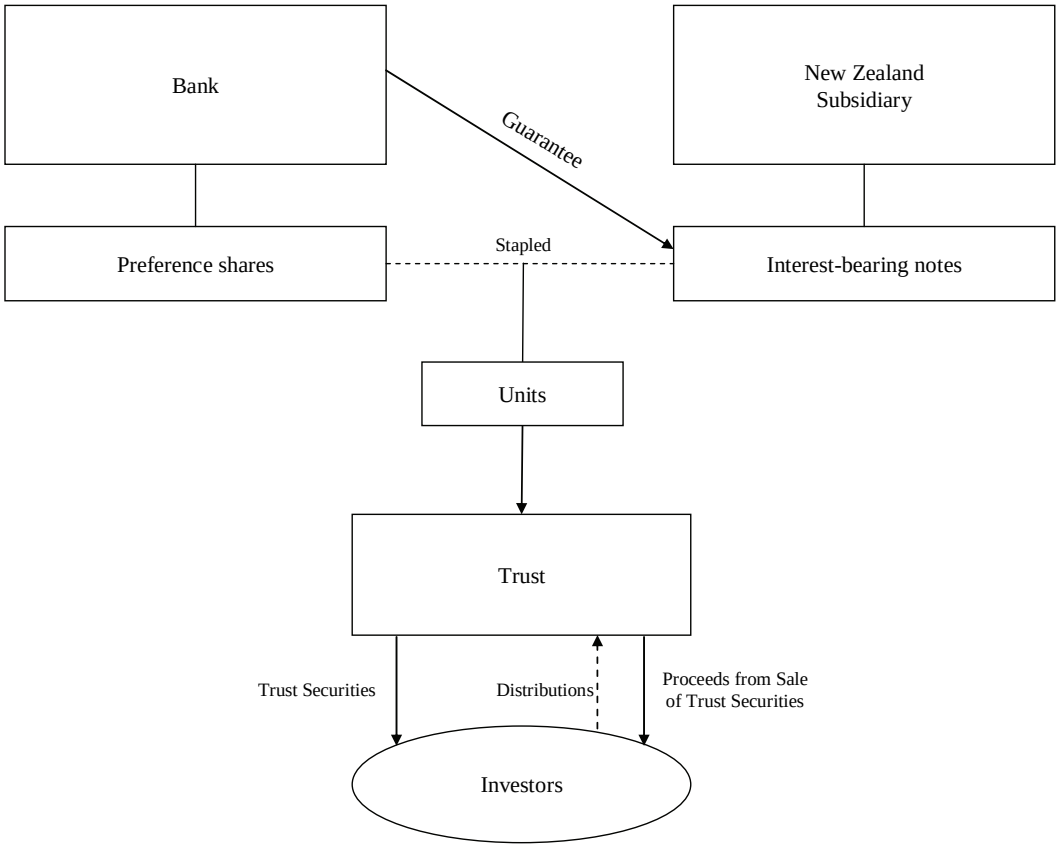
  – the bank electing that an assignment event occur; or

  – the repurchase, conversion or redemption of the notes.

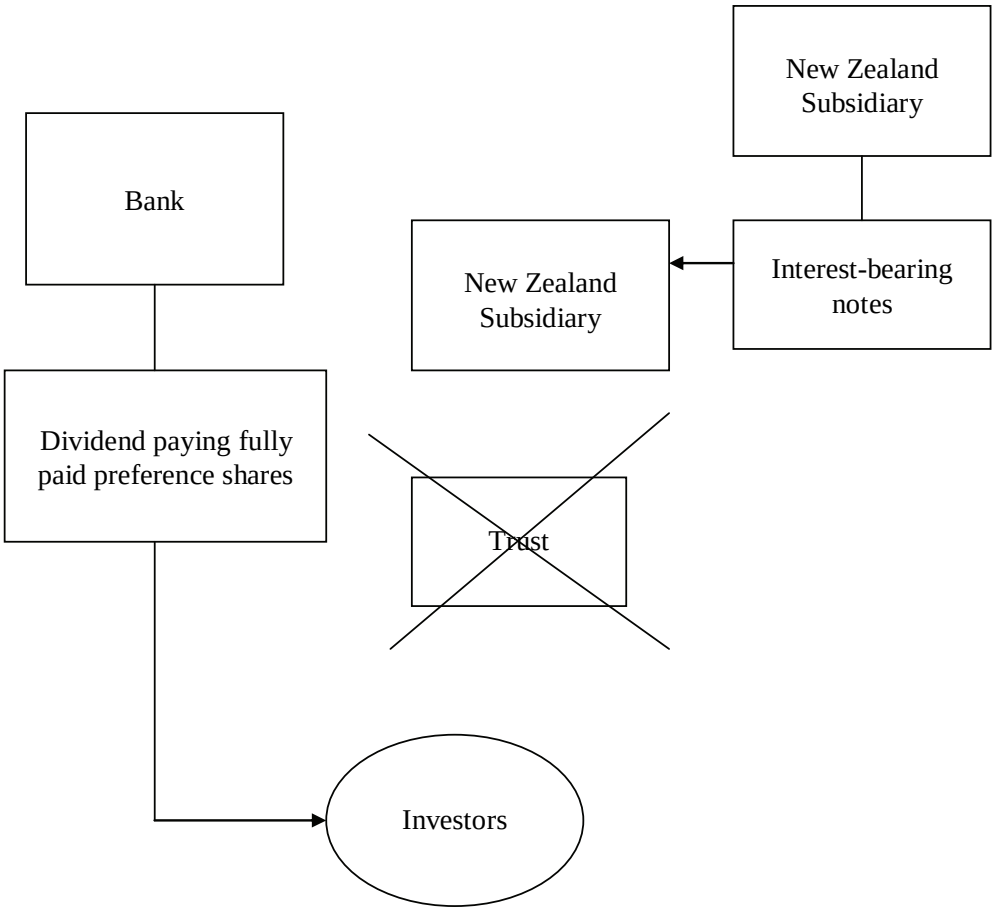
The securities rank for payment in a winding-up of the bank ahead of ordinary shares and equally with equal ranking capital securities, but are subordinated to claims of the bank's deposit holders and other senior creditors.

- ***Australian Bank Non-Dividend Paying Preference Shares Stapled to Subsidiary Debt Securities, Australian Market only (since 2003)***

Pre-Conversion Event



Post-Conversion Event



Selected issue

- Australia and New Zealand Banking Group Limited (2003)

Transaction benefits

- Primary regulator capital treatment – bank level Tier 1 capital.
  - The trust securities, while treated as Tier 1 capital, are classified as loan capital of the bank.
- The New Zealand subsidiary obtains an interest deduction on the notes, which are a legal form of debt for the purposes of the New Zealand subsidiary.
- Available investor tax credits saved for Australian ordinary shareholders.
- Avoids Australian and New Zealand withholding tax on distributions made on the trust securities.

The notes and preference shares are stapled together and deposited as a unit into the trust and may not be separately traded. Each trust security corresponds to a unit.

The bank guarantees payments on the notes on a subordinated basis.

So long as no conversion event (as described below) has occurred, the preference shares will not pay dividends and the distributions made on the trust securities will be derived from interest payments paid to the trust by the New Zealand subsidiary or payments made by the bank pursuant to the guarantee.

Interest is non-cumulative and is not due and payable on any interest payment date if:

- the amount of interest payable on the notes on the interest payment date would exceed the bank's distributable profits as at the record date for the interest payment;
- the interest payment would result in the total capital adequacy ratio or Tier 1 capital ratio of the bank falling below regulatory required minimums; or
- the bank's primary regulator objects to the payment.

If and so long as the New Zealand subsidiary fails to pay interest, the bank may not:

- pay any dividends on any of its share capital;
- repurchase, redeem or otherwise acquire any of its ordinary shares; or
- pay any principal, premium or interest on, or repurchase or redeem any of its debt securities that rank equal with or junior to the guarantee.

Events of default under the notes include certain events involving the liquidation or winding-up of the bank or the New Zealand subsidiary.

A conversion event with respect to a trust security will be the earliest occurrence of any of the following dates or events:

- any date selected by the bank in its absolute discretion;
- the business day prior to the fiftieth anniversary of issuance;
- a redemption date with respect to the preference shares comprising a component of the related trust security;
- the holder of the trust security elects to exchange the trust security for ordinary shares of the bank;

- failure of the trust to make a distribution due under the trust securities on or within seven business days of the relevant distribution date;
- any date on which the primary regulator determines that the Tier 1 or total capital adequacy ratios of the bank have fallen below statutory minimums;
- the issuance by the primary regulator of a written directive for the bank to increase its capital;
- the appointment by the primary regulator of a statutory manager to the bank or the assumption by the primary regulator of control of the bank or commencement of proceedings for the winding-up of the bank;
- any date on which the retained earnings of the bank have fallen below zero; or
- an event of default under the notes.

Upon the occurrence of a conversion event with respect to a unit underlying a trust security:

- the preference share comprising a component of the unit underlying the trust security will convert into a dividend paying instrument;
- the note comprising a component of such unit will detach from the preference share and will be transferred by the trust to a subsidiary of the bank;
- the trust security will be redeemed and, depending on the nature of the conversion event, the related preference share or cash or ordinary shares of the bank in respect thereof will be distributed to the holder; and
- if the conversion event relates to all of the trust securities, the trust will be dissolved.

Because the notes are not repayable prior to a conversion event, holders of trust securities will never be entitled to payment in respect of the principal of the notes.

The preference shares may be redeemed by the bank for cash following the expiration of the applicable non-call period (*i.e.*, 7 to 10 years following issuance).

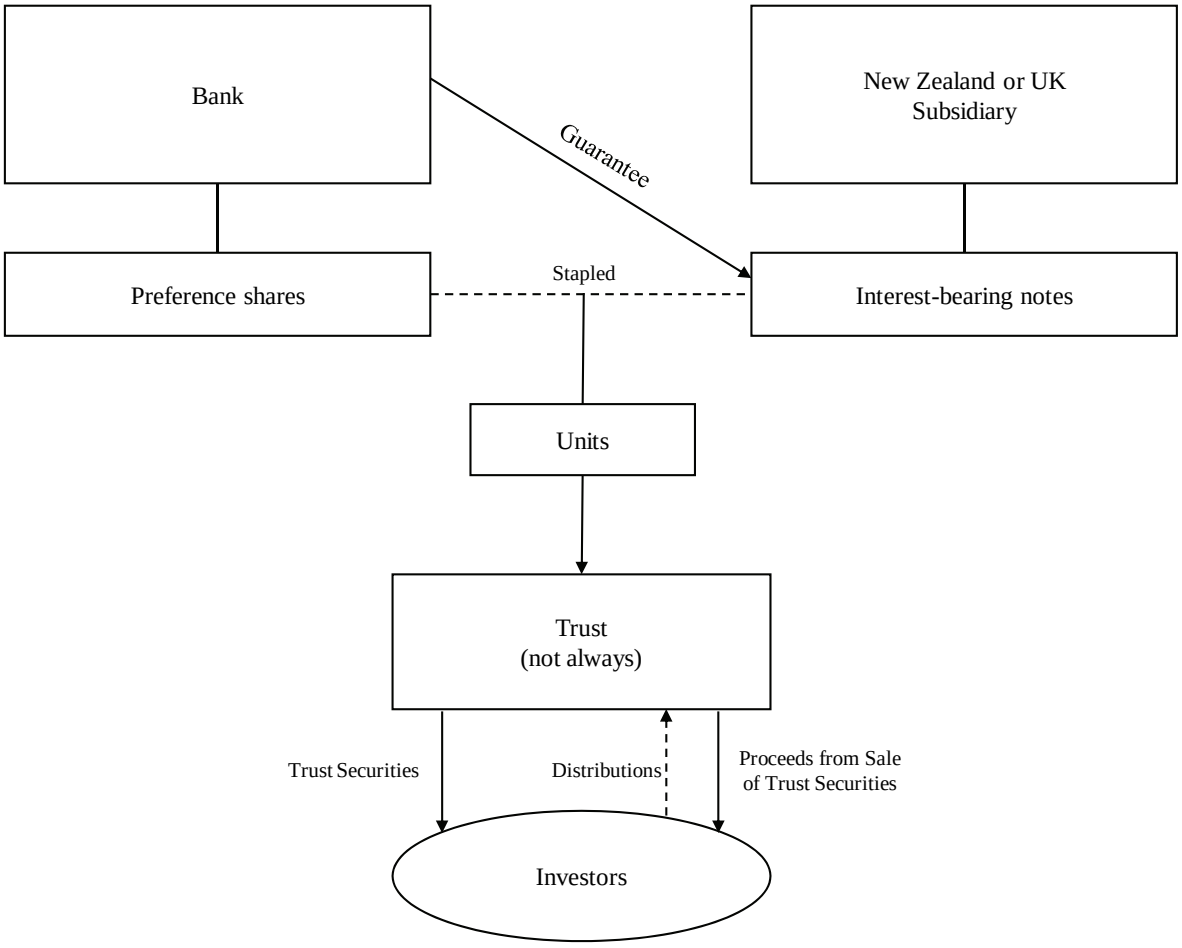
If the bank does not redeem the preference shares at the end of the non-call period or on any dividend payment date thereafter, holders will have the right to exchange each trust security for ordinary shares of the bank having a market value equal to US$1,000 per trust security.

On the fiftieth anniversary of issuance, each preference share outstanding following the conversion event on the immediately preceding business day will automatically be exchanged for ordinary shares of the bank having a market value equal to US$1,000.

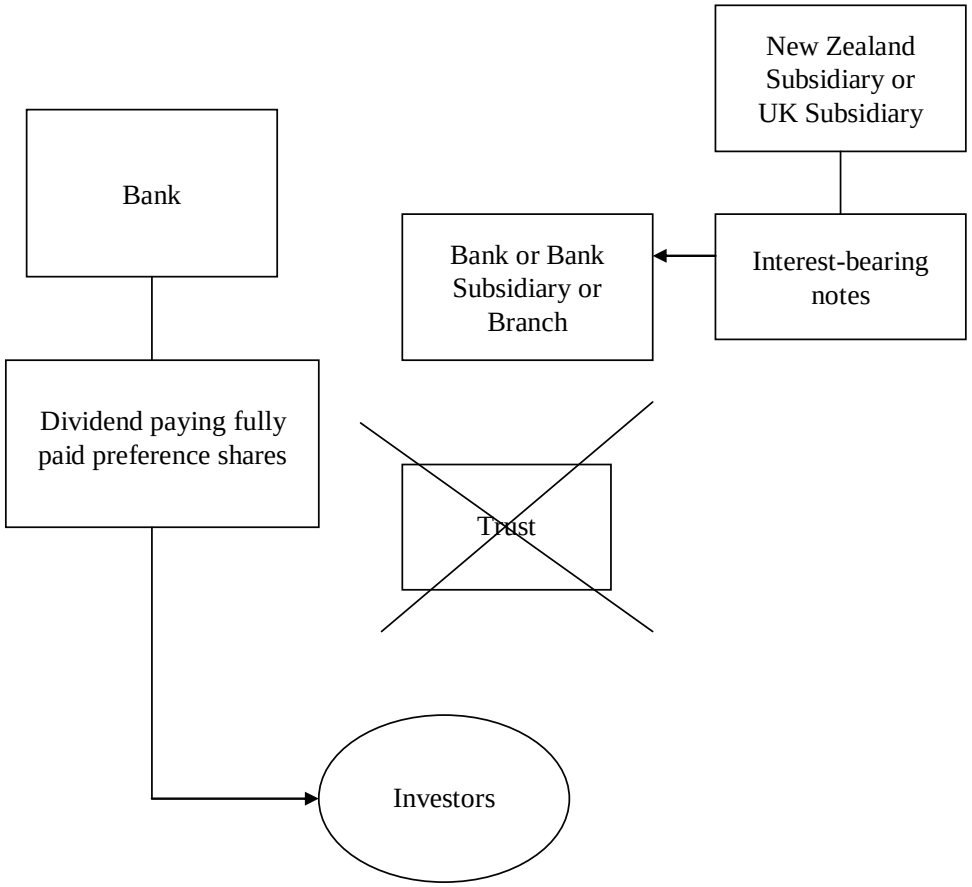
Holders of trust securities may withdraw the units represented by such trust security from the trust.

- ***Australian Bank Non-Dividend Paying Preference Shares Stapled to Subsidiary Debt Securities (since 2003)***

Pre-Assignment or Conversion Event



Post-Assignment or Conversion Event



Selected issues

- Australia and New Zealand Banking Group Limited (2003 and 2004)
- Commonwealth Bank of Australia (2006)
- Australia and New Zealand Banking Group Limited (2007)
- Commonwealth Bank of Australia (2007)

Transaction benefits

- Primary regulator capital treatment – bank level Tier 1 capital.
  - The trust securities, while treated as Tier 1 capital, are classified as loan capital of the bank.

- New Zealand or UK subsidiary obtains an interest deduction on the notes, which are a legal form of debt for purposes of the New Zealand or UK subsidiary.

- Available investor tax credits saved for Australian ordinary shareholders.

- Avoids Australian, New Zealand and UK withholding tax on distributions made on the trust securities.

Features

- The notes and preference shares are stapled together and deposited as a unit into the trust (which is a US-domiciled trust that may be a subsidiary of the bank and qualifies as a grantor trust for US tax purposes) and may not be separately traded. Each trust security corresponds to a unit.

- The bank guarantees payments on the notes on a subordinated basis.

- Generally speaking, so long as no assignment or conversion event (as described below) has occurred, the preference shares will not pay dividends and the distributions made on the trust securities will be derived from interest payments paid to the trust by the New Zealand or UK subsidiary or payments made by the bank pursuant to the guarantee.

- Interest is non-cumulative and is not due and payable on any interest payment date if:

  – the amount of interest payable on the notes on the interest payment date would exceed the bank's distributable profits as at the record date for the interest payment;

  – the interest payment would result in the total capital adequacy ratio or Tier 1 capital ratio of the bank falling below regulatory required minimums; or

  – the bank's primary regulator objects to the payment.

- The preference shares may be redeemed by the bank for cash following the expiration of the applicable non-call period (*i.e.*, 10 years following issuance or at any time upon certain tax or regulatory events negatively affecting the bank), which, in turn, triggers a redemption of the related trust securities. The trust securities may also be redeemed for qualifying Tier 1 securities, and the terms of the preference shares may be amended and such preference shares may be issued to holders of the trust securities in redemption thereof, in either case, in the event the trust securities and/or preference shares no longer qualify as Tier 1 capital.

- If and so long as the New Zealand or UK subsidiary fails to pay interest, the bank may not:
  - pay any dividends on any of its share capital;
  - repurchase, redeem or otherwise acquire any of its ordinary shares; or
  - pay any principal, premium or interest on, or repurchase or redeem any of its debt securities that rank equal with or junior to the guarantee.
- Events of default under the notes include certain events involving the liquidation or winding-up of the bank or the New Zealand or UK subsidiary.
- An assignment or conversion event with respect to a trust security will be the earliest occurrence of any of the following dates or events:
  - any date selected by the bank in its absolute discretion;
  - the business day prior to the maturity date;
  - a redemption date with respect to the preference shares comprising a component of the related trust security;
  - if appropriate, the holder of the trust security elects to exchange the trust security for ordinary shares of the bank;
  - failure by the bank to pay a dividend on the preference shares within the applicable grace period after the dividend payment date;
  - if applicable, any date set for the repurchase of units by an entity nominated by the bank if (i) there are insufficient funds to repurchase all the units to be repurchased on such date or (ii) a holder of a unit which has been withdrawn from the trust and is due to be repurchased is not paid on that repurchase date;
  - any date set for the redemption of any preference shares if (i) the property trustee has insufficient funds on deposit to redeem all of the preference shares called for redemption or (ii) a holder of a unit which has been withdrawn from the trust and which is due to be redeemed is not paid on that redemption date;
  - failure of the trust to make a distribution due under the trust securities, or for the bank to make a payment under the trust guarantee, within the applicable grace period after the relevant distribution date;

- failure by the New Zealand or UK subsidiary to make an interest payment under the notes, or for the bank to make a payment under the guarantee, within the applicable grace period after the relevant interest payment date;
- any date on which the primary regulator determines that the Tier 1 or total capital adequacy ratios of the bank have fallen below statutory minimums;
- the issuance by the primary regulator of a written directive for the bank to increase its capital;
- the appointment by the primary regulator of a statutory manager to the bank or the assumption by the primary regulator of control of the bank or commencement of proceedings for the winding-up of the bank;
- any date on which the retained earnings of the bank have fallen below zero; or
- an event of default under the notes.

■ Upon the occurrence of an assignment or conversion event with respect to a unit underlying a trust security:

- the preference share comprising a component of the unit underlying the trust security will convert into a (fully) dividend paying instrument;
- the note comprising a component of such unit will detach from the preference share and will be transferred by the trust to the bank or a subsidiary of the bank;
- the trust security will be redeemed and, depending on the nature of the assignment or conversion event, the related preference share, qualifying Tier 1 security or cash or ordinary shares of the bank in respect thereof, will be distributed to the holder; and
- if the assignment or conversion event relates to all of the trust securities, the trust will be dissolved.

■ Because the notes are not repayable prior to a conversion event, holders of trust securities will never be entitled to payment in respect of the principal of the notes.

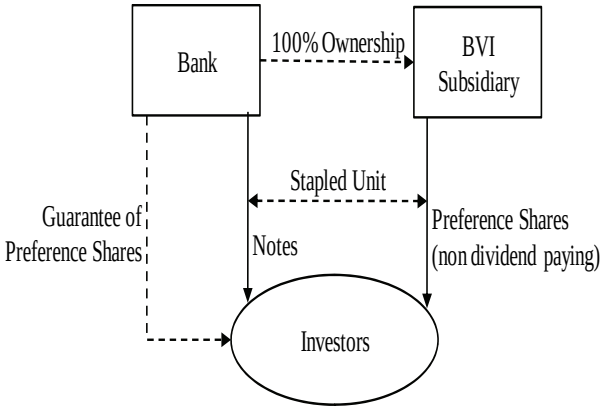
■ If the trust is a hat check trust, holders of trust securities may withdraw the units represented by such trust security from the trust.

- Upon a winding-up of the bank, the guarantee (and effectively the trust securities) rank as junior subordinated indebtedness of the bank (or *pari passu* with the bank's preference shares).

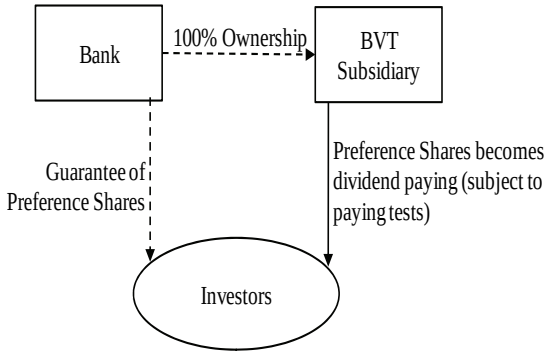
- Trust security holders have the right to proceed directly against the bank if the trust fails to pay a distribution within the applicable grace period.

- ***Hong Kong Bank Subsidiary Non-Dividend Paying Preference Shares Stapled to Subordinated Notes (since 2009)***

Pre-Assignment



Post-Assignment



Selected 2009 issue

- *The Bank of East Asia, Limited (October 2009)*

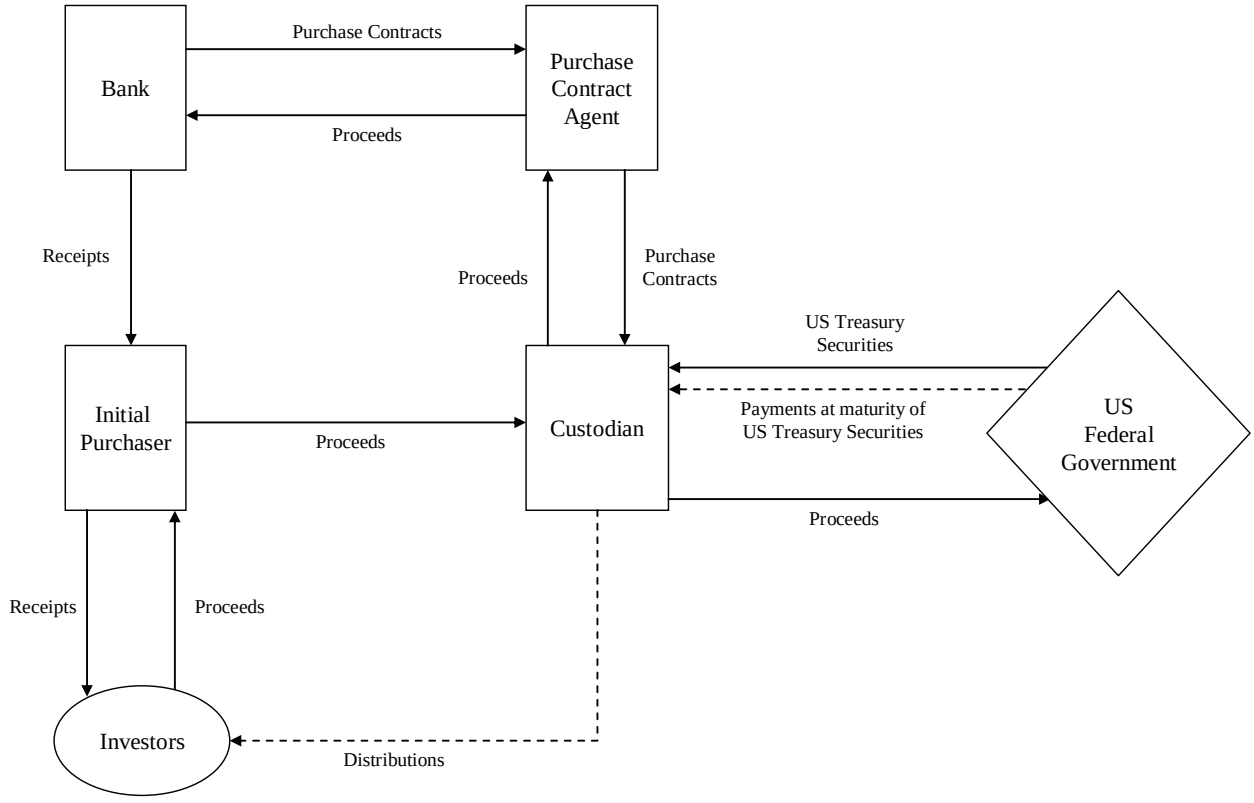
Features

- The offering is comprised of subordinated notes issued by The Bank of East Asia, Limited and non-cumulative preference shares issued by a British Virgin Island wholly-owned subsidiary.
- The notes and preference shares are stapled and may only be traded together as units.
- The notes have a long maturity date of 50 years, and pay interest initially at a fixed interest rate, but then pay a floating interest rate which is LIBOR plus a margin.
- Preference shares have no fixed or final redemption date, and holders of preference shares are not entitled to receive any dividend. The preference shares rank *pari passu* without any preference amongst themselves and in priority to ordinary shares of the issuer.
- On the occurrence of an assignment event the preference shares become dividend-paying, and the note is transferred to the issuer of the preference shares for nil value. An assignment event includes where: (i) there is deferral of payment on any notes; (ii) the Hong Kong Monetary Authority determine that the capital adequacy ratio of The Bank of East Asia, Limited is less than 8 percent or where winding-up proceedings are instituted against The Bank of East Asia, Limited and (iii) there is a default in the payment of any amount in respect of the notes.
- On the occurrence of a substitution event, substitute preference shares are issued by The Bank of East Asia, Limited. A substitution event includes where the Hong Kong Monetary Authority determine that the capital adequacy ratio of The Bank of East Asia, Limited is less than 8 percent or where winding-up proceedings are instituted against The Bank of East Asia, Limited.
- The substitute preference shares pay dividends in priority to the payment of any dividend to holders of ordinary shares.
- The notes are governed by English Law. The preference shares are governed by the laws of the British Virgin Islands.

CHAPTER 10

BANK MANDATORY CONVERTIBLE OR EXCHANGEABLE TIER 1 INSTRUMENTS

- ***Depositary Receipts Representing Prepaid Australian Bank Ordinary Share Forward Purchase Contracts (since 1998)***



Direct issue of bank under forward purchase contracts.

Selected issue

- St. George Bank (1998)

Transaction benefits

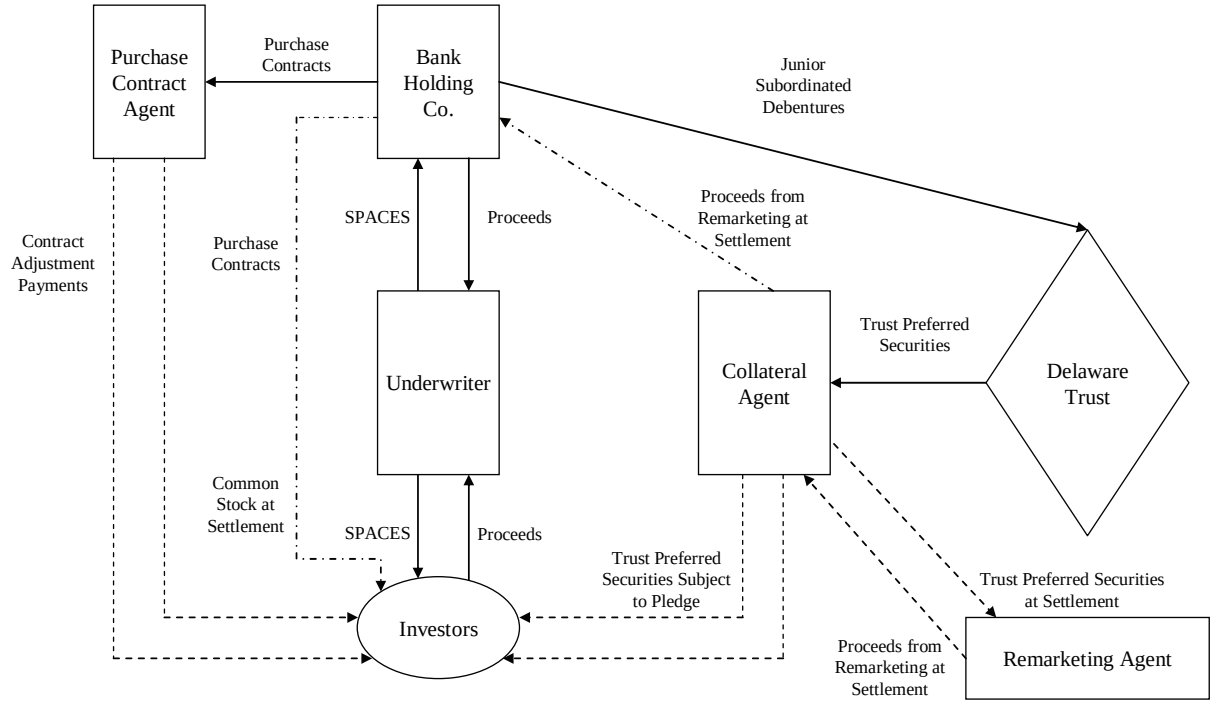
- Primary regulator capital treatment – bank Tier 1 capital.
- Not subject to 15 percent innovative basket limitation.
- Prior to the contract settlement date, non-dilutive to the bank's ordinary shares.
- The cost of equity does not require the use of franking credits, which can instead be used with respect to dividends paid to holders of the bank's ordinary shares.

The depositary receipts were listed on the Winnipeg Stock Exchange to avoid Australian stamp duty.

Features

- Fixed semi-annual payments to investors from maturing US treasuries held by the depositary for the benefit of receipt holders.
- The number of bank ordinary shares to be purchased on the contract settlement date is dependent upon the ordinary share trading price and the US dollar/Australian dollar exchange rate on that date, and is subject to a floor and a collar.
- The purchase contracts settle three years after the date the receipts are issued.
- The purchase contracts accelerate upon the occurrence of reorganization events such as a winding-up or a takeover of the bank.
- Holders of the receipts may withdraw the underlying purchase contracts and related forward purchase contracts at any time.
- The depositary is not an investment company for purposes of the 1940 Act because of the withdrawal feature.

- ***US Synthetic Mandatory Exchangeable Securities (since 2002)***



Each security consists of a stock purchase contract and a beneficial interest in a trust preferred security of the issuing bank holding company that collateralizes the holder's obligation to purchase the underlying common stock of the issuing bank holding company on the stock purchase date.

Selected issues

- Capital One Financial Corporation (2002)
- Provident Financial Group, Inc. (2002)
- State Street Corporation (2003)
- Marshall & Ilsley Corporation (2004)

Selected product name

- Common SPACES

Transaction benefit

- Primary regulator capital treatment – Tier 1 treatment for the synthetic mandatory convertible security. On March 1, 2005, the Board of Governors of the Federal Reserve System issued final regulations on trust

preferred securities and the definition of capital. Such regulations, in part, exempt qualifying mandatory convertible preferred securities from the 15 percent limitation on restricted core capital elements applicable to internationally active banking organizations.[58]

Features of Marshall & Ilsley issue

- Two components:
  - a variable-rate purchase contract pursuant to which the investor agrees to purchase from the issuer a number of shares of common stock which varies depending on the share price of the common stock at the time of settlement; and
  - a trust preferred security, or STACKS, representing an undivided beneficial ownership interest in the assets of the issuer sponsored trust. The assets of the trust consist solely of deferrable subordinated debt securities issued by the bank holding company to the trust.
- Deferrable quarterly payments on the variable-rate purchase contract that coincide with the periodic payments provided by the STACKS.
- The STACKS are pledged to the collateral agent for the benefit of the issuer to secure the holder's obligation to purchase the issuer's common stock under the variable-rate purchase contract.
- Accounted for using the treasury stock method such that there is no immediate dilution in earnings per share calculations.
- The holder is permitted to hold the STACKS separately from the Common SPACES by substituting treasury securities for the STACKS as collateral for the holder's obligation to purchase the issuer's common stock on the stock purchase date pursuant to the purchase contract. Following any such substitution, the holder will hold separate STACKS and a Stripped Common SPACES comprised of a stock purchase contract and an interest in the substituted treasury security.
- The settlement rate of the Common SPACES is based upon the market price of the common stock at the time of pricing of the Common SPACES plus a premium. The variable settlement rate mechanism effectively collars the degree to which an investor will participate in an appreciation of the issuer's stock price.

[58] For further information on this topic, see Appendix A (*Basel Committee and US Regulatory Innovative Tier 1 Capital Requirements*).

- On the stock purchase date, holders are issued the number of shares per purchase contract equal to the settlement rate. The proceeds from the successful remarketing of the STACKS are used to satisfy the holder's payment obligations in respect of the stock purchase contracts unless the holder pays cash in satisfaction of the purchase obligation, in which case the holder receives upon settlement the number of shares of common stock equal to the settlement rate and separate STACKS. If there is a failed remarketing, the stock purchase date is deferred for up to four quarterly periods until a successful remarketing or a failed final remarketing occurs.

Features of State Street Issue

- Primary regulator capital treatment – by collateralizing the holders' purchase obligations under the purchase contracts with treasuries rather than trust preferred securities and concurrently issuing the trust preferred to a separate investor base, the trust preferred securities receive Tier 1 capital treatment.

- Selected product name – SPACES

- Two components

  – SPACES, consisting of:

  – a fixed rate purchase contract pursuant to which the investor agrees to purchase from the issuer a fixed number of shares of common stock at settlement;

  – a fractional ownership interest in a zero-coupon US treasury strip that matures on the settlement date of the fixed rate purchase contract in a dollar amount at maturity equal to the purchase price of the common stock to be purchased at settlement;

  – an ownership interest in a portfolio of zero-coupon US treasury strips that mature on a quarterly basis through the settlement date of the fixed rate purchase contract which provides a quarterly income stream to the investor; and

  – a variable-share repurchase contract pursuant to which the investor agrees to deliver to the issuer between zero and a fraction of one share of the issuer's common stock depending on the share price of the issuer's common stock at the time of settlement.

- Deferrable quarterly payments on the fixed rate purchase contract and the variable rate repurchase contract that coincide with the periodic payments provided by the treasury portfolio.

- The fractional ownership interest in the zero-coupon US treasury strip is pledged to the issuer to secure the holder's obligation to purchase the issuer's common stock under the fixed rate purchase contract.

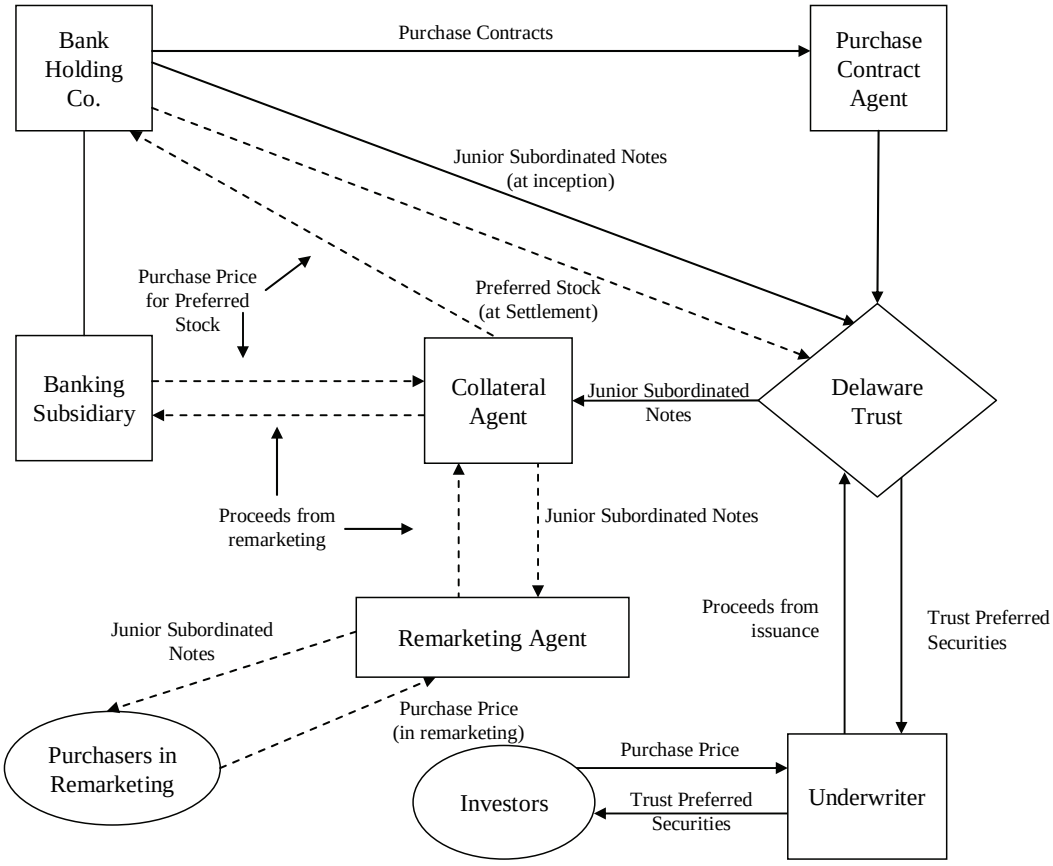
- One of the shares of common stock issuable pursuant to the fixed rate purchase contract component of the SPACES is pledged to secure the holder's obligation to deliver a fraction of a share under the variable rate repurchase contract.

- The settlement rate of the SPACES, as is the case with a typical mandatory convertible, is based upon the market price of the common stock at the time of pricing of the SPACES plus a premium.

  – Unlike the typical mandatory convertible structure, rather than a single purchase contract with a varying settlement amount, there is a fixed rate purchase contract pursuant to which the investor receives common stock and a variable rate repurchase contract pursuant to which the investor may be required to deliver between zero and a fraction of a share, depending on the stock price at the time of settlement.

  – The settlement date for the variable rate repurchase contract is one calendar quarter subsequent to the settlement date of the fixed rate repurchase contract.

- ***US Synthetic Mandatory Exchangeable Securities – Convertible for Preferred Stock (since 2006)***



Selected issues

- Wachovia Corporation (2006)
- US Bancorp (2006)
- National City Corporation (2008)
- Wells Fargo & Company (2008 – two issues)
- State Street Corporation (2008)

Selected product name – WITS (or ITS)

- Primary regulator capital treatment – The Wachovia Corporation transaction involved mandatory convertible trust preferred securities that were structured to obtain limited tax deductibility, Tier 1 treatment and 75 percent equity credit from Moody's. On January 23, 2006, the Board of

Governors of the Federal Reserve issued a letter to Wachovia Corporation which confirmed that trust preferred securities that convert into non-cumulative perpetual preferred stock (instead of common stock) constitute qualifying mandatory convertible preferred securities within the meaning of the Board's Capital Guidelines. Accordingly, such securities would be exempt from the 15 percent limitation on restricted core capital elements applicable to internationally active banking organizations and are instead subject to the limitation that an internationally active banking organization may include restricted core capital elements in Tier 1 capital up to 25 percent of Tier 1 capital so long as restricted core capital elements that exceed 15 percent of Tier 1 capital are in the form of qualifying mandatory convertible securities.

- Rating agency treatment – The structure is afforded "basket D" treatment by Moody's Investors Service, Inc. Accordingly, the WITS attain 75 percent equity credit.

- Each WITS is initially offered as a trust preferred security of an issuer sponsored trust corresponding to two underlying components:

  – a fixed rate junior subordinated note issued by the bank holding company; and

  – a $1/100^{th}$ interest in a stock purchase contract pursuant to which the trust agrees to purchase from the issuer one share of preferred stock of the issuer.

- Deferrable quarterly contract payments on the purchase contracts and deferrable interest payments on the junior subordinated notes provide the funds to the trust with which it makes quarterly distribution payments on the WITS.

- The junior subordinated notes are initially pledged by the trust to the issuer to secure the trust's obligation to purchase the issuer's preferred stock under the purchase contracts.

- The junior subordinated notes will be remarketed approximately one month in advance of the settlement date for the purchase contracts in order to raise proceeds to satisfy the trust's payment obligation under the purchase contracts. Pending the purchase of the preferred stock on the settlement date, the proceeds of the remarketing are deposited in an interest bearing account with a banking subsidiary of the issuer.

  – In connection with the remarketing:

    – the interest rate of the junior subordinated notes will be reset to a level that will enable the proceeds of the

remarketing to be sufficient to satisfy the payment obligation under the purchase contracts; and

- the issuer may elect to modify certain terms of the junior subordinated notes, including the term to maturity and the date after which the junior subordinated notes may be redeemed.
  - Although the issuer may modify the maturity date and initial redemption date of the junior subordinated notes, the junior subordinated notes may not mature or be subject to redemption by the issuer on a date that is earlier than approximately nine years following the original issuance of the WITS (which is approximately four years following the scheduled remarketing date).
  - Following the remarketing:
    - the junior subordinated notes may qualify as Tier 2 capital; and
    - unless the issuer redeems the preferred stock, both the junior subordinated notes and the preferred stock will remain outstanding.

- The settlement date for the repurchase contracts is scheduled to occur approximately five years from the date of issue of the security.
  - Because the settlement date for the purchase contracts occurs five years following the issuance of the WITS rather than the more customary three year period for other synthetic mandatory convertible securities, the structure provides significant tax benefits to the issuer since the issuer is entitled to tax deductions in respect of five, rather than three, years of interest payments on the junior subordinated notes.
  - Because the settlement date is permitted to occur on a date that is beyond the customary third anniversary of issuance, the security provides for early settlement in the event of certain adverse financial events relating to the issuer.
  - The settlement date can also be postponed for up to four quarterly periods in the event that the junior subordinated notes are not successfully remarketed.

- In the structure, holders of WITS may substitute US Treasury Securities for junior subordinated notes as collateral to secure the purchase

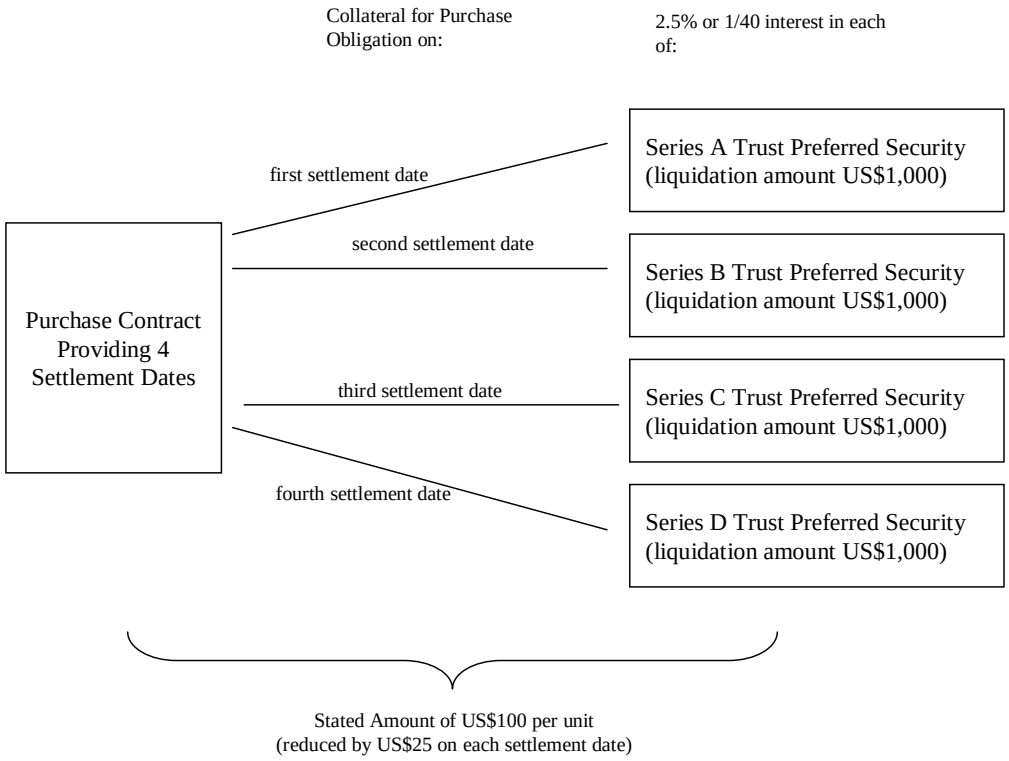
obligation under the purchase contract. In such a case, for each such substitution two other classes of trust preferred securities will be delivered to the holder:

- a trust preferred security that corresponds to the junior subordinated note that has been released from the pledge; and
- a trust preferred security that corresponds to a purchase contract and the US Treasury Securities that the holder has substituted as collateral to secure the purchase obligation under the related purchase contract.

■ Following the settlement date for the purchase contract, the preferred stock will comprise the assets of the trust.

- The preferred stock will pay non-cumulative dividends at a floating rate, if, as and when declared by the issuer's board of directors.
  - Unlike interest payable on the junior subordinated notes, dividends payable on the preferred stock will not be deductible for the issuer for US federal income tax purposes.
- The preferred stock will be redeemable by the issuer at any time following its issuance (unless there has been an acceleration of the stock purchase contracts, in which case the preferred stock will not be redeemable until approximately the fifth anniversary from the original issuance of the WITS).
  - Any redemption of the preferred stock will be subject to the prior approval of the Board of Governors of the Federal Reserve.

- ***Bifurcated Mandatory Convertible Trust Preferred Securities***



Selected issue

■ Citigroup

Selected Product Name

■ Upper DECS

The Upper DECS are units, each of which consists of:

■ a 2.5 percent or 1/40 interest in four separate series of trust preferred securities; and

■ a stock purchase contract pursuant to which the holder is obligated to purchase a variable number of shares of common stock of the issuer on each of four purchase contract settlement dates.

The trust preferred securities collateralize the holders' obligation to purchase common stock of the issuer on the four purchase contract settlement dates.

The original stated amount of each unit is US$100. The stated amount of each unit declines by US$25 on each purchase contract settlement date.

On each purchase contract settlement date, the holder is obligated to purchase, and the issuer is obligated to sell, a variable number of shares of common stock equal to the sum of the daily settlement amounts over a 20 trading-day period beginning the 23rd trading day prior to the applicable settlement date.

The daily settlement amount for each trading day will equal the number of shares of common stock of the issuer equal to 1/20 multiplied by the quotient obtained by dividing US$25 by:

- the reference price, if the volume-weighted average price of the common stock on such trading day is less than or equal to the reference price;
- the volume weighted average price of the common stock on such trading day, if the volume weighted average price of the common stock on such trading day is greater than the reference price but less than the threshold appreciation price; and
- the threshold appreciation price, if the volume-weighted average price of the common stock on such trading day is greater than or equal to the threshold appreciation price.

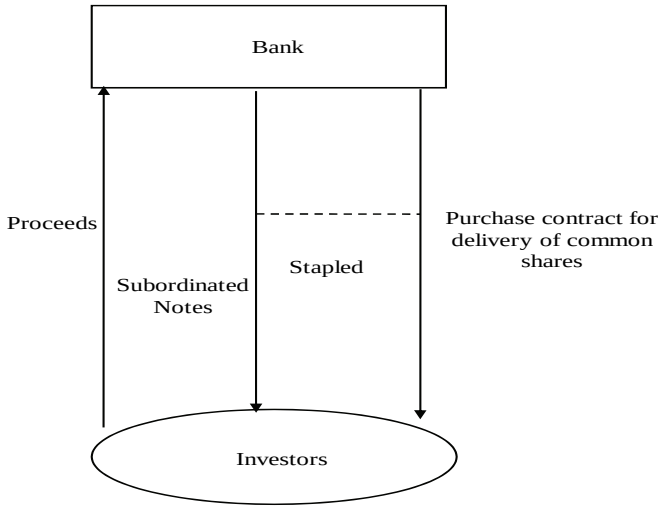
The capital securities of each series will be remarketed three months prior to the purchase contract settlement date corresponding to the purchase obligation that the trust preferred securities of such series collateralizes.

- If there is a failed remarketing in connection with any purchase contract settlement date, the issuer will exercise its rights as a secured party with respect to the applicable series of trust preferred securities in satisfaction of the holders' purchase obligation on such purchase contract settlement date.
- If distributions have been deferred on the trust preferred securities, the remarketing proceeds must include an amount equal to the accrued and unpaid interest. If the remarketing is not successful, the issuer is obligated to issue to holders of the Upper DECS junior subordinated notes in an aggregate principal amount equal to the deferred interest.

Distributions on the Upper DECS are comprised of distributions payable on the capital securities and contract adjustment payments payable on the related stock purchase contracts.

- Distributions are subject to deferral at the option of the issuer and at the direction of the Federal Reserve Board.

- ***US Tangible Dividend Enhanced Common Stock (since 2009)***



Selected 2009 issue

■ *Citigroup Inc. (December 2009)*

Selected Product Name

■ T-DECS

Features

■ The T-DECS are units, each of which consists of:

- a prepaid stock purchase contract; and
- a junior subordinated amortizing note.

■ The prepaid stock purchase contract will automatically convert into common stock of Citigroup after three years. The purchase contract holders will not receive any cash distributions.

■ The notes will pay a fixed interest rate and mature after three years.

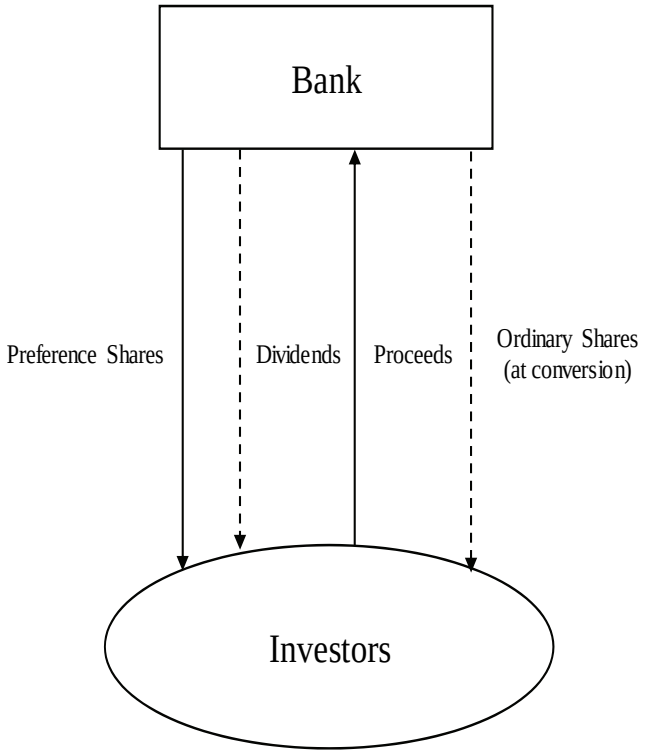
■ The T-DECS may be separated into their individual component parts. If a person holds a separate purchase contract and note, they may be combined to recreate new T-DECS.

- If Citigroup elects to settle the purchase contracts early, holders of the notes will have the right to require Citigroup to repurchase their notes for cash.

- Citigroup intends to use the proceeds of the T-DECS to repurchase and retire US$20 billion in trust preferred securities held by the US Department of Treasury pursuant to Citigroup's participation in TARP.

- Listed on the New York Stock Exchange.

- ***Australian Mandatory Convertible Preference Shares (since 2009)***



Selected 2009 issue

- *Australia and New Zealand Banking Group Limited (November 2009)*

Features

- The convertible preference shares are fully paid preference shares.
- The convertible preference shares are classified as non-innovative residual Tier 1 capital.
- The preference shares will mandatorily convert into ordinary shares of the issuer approximately 6 years from issue (*i.e.*, December 2016), unless certain mandatory conversion conditions are not satisfied or the issuer elects for a third party to purchase the preference shares prior to the conversion date.
- Dividends on the preference shares are preferred non-cumulative and pay a floating rate of interest.

- The issuer, subject to approval from the APRA, may elect to exchange the preference shares if certain events occur, such as an acquisition event, a tax event or a regulatory event.

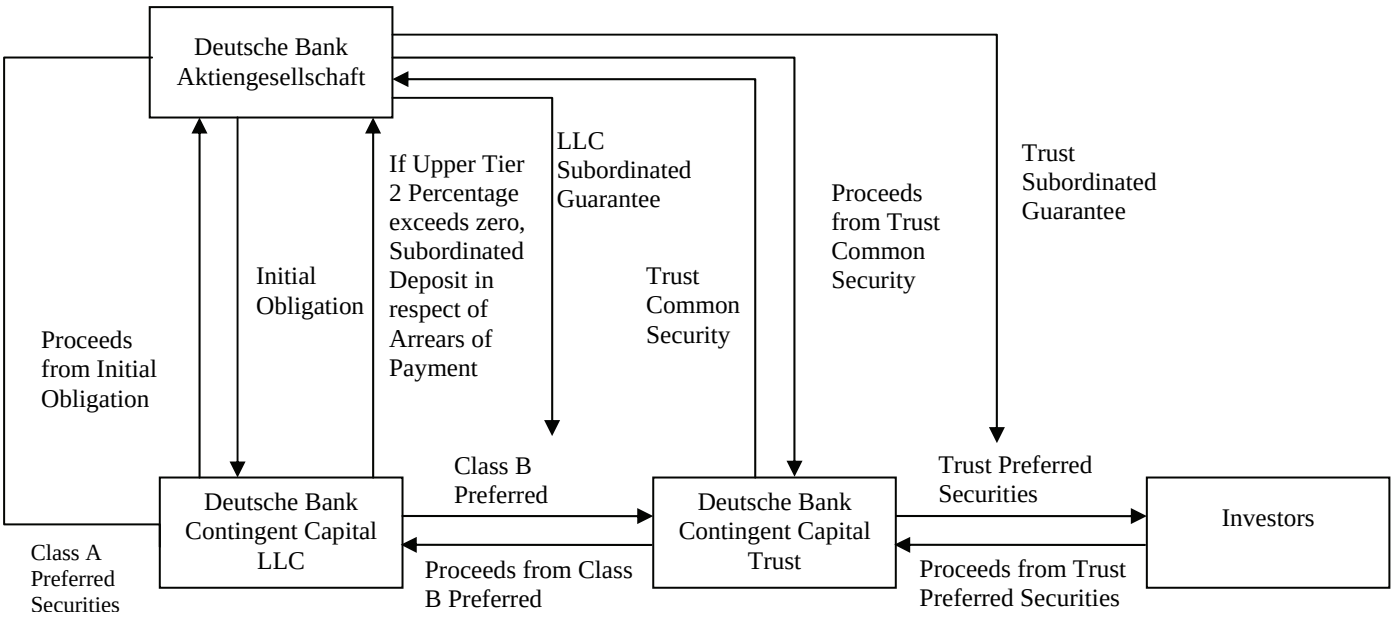
- Rank ahead of ordinary shares, equally with certain issued preference shares and any other equal ranking instruments, but behind all senior ranking securities or instruments, and all deposits or other creditors.

- Listed on the Australian Stock Exchange.

CHAPTER 11

BANK CONTINGENT CAPITAL INSTRUMENTS

- ***Deutsche Bank Contingent Capital Securities (since 2007)***



Selected issues

- Deutsche Bank Contingent Capital Trust I (March 2007)
- Deutsche Bank Contingent Capital Trust II (May 2007)
- Deutsche Bank Contingent Capital Trust III (February 2008)
- Deutsche Bank Contingent Capital Trust IV (May 2008)
- Deutsche Bank Contingent Capital Trust V (May 2008)

Features

- Except for the contingent Tier 1 capital feature of these issues discussed below, as the above diagram shows, these issues have a number of structural similarities to the *German Bank Subsidiary Preferred (since*

1999) and the *US Bank Holding Company and Irish Bank Guaranteed Subsidiary Preferred (since 1999)* structures discussed in *Chapter 5 – Bank Tax Deductible Non-Operating Subsidiary Tier 1 Instruments.*

- The issuer is a Delaware trust, and the intermediate subsidiary is a Delaware limited liability company.

- The common securities of the trust are held by the bank, and the common securities and class A preferred securities of the intermediate subsidiary are held by the bank.

- Generally, distributions on the class B preferred securities of the intermediate subsidiary which are held by the trust will only be authorized if the subsidiary has sufficient operating profits and the bank has sufficient distributable profits, and the payment is not otherwise prohibited by an order of the German Federal Financial Supervisory Authority.

- The bank guarantees, on a subordinated basis, payments in respect of the trust preferred securities and the class B preferred securities.

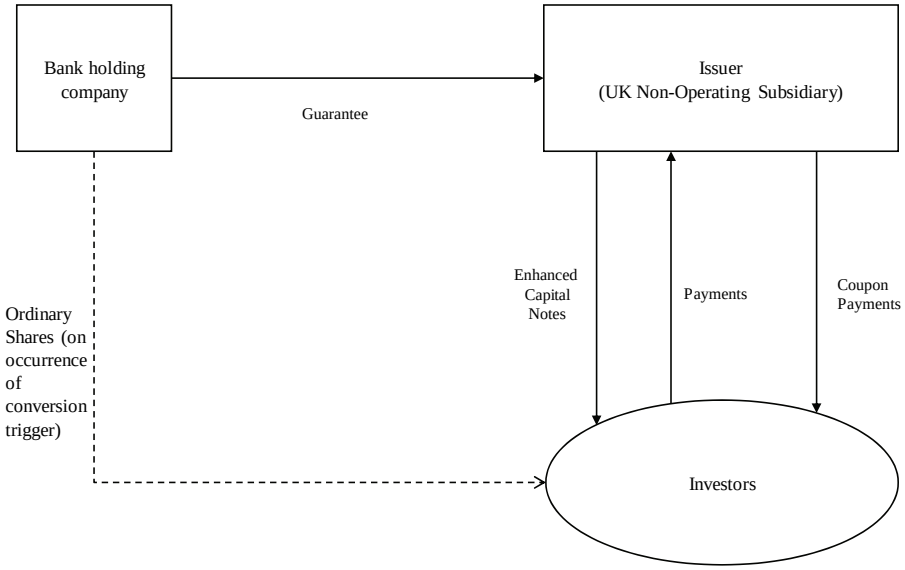
- All of the class B preferred securities of the intermediate subsidiary will be initially treated as consolidated Upper Tier 2 regulatory capital.

- Prior to a specified date, the bank may, under the limited liability company agreement, elect to qualify all or, in some cases, a percentage of each and every class B preferred security as consolidated Tier 1 regulatory capital (the "Tier 1 Election"). In some transactions, this is a one-time election, while other transactions provide for elections on one or more occasions in specified incremental percentages of the class B preferred securities. The effectiveness of the Tier 1 Election is subject to certain conditions. Upon the effectiveness of the Tier 1 Election, a corresponding percentage of the trust preferred securities are characterized as subject to the Tier 1 Election.

- Distributions on the portion of the trust preferred securities and the class B preferred securities subject to an effective Tier 1 Election (the "Tier 1 Percentage") are non-cumulative, while distributions on the portion of those securities not subject to the Tier 1 Election (the "Upper Tier 2 Percentage") are cumulative.

- Any excess interest payment received by the intermediate subsidiary on the Bank's subordinated note held by it due to a deferral of distributions on the Upper Tier 2 Percentage of the class B preferred securities are deposited into an interest bearing subordinated deposit account at the bank pursuant to a subordinated deposit agreement under which such deposits will be paid to the intermediate subsidiary to the extent required to pay arrears of distributions on the Upper Tier 2 Percentage of the class B preferred securities to the trust.

- ***UK Contingent Capital Securities (since 2009)***



Selected 2009 issue

- *Lloyds Banking Group plc (December 2009 – two issues)*[59]

Selected Product Name

- Enhanced Capital Notes ("ECNs")

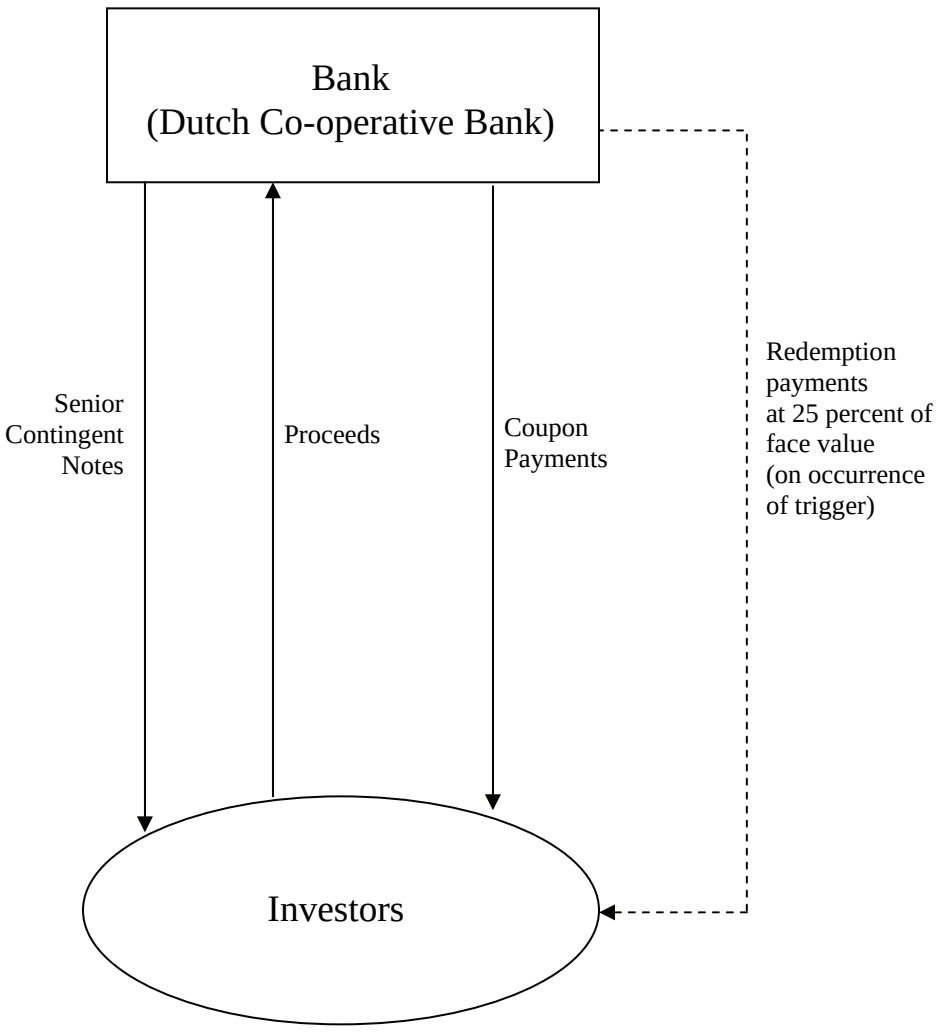
Features

- The ECNs were issued by a non-operating subsidiary pursuant to a Enhanced Capital Note Program unconditionally and irrevocably guaranteed by Lloyds Banking Group plc.
- The ECNs are undated, although the Enhanced Capital Notes Program allows for dated ECNs.
- If the core Tier 1 ratio of Lloyds Banking Group plc falls to below 5 percent, each ECN will be converted into new and/or existing ordinary shares of Lloyds Banking Group plc (referred to as the "conversion event") by dividing the principal amount of an ECN by (i) in the case of ECNs where the specified currency is not pounds sterling, the conversion price in effect on the conversion date or (ii) in the case of ECNs where the specified currency is pounds sterling, by the specified conversion price.

[59]Securities issued pursuant to an exchange offer, see page 310, Chapter 17 (*Liability Management Transactions*).

- The ECNs are not convertible at the option of the ECN holders.
- Whether the "conversion trigger" has been satisfied will be determined by the latest published annual or senior annual consolidated financial statements of the parent or as otherwise publicly disclosed by the parent at any time.
- The ECNs pay a fixed interest rate up to the first optional redemption date and then pay a floating interest rate linked to 3 month US dollar LIBOR plus a margin.
- The ECNs constitute direct, unsecured and subordinated obligations of the relevant issuer and rank *pari passu* and without any preference amongst themselves.
- Call option features that allow the issuer to redeem the ECNs in whole (but not in part) on the first optional redemption date (10 plus years after issue) and each interest payment date thereafter.
- Limited events of default, restricted to failure to pay interest / principal or an order is made (or resolution passed) for the winding-up of the issuer of the guarantor.
- Governed by English law. The guarantee is governed by Scottish law.
- Listed on the London Stock Exchange.

- ***Dutch Contingent Capital Securities (since 2010)***



Selected 2010 issue

■ *Rabobank Nederland (March 2010)*

Selected Product Name

■ Senior Contingent Notes ("SCNs")

Features

■ The SCNs were a direct issuance by Rabobank Nederland

■ If the equity capital ratio of Rabobank Group falls to below 7 percent on an initial trigger date and a related subsequent trigger test date, the

principal amount of all of the SCNs shall be reduced and written down to 25 percent of their original principal amount (the "Write Down Redemption Price") and all of the SCNs will be redeemed by Rabobank Nederland at the Write Down Redemption Price.

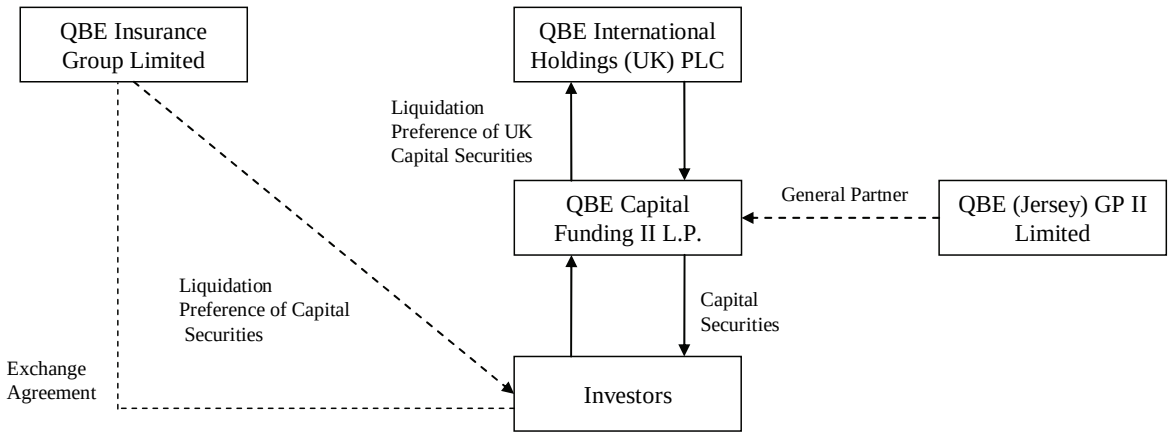
- The SCNs are also redeemable upon a tax law change at par or a special redemption price, depending on the nature of the tax law change.
- No principal write down of the SCNs and related redemption at the Write Down Redemption Price will occur if a notice of redemption due to a tax law change has been previously given or an event of default has occurred and has not been remedied prior to the subsequent trigger test date.
- Rabobank Nederland will publish in its annual and semi-annual consolidated financial statements the equity capital ratio of the Rabobank Group as of the date the financial statements are prepared and provide copies to the fiscal agent.
- The SCNs pay a fixed interest rate payable annually in arrears.
- The SCNs constitute unsubordinated and unsecured obligations of Rabobank Nederland and rank *pari passu* and without any preference among themselves.
- The SCNs have the benefit of a negative pledge in relation to Rabobank Nederland.
- The SCNs are not rated.
- Governed by Dutch law.
- Admitted to trading on Euronext Amsterdam by NYSE Euronext.

CHAPTER 12

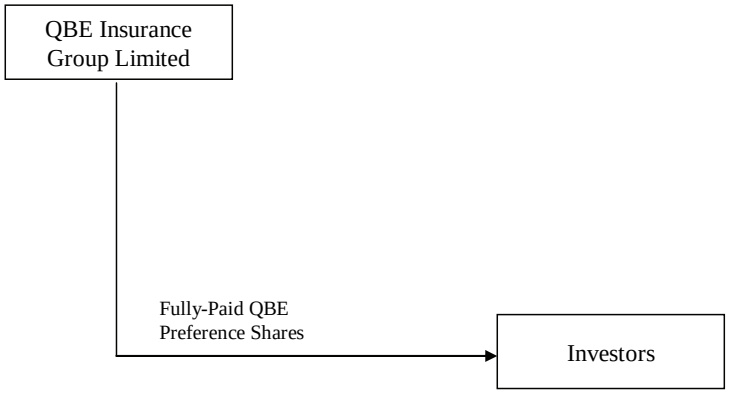
INSURANCE COMPANY INSTRUMENTS

- ***Australian Guaranteed Perpetual Capital Securities (since 2006)***

Pre-exchange



Post-exchange



Selected issues

- QBE Insurance Group Limited (2006)
- QBE Insurance Group Limited (2007)

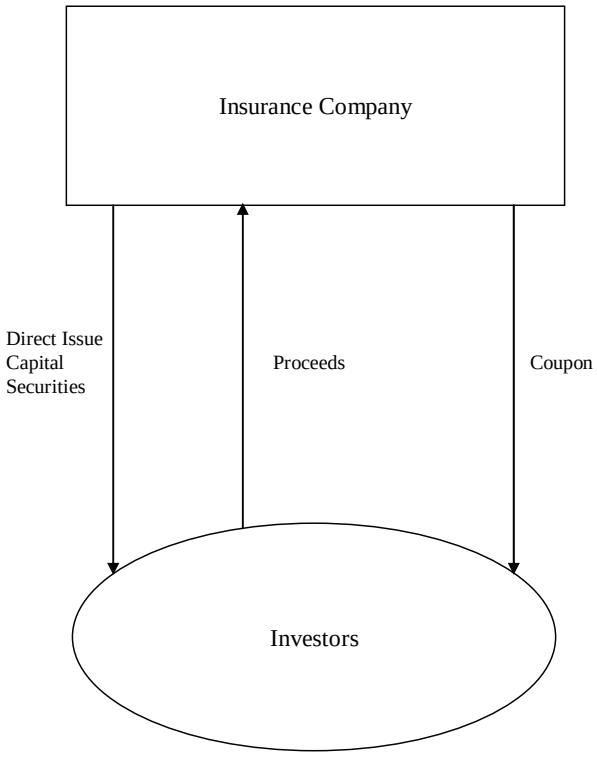
Transaction benefit

- Primary regulator capital treatment – insurance level Tier 1.

Features

- Securities are issued via a Jersey limited partnership.
- Securities rank junior to subordinated debt, but senior to share capital. It is the stated intention that on liquidation the securities should rank equally with non-cumulative preference shares.
- Perpetual (NC10).
- Fixed rate coupons payable until the first call date, stepping up to floating rate thereafter.
- Interest is payable, prior to an exchange event, only to the extent that the issuer has available funds to do so.
- The securities are mandatorily convertible for preference shares if a distribution or an applicable redemption price is not paid in full within 20 business days of it becoming due or in certain specified situations. The issuer may opt to exchange the capital securities for preference shares.
- Dividend stopper in the event that interest or principal is not paid in full when due, preventing the issuer or any entity it directly or indirectly controls from redeeming, repurchasing or declaring or paying a dividend on equity until such time as the payment is no longer outstanding.
- Issuer optional redemption in whole, but not part (i) on, or on any interest payment date thereafter, the first call date, at the par redemption price, or (ii) at any time, upon the occurrence of certain tax, regulatory or other specified events at the make-whole redemption amount.
- Irish listed.
- The securities are governed by Jersey law.

- ***UK, Dutch, Bermudan, Norwegian and Swiss Perpetual or Dated Subordinated Debt Securities (since 2004)***



Selected issues

- Aviva (UK) (2004)
- Aegon (Dutch) (2004)
- Prudential plc (UK) (2005)
- Old Mutual (UK) (2005)
- Royal & Sun Alliance Insurance Group (2006)
- Aegon (Dutch) (2006 – two issues)
- Eureko (Dutch) (2006)
- Legal & General Group PLC (UK) (2007)
- The Society of Lloyd's (UK) (2007)
- Aegon (Dutch) (2007)

- Eureko B.V. (Dutch) (2008)
- Storebrand Livsforsikring AS (Norwegian) (2008 – three issues)
- The United Kingdom Mutual Steam Ship Assurance Association (Bermuda) Limited (Bermudan) (2008)

Selected 2009 issue

- *Prudential plc (UK) (June 2009)*
- *ASR Nederland (Dutch) (August 2009)*[60]

Transaction benefits

- Primary regulator capital treatment – insurance level Tier 1.
  - Limited to 15 percent innovative Tier 1 basket.
- Interest deduction at the insurance company level for distributions on the securities.
- No withholding tax on dividend payments (see below).

Perpetual securities that have no maturity date are issued directly by the insurance company pursuant to a trust deed or trust indenture. Terms may vary from issue to issue but generally are as described below.

Redemption can only be in whole and not in part at the option of the issuer subject to prior consent of the appropriate regulatory overseer and to certain solvency thresholds being met for the six months prior to the proposed redemption. Redemption can also occur following a change of control event or a change in tax status.

Interest payments can vary from being a fixed rate for an initial period and then a variable rate thereafter to a fixed rate set above a published variable interest rate, such as LIBOR or EURIBOR. Other examples include a rate reset after a term of five or ten years pegged to a published variable rate.

These securities are subordinated to the claims of senior creditors (including upper and lower Tier 2) in that payments in respect of these securities are conditional upon the issuer being solvent at the time of payment and in that no payments are due except to the extent the issuer could make such payments and still be solvent immediately thereafter.

The securities rank *pari passu* with holders of the most senior class of preference shares with non-cumulative dividends.

[60] Securities issued pursuant to an exchange offer, see page 308, Chapter 17 (*Liability Management Transactions*).

Payments generally may be deferred by the insurance company subject to certain qualifications, some of which are as follows:

- payments will be mandatory to the extent that the insurance company pays on ordinary shares or *pari passu* preference shares;
- except in the case of a mandatory payment, payment may be deferred at the insurance company's election or option;
- deferral of payment may occur without any requirement to pay interest on the deferred amount if and so long as the insurance company determines that the insurance company was, or the payment would have resulted in the insurance company being, in non-compliance with applicable insurance company capital regulations or pre-determined contractual insolvency thresholds;
- if the insurance company determines that it is not in compliance with applicable capital adequacy regulations, it must either defer payment or satisfy the payment with proceeds from the issuance of ordinary shares; and
- if the insurance company is not making payments on *pari passu* preference shares then payment must be deferred, except in the case of a mandatory payment.

Deferral of interest payments can be at the option of the issuer. Deferral does not require a trigger, although this is also true of many non-operating subsidiary trust preferred transactions. The issuer (in most cases the operating company subsidiary of the insurance company holding company) is able to defer coupons for any period of time, although neither the issuer nor its holding company is allowed to declare or pay a dividend during deferral, apart from final dividends already declared or a dividend paid by the issuer to the holding company. Deferral is in two forms:

- General Deferral – at the option of the issuer. Coupon so deferred accrues at the prevailing interest rate plus a premium until paid; and
- Exceptional Deferral – when the issuer does, or is about to, breach its capital requirements. Deferral is only for one coupon period (*i.e.*, one year) and there is no interest on interest. This exceptionally deferred payment has to be paid once the payment can be made without breaching the capital rules. Regulatory approval (such as the FSA) is required to make payment following exceptional deferral.

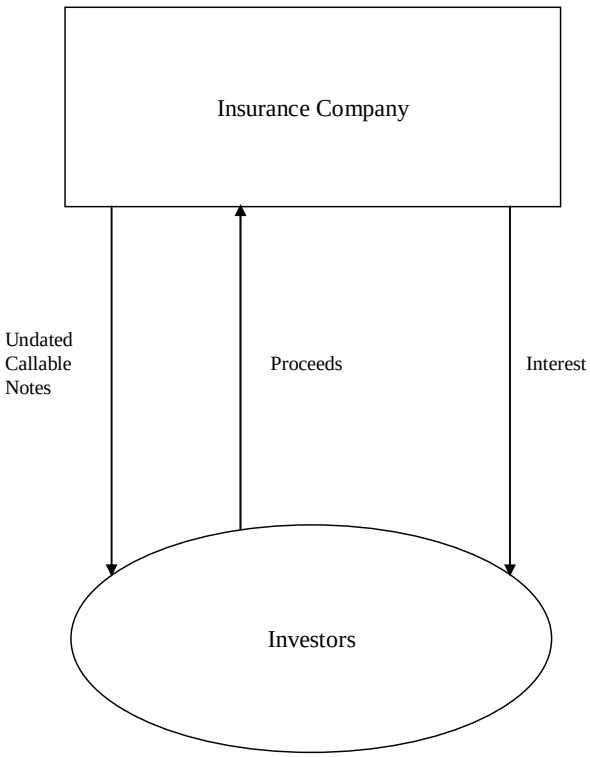
The issuer and, to the extent there is a holding company guarantee, the holding company, are required to keep available for issue enough of its shares as it reasonably considers would be required to satisfy from time to time the next year's coupon payments using the ACSM.

These securities typically have a dividend stopper as well as a capital stopper feature. If the issuer defers payment for any reason, while any payment is deferred, neither the issuer nor the guarantor may (i) declare or pay a dividend or a distribution on any of their respective ordinary or preference shares or stock or other issued Tier 1 securities or (in the case of the Guarantor) make any payment under a Tier 1 guarantee in respect of any such dividend or distribution (other than a final dividend declared by the holders of the ordinary stock of the guarantor before such payment is so deferred, or a dividend or a distribution or payment is made by the issuer to the guarantor, any holding company of the guarantor or to another wholly-owned subsidiary of the guarantor) or (ii) redeem, purchase or otherwise acquire any of their respective ordinary shares, ordinary stock or other Tier 1 securities (other than where such shares or stock are held by the issuer, the guarantor, any holding company of the guarantor or any wholly-owned subsidiary of the guarantor as well as certain other non-material carve-outs). Alternately, these securities may require the payment of interest if payments are made on junior instruments.

If under the relevant rules and regulations, or as a result of a change thereto, (i) the securities would not be capable of counting as cover for the minimum capital resource requirements applicable to the issuer under the applicable rules and regulations or (ii) the issuer is entitled to substitute the securities with preference shares, and such substituted preference shares are no longer eligible to qualify for inclusion in the Tier 1 capital of the issuer, then the issuer may have the right to redeem all, but not some, of the securities or substitute at any time all (and not only some) the securities for other securities that would qualify as innovative Tier 1 capital or Upper Tier 2 securities.

Royal Sun & Alliance Insurance Group's May 2006 issue was guaranteed by a subsidiary, Royal Sun & Alliance Insurance.

- ***French, German, Irish, Italian and Swiss Perpetual Subordinated Debt Securities (since 2003)***



Selected issues

- AXA (French) (2003)
- AXA (French) (2004)
- Allianz (German) (2004)
- Assurances Générale de France (French) (2005)
- Allianz (German) (2005)
- Assurances Générale de France (French) (2005)
- Groupama (French) (2005)
- Allianz (German) (Dutch Finance Subsidiary) (2006)
- Swiss Reinsurance Company (Swiss) (one direct issue via an unaffiliated Dutch repack SPV in May 2006 and one subsidiary preferred securities issue via an English and Welsh intermediate corporate subsidiary and a Jersey LP subsidiary as issuer in May 2006)

- CNP Assurances (French) (2006 – two issues)
- Assicurazioni Generali SpA (Italian) (2006)
- AXA (French) (2006 – five issues)
- SCOR (French) (2006)
- La Mondiale (French) (2006)
- Irish Life Assurance (Irish) (2007)
- Assicurazioni Generali SpA (Italian) (2007)
- Assicurazioni Generali SpA (Italian) (issued through a wholly-owned SPV incorporated in the Netherlands) (2007)
- Münchener Rückversicherungs-Gesellschaft Aktiengesellschaft in München (German) (2007)
- Swiss Reinsurance Company (Swiss) (three issues – each a direct issue via an unaffiliated Dutch repack SPV) (2007)
- Groupama (French) (2007)
- AXA (French) (2007)
- Allianz (Incorporated as a European Company in Munich, Germany) (2008)

Transaction benefits

- Primary regulator capital treatment – Core Tier 1.
- Interest deduction at the bank level for distributions on the securities.
- No withholding tax on dividend payments.

Perpetual maturity.

In some cases, distributions are non-cumulative and are payable in any fiscal year only to the extent of available distributable funds for that fiscal year. Available distributable funds means the amount shown as such on the latest published annual accounts of the insurance company, adjusted for any subsequent profit or loss of the insurance company.

In some cases, the Tier 1 capital securities provide for optional and mandatory deferral of interest. Optional deferral is typically only permitted if the issuer or, in the case of a finance subsidiary, the guarantor has not made payments on its

ordinary shares. Interest is mandatorily deferrable if the issuer or, in the case of a finance subsidiary, the guarantor, does not satisfy its insolvency conditions, which typically means the issuer or the guarantor, as the case may be, is and after the payment will be solvent and would satisfy the minimum solvency margin applicable to it. Some Tier 1 instruments provide the issuer with the option to satisfy deferred interest through an ACSM that involves the sale of shares or hybrid capital of the issuer or the guarantor.

In most of these transactions, if distributions are not paid in full, the insurance company cannot pay cash distributions on its capital stock unless it pays four semi-annual distributions on the securities.

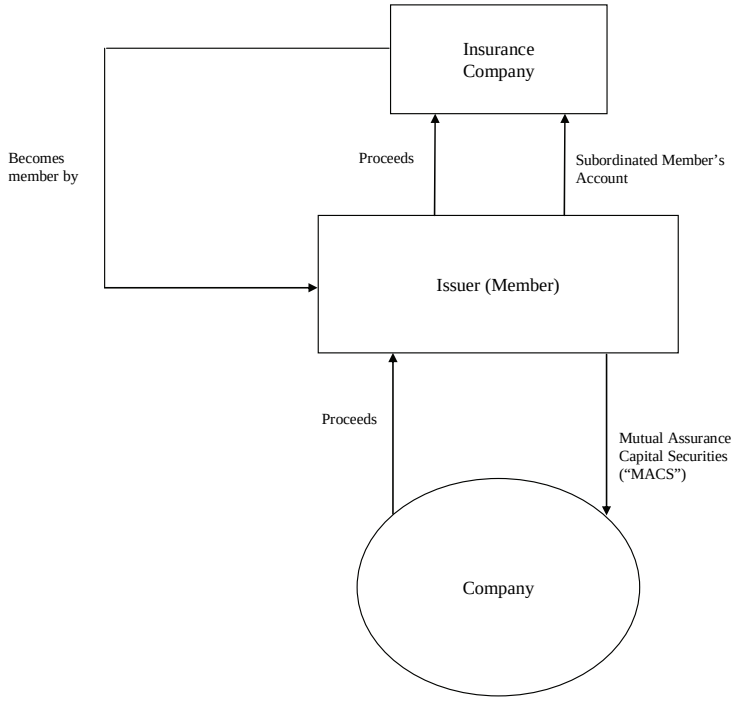
Securities can be issued under a Euro MTN program.

The securities have a loss absorption feature in that if the issuer is insolvent and cannot increase its share capital to off-set the insolvency event, the board has the right to reduce the nominal amount of the securities to off-set its losses and thereafter to enable it to continue its business. Equally, if there is subsequently consolidated net income for at least two consecutive financial years following an insolvency event (and the loss absorption event), the issuer must increase the nominal amount of the notes up to such maximum amount to the extent that any such reinstatement does not trigger the occurrence of another insolvency event.

Typical call provisions for tax and regulatory changes are included. For example, if the issuer determines that the securities no longer qualify for inclusion in the Tier 1 capital or core capital of the issuer or if the securities are not eligible for the purposes of calculating the consolidated solvency margin of the issuer, then the issuer has the right to redeem the securities.

To avoid Swiss withholding tax, Swiss issuers (as Swiss Reinsurance Company did in 2006) may issue their direct issue Tier 1 capital securities to a non-affiliated Dutch company that sells CDOs that are collateralized by those vehicles. Due to 1940 Act and ERISA issues, these sales have generally been made outside the US capital markets to non-US investors pursuant to Regulation S under the US Securities Act of 1933, as amended (the "Securities Act").

- ***UK Non-Operating Subsidiary Capital Securities (since 2004)***



Selected issue

- Standard Life (2004)

Transaction benefits

- Primary regulator capital treatment – Innovative Tier 1.
- Payments under the member's account and insurance policy are tax deductible to the insurance company.

Features

- The insurance policy is the issuer's only asset.
- The proceeds of the issuance are made available by the issuer to the insurance company under the SMA Agreement. The terms of the SMA Agreement with respect to principal amount, rate of interest, provisions for interest deferral and repayment match the corresponding terms of the securities.
- The obligations of the insurance company under the SMA Agreement constitute direct, unsecured and unconditional obligations of the insurance company. All claims under the SMA Agreement, however, will be subordinated in right of payment to all other insurance policy claims and no payment can be made or be due to be made in respect of amounts

payable under the SMA Agreement unless all of the other insurance policy claims have been satisfied in full prior to such payment.

- Interest on the securities is deferrable upon the occurrence of an insolvency event or if certain minimum coverage ratios are not fulfilled.

- Interest is non-cumulative if either a mandatory or optional interest deferral event occurs. However, such deferred interest is capitalized into the principal amount of the securities, provided that such capitalization will not make the insurance company insolvent.

- The insurance company also enters into a deed of indemnity and guarantee in respect of specific liabilities with the issuer (as well as the trustee and paying agents) whereby the insurance company would, among other things, provide a guarantee to meet certain operating expenses associated with the operation of the issuer (but not payments of principal or interest or any other amounts in respect of the securities).

- ***FSA Rules on Tier 1 Capital for Insurance Companies***

The FSA will, during the course of 2010, be consulting on the implementation of the Solvency II Framework Directive in the UK. This will likely result in the requirements discussed below being amended to conform to the requirements as to own funds under Solvency II. That in turn is likely to follow to a certain extent the changes which have already been implemented in the Capital Requirements Directive, which apply to banks.

Chapter 2 of the FSA's General Prudential Sourcebook ("GENPRU") identifies two categories, or tiers, of capital applicable to insurers: Tier 1 and Tier 2. Tier 1 capital is sub-divided into three categories: Core Tier 1, perpetual non-cumulative preference shares and Innovative Tier 1. Tier 2 is sub-divided into upper and lower Tier 2. The elements in Core Tier 1 can be included in a firm's regulatory capital without limit. Lower tiers of capital are either subject to limits or require a waiver to be eligible for inclusion in a firm's capital resources. Examples of the types of capital that fall into the various tiers are set out below.

Tier 1 capital should be able to absorb losses, be permanent (cannot be redeemed at all or can only be redeemed on a winding-up of the firm), rank for repayment upon winding-up after all other debts and liabilities, and have no fixed costs.

Core Tier 1 Capital

The main components of Core Tier 1 capital are:

- permanent share capital;

- profit and loss account and other reserves;

- share premium account;

- externally verified interim net profits;
- positive valuation differences; and
- fund for future appropriations.

Perpetual Non-cumulative Preference Shares

Perpetual non-cumulative preference shares should be perpetual and redeemable only at the issuer's option. Any feature that, in conjunction with a call, would make a firm more likely to redeem perpetual non-cumulative preference shares would normally result in a classification as an Innovative Tier One instrument. Such features would include a step-up, bonus coupon on redemption or redemption at a premium to the original issue price of the share.

Innovative Tier 1 Capital

If a Tier 1 instrument is redeemable and is issued on terms that a reasonable person would think that the issuer is likely to redeem or the issuer is likely to have a substantial economic incentive to redeem, then the instrument is an Innovative Tier 1 instrument. Innovative Tier 1 instruments include, but are not limited to, those incorporating a step-up or principal stock settlement and cumulative coupons provided that such coupons, if deferred, are paid by the issuer in the form of permanent share capital.

Upper and Lower Tier 2 Capital

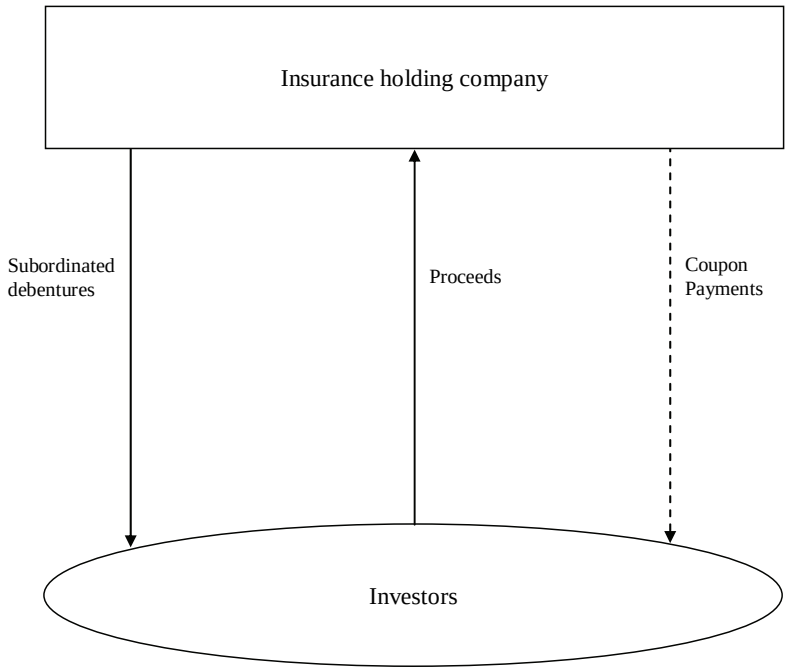
A capital instrument must not form part of the Tier 2 capital of an insurer unless it meets certain general conditions, including that the claims of creditors must rank behind those of all unsubordinated creditors; the only events of default must be non-payment or the winding-up of the firm; the remedies available in the event of non-payment must be limited to the winding-up of the firm; the debt must not become due and payable before its stated final maturity date (if any) except on an event of default; creditors must waive their right to set off amounts they owe the firm against subordinated amounts and the debt must be unsecured and fully paid up.

A major distinction between upper and lower Tier 2 capital is that only perpetual instruments may be included in upper Tier 2 capital, whereas dated instruments are included in lower Tier 2 capital.

In addition to the general conditions for Tier 2 capital listed above, upper Tier 2 capital must meet certain additional conditions, including that the debt must have no fixed maturity date, the contractual terms of the instrument must provide for the issuer to have the option to defer any interest payment on the debt and the contractual terms of the instrument must provide for the loss absorption capacity of the debt and unpaid interest while enabling the issuer to continue its business.

Lower Tier 2 capital must meet general conditions for Tier 2 capital listed above and have an original maturity of at least five years or have no fixed maturity date. Insurance lower Tier 2 capital generally consists of long-term subordinated debt.

- ***US and UK Direct Issue Subordinated Debentures (since 2007)***



Selected issues

- Ambac Financial Group, Inc. (US) (2007)
- American International Group, Inc. (US) (2007 – four issues)
- Chubb Corporation (UK) (2007)
- Lincoln National Corporation (US) (2007)
- The Travelers Company, Inc. (US) (2007)
- Everest Reinsurance Holdings, Inc. (US) (2007)
- Allstate Corporation (US) (2007 – two issues)
- Nationwide Financial Services, Inc. (US) (2007)
- StanCorp Financial Group, Inc. (US) (2007)
- Progressive Corporation (US) (2007)
- Great-West Lifeco Inc. (US) (Issued through a Delaware finance subsidiary) (2007)
- Prudential Financial, Inc. (UK) (2008)

- American International Group, Inc. (US) (2008 – two issues)
- Hartford Financial Services Group (US) (2008)

Selected 2009 issues

- *RSA Insurance Group plc (UK) (May 2009)*
- *Metlife Inc. (US) (June 2009)*
- *Legal & General Group plc (UK) (July 2009)*

Features

- Direct issue.
- Debentures rank junior to subordinated debt, but senior to share capital.
- The debentures have a maturity of between 30 and 70 years (NC10).
- Fixed rate coupons payable until the first call date, stepping-up to floating rate thereafter.
- Limited events of default only encompassing (i) default in the payment of interest in full for a period of 30 days after the conclusion of an interest deferral period which lasts for 10 years, (ii) failure to pay principal on the final maturity date or upon a call for redemption and (iii) and specified insolvency events. Following an event of default as described in (i) at least 25 percent of the debenture holders will be permitted to accelerate the amount outstanding. Following an event of default as described under (iii), the full amount owing under the debentures will automatically be accelerated. No other event of default or breach of covenant will result in acceleration.
- Optional interest deferral for one or more periods of up to 10 consecutive years. Deferred interest is cumulative. During a deferred interest period the issuer and its subsidiaries may not, except in limited circumstances: (i) declare or pay any dividends on, redeem, purchase or acquire any capital stock; (ii) make any payment of principal, interest or premium, or repay or repurchase any *pari passu* or junior debentures; nor (iii) make and guarantee payments on guarantees ranked *pari passu* or junior.
- No mandatory deferral features.
- Issuer optional redemption in whole, but not part (i) on, or at any time after, the first call date, at 100 percent of the principal amount plus accrued and unpaid interest, or (ii) before the first call date at the make-whole redemption amount plus accrued and unpaid interest, or (iii)

upon occurrence of certain tax or rating agency events at the applicable make-whole redemption amount plus accrued and unpaid interest.

- Alternative coupon satisfaction mechanism applies where deferred interest is payable, with the Issuer being required to issue and/or sell new shares or treasury shares until an amount sufficient to pay, in full, the deferred interest (and compound interest thereon) has been raised. Failure to comply with this obligation will constitute a breach of covenant but will not give rise to an event of default or a right to acceleration.

- Replacement capital covenant – the company contractually commits to one or more classes of its existing note holders not to redeem the debentures (and, in certain structures, not to allow the maturity of the securities) unless, within 180 days prior to the date of redemption, it has first issued and sold debentures that have equity-like characteristics that are the same as, or more equity-like than, the debentures at that time.

- Proceeds of issue stated to be used for general corporate purposes, redemption of debentures or repurchase of stock.

- Listed on the New York Stock Exchange.

- Governed by New York law.

- Securities classified as debt for IFRS purposes.

CHAPTER 13

BANK AND INSURANCE COMPANY INSTRUMENT CDOS

Selected US CDO issues (by sponsor/underwriter)

- Salomon Smith Barney (1) (1999)
- First Tennessee & Keefe Bruyette (1) (2000)
- Salomon Smith Barney (1) (2000)
- First Tennessee (3) (2001)
- Sandler O'Neill & Barclays Capital (1) (2001)
- Sandler O'Neill & Salomon Smith Barney (2) (2001)
- Bear Stearns, Sandler O'Neill & Salomon Smith Barney (3) (2002)
- First Tennessee & Keefe Bruyette (5) (2002)
- Sandler O'Neill & Salomon Smith Barney (1) (2002)
- Trapeza & CSFB (1) (2002)
- Bear Stearns (2) (2003)
- Citigroup (2) (2003)
- Cohen & Merrill Lynch (2) (2003)
- Dekania & Merrill Lynch (1) (2003)
- First Tennessee & Keefe Bruyette (5) (2003)
- Sandler O'Neill & Salomon Smith Barney (1) (2003)
- Trapeza & CSFB (4) (2003)
- Bear Stearns (2) (2004)
- Cohen & Merrill Lynch (2) (2004)
- Cohen, Merrill Lynch & Sandler O'Neill (1) (2004)
- Citigroup (1) (2004)
- Dekania & Merrill Lynch (1) (2004)

- First Tennessee & Keefe Bruyette (4) (2004)
- Morgan Stanley (1) (2004)
- Stone Castle & Sandler (2) (2004)
- Trapeza & CSFB (2) (2004)
- Taberna & Merrill Lynch (4) (2005)
- FTN Financial Capital Markets (3) (2005)
- Cohen & Merrill Lynch (3) (2005)
- Trapeza & CSFB (2005)
- Bear Stearns (2005)
- Wachovia Securities (2005)
- Greenwich Capital Partners (2005)
- Bear Stearns (1) (2006)
- Citigroup (1) (2006)
- JPMorgan (1) (2006)
- Janney Montgomery Scott (1) (2006)
- Ryan Beck & Co. (1) (2006)
- Santander Investment Sovereign Securities Corporation (1) (2006)
- FTN Financial Capital Markets and Keefe, Bruyette & Woods (2007 – three issues)
- JPMorgan and Morgan Keegan & Company, Inc (2007 – two issues)
- ABN AMRO Incorporated and Cohen & Company Securities, LLC (2007)
- Cohen & Company Securities, LLC and Vining Sparks IBG, L.P. (2007)
- Merrill Lynch and StoneCastle Securities, LLC (2007)
- Bear, Stearns & Co. Inc. and Sun Trust Robinson Humphrey (2007)
- FTN Financial Capital Markets and Keefe, Bruynette & Woods (2007)

- Bear, Stearns & Co. Inc. – the portfolio is comprised of hybrid and non-hybrid securities (2007)
- Vining Sparks IBG, L.P. and Deutsche Bank Securities and Cohen & Company Securities, LLC (2007)

Selected European CDO issues (by sponsor/underwriter)

- HSH Nordbank (Denmark) (1) (2004)
- Dekania & Merrill Lynch – comprised of insurance company subordinated debt (2005)
- Lehman Brothers (2006)
- UBS (2006)
- Goldman Sachs (2006)
- JPMorgan and Barclays Capital (2007)
- Merrill Lynch International, BNP Paribas and Cohen & Company Securities, LLC – the portfolio is comprised of hybrid and non-hybrid securities (2007)

Transaction benefits

- Enables small banks and insurance companies to access the capital markets for innovative capital raisings.
- Deeper primary and secondary markets for trust preferred and other regulatory capital instruments.
- Minimizes issuer disclosure required for marketing or regulatory purposes.

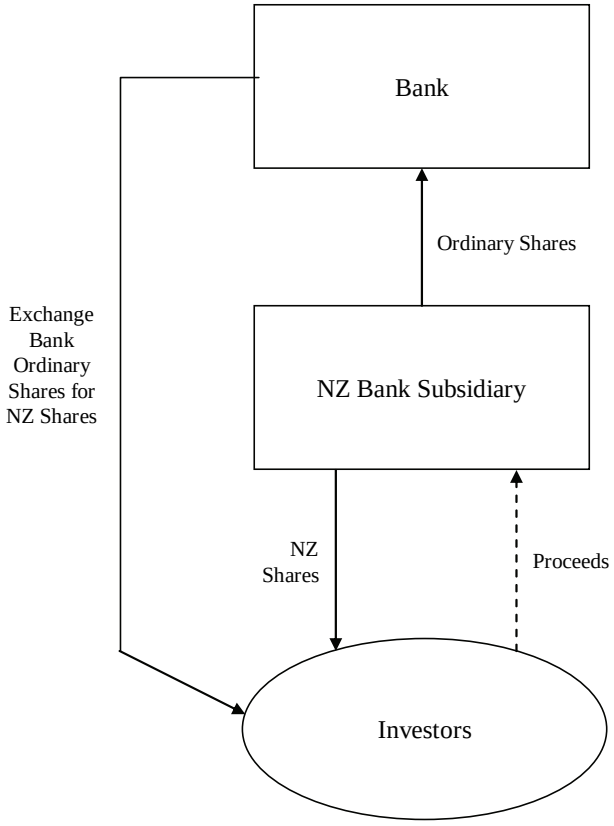
Features

- Non-recourse notes issued by orphan vehicles.
- Senior/subordinated structure.
- Combination of primary and secondary market trust preferred and other regulatory capital, including Tier 2 instruments and surplus notes.
- CDO issuer assets include bank capital instruments, insurance company capital instruments or both.

CHAPTER 14

OTHER BANK INSTRUMENTS

- ***Australian Bank Banking Subsidiary Tracking Stock Exchangeable into Bank Ordinary Shares (since 1999)***



Selected issue

- New Zealand subsidiary of Westpac (1999)

Transaction benefits

- Primary regulator capital treatment – bank parent minority interest Tier 1 capital.
- Ordinary share equivalent that saves Australian franking credits for Australian resident shareholders.

- Enables the bank to stream New Zealand imputation credits to New Zealand shareholders.
- Potential benefits on transfer of proceeds to the bank.

Features

- Dividends on New Zealand shares are the New Zealand dollar equivalent of dividends on the bank's ordinary shares.
- Indirect voting rights equivalent to those of the bank's ordinary shares.
- Mandatory exchange for bank ordinary shares upon:
  - winding-up of the bank;
  - takeover of the bank; or
  - the bank ceases to control the New Zealand share issuer.
- Exchangeable for bank ordinary shares at bank's option if:
  - adverse tax changes affecting the structure;
  - the bank's primary regulator ceases to accept the New Zealand shares as Tier 1;
  - events preceding the winding-up of the bank of the New Zealand share issuer;
  - less than 15 percent of the New Zealand shares are held by third party investors; or
  - the liquidation of the bank outside Australia.
- Exchange for bank ordinary shares at investor's option if:
  - failure to pay a New Zealand dollar equivalent dividend when bank ordinary share dividends are paid;
  - support agreement or voting deed no longer effective;
  - delisting of New Zealand shares from the New Zealand Stock Exchange;
  - tax ruling changes that adversely affect New Zealand shareholders; or

- more than 30 percent of the bank's ordinary shares are acquired by one party.

- The exchanges are between the bank and the investor pursuant to an exchange deed by the bank.

- The bank agrees in a support agreement to ensure the solvency of the New Zealand share issuer.

CHAPTER 15

EUROPEAN CORPORATE INSTRUMENTS

In addition to the more familiar uses of hybrid capital products by banks, bank holding companies, insurance companies and other deposit-taking institutions and finance companies, recent years have also seen an increase of interest in the potential uses and benefits of hybrid capital products for corporate issuers. While hybrid product issuance by corporates has been a familiar part of the US landscape since the 1980s (often as money market auction rate preferred and remarketed securities), such products have only recently attracted widespread interest in Europe. Prior to the February 2005 publication by Moody's of refinements to its rating methodology for hybrid capital products, there was a general perception amongst issuers and investors that rating agency recognition of the benefits of such products was both insufficient and unpredictable. Moody's refinements represented a significant change, bringing greater clarity to the requirements for equity treatment. That change, together with IAS 32's roadmap for equity or debt accounting, energized the growth in corporate issuance of such products. Although deal flow did not live up to some of the more optimistic predictions, a number of European corporates successfully completed hybrid offerings after 2005, although deteriorating market conditions through 2008 led to an almost total cessation of corporate hybrid issuance during late 2008 and 2009.

In addition to equity credit, there are a number of considerations that helped fuel the popularity of such transactions, including the relative cost of hybrid capital to equity capital, and the way in which hybrid capital can be used to improve ratings or returns to shareholders through enhancing earnings per share. Issuers have increasingly recognized that such products offer a non-dilutive and credit positive way to grow their businesses, with generally positive implications for their financial ratios. As is the case with bank and insurance company regulatory capital instruments, hybrid capital products have been viewed by corporates as "cheap

equity" rather than "expensive debt," bringing the benefits of tax deductibility, balance sheet support and the avoidance of equity dilution.

Since the refinements to Moody's methodology in February 2005, hybrid capital products have been issued by European corporates for some of the following reasons:

- *Bolstering credit ratings by replacing senior debt with hybrid capital* – replacing senior debt with hybrid capital, thereby decreasing net debt by the amount of the equity credit attributed to the hybrid capital product and improving the issuer's credit profile from a rating agency perspective.

- *Returning shareholder value whilst preserving credit ratings* – financing equity buy-backs or dividend increases in a manner that does not materially increase leverage.

- *Financing acquisitions or building an acquisition "war-chest" whilst preserving credit ratings* – raising acquisition finance, in substitution for (or in combination with) more traditional asset disposals or equity or senior debt issuances.

- *Funding pension contributions whilst improving credit profile* – whilst rating agencies have traditionally ascribed an element of 'equity'-like credit to pension and post-retirement liabilities, funding such liabilities with hybrid capital may be more beneficial from a rating perspective, improving adjusted leverage ratios. The equity credit applied to the hybrid capital product usually exceeds that ascribed to the pension liability. Hybrid capital products have also been used to fund pension plan deficits.[61]

- *Reducing the cost of capital* – replacing senior debt and common equity with hybrid capital, taking advantage of the combination of tax deductibility and equity capital credit for balance sheet purposes, generally facilitating an overall reduction in the cost of capital.

- *Raising an 'equity substitute' on a non-dilutive basis* – hybrid capital products represent a real substitute to traditional equity financings for private and state-owned enterprises where there is a need to strengthen balance sheets without diluting existing ownership.[62]

Some notable features of European hybrid capital transactions completed since early 2005 include the following:

- Unlike European bank regulatory capital products, which have traditionally been sold into the US SEC-registered and Rule 144A markets, European corporate hybrid capital issues have been sold primarily outside of the US pursuant to Regulation S. In this respect, they have mirrored the emergence of the European Tier 1 and high yield markets.

[61] See Henkel KGaA's November 2005 offering on page 268.
[62] See the offerings by Vattenfall AB on page 276, Otto KGaA on page 268 and Porsche AG on page 268.

- While some transactions have been structured using traditional Euromarket standard English law capital markets format (with jurisdictional specific, local law subordination provisions), some of the more recent deals have been governed by the laws of the issuer's home jurisdiction, particularly in the case of German issuers.

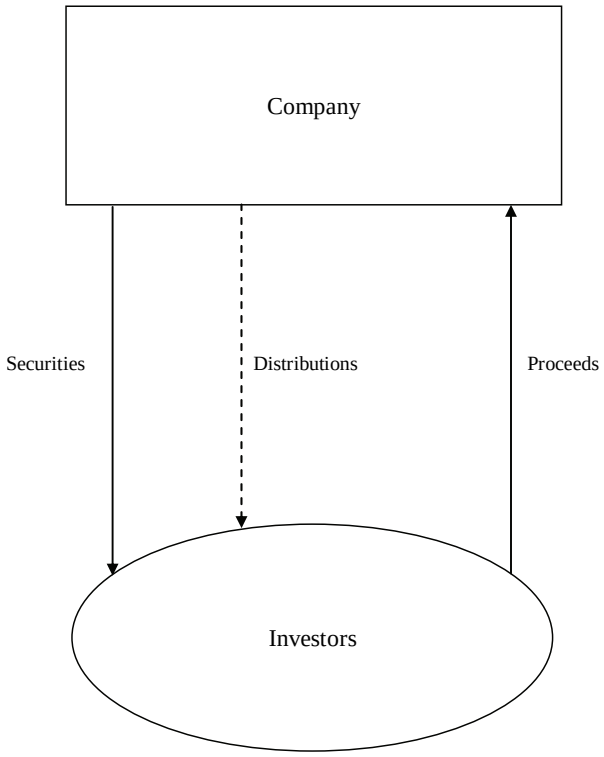
- Unlike bank regulatory capital products, which often employ complex issuing structures, European corporate hybrid capital products have generally been structured either as direct issuance, debt-like instruments, or comparatively "plain vanilla" subsidiary issues, having the benefit of a subordinated parent guarantee.

- Some of the recent corporate hybrids have been somewhat controversial. It is argued that, unlike banks, insurance companies and other regulated businesses, the risk profile for such products associated with corporate issuers has not been fully appreciated. In a number of cases, issuers have been family controlled or closely held companies with a more limited commitment to the capital markets. There have already been some instances of default.

The European corporate hybrid market was effectively closed throughout 2009, although the latter months of 2009 saw some renewed interest with Swiss jam-maker Hero AG's CHF400 million issue of perpetual (NC7) capital securities being the first corporate hybrid bond issue denominated in Swiss francs, and a privately placed €120 million issue by Finnair Plc. In February 2010 Dutch utility company TenneT's issue of €500 million of fixed-to-floating rate perpetual capital securities attracted considerable market interest, being seen as a potential trend-setting transaction as European corporates move away from dealing with liquidity issues and start to focus on balance sheet repair. As a form of "mezzanine capital," it is likely that corporate issuers will continue to be attracted to hybrid products, often as a complement to more traditional forms of debt and equity finance. However, recent changes to the rating agencies respective criteria for equity credit and treatment of hybrid products (see also Fitch's downgrade of twenty EMEA non-financial corporate hybrid transactions in late January 2010) suggest that significant structural changes will likely need to be made to corporate hybrids to ensure that equity credit is given in the future; a greater focus on permanence and loss absorption on a going-concern basis may be expected (for example, with more stringent requirements for replacement capital covenants at redemption) together with a reassessment of credit given for stock-settlement mechanisms.

Set out below is a brief summary of selected features of certain European corporate hybrid products issued since the beginning of 2005.

- ***Austrian Direct Issue Subordinated Perpetual Securities (since 2007)***



Selected issues

- Wienerberger AG, an Austrian brick manufacturer (Direct) (2007)
- Voestalpine AG, an Austrian metals group (Direct) (2007)
- Swietelsky Baugesellschaft m.b.H, an Austrian construction group (Direct) (2007)
- Swarco Holding AG, an Austrian traffic management company (Direct) (2008)

Features

- Direct issues by principal group entities.
- Deeply subordinated ranking junior to all other subordinated or unsubordinated debt, but senior to share capital.
- Perpetual. Swarco Holding AG (NC3); Swietelsky Baugesellschaft m.b.H (NC5); voestalpine AG (NC7); and Weinerberger AG (NC10).

- Fixed rate coupons payable until the first call date, stepping-up to floating rate thereafter. Additional step-ups in the event of a change of control.

- Events of default limited to insolvency related events.

- Optional interest deferral. Deferred interest is payable, in the event that (i) the issuer resolves on or pays a dividend, other distribution or payment in respect of specified classes of the relevant issuer's shares; (ii) the issuer or a group entity resolves on or pays a dividend, other distribution or payment in respect of any junior security or parity security; (iii) the issuer or another group entity repurchases or otherwise acquires any parity security, junior security or any shares of any class of shares of the issuer for any consideration except by conversion into or exchange for shares, subject to limited exceptions; or (iv) the issuer makes a payment of interest on a scheduled interest payment date; or (v) in the case of Swietelsky and Swarco Holding AG, in the event that certain capital expenditure related ratios are hit; or (vi) in the case of voestalpine AG and Swarco Holding AG, on the occurrence of certain insolvency events.

- An ACSM applies (in the case of Weinerberger AG only) where deferred interest is payable, with the Issuer being required to (i) issue and/or sell new shares or treasury shares up to a specified maximum amount of the issuer's outstanding issued share capital and/or (ii) issue certain eligible securities in a maximum aggregate amount of up to 25 percent of the aggregate principal amount of the securities. If the issuer is unable to issue or sell new shares, treasury shares or eligible securities, the obligation to pay deferred amounts will lapse.

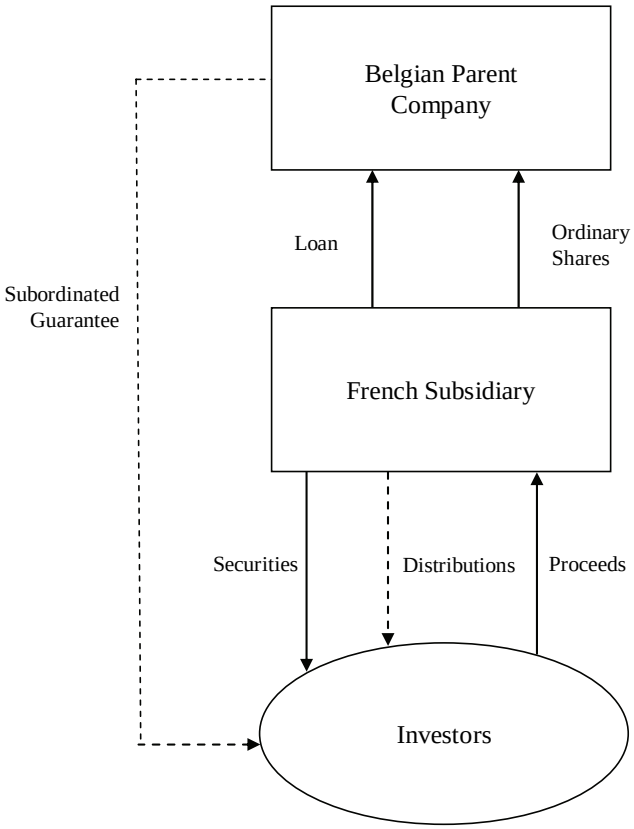
- No mandatory deferral features.

- Issuer optional redemptions at par on (a) the first call date or (b) any interest payment date thereafter. Issuer optional redemptions at any time following (i) certain tax events, (ii) a change in rating agency equity credit afforded to the securities (not in the Swarco Holding AG issue), (iii) a change in accounting treatment, (iv) in the event of there being less than 25 percent or the originally issued securities outstanding, or (v) in the case of an IPO event whereby the current shareholders seek shares of Swarco Holding AG by means of an IPO and listing, in each case subject to payment of a make-whole premium (except in the Swarco Holding AG issue where optional redemption on a gross-up event is at par).

- voestalpine AG securities allow the issuer to exercise optional redemption for any reason before the first call date at the "Special Make-Whole Redemption Amount."

- Issuer optional early redemptions at par plus accrued but unpaid amounts upon change of control, except in the case of Swarco Holding AG where redemption is at a make-whole premium.
- Proceeds of issue used for refinancing existing short-term indebtedness and general corporate purposes.
- Austrian law.
- Vienna and Frankfurt listings.
- Notes classified as equity for IFRS purposes.

- ***Belgian Guaranteed Subsidiary Dated Subordinated Securities (since 2006)***



Selected issue

- Solvay, a Belgian-based international chemicals and pharmaceuticals group (French subsidiary) (2006)

Features

- Issued through a French incorporated subsidiary with the benefit of subordinated guarantee from the Belgian parent company.
- Securities are deeply subordinated pursuant to article L.228-97 of the French *Code de Commerce*. Junior to subordinated debt, *titres participatifs* and *prets participatifs*, but senior to share capital.
- Term securities – 98 years (NC10).
- Fixed rate coupons payable until the first call date, stepping-up to floating rate thereafter.
- No events of default.

- Optional interest deferral. Deferred interest is cumulative and payable in the event that (i) the issuer or the guarantor declares or pays a dividend in relation to any specified equity securities; (ii) the guarantor or any of its subsidiaries (including the issuer) declares or makes a payment of any nature, on or in respect of any junior or *pari passu* ranking securities issued by the issuer or the guarantor and/or guaranteed by the guarantor; (iii) the guarantor or any of its subsidiaries (including the issuer) redeems, repurchases or repays any junior or *pari passu* ranking securities, or any specified equity securities; (iv) any deferred amounts being outstanding one calendar day before the fifth anniversary of the interest payment date on which such amounts were initially due and payable but the payment of which was deferred; or (v) the issuer making a payment of interest on an interest payment date.

- An ACSM applies where deferred interest is payable, with the guarantor being required to (i) issue and/or sell, or cause the issuer to issue and/or sell, ordinary shares up to a specified maximum amount of the guarantor's aggregate outstanding issued share capital and/or (ii) issue, or cause the issuer to issue, certain eligible securities in a maximum aggregate amount of up to 25 percent of the aggregate principal amount of the securities. If the guarantor fails to raise, or cause the issuer to raise, proceeds under such alternative coupon settlement mechanism which are equal to such deferred amounts within 12 months of the occurrence of the relevant event, the claims of the holders in respect of the shortfall shall be cancelled and the non-payment by the issuer of such shortfall shall not constitute a default.

- No mandatory deferral features.

- Issuer optional redemption on (i) the first call date or (ii) any interest payment date thereafter. Issuer optional redemption at any time following certain tax events, subject to payment of a make-whole premium.

- No early redemption upon change of control.

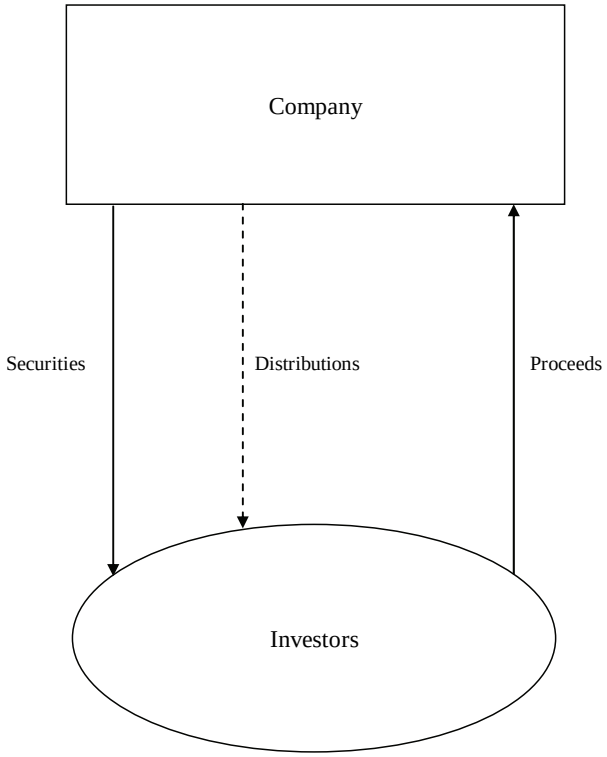
- Proceeds of issue used for refinancing previous acquisition and certain maturing debt.

- English law, subject to French and Belgian law subordination provisions.

- Luxembourg listing.

- Notes not classified as equity for IFRS purposes.

- ***Danish Direct Issue Dated Subordinated Securities (since 2005)***



Selected issue

- Dansk Olie & Naturgas A/S, a Danish state-owned energy group (2005)

Features

- Direct issuance by principal group entity.
- Securities rank *pari passu* with subordinated debt, but senior to share capital.
- Term securities – 1000 years (NC10).
- Fixed rate coupons payable until the first call date, stepping-up to floating rate thereafter.
- Limited events of default, restricted to failure to pay interest where not deferred and insolvency events.
- Where there has been a payment default, the Trustee may initiate bankruptcy proceedings in Denmark (but not elsewhere).

- Optional deferral of interest for any period of time. Deferred interest is cumulative. No dividend or other distribution may be declared or paid in relation to any equity or *pari passu* ranking securities, and none of the securities nor any equity or *pari passu* ranking securities may be redeemed, until deferred interest has been settled. Deferred interest can only be settled through an ACSM, through the issuance of ordinary shares (subject to a cap of 2 percent of the issuer's then outstanding share capital), further *pari passu* ranking securities or further securities having the same terms as the existing securities other than the interest commencement date (subject to a cap of 25 percent of the aggregate principal amount of the securities first issued).

- No mandatory deferral features.

- Issuer optional redemption on (i) the first call date or (ii) any interest payment date thereafter. Issuer optional redemption at any time following certain tax events, subject to payment of a make-whole premium in the event that redeemed early for tax reasons prior to the first call date.

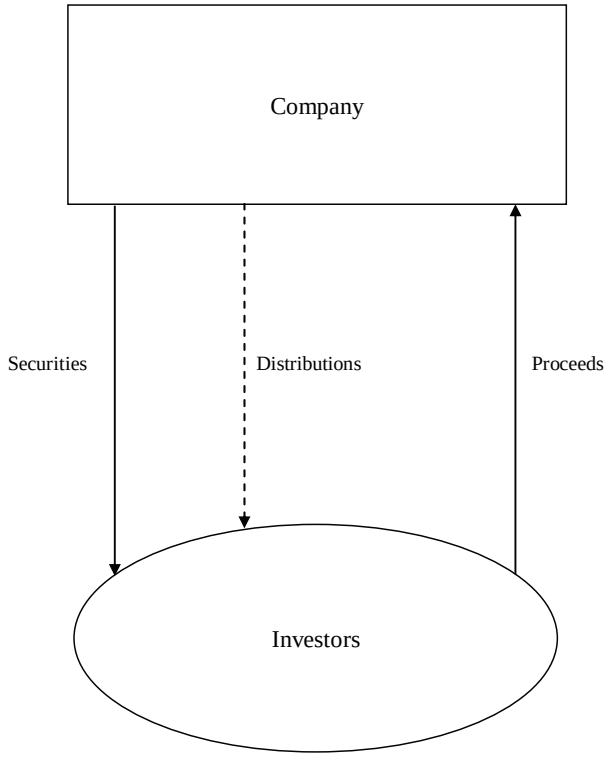
- No early redemption upon change of control.

- Proceeds of issue used for refinancing debt and general corporate purposes.

- English law, subject to Danish subordination requirements.

- Luxembourg listing.

- ***Dutch Direct Issue Perpetual Securities (since 2009)***



Selected 2010 issue

- *TenneT Holding B.V., a Dutch state-owned energy group (February 2010)*

Features

- Direct issuance by principal group holding company.
- Securities rank *pari passu* with subordinated debt, but senior to share capital.
- Perpetual (NC7).
- Fixed rate coupons with a step-up at the first call date (*i.e.*, year 7), with a further step to a floating rate 5 years thereafter.
- Limited events of default, restricted to failure to pay interest where not deferred.
- Optional deferral of interest for any period of time. Deferred interest is cumulative. Dividend pusher.

- No mandatory deferral features.
- Issuer optional redemption on (i) the first call date (year 7), (ii) the step-up date (year 12) or (iii) any interest payment date after the step-up date. Issuer optional redemption at any time following certain tax events, subject to payment of a make-whole premium in the event that the securities are redeemed early for tax reasons. The issuer has also entered into a replacement capital covenant in favor of holders of the securities which places certain restrictions on its ability to repay, redeem or repurchase any of the securities on or after June 2, 2017 unless a certain amount of a specified class of qualifying securities are issued by the issuer to replace the securities repaid, redeemed or repurchased.
- Issuer optional early redemption upon change of control.
- Issuer optional early redemption upon rating event.
- Issuer optional early redemption upon change of accounting treatment.
- Proceeds of issue used for general corporate purposes.
- Governed by Dutch law.
- Euronext Amsterdam listing.

- ***Finnish Direct Issue Perpetual Subordinated Securities (since 2009)***

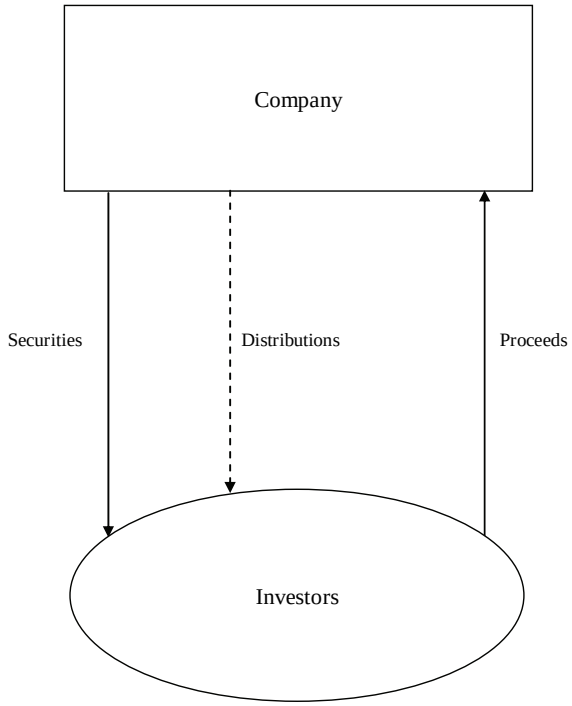
  Selected 2009 issue

  - *Finnair Plc , the Finnish airline (September 2009)*

  Features

  - Direct issuance by principal group company.

- ***French Direct Issue and Guaranteed Subsidiary Perpetual Subordinated Securities (since 2005)***



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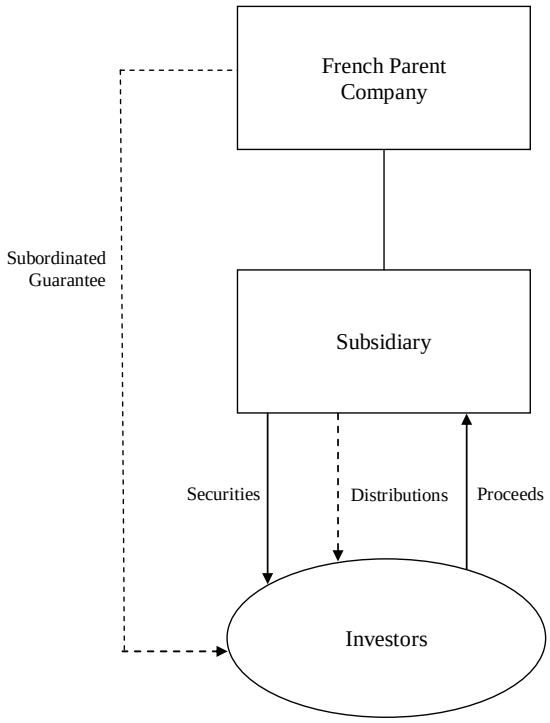


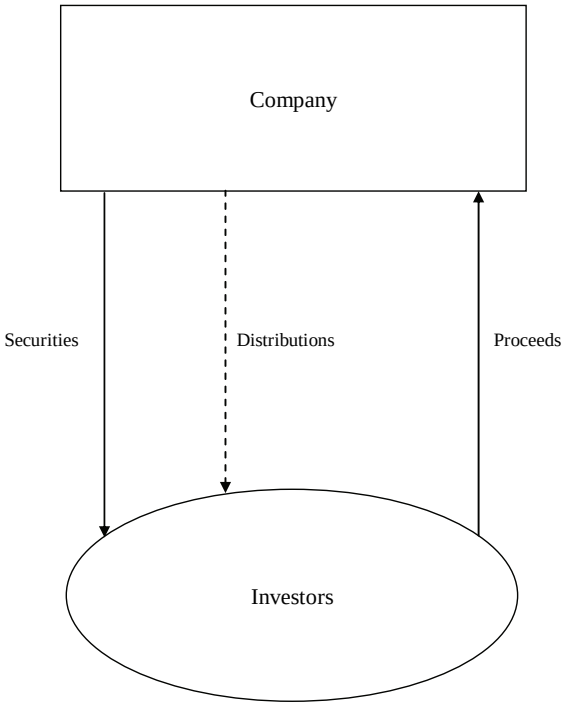
Selected issues

- Casino Guichard-Perrachon, a French-based international retail group (2005)
- Vinci S.A., a French-based international infrastructure, corporation and information technology group (2006)
- Eurofins Scientific (2007)

Features

- Direct issuance by principal group entity.
- Securities are deeply subordinated pursuant to article L.228-97 of the French Code de Commerce. Junior to subordinated debt, *titres participatifs* and *prets participatifs*, but senior to share capital.
- Perpetual (NC7).
- Fixed rate coupons payable until the first call date, stepping-up to floating rate thereafter. Additional step-up in the event of a change of control.
- No events of default.
- Optional interest deferral if for the 12 months prior to the interest payment date (i) no dividend or other distribution was paid or declared and (ii) there was no optional redemption or repurchase of equity securities or parity securities. The issuer to give notice of such interest deferral to Bondholders. Deferred interest is cumulative.
- An ACSM applies where deferred interest remains unpaid after twelve months, with the issuer's stated intention (but with no obligation) to issue and/or sell new equity securities or issue new parity securities up to a specified maximum amount of the issuer's outstanding issued share capital.
- Issuer optional redemption at par on (i) the first call date; or (ii) any interest payment date thereafter. Issuer optional redemption at any time following (i) certain tax events, (ii) change in accounting treatment, (iii) change of control, in each case at par plus accrued but unpaid amounts.
- French law.
- Frankfurt (unregulated market).

- ***German Direct Issue and Guaranteed Subsidiary Dated or Perpetual Subordinated Securities (since 2005)***



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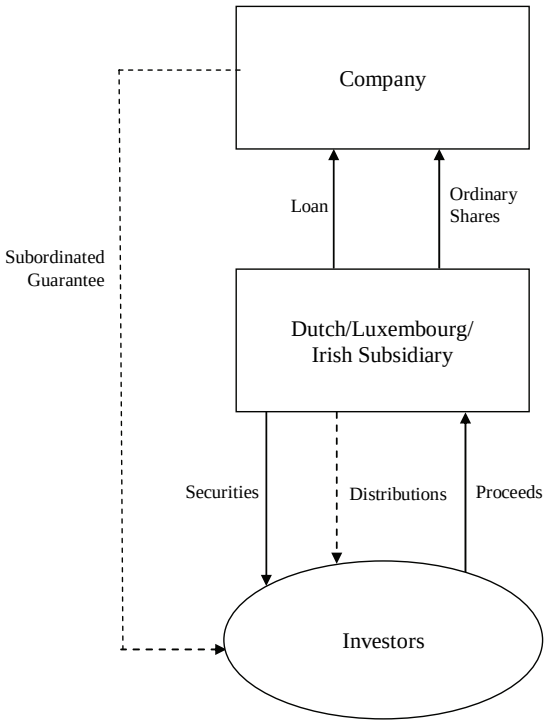


Selected issues

- TUI AG, Europe's leading tourism and shipping company (Direct) (2005)
- Bayer AG , a healthcare and pharmaceuticals group (Direct) (2005)
- Henkel KGaA, a chemicals and pharmaceuticals group (Direct) (2005)
- Südzucker AG, Europe's leading sugar provider (Direct) (2005)
- Otto (GmbH & Co KG), the privately held mail order retailer (Direct) (2005)
- Porsche AG, a privately held sports car manufacturer (Irish subsidiary) (2006)
- Linde AG, a gas and chemicals group (Dutch subsidiary) (2006)
- Siemens AG, an electronics and electrical engineering group (Dutch subsidiary) (2006)
- Pfleiderer Aktiengesellschaft (Dutch subsidiary) (2007)
- Eurogate GmbH & Co. KGaA, KG (Direct) (2007)
- Deutsche Börse AG, a German stock exchange transaction service provider (Direct) (2008)

Features

- Both direct and subsidiary issuances. Subsidiary issuances issued via Dutch (in the case of Südzucker, Linde, Siemens and Pfleiderer), Luxembourg (in the case of Otto) and Irish (in the case of Porsche) finance subsidiaries, with respective parent guarantees given on a subordinated basis.
- The relevant securities are subordinated to all other creditors (save where specified), but senior to share capital. TUI's 2005 securities provide that payments of arrears rank *pari passu* with payments to shareholders. Henkel's 2005 securities are expressly stated to be permanent capital – *i.e.*, will be replaced with a substitute issue of similar securities or ordinary or preference shares.
- Perpetual (in the case of TUI, Südzucker, Otto, Porsche, Eurogate and Pfleiderer) or term dated (in the case of Bayer, Henkel, Linde, Siemens, Deutsche Börse). "No call" periods range from 5 years (in the case of Porsche, Pfleiderer and Deutsche Börse) and 7 years (in the case of TUI and Otto) to 10 years (in the case of Südzucker, Bayer, Henkel, Linde,

Siemens and Eurogate). Deutsche Börse's 2008 securities also have a second call at year 10.

- Generally fixed rate coupons payable until the first call date, stepping-up to floating rate thereafter. Porsche's 2006 securities pay fixed rate coupons through to maturity. The Deutsche Börse's 2008 securities pay a fixed coupon until the first call date, with a floating rate thereafter. The floating rate steps-up at year 10.

- Generally no events of default or, if any, limited to specified insolvency events.[63] Deutsche Börse 2008 securities also provide for an event of default if the issuer fails to pay interest for five consecutive years.

- All issues contain optional interest deferral features, generally on a cumulative basis (not in the case of the Deutsche Börse issue) and with deferrals only permitted to the extent that dividends and other distributions are not declared or paid on other capital securities. Deferred interest is generally repayable to the extent that any such dividends or distributions are subsequently paid. Certain issues also provide for alternative coupon settlement features applicable to deferred coupons, where deferred amounts can (or will) be satisfied out of the proceeds of issue of new equity securities.[64]

- Deutsche Börse's 2008 securities include legally binding replacement capital provisions (reflecting S&P's revised guidelines published in 2007) which apply after the first call date.

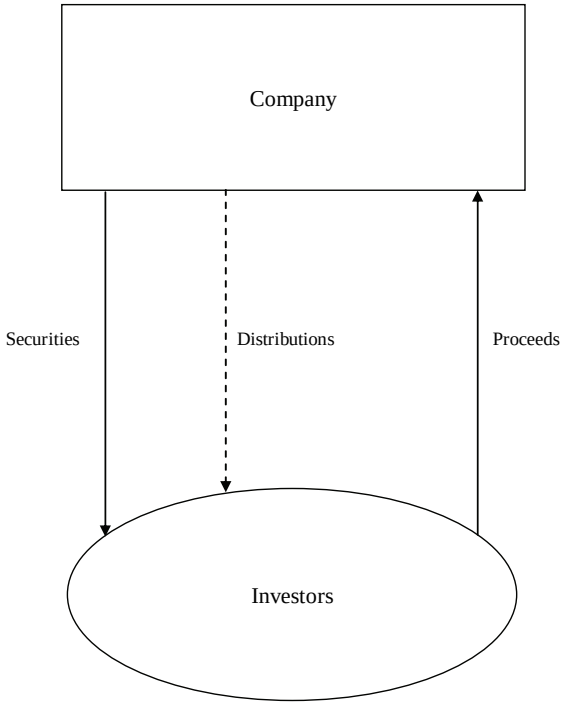
- Generally no mandatory deferral features, save in the case of the Bayer, Henkel and Siemens issues where mandatory deferral provisions are triggered by cash flow or interest coverage tests.

- Each issue of securities provides for optional early redemption of the securities upon the specified call date or for certain tax, accounting or rating agency events. Additional early redemption provisions include upon change of control (see below) or, in the case of the Deutsche Börse and TUI issues, there being only a certain percentage of the original principal amount of the issue outstanding (less than, or equal to, 25 percent in case of Deutsche Börse, and less than 20 percent in the case of TUI). Early redemption is either at par or subject to payment of a make-whole premium.

[63] See TUI, Südzucker, Bayer and Siemens on page 268.
[64] See TUI, Henkel and Siemens on page 268.

- There are differing approaches to change of control provisions:
  - TUI's 2005 securities, Eurogate's securities and Pfleiderer's securities contain a coupon step-up of 5 percent on a change of control, subject to right of redemption;
  - Otto – The securities are subject to early redemption at their principal amount plus a make-whole in the event of a change of control, unless the issuer obtains post-event investment grade rating from Moody's, Standard & Poor's Rating Services or Fitch;
  - Deutsche Börse – redemption of the securities in the event of change of control is at their principal value plus any interest accrued until the redemption date and all outstanding arrears of interests; and
  - Südzucker, Porsche, Henkel – No early redemption upon change of control.
- Proceeds of issuance used for a range of purposes, from refinancing of existing indebtedness to funding acquisitions, or pension deficits.
- All issues are German law governed, with local law subordination provisions in the case of those subsidiary issuances (Südzucker, Linde, Siemens, Otto, Porsche and Pfleiderer).
- IFRS classification:
  - Equity – Südzucker / Otto / Porsche; and
  - Non-Equity – Henkel.

- ***Irish Direct Issue Perpetual Subordinated Securities (since 2007)***



Selected issues

- Xenon Capital P.L.C. (2007)
- International Securities Trading Corporation P.L.C., Irish unregulated investment entity (2007)

Features

- Direct issue.
- Perpetual (NC5).
- Fixed interest rate.
- Optional redemption at the option of the issuer on the first call date, on any subsequent interest date or at any time upon the occurrence of certain tax events.
- Investor put provisions allowing holders of the securities to require the issuer to redeem all (but not some) of the securities if the issuer has received, during the put notice period, put notices from holders of at least two-thirds of the nominal aggregate amount of the securities outstanding on the final day of the put notice period.

- Optional interest deferral. Deferred interest will become immediately due and payable on the date of the occurrence of the earliest of: (i) the date on which the issuer next pays any interest amount in respect of the securities; (ii) the date on which any of the securities are redeemed or repurchased; or (iii) the commencement of the winding-up of the issuer.

- Dividend stopper in the event that interest is deferred, in whole or in part, preventing the issuer or any entity it directly or indirectly controls from (i) declaring or paying a dividend on equity or securities ranking *pari passu*, or (ii) redeeming or repurchasing equity or securities ranking *pari passu*, until such time as the deferred interest is no longer outstanding.

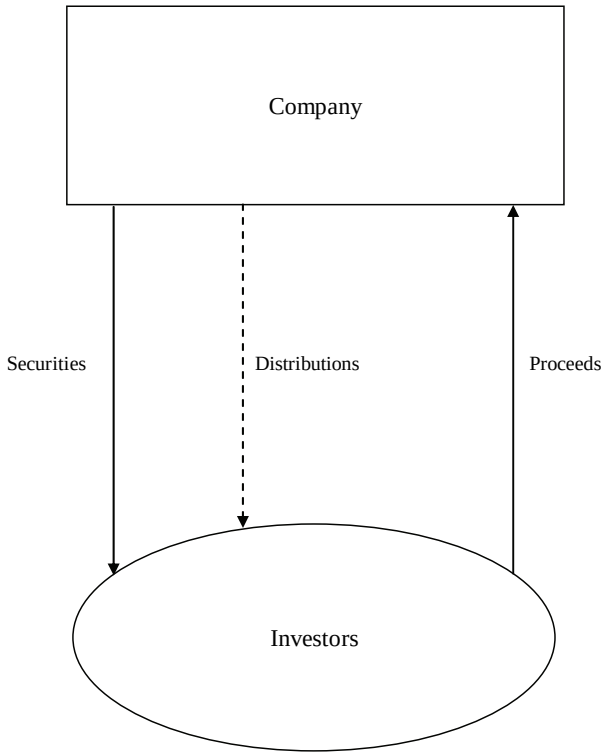
- Events of default limited to winding-up only.

- Proceeds to be used to repay short term debt of the issuer and for general corporate purposes.

- Irish and Singapore listings.

- English law governed except for the subordination provisions which are Irish law governed.

- ***Italian Direct Issue Dated Subordinated Securities (since 2006)***



Selected issue

- Lottomatica S.p.A., an international lottery and gaming group (2006)

Features

- Direct issuance through principal group entity.
- The securities constitute *obligazioni* pursuant to Articles 2410 *et seq*. of the Italian Civil Code, being direct, unsecured and subordinated obligations of the issuer.
- Term securities – 60 years (NC10).
- Fixed rate coupons payable until the first call date, stepping-up to floating rate thereafter.
- Limited events of default, including (i) failure to pay optionally deferred or equity funded deferred interest within specified grace periods, or the Issuer (a) declares or pays any distribution in relation to junior securities otherwise than in the form of equity or (b) repurchases or redeems any equity securities (other than pursuant to conversion or exchange

mechanics), (ii) covenant defaults unremedied for 60 days and (iii) the occurrence of specified insolvency related events.

- Optional interest deferral. Deferred interest becomes immediately payable in cash on the date which is the earliest to occur of (i) the date on which the issuer next pays any interest amount in respect of the securities or any interest amount is payable in respect of the securities (unless payment thereof is deferred); (ii) the date on which a payment is next made in relation to any capital securities; (iii) the due date for redemption of the securities, whether at their Maturity Date, or any Early Redemption Date, or the date on which the Securities become immediately due and repayable on the occurrence of an Enforcement Event; (iv) the date which is 180 days after any petition is filed by any third party in connection with any Insolvency Proceedings in respect of the issuer, where such petition has not been dismissed by such 180th day; and (v) the date on which an order is made or a resolution is passed for the voluntary or involuntary liquidation, dissolution or winding-up of, or an administrative and/or court order is made for any Insolvency Proceedings in respect of, the issuer, or the date on which the issuer takes any corporate action for the purposes of opening, or initiates or consents to, Insolvency Proceedings in respect of it.

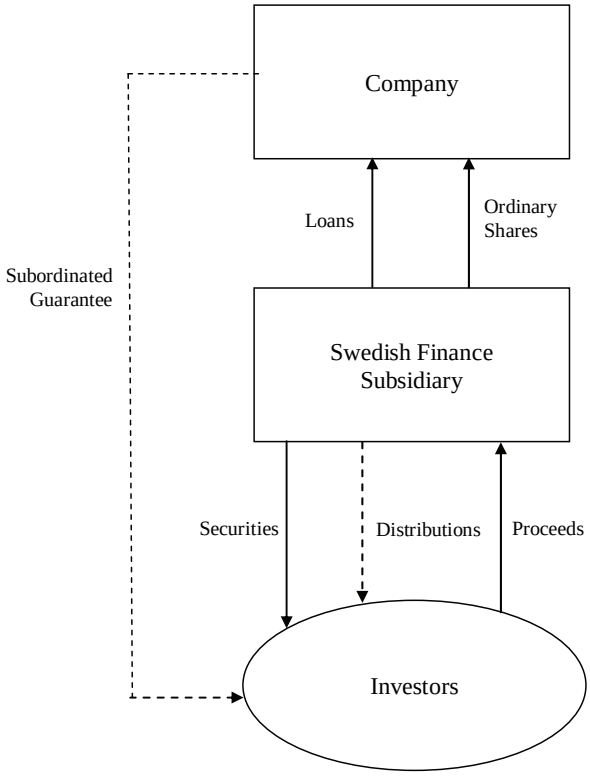
- Mandatory deferral provisions linked to an interest coverage ratio, unless and to the extent that the issuer has available cash proceeds raised from the issue or contribution of equity during the previous six-month period and specified at the time of such issue or contribution to be for the purpose of enabling the payment of all or part of such scheduled interest.

- If any optionally deferred interest that has not been paid in full in cash on or before the fifth anniversary of the Interest Payment Date on which such interest was first deferred, or mandatorily deferred interest remains unpaid, the issuer is required to fund such payments using the proceeds of issue or contribution of equity. Such deferred interest will become immediately payable in cash on the date which is the earlier to occur of (i) seven business days following the settlement of an issue or contribution of equity for the purpose of payment of such deferred interest, to the extent of the proceeds received by the issuer; (ii) the tenth anniversary of the Interest Payment Date on which payment of the relevant scheduled interest amount was first deferred in accordance with the conditions; (iii) the due date for the redemption of the Securities; or (iv) following certain insolvency related events.

- Issuer optional redemption at par plus interest on the (i) tenth anniversary or (ii) any interest payment date thereafter. Issuer optional redemption at any time following certain tax events or a change of control, subject to a make-whole.

- Issuer optional early redemption on change of control.
- Proceeds of issue used for financing the acquisition of US gaming group, GTECH.
- English law, subject to Italian law subordination provisions.
- Luxembourg listing.
- Notes not classified as equity for IFRS purposes.

- ***Swedish Guaranteed Subsidiary Perpetual Subordinated Securities (since 2005)***



Selected issue

- Vattenfall AB, a state-owned energy group (2005)

Features

- Issued through a Swedish finance subsidiary with the benefit of a subordinated guarantee from the Swedish parent company.
- Securities rank junior to subordinated debt, but senior to share capital.
- Perpetual securities (NC10).
- Fixed rate coupons payable until the first call date, stepping-up to floating rate thereafter.
- Limited events of default only, encompassing interest payment defaults, specified insolvency events, or the guarantee ceasing to be in full force or effect.
- Optional interest deferral. Deferred interest is cumulative, save to the extent that a specified interest coverage test is not maintained, in which case the relevant interest payment ceases to be due and payable.

- Compulsory payments of interest (including deferred interest) if payments are made by issuer on *pari passu* or junior securities or if the guarantor declares or pays any dividend.
- No mandatory deferral features.
- Issuer optional redemption on (i) the first call date, (ii) any interest payment date thereafter, or (iii) upon occurrence of certain tax events. Issuer's stated intention is to redeem the securities out of the proceeds of issue of equity by the guarantor or an new issue of *pari passu* securities.
- No early redemption upon change of control.
- Proceeds of issue used for general corporate purposes.
- English law, subject to Swedish subordination requirements.
- London listing.
- Notes classified as equity for IFRS purposes.

- ***Swiss Direct Issue Perpetual Subordinated Securities (since 2009)***

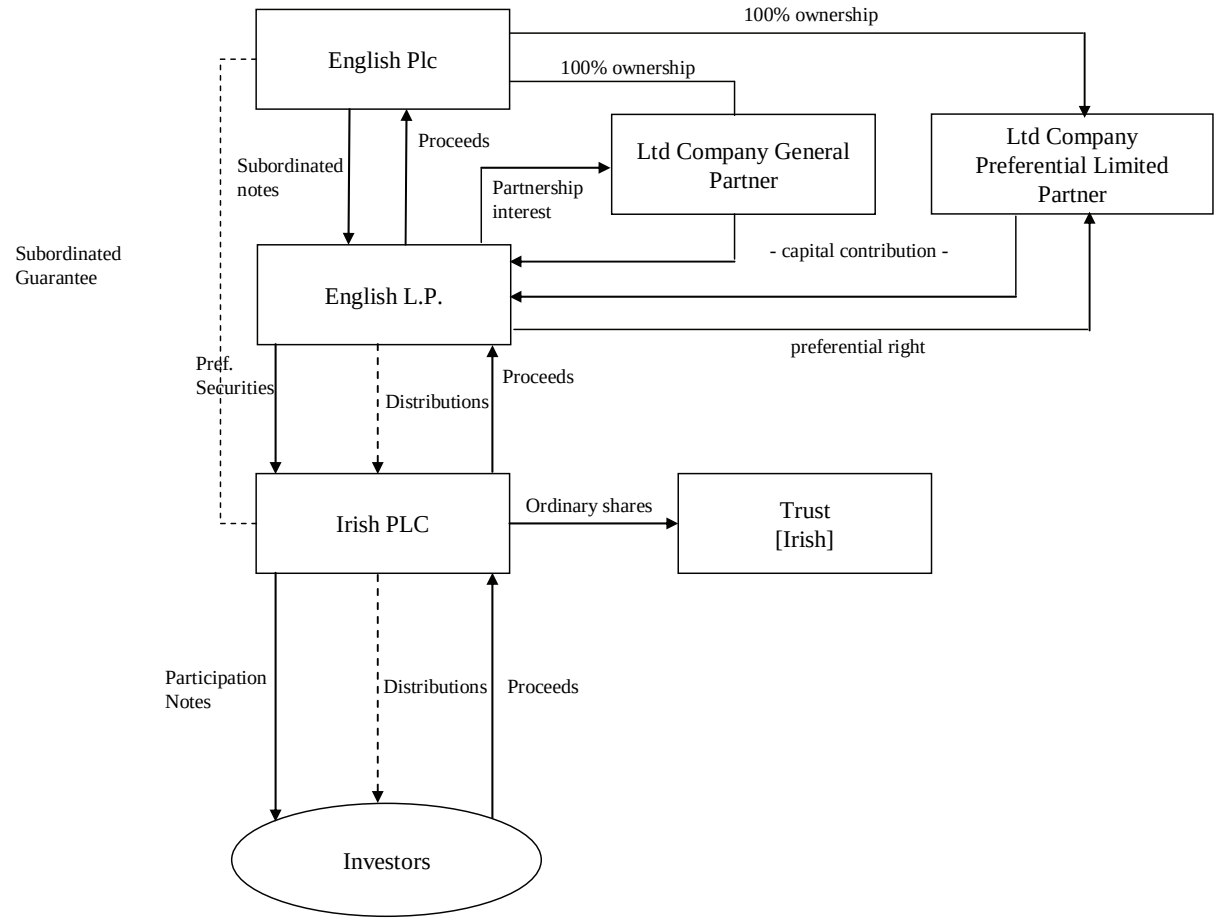
  Selected 2009 issue

  - *Hero AG, a Swiss jam maker (October 2009)*

  Features

  - Direct issuance by principal group company.

- ***United Kingdom Subsidiary Issued and Repackaged Perpetual Securities (since 2007)***



Selected issue

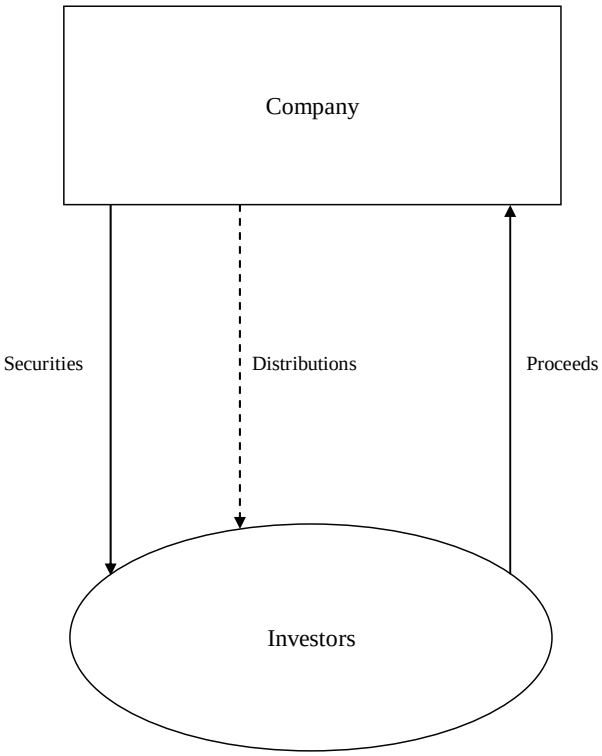
- LCH.Clearnet Group Limited (English Limited Partnership issuing entity and Irish incorporated repackaging vehicle) (2007)

Features

- Irish PLC repackaging vehicle issuing notes secured on notes issued through an English Limited Partnership subsidiary with the benefit of a subordinated guarantee from the English parent company.
- Perpetual (NC10).
- Rank such that holders are provided with rights on liquidation which are equivalent to non-cumulative preference shares of the Guarantor.
- Fixed rate coupons payable until the first call date, stepping-up to floating rate thereafter.

- Mandatory interest deferral if a capital deficiency event has occurred or would occur as a result of the payment. Interest is non-cumulative.
- Dividend and distribution stopper in the event that interest is not paid in full.
- Issuer optional redemption on (i) the first call date or (ii) any interest payment date thereafter.
- Issuer optional redemption at any time at the Make-Whole Redemption Price if the securities no longer qualify as Tier 1 Capital.
- Preferred Securities Substitution provisions in the event that the Subordinated Notes are redeemed whilst the Preferred Securities remain in issue.
- No events of default.
- Governed by English law.
- Irish Listed.

- ***United Kingdom Direct Issued Dated or Perpetual Capital Securities (since 2007)***



Selected issues

- Rexam PLC, a consumer packaging company (2007)
- Mann Group plc, a provider of alternative investment products and solutions (2008).

Features

- The first direct issue by an English corporate.
- Dated securities with a maturity of 60 years (NC10).
- The securities are direct, unsecured, subordinated obligations of the issuer. On an insolvent winding-up, the securities rank immediately above ordinary shares in respect of any outstanding interest. In respect of principal the securities rank equally with holders of preference shares.
- Fixed rate coupons payable until the first call date, stepping-up to floating rate thereafter with quarterly rate resets.
- Optional interest deferral for up to 5 consecutive years. If certain leverage ratios are exceeded, the issuer is required to use reasonable endeavors to

satisfy interest payments. Deferred interest is cumulative. During a deferred interest period the issuer and its subsidiaries may not, except in limited circumstances (i) declare or pay any dividends on, redeem, purchase, or acquire any capital stock nor (ii) make any payment of principal, interest or premium, or repay or repurchase any *pari passu* or junior debentures.

- Limited events of default only, encompassing (i) default in the payment of interest after the conclusion of an interest deferral period which lasted for 5 years (or 10 years in the case of a interest deferral period which came about due to the issuer exceeding certain financial ratios), (ii) failure to pay interest within 30 days of an interest payment date which has not been deferred and (iii) and specified insolvency events.

- No mandatory deferral features.

- Issuer optional redemption in whole, but not part (i) on, or at any time after, the first call date, at 100 percent of the principal amount plus accrued and unpaid interest, (ii) before the first call date at the make-whole redemption amount plus accrued and unpaid interest, or (iii) upon occurrence of certain tax, accounting or rating agency events at the applicable make-whole redemption amount plus accrued and unpaid interest.

- If the option to redeem is exercised within six months of confirmation of a change of control event the securities will be redeemed at 101 percent of their principal amount. If, following confirmation of a change of control which will trigger a ratings downgrade, the option to redeem the securities is not exercised the prevailing interest rate will increase by 5 percent per annum from the date of the change of control.

- The company states an intention not to redeem the securities unless, within 180 days prior to the date of redemption, it has first issued and sold securities that have equity-like characteristics that are the same as, or more equity-like than, the securities at that time.

- Proceeds of issue stated to be used for the acquisition of a US plastics manufacturer and for general corporate purposes.

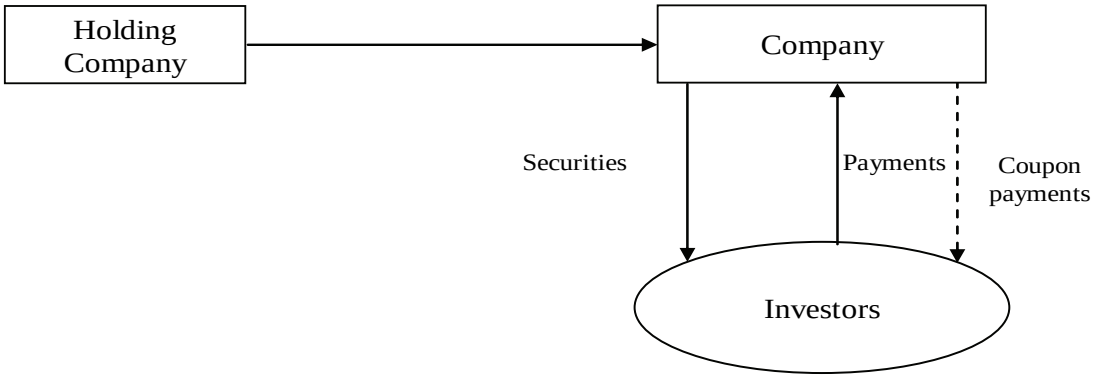
- Governed by English law.

- London listed.

CHAPTER 16

US AND OTHER NON-EUROPEAN CORPORATE INSTRUMENTS

- ***US and Canadian Direct Issue Unsecured Securities (since 2007)***



Selected issues

- Newcastle Investment Corp., a real estate investment and finance company (US) (2007)
- PPL Capital funding, Inc., a finance subsidiary of PPL Corporation whose primary business activities are as an energy and utility holding company (US) (2007)
- TransCanada PipeLines Limited, an energy infrastructure company (Canada) (2007)
- CVS Caremark Corporation, an owner and operator of retail pharmacies (US) (2007)
- Enterprise Products Operating L.P., a midstream energy company (US) (2007)
- Wisconsin Energy Corporation, a holding company owning utility and non-utility energy companies (US) (2007)

- FPL Group Capital, a finance subsidiary of FPL Group whose primary business activities are in electrical utilities (US) (2007 – three issues)
- Delphi Financial Group, Inc., an integrated employee benefit services company (US) (2007)
- TEPPCO Partners, L.P., an owner and operator of carrier pipelines for refined and liquefied petroleum (US) (2007)
- Puget Sound Energy, a public utility corporation (US) (2007)
- General Electric Capital Corporation (US) (2007)
- Enbridge Energy Partners, L.P., an owner and operator of crude oil, natural gas and petroleum transportation and storage assets (US) (2007)
- Constellation Energy Group, Inc., an energy wholesaler (US) (2008)
- American Electric Power Company, Inc., a public utility company (US) (2008)

Features

- Direct issue (TEPPCO Partners L.P. having the benefit of a subsidiary guarantee. PPL Energy Capital Funding, Inc. and Enterprise Products Operating L.P having the benefit of a holding company guarantee).
- Securities rank junior to subordinated debt, but senior to share capital.
- The securities have a maturity of between 30 and 60 years, except for Newcastle Investment Corp., which is perpetual (NC10).
- Fixed rate coupons payable until the first call date, stepping-up to floating rate thereafter.
- Limited events of default only, encompassing interest payment defaults (where an option to defer payments has not been exercised), failure to pay principal when due and specified insolvency events.
- Optional interest deferral for one or more periods of up to 10 consecutive years. Deferred interest is cumulative. During a deferred interest period the issuer and its subsidiaries may not, except in limited circumstances (i) declare or pay any dividends on, redeem, purchase or acquire any capital stock; (ii) make any payment of principal, interest or premium, or repay or repurchase any *pari passu* or junior securities; nor (iii) make and guarantee payments on guarantees ranked *pari passu* or junior.
- No mandatory deferral features.

- Issuer optional redemption in whole, but not in part (i) on, or at any time after, the first call date, at 100 percent of the principal amount plus accrued and unpaid interest, or (ii) before the first call date at the make-whole redemption amount plus accrued and unpaid interest, or (iii) upon the occurrence of certain tax or rating agency events at the applicable make-whole redemption amount plus accrued and unpaid interest.

- Replacement capital covenant – the issuer contractually commits to one or more classes of its existing note holders not to redeem the securities (and, in certain structures, not to allow the maturity of the securities) unless, within 180 days prior to the date of redemption, it has first issued and sold securities that have equity-like characteristics that are the same as, or more equity-like than, the securities at that time.

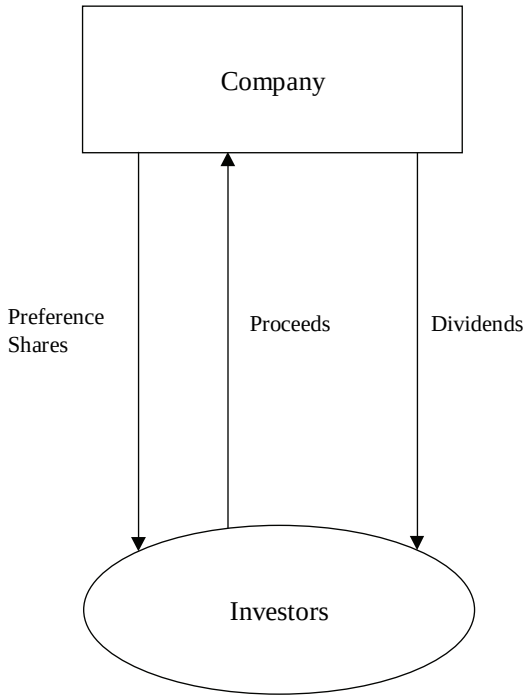
- Proceeds of issue stated to be used for general corporate purposes, redemption of securities or repurchase of stock.

- Most issues are either listed on the New York Stock Exchange or are not listed.

- Governed by New York law.

- Securities classified as debt for IFRS purposes.

- ***US Preference Shares (since 2008)***



Selected issue

- Las Vegas Sands Corp. (2008)

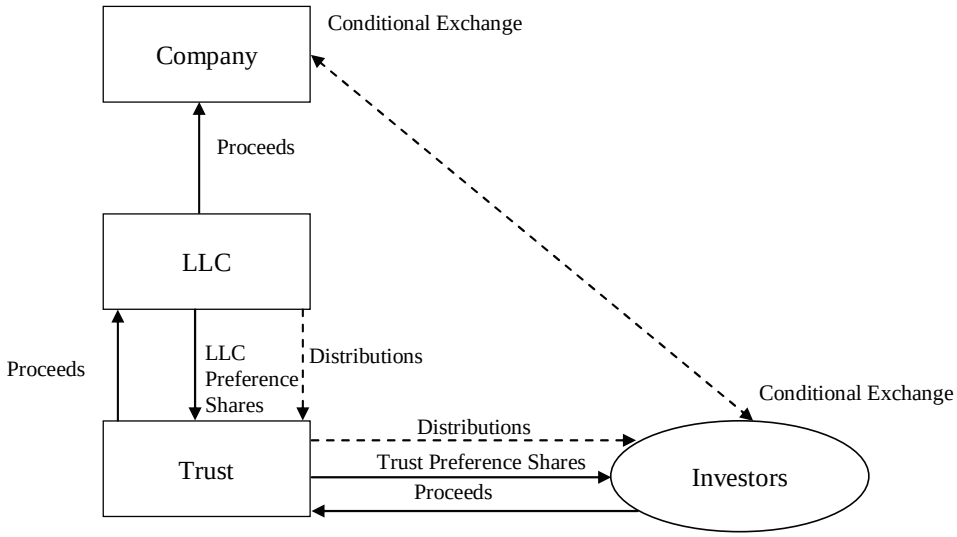
Features

- The preference shares are perpetual.
- Holders are entitled to receive cumulative cash dividends quarterly, when and if declared, at a per annum rate of 10 percent.
- The issuer may not redeem the securities prior to November 15, 2011. On or after that date, the issuer may, at its option, redeem the securities in whole or in part at a price of US$110.00 per share plus any accrued and unpaid dividends (originally, securities were offered at a price of US$100.00).
- Purchasers received one warrant to purchase 16.6667 shares of common stock at an exercise price of US$6.00 per share for each share of preferred stock purchased.

- The securities rank as to payment of dividends and distributions of assets upon dissolution, liquidation or winding-up (i) junior to all the issuer's and its subsidiaries' existing and future debt obligations; (ii) junior to any class or series of capital stock, the terms of which provide that such class or series will rank senior to the securities; (iii) senior to the issuer's common shares; and (iv) *pari passu* with any other class of the issuer's capital stock, the terms of which provide that such class or series will rank equally with the securities both in the payment of dividends and in the distribution of assets on any liquidation, dissolution or winding-up of the issuer.

- Unless all accrued and unpaid dividends on the securities for all past quarterly dividend periods have been paid in full, the issuer will not (i) declare or pay any dividend on any party stock or junior stock, unless it is paid in the form of junior stock; and (ii) redeem, purchase or otherwise acquire any junior stock or parity stock.

- ***Australian and New Zealand Step-up Preference Securities (since 2007)***



Selected issues

- PaperlinX, a paper merchant and manufacturer (issued through a subsidiary SPV and trust structure incorporated in Australia) (Australia) (2007)
- Downer, an engineering and construction company (issued through a finance subsidiary also incorporated in New Zealand) (New Zealand) (2007)

Features

- Securities are issued via a trust structure.
- Securities rank junior to subordinated debt, but senior to share capital.
- Perpetual (NC5).
- Fixed rate coupons payable until the first call date, stepping-up to floating rate thereafter.
- Issuer optional interest deferral for any reason. Deferred interest is non-cumulative.
- Dividend stopper in the event that interest or principal is not paid in full when due, preventing the issuer or any entity it directly or indirectly

controls from redeeming, repurchasing or declaring or paying a dividend on equity until such time as the payment is no longer outstanding.

- The issuer may at its option realize the securities by redemption, resale or exchanging them for ordinary shares. The issuer may realize the securities (i) on a remarketing date, (ii) on, or at any time after, the first call date, (iii) on the occurrence of an acquisition event, (iv) upon occurrence of certain tax, regulatory or accounting events, (v) following a resolution to remove the company as the responsible entity or a winding-up event, or (vi) if the aggregate face value of the securities falls below a specified value. A holder of a security may request realization on the occurrence of a change of control event.

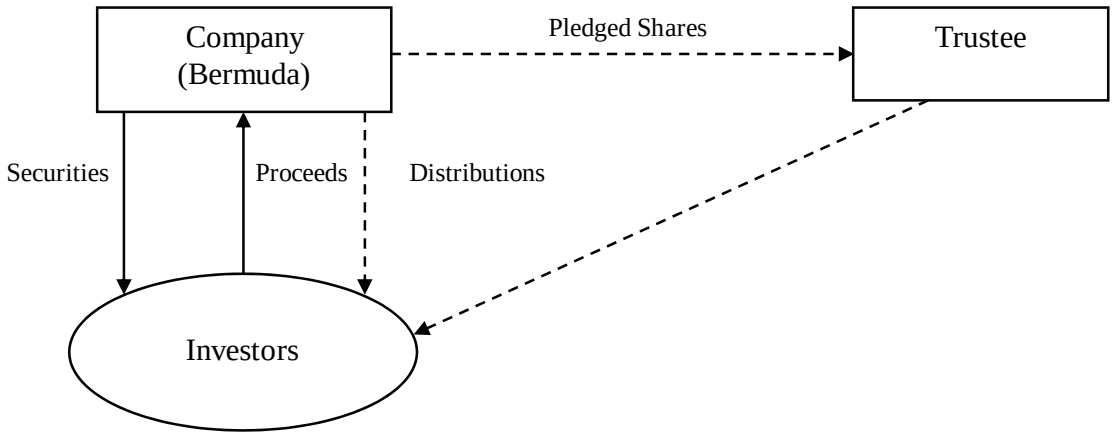
- The securities are mandatorily convertible for preference shares if there is a breach of an undertaking or a winding-up event. A preference share issued following a breach of an undertaking is immediately redeemable at the option of the holder.

- Holder optional call in relation to all, or part of their notes, at 100 percent of the outstanding principal amount plus accrued and unpaid interest, upon the occurrence of a change of control.

- The PaperlinX securities are Australian listed; the Downer securities are New Zealand listed.

- The PaperlinX securities are governed by Australian law; the Downer securities are governed by New Zealand law.

- ***Bermudan and Brazilian Fixed Rate Perpetual Securities (since 2007)***



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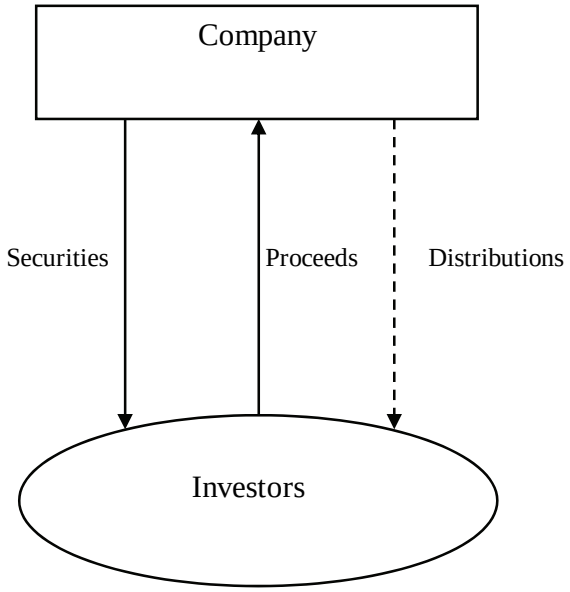


Selected issues

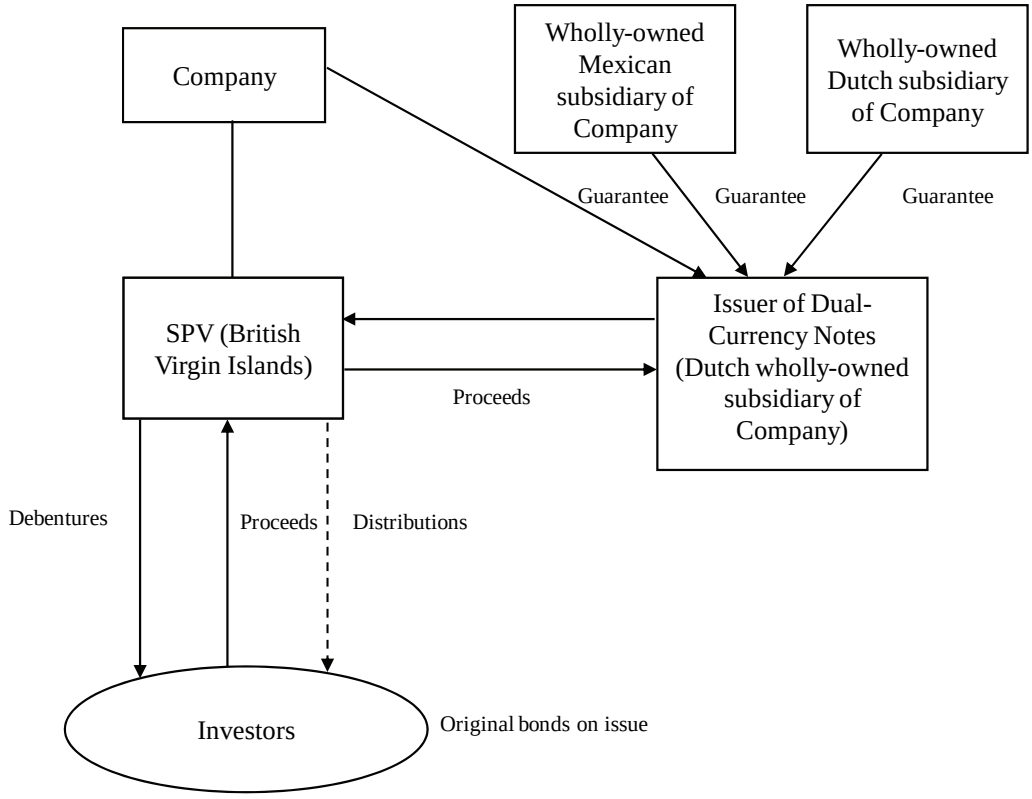
- GP Investments, Ltd., a private equity company which consolidates certain activities of a Latin American private equity firm (a Bermudan subsidiary of a Brazilian company) (2007)
- Rede Empresas de Energia Elétrica S.A., a publicly held electric company (Brazilian) (2007)

Features

- Direct issue (GP Investments having the benefit of a first priority pledge representing 100 percent of the currently issued and outstanding shares of the issuer's wholly-owned subsidiary).
- Notes constitute senior indebtedness and rank junior to subordinated debt, but senior to share capital.
- The notes are perpetual (NC5).
- Fixed rate coupons with no step-up feature.
- Events of default encompassing (i) interest payment defaults continuing for a period of 30 days after interest becomes due and payable; (ii) failure to pay principal when due; (iii) failure to maintain the minimum level of funds required in the debt service/interest reserve account; (iv) failure, continuing for a period of 60 days after the relevant notice has been given, to comply with covenants or agreements in specified documents; (v) some limited cross-default provisions for amounts in excess of US$2.5 million; and (vi) specified insolvency events.
- No interest deferral features.
- Issuer optional redemption in whole, but not part (i) on, or at any time after, the first call date, by giving at least 30 but not more than 60 days' notice, or (ii) upon occurrence of certain tax events at the applicable make-whole redemption amount plus accrued and unpaid interest, in both cases, at 100 percent of the outstanding principal amount plus accrued and unpaid interest and additional amounts.
- Holder optional call in relation to all, or part of their notes, at 100 percent of the outstanding principal amount plus accrued and unpaid interest, upon the occurrence of a change of control.
- Limited negative pledge provisions.
- Trustee to set-up and maintain a debt service/interest reserve account which will be fully-funded when it contains funds enough to pay in full the amounts due on the notes for the following six interest payment dates. The trustee will have exclusive control of the account, although the issuer may direct the trustee to make interest payments from the account or to invest certain amounts.
- Proceeds of issue stated to be used for general corporate purposes.
- Irish listed – GP Investments; Luxembourg listed – Rede.

- Governed by New York law.
- Notes expected to be classified as equity for IFRS purposes.

- ***Mexican Callable Perpetual Debentures (since 2007)***



Selected issue

- Cemex, a cement company (issued through a subsidiary SPV incorporated in the British Virgin Islands) (2007)

Features

- Subsidiary SPV issuer repacking perpetual dual-currency notes issued by a Dutch finance subsidiary of Cemex and co-guaranteed by Cemex.
- Securities constitute senior indebtedness and rank junior to subordinated debt, but senior to share capital.
- Securities are perpetual (NC5).
- Fixed rate coupons payable until the first call date, stepping-up to floating rate thereafter. Additional step-up provisions in the event of a change of control resulting in additional interest of 5 percent per annum.

- Events of default encompassing (i) principal and interest payment defaults continuing for a period of 30 days after monies becomes due and payable; (ii) failure to pay an amount under the conversion payment undertaking within 30 days of the monies becoming due and payable; (iii) failure to observe obligations with respect to agreed limits on mergers, sales and consolidation of certain assets; (iv) failure, continuing for a period of 30 days after the relevant notice has been given, to comply with covenants or agreements in specified documents; (v) any of the dual-currency notes, the note indenture or other specified documents cease to be in full force and effect; and (vi) specified insolvency events.

- Optional interest deferral provisions. Deferred interest is non-cumulative but triggers a conversion of the interest rate from Yen Rate to Euro Rate. During a deferred interest period the issuer and its subsidiaries may not, except in limited circumstances (i) declare or pay any dividends on, redeem, purchase, or acquire any capital stock; (ii) make any payment of principal, interest or premium, or repay or repurchase any *pari passu* or junior securities; nor (iii) make and guarantee payments on guarantees ranked *pari passu* or junior.

- No mandatory deferral features.

- Mandatory conversion from Yen Rate to Euro Rate in specified circumstances, including the first time the issuer elects to defer interest payments and the declaration of an event of default.

- Issuer optional redemption (i) in whole or part (provided that if redemption is in part only, at least €200 million of the principal amount of the notes remains outstanding) on, or at any time after, the first call date, at par plus accrued and unpaid interest, or (ii) in whole, but not in part, within 90 days of the occurrence of a change of control event.

- Proceeds of issue stated to be used for general corporate purposes and to repay indebtedness.

- The dual-currency notes are not listed.

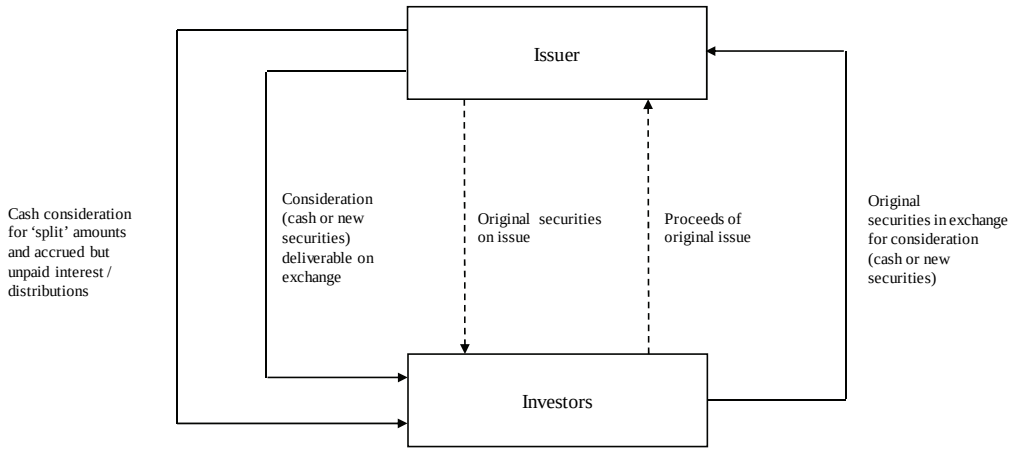
- Governed by New York law.

CHAPTER 17

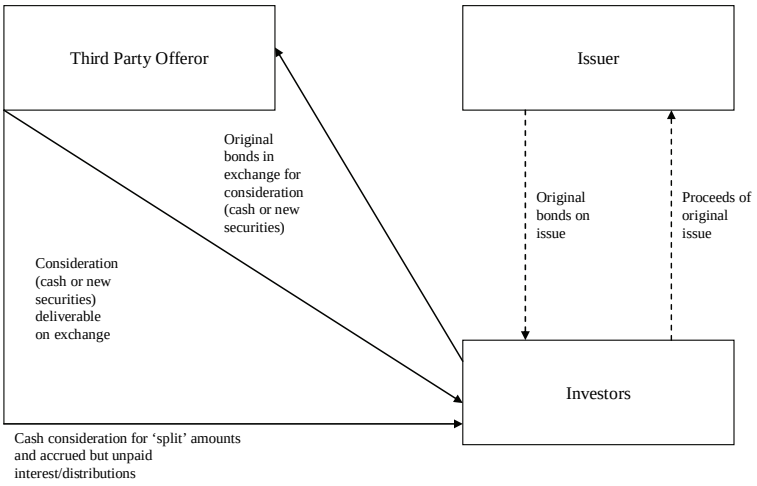
LIABILITY MANAGEMENT TRANSACTIONS

Cash Tender Offers and Exchange Offers

By the Issuer



By a Third Party



Rationale for, and types of, Liability Management Transactions

Background

Issuers of debt or hybrid securities often engage in transactions directly with the holders of their outstanding securities with a view to purchasing, or amending the terms of, those securities. Issuers perform these transactions for a variety of reasons, including, but not limited to, re-organizing their capital structures, de-leveraging, eliminating securities paying high coupons, removing burdensome covenants and restrictions, extending first "soft call" or maturity dates or purchasing securities at an advantageous price and subsequently cancelling them, thereby realizing a profit for accounting purposes.

Liability management transactions have been one of the main themes in the hybrid capital sector since the fourth quarter of 2008, with approximately €122 billion equivalent of liability management transactions executed by October 2009.[65] As the credit crunch deepened throughout 2008 and 2009 and financial institutions turned to governments for taxpayer funded support packages, hybrid capital securities issued by many financial institutions suffered downgrades with such securities trading at substantial discounts to par throughout much of 2009 and to date in 2010. As banks and other financial institutions have sought to restructure balance sheets, a large number of institutions have taken advantage of those depressed prices to either buy-back and cancel significant amounts of their outstanding hybrid capital and Tier 2 subordinated securities, in many cases allocating the accounting gains realized by such purchases to core Tier 1 capital, or to exchange outstanding capital securities either for new senior securities in lieu of cash consideration for such buy-back, or new capital securities providing additional regulatory benefit. Institutions which undertook such transactions in 2009 in most instances can be grouped into two general categories: (i) distressed entities that needed to improve liquidity by reducing leverage; and (ii) over-leveraged entities exposed to significant refinancing risk utilizing exchange offers to extend first "soft calls" and maturities. Investors

[65] Source: Calyon Market Update – October 2009.

benefited from the opportunity to earn a premium on what had become a distressed asset class, see *Selected 2009-2010 exchange offers* below.

Mechanics

In the absence of express provisions within the terms and conditions of the relevant securities which give the issuer the option to redeem those securities prior to their scheduled maturity date (*i.e.*, an issuer call option), or where such an issuer call option cannot be exercised at an economically attractive rate (*e.g.*, because the call price is at a substantial premium to the current market price), there are a number of avenues open to issuers to allow them to purchase and effectively redeem all or a portion of an existing outstanding series of securities before the scheduled maturity date.

The terms and conditions of many debt or hybrid securities (particularly those governed by English law) may expressly permit the issuer or its affiliates to purchase those securities in the open market or otherwise at any price. It is usually a contractual requirement that such securities are cancelled once purchased. Where the purchaser is not the original issuer of the securities (*i.e.*, it is a 'third party' offer, where the offeror is another group member or affiliate, or a special purpose acquisition vehicle), that purchaser will in many cases not be required to arrange for the cancellation of the securities unless the terms of the securities require otherwise and, occasionally, issuers who purchase their own securities will also have the discretion to hold purchased securities in "treasury" for subsequent re-sale. However, the absence of any such express permissive provisions within the terms and conditions of the relevant securities should not (at least as a matter of New York law or English law) preclude an issuer, or third party offeror, from purchasing those securities itself, provided that such purchase is not otherwise expressly prohibited by contract, applicable law or regulatory requirements[66] or pursuant to the relevant offeror's constitutive documents. One of the most significant challenges arising within the context of liability management transactions in respect of hybrid capital securities can be actually effecting a cancellation of the purchased securities in order to achieve the desired deleveraging, particularly given the structural complexity of many outstanding hybrid capital securities (with multi-layered structures and a complex interplay of contractual arrangements governed by differing governing laws made between entities located in different jurisdictions and subject to differing taxation regimes), many of which do not contain any, or contain very limited, contractual provisions to facilitate restructurings or cancellations.

Beyond such permissive provisions in the terms and conditions of securities there are, however, rarely any clear contractual requirements or mechanics as to how such purchases should be structured and/or implemented. Issuers can accomplish such goals in a number of ways: by means of open market purchases and privately negotiated transactions, either on an *ad hoc* basis or under a buy-back program; pursuant to a public tender offer for cash consideration (*i.e.* a "cash tender offer") or new securities (*i.e.*, an "exchange offer") or, if it is necessary to amend the terms of existing securities, by means of a "consent solicitation." The method utilized

[66] In the case of hybrid capital securities, a buy-back of securities (whether for cash consideration or as part of an exchange offer) will invariably require the *de facto* consent of the relevant regulatory authority, whether or not the terms of the relevant securities expressly contemplate the need for such consent. Taxpayer supported European financial institutions that utilised funds received or made available as part of taxpayer funded support arrangements have attracted considerable complaint from regulatory authorities for doing so. Both the Basel III proposals and the CEBS Guidelines expressly contemplate regulatory consent requirements for buy-backs of capital securities.

by the offeror will be influenced by a variety of factors, including the terms of the existing securities, the time period available to complete the proposed transaction and the funds available to it for such purpose.

Buy-back programs and privately negotiated transactions

A buy-back program is an arrangement where an offeror appoints a broker (usually an investment bank) to discretely (*i.e.*, without a general announcement to the market) purchase securities in the open market on the offeror's behalf, usually within certain price and volume limits, over a given period of time. Such open market purchases may be the most economical method available, especially when the offeror is not seeking to purchase a large percentage of its outstanding securities. Purchases of securities from time to time in the open market have an advantage over public tender offers in that they may be engaged in opportunistically, do not require the offeror to pay a premium over the current market price and, generally, do not require compliance with extensive rules or regulations. Such arrangements are usually documented on the relevant bank's standard brokerage terms with little involvement of external counsel and, accordingly, the costs associated with such purchases are generally *de minimis*.

Privately negotiated transactions, however, may be the most effective method available to an offeror if the target security is in the hands of a limited number of holders. In that instance, the offeror can negotiate directly with the holders. However, unlike open market purchases, in the case of privately negotiated transactions, the offeror will usually pay a premium over the prevailing market price.

Where such activities take place in the United States, or where the securities are held by US persons (as defined in Regulation S under the Securities Act), the provisions of the US Securities Exchange Act of 1934, as amended (the "Exchange Act"), will apply, and it will be important to ensure that the relevant purchase activity is structured in such a manner as not to be classified as a "tender offer" falling within the scope of the Exchange Act. If the buy-back program does constitute a tender offer for the purposes of the Exchange Act, then, in addition to the premium usually associated with such activities, the transaction costs will likely be materially higher.

In either such case, given the absence of public disclosure of the fact that such transactions are taking place, the offeror (and the relevant broker on its behalf) will need to be mindful of the potential for liability as a result of the various requirements in applicable jurisdictions (including throughout the European Economic Area ("EEA")) relating to market abuse, insider dealing and misleading statements and practices. See also *Tender offers for cash consideration – European legal considerations* below.

Tender offers for cash consideration

A "tender offer" is an offer made by an offeror to the holders of certain specified outstanding securities to purchase all or some of those securities on specified terms, subject to the satisfaction of certain conditions.

US legal considerations

For US law governed tender offer transactions, the "offer" is usually structured as an open offer by the offeror to purchase the relevant securities, subject to the satisfaction of relevant, objectively determinable conditions. Conversely, where the tender offer is governed by English law, the "offer" is usually structured as an invitation by the offeror to the holders of the relevant securities inviting those holders to offer (or "tender") their securities for sale, with the offeror's acceptance of such "tenders" being subject to the satisfaction of specified conditions (such as a requirement that holders holding a specified minimum percentage of the outstanding principal amount of the securities participate and tender their securities; that a specified proportion of holders vote in favor of relevant resolutions in a linked consent solicitation[67]; or that the issuer raises sufficient funds under another financing transaction). The English law structure gives the offeror far greater discretion as to the level of conditionality that can be imposed in relation to the transaction and effectively allows the offeror an unfettered discretion as to whether it will accept for purchase any securities tendered to it.

The precise terms of the offer will be set out in a document (a tender offer memorandum) addressed by the offeror to the holders of its existing securities. Where such an offer is made in the United States or in relation to securities to which the provisions of the Exchange Act apply, early consideration will need to be given to the detailed requirements of the Exchange Act and the various rulings of the SEC. These set out a series of rules applicable to tender offers for both equity and debt securities to which the Exchange Act applies. There is, however, no similar general over-arching regulatory framework for tender offers which fall outside of the scope of the Exchange Act.

While the Exchange Act does not contain a definition of what types of purchases constitute a "tender offer," it does set out specific rules applicable to transactions that are tender offers. The determination of whether a particular purchase arrangement constitutes a tender offer is made by applying a series of subjective factors that have evolved from elements suggested by the SEC and court decisions. The SEC has suggested that courts look to the following eight factors in determining the existence of a tender offer:

> whether there is an active and widespread solicitation of security holders;
>
> whether the solicitation is for a substantial percentage of the issuer's securities;
>
> whether the offer to purchase is made at a premium over the prevailing market price;
>
> whether the terms of the offer are firm rather than negotiable;
>
> whether the offer is contingent upon the tender of a fixed minimum number of securities and perhaps subject to a ceiling of a fixed maximum number of securities to be purchased;
>
> whether the offer is open for only a limited period of time;

[67] See *Consent Solicitations* below for further information on such solicitations.

whether the offerees are pressured to respond and sell into the offer; and

whether public announcements of a purchasing program precede or accompany a rapid accumulation of large amounts of the subject securities.

Due to the absence of a statutory definition of a tender offer, numerous court cases have been brought alleging that certain purchase transactions or series of transactions constitute a tender offer, requiring the protections of the applicable rules under the Exchange Act.

As a result of these court cases, it has become clear that large open market or privately negotiated transactions do not constitute tender offers solely as a result of the percentage of securities acquired or the number of persons from whom the acquisitions are made. What is less clear, however, is exactly how the eight factor test is to be applied in determining whether a particular purchase transaction or series of transactions, not constituting a conventional tender offer, should be treated as a tender offer.

If the purchase activity is classified as a tender offer, compliance with certain provisions of US federal securities laws, and the rules and regulations thereunder, is required. If such provisions are not complied with, the offeror may be subject to complaints initiated by the SEC or holders of the securities alleging that: (i) some aspect of the tender offer constitutes a fraudulent, deceptive or manipulative act as a result of non-compliance with applicable rules and regulations; (ii) an open market buy-back program prior to a tender offer constitutes a "creeping" tender offer in violation of the tender offer rules and regulations; or (iii) an open market buy-back program following a tender offer constitutes a *de facto* extension of the tender offer not in compliance with applicable rules and regulations.

US tender offers in respect of debt securities are subject to the general antifraud and antimanipulative provisions of Regulation 14E of the Exchange Act. Unlike the rules applicable to equity tender offers, Regulation 14E does not set out any filing or specific disclosure requirements. Many of the rules related to debt tender offers have developed as a result of no-action letters issued by the SEC's staff (the "Staff") and informally articulated positions. The determination of whether a particular security is to be viewed as "equity" or "debt" for the purposes of these requirements is fact specific and must be made by the offeror's counsel after reviewing the specific terms of the security in question.

As a general rule, an offeror will prefer to keep the tender offer period to a minimum in order to limit the exposure to changes in interest rates during the tender offer period. Several requests for no-action have been granted by the Staff in connection with the twenty business day tender offer period required by Rule 14e-1(a). In those letters, the Staff was asked to concur with the position that such tender offers need only be held open for seven to ten calendar days. The relief requested in these letters stemmed from the increased market and interest rate risks to which an issuer seeking to purchase its debt securities in a tender offer is exposed by virtue of the tender period required by Rule 14e-1(a). The relief granted in these no-action letters applies to situations where an issuer (but, notably, not a third party offeror) conducts a tender offer: (a) pursuant to which it offers to purchase for cash any and all investment grade non-convertible debt of a particular class or series, (b) that is open to all record and beneficial holders of that class or series of debt; (c) that is conducted in a manner designed to afford all record and

beneficial holders of that class or series of debt a reasonable opportunity to participate in the tender offer, including the dissemination of the offer on an expedited basis in situations where the tender offer is open for a period of less than ten calendar days; and (d) that is not made in anticipation of or in response to other tender offers for such issuer's securities.

The Staff also extended its position to the period of time that issuer (but, again, not a third party) debt tender offers must be kept open after the announcement of an increase or decrease in the consideration offered. It is the Staff's position that any extension should be commensurate with the length of the original tender offer, rather than the ten business days discussed above.

European legal considerations

There are few clear regulatory requirements or parameters which expressly contemplate debt tender offers (*i.e.*, outside of the United States). Significantly, there are no generally applicable statutory minimum time periods during which offers must be kept open. As is often the case with Euromarket transactions, the starting point for the majority of transactions has been US precedent and, accordingly, most structures and arrangements in the Euromarkets closely resemble Regulation 14E compliant structures used in the context of US tender offers, although with added flexibility given the non-applicability of Regulation 14E.

From an English law perspective, the key legal and regulatory requirements that apply to tender offers are the financial promotion, market abuse, manipulative practices and insider dealing related provisions under the UK Financial Services and Markets Act 2000, including those provisions implementing the requirements of the EU's Directive 2003/6/EC (the "Market Abuse Directive"). The Market Abuse Directive is also implemented in each Member State of the EEA and, accordingly, substantially similar requirements apply in each EEA Member State. In addition, consideration also needs to be given to the prospectus publication requirements of the EU Directive 2003/71/EC (the "Prospectus Directive"), again, as implemented in each EEA Member State. Significantly, a tender offer for cash consideration will not be an offer of securities to the public within the scope of the Prospectus Directive and, therefore, should not trigger any of the prospectus publication requirements under that Directive. However, see *Exchange Offers* below for a discussion of prospectus publication requirements within the context of exchange offers. Some European jurisdictions (*e.g.*, Italy, Belgium and France) also have additional local legal regulations, requirements and restrictions which can operate to limit (or in the case of Italy, effectively preclude) the making of cash tender offers and/or exchange offers to holders in such jurisdictions by, for example, restricting the ability to distribute offering materials. A key first step in any transaction will, therefore, be to identify the relevant jurisdictions in which holders are located with a view to excluding appropriate holders so as to avoid the need to comply with such restrictions.

Exchange Offers

As an alternative to a cash tender offer, an offeror may offer to exchange a new security for an existing outstanding security. As access to financing has been restricted throughout the credit crunch, many financial institutions have relied upon exchange offers to refinance outstanding indebtedness or to restructure balance sheets and/or to obtain relief for debt service

requirements. See *Selected 2009-2010 exchange offers* below. In order to induce holders to participate in an exchange offer, the offeror will have to offer some incentive to the holder for giving up their existing security for a new one with different terms, be it an increase in yield or an elevated position in the relevant offeror's capital structure.

US legal considerations

Unlike a cash tender offer, an exchange offer involves the offering of a new security. In the context of US-related transactions, the rules applicable to cash tender offers apply equally to exchange offers, although certain of the SEC no-action positions do not apply. In particular, as an exchange offer constitutes an offering of new securities, it must be registered with the SEC unless an exemption from registration is available. Exchange offers are also subject to the anti-fraud provisions of the Securities Act and Rule 10b-5 under the Exchange Act.

From a US perspective, exchange offers can be structured in one of three ways: (i) a Section 3(a)(9) exchange offer, (ii) a private Section 4(2) exchange, or (iii) as a registered exchange offer.

Section 3(a)(9) exchange offers

Section 3(a)(9) of the Securities Act provides an exemption from registration for any security exchanged by an issuer exclusively with its existing security holders if the following conditions are met: (i) no payment is made by the issuer for solicitations made in connection with the offering; (ii) the existing securities and the new securities, are all offered by the same issuer; and (iii) security holders are not required to contribute cash or other property, other than the existing securities, in exchange for the new securities. However, cash or other consideration can be offered by the issuer to holders along with the new securities.

As stated above, for Section 3(a)(9) to be available, both the new security issued and the existing security surrendered in the exchange must be those of the same issuer. This is often referred to as the "issuer identity requirement." However, the issuer identity requirement is not absolute, particularly in the area of guaranteed securities or other securities having multiple issuers and the analysis will depend on the particular nature of the relevant securities. The SEC has issued interpretations in which it has granted exceptions to the issuer identity requirement for substantially identical issuers and in other specific fact situations.

The prohibition on payments for solicitation under Section 3(a)(9) prevents an issuer from hiring a transaction advisor to solicit participation in the relevant offer, particularly where the fees paid to such advisor are based upon the success of the offering. This prohibition greatly limits the use of the Section 3(a)(9) exemption as the restriction on solicitation payments will preclude an issuer from the standard approach of appointing one or more investment banks as dealer managers to assist in the exchange offer process. The Section 3(a)(9) exemption is, however, not lost because cash or other consideration is given to the holders of the existing securities making the exchange along with the new securities that are being issued. This means that Section 3(a)(9) permits payments made by the issuer directly or indirectly to the security holders in connection with an exchange of securities when such payments are part of the terms of the exchange offer.

Because a Section 3(a)(9) exchange offer is exempt from registration with the SEC, these transactions can be completed relatively swiftly. Unlike private placement exchange offers, there is no restriction on the nature of the offerees; offers can be made to non-accredited investors and accredited investors. There is also no restriction on general solicitation and advertising. It is important to keep in mind that Section 3(a)(9) only provides the issuer with an exemption from the registration and prospectus delivery requirements; it is silent as to the ability of persons receiving the exchanged securities to resell them and such persons must rely upon their own exemptions. If the existing securities were freely tradable, the person receiving the new securities will, in the ordinary case, be able to sell them in reliance on the exemptions set forth in Section 4(1) or Section 4(3) of the Securities Act. If the existing securities were restricted securities, then the new securities will assume the character of the existing securities, which means that they will also be restricted securities and the holder will be permitted to "tack" the holding period of the existing securities for Rule 144 purposes.

Private exchange offers

An offeror may choose to conduct an exchange offer as a private placement of new securities that is exempt from registration under Section 4(2) of the Securities Act. In such a private exchange offer, offers are typically limited to qualified institutional buyers and offshore investors pursuant Regulation S, as well as to accredited investors. As is the case with any private placement, general solicitation or advertising is prohibited and an issuer must determine that the holder of the existing securities is eligible to participate before sending the offering documents to that holder.

Registered exchange offers

An SEC-registered exchange offer is often used where the outstanding securities are widely held and the offeror cannot rely on a Section 4(2) private placement or Section 3(a)(9) exemption. Unlike exchange offers conducted pursuant to Section 3(a)(9), registered exchange offers (like Section 4(2) private placements) facilitate third party offers by permitting a new issuing entity to issue its securities in exchange for the existing securities of another company (usually an affiliate). In a registered exchange offer, the offeror of the new securities will prepare and file with the SEC a registration statement on Form S-4 covering the new securities being offered. The registration process requires substantial public disclosure and can be expensive and time consuming due to the fact that the registration is subject to SEC review. Such registered exchange offers may be beneficial in situations where securities are widely distributed or are not held by holders eligible to purchase new debt in a private placement. In addition, new securities in a registered exchange offer are freely transferable, which provides holders with greater liquidity than with privately placed securities. Based on interpretations of the SEC, new securities issued in an exchange offer for existing securities can be offered for resale, resold and otherwise transferred by any security holder without compliance with the registration and prospectus delivery provisions of the Securities Act, if:

> The security holder is not an affiliate of the offeror within the meaning of Rule 144 under the Securities Act.

The exchange securities are acquired in the ordinary course of the holder's business.

The security holder does not intend to participate in a distribution of such exchange securities.

European legal issues

Where there is a European aspect to an exchange offer, the offer of the new securities will need to be structured to fall within an applicable exemption under Article 3(1) of the Prospectus Directive unless the applicable offer memorandum is to be approved as a prospectus for the purposes of the Prospectus Directive. Similarly, if it is intended that the new securities are to be admitted to trading on a regulated market in the EEA (which would be common), an approved prospectus will need to be published in connection with that admission to trading.

The customary exemptions from the requirement to publish a prospectus under the Prospectus Directive will usually be available to offerors, but particular care should be taken to ensure that that is the case. The exemptions under Article 3(2)(a) (offers addressed solely to qualified investors) or Article 3(2)(b) (offers addressed to fewer than 100 natural or legal persons per Member State) may not be available depending on the applicable investor base holding those securities; issues originally sold to institutional investors may very well have become widely distributed to "retail" investors through so-called "retail cascades." Similarly, structuring the issue of the new securities to fall within the customary exemption under Article 3(2)(d) (offers of securities whose minimum denomination per unit amounts to at least €50,000 (or its equivalent)) may not be practicable if the exchange ratio/price is less than par (which will likely be the case) and the minimum denomination of the existing securities is currently €50,000. In those circumstances, the new securities would need to have minimum denominations off less than €50,000 or if that is not achievable (for example because the new securities are to be listed and the relevant issuing entity wishes to rely on the reduced disclosure requirements available for "wholesale securities" under the Prospectus Directive's implementing regulations), provision will need to be made either to exclude holders wishing to tender amounts of existing securities which, when multiplied by the exchange ratio/price, give rise to less than an integral multiple of the relevant minimum denomination, or for such holders to be fully or partially paid in cash.

Consent Solicitations

Consent solicitations are formal requests by issuers for holders' consents to certain amendments to the terms of the documents governing the relevant series of securities. Requests for such consents can be directed at, amongst other things, removing restrictive covenants or, occasionally, can be made in conjunction with a cash tender offer or exchange offer with a view to amending the terms of the existing securities so as to incentivize holders to participate in the tender offer; for example, to include an issuer call option, thereby enabling the issuer to effectively "squeeze-out" non-tendering holders.

The governing documents for most New York law or English law governed securities provide detailed mechanics allowing for amendments to the terms and conditions of those securities with the consent of the holders. In many cases, such amendments can be made with

the consent of a majority of the holders, although the majority of New York law indentures (and most English law trust deeds) provide that certain amendments (usually amendments which would or might affect the time, manner, amount or place of payment or redemption of the securities, which are traditionally referred to as "reserved matters") require the consent of some amount greater than a majority (*i.e.* whether 100 percent, 75 percent or 66⅔ percent of the outstanding holders). Issuers will sometimes pay a separate fee for the giving of consents.

Many indentures, trust deeds or fiscal agency agreements also include detailed provisions relating to the mechanics for holding meetings of holders of securities to consider and vote on relevant amendments, etc. All such provisions will need to be complied with, in particular those relating to quorum requirements and notice periods, all of which will need to be factored into appropriate timetables. If a consent solicitation is made in conjunction with a tender offer, the terms of the offer will usually provide that tendering holders are deemed to consent in favor of (*i.e.*, consent to) the relevant amendments by tendering their securities for sale.

As financial institutions re-assess their outstanding capital securities in the light of changing regulatory requirements consent solicitations directed at varying the terms of existing securities so as to avoid 'regulatory calls' (*i.e.*, early redemptions as a result of changes to regulatory requirements) or otherwise ensure continuing regulatory capital treatment may also become common place.

Set out below is a brief summary of some of the features of certain exchange offers and cash tender offers which have taken place throughout 2009 and early 2010.

One notable transaction from 2009 was Lloyds Banking Group's November 2009 exchange offer of 52 separate series of existing subordinated notes and hybrid capital securities for contingent convertible capital securities known as ECNs which convert at a specified trigger point into common equity; in Lloyd's case, if its core Tier 1 ratio falls below 5 percent. While such CoCo securities are not new, the Lloyds issue has attracted considerable interest from regulators and potential issuers on both sides of the Atlantic given the possibility of these securities providing additional core Tier 1 capital in times of market stress.[68] There are, however, some practical concerns with the instruments, for example as to the level at which the conversion trigger is set and concerns that the extra capital cushion expected to be generated in the event of a conversion may be too small to provide the required capital buffer. Notwithstanding these concerns it is to be expected that other issuers will seek to emulate the success of Lloyds' ECNs[69], although the extent to which CoCo securities or other contingent capital securities become a stand-alone asset class for 'new money' (as opposed to rolling-over or refinancing) investors remains to be seen, Rabobank Nederland's March 2010 issue of SCNs has increased the potential for such a stand-alone asset class. The added emphasis on loss

[68] The interest in contingent convertible capital securities that the Lloyds issue has generated has been further heightened by the issuance in March 2010 of SCNs by Rabobank Nederland. Given that Rabobank Nederland is a co-operative and does not have a share capital, instead of the equity conversion mechanism utilized by Lloyds in its issuance of ECNs, the SCNs were structured to result in a principal write-down (of 75 percent) and related redemption (of the outstanding 25 percent in principal amount) of all the SCNs when a specified equity capital ratio trigger point is reached. See Chapter 11 (*Bank Contingent Capital Instruments*).

[69] See, for example, Yorkshire Building Society's proposed issue of CoCos as part of its merger with Chelsea Building Society; on completion of the merger (which is expected to be April 1, 2010), holders of Chelsea Building Society's £200 million subordinated debt securities will be invited to exchange them for Yorkshire Building Society issued lower Tier 2 notes which will be convertible into profit participating deferred shares in the event that the core Tier 1 capital of Yorkshire Building Society falls below 5 percent.

absorbency in both the Basel III proposals and the CEBS Guidelines, and in particular the requirement under the CEBS Guidelines for 'going concern' capital to provide features resulting in either mandatory conversion into equity capital securities or principal write-downs in the event of stress situations, both suggest that CoCo securities are likely to be a product of substantial attention and discussion over coming months. As issuers seek to restructure balance sheets to comply with the Basel III proposals and/or the CEBS Guidelines it is to be expected that the trend for exchange offers, consent solicitations and other liability management transactions will only continue.

Selected exchange offers

- QBE Insurance Group Limited exchange offer (Australian) (2008)
- Standard Chartered exchange offer (UK) (2008)

Features

- QBE Insurance Group Limited's December 2008 exchange offer involved separate offers to exchange up to US$550,000,000 of outstanding hybrid capital securities issued by QBE Capital Funding II L.P. for US dollar denominated senior notes issued by QBE and to exchange up to £300,000,000 of outstanding hybrid capital securities issued by QBE Capital Funding L.P. for pounds sterling denominated unsecured senior notes issued by QBE. Approximately 54.75 percent of eligible US dollar denominated hybrid capital securities and 90.83 percent of eligible pounds sterling denominated hybrid capital securities were tendered. As a result of the exchange offers, QBE realized a profit by acquiring the outstanding capital securities at a discount to par, while investors benefited from receiving higher-ranking securities and a higher coupon at a price that was approximately 10 percent over the trading price of the outstanding capital securities. The reduction in QBE's regulatory capital resulting from the replacement of such capital securities was offset by a simultaneous overnight placement by QBE of A$2 billion of ordinary shares.
- In November 2008, Standard Chartered invited holders of its US$400,000,000 Undated Primary Capital Floating Rate Notes, US$300,000,000 Undated Primary Capital Floating Rate Notes, US$400,000,000 Undated Primary Capital Floating Rate Notes and US$200,000,000 Undated Primary Capital Floating Rate Notes to tender any and all of such Notes for purchase by Standard Chartered for cash. Participation in such tender offers was in excess of 70 percent for each series of such Notes.

Selected 2009-2010 exchange offers

- *Allied Irish Bank, plc exchange offers (Irish) (June 2009)*
- *ASR Nederland N.V. exchange offers and consent solicitations (Dutch) (July 2009)*

- *Banco Popular Español, S.A. exchange offers (Spanish) (November 2009)*
- *Banco Santander, S.A. exchange offers (Spanish) (July and August 2009)*
- *Barclays Bank plc exchange offer (UK) (April 2009)*
- *BBVA International Preferred, S.A. exchange offers (Spanish) (October 2009)*
- *BPCE exchange offers (French) (July 2009)*
- *BNP Paribas exchange offer (French) (November 2009)*
- *Citizens Republic Bancorp, Inc. exchange offers (US) (September 2009)*
- *Doral Financial Corporation exchange offers (US) (August 2009 and February 2010)*
- *Friends Provident plc exchange offers (US) (May 2009)*
- *General Electric Capital Corporation (US) (February 2010)*
- *Lloyds Banking Group plc exchange offers (UK) (November 2009)*
- *Lloyds TSB exchange offer (UK) (January 2009 and March 2009)*
- *Popular, Inc. exchange offers (Spanish) (August 2009)*
- *RaboBank Nederland exchange offers (Dutch) (May 2009)*
- *Regions Financial Corporation, Inc. exchange offers (US) (June 2009)*

Selected 2009-2010 cash tender offers

- *Banco Santander, S.A. tender offers (Spanish) (January and February 2010)*
- *Bank of Ireland tender offers (Irish) (May 2009)*
- *BNP Paribas tender offers (French) (November 2009)*
- *KBC Bank NV tender offers (Dutch) (September 2009)*
- *National Australia Bank Limited tender offers (Australian) (July 2009)*
- *Royal Bank of Scotland plc cash tender offers (UK) (March 2009)*
- *UBS cash tender offer (Swiss) (March 2009)*
- *Unicredit Bank AG tender offers (German) (January 2010)*

Features

- In June 2009, ***Allied Irish Bank, plc*** announced that it was inviting all holders of six series of euro and pounds sterling denominated Tier 1 and Tier 2 hybrid securities (comprised of a mixture of perpetual notes and perpetual preference shares) of AIB Capital Exchange Offering 2009 Limited for two series of new 10 year bullet dated subordinated Lower Tier 2 capital qualifying hybrid securities with a combined value of €1.3 billion. The announced purpose of the transaction was to increase the equity accretion of the group.

- In July 2009, ***ASR Nederland*** (formally Fortis Verzekeringen Nederland N.V. (and wholly-owned by the Dutch state)) invited holders of certain euro denominated non-cumulative trust preferred securities issued by various Delaware trust issuing entities to exchange such securities for euro denominated perpetual guaranteed capital securities to be issued by ASR Nederland.[70] The aims of the exchange offers were two-fold: to further strengthen the solvency margin and capital base following ASR Nederland's separation from the Fortis Group, and; to provide holders of existing securities with the opportunity to exchange such securities for directly issued Tier 1 securities with terms which were aligned to then prevailing market standards. The transaction involved a consent solicitation where exchanging holders consented (via exit consents) to certain amendments to the underlying Delaware partnership and trust structures to facilitate a collapse of the existing transaction structures and distribution of the partnership and trust assets in the form of new, direct issue hybrid capital securities issued by ASR Nederland.

- In November 2009, ***Banco Popular Español*** invited holders of three series of euro denominated Tier 1 perpetual securities issued by ***Popular Capital, S.A.*** to exchange such securities for new euro Lower Tier 2 fixed-to-floating step-up subordinated securities issued by Banco Popular Español. The aggregate participation rate for the exchange offers was 60 percent of the existing securities. The total amount of new securities issued by Banco Popular Español was €335,150,000. The announced purpose of the exchange offer was to strengthen the bank's balance sheet.

- In July 2009, ***Banco Santander, S.A.***, along with a number of subsidiaries, initiated a number of combined exchange offers covering 22 of the group's euro, pounds sterling and yen denominated Tier 1 hybrid securities and upper Tier 2 securities with a nominal value of €5.9 billion. As most of the relevant securities were traded on a discount to their nominal value, the exchange offers resulted in a capital gain for the group, while investors benefited from receiving new securities with a market coupon, and a one-time cash premium.[71] A separate exchange offer

[70] For a description of the features of the hybrid securities issued pursuant to the exchange offer, see page 234, Chapter 12 (*Insurance Company Instruments*).

[71] For a description of the features of the hybrid securities issued pursuant to the exchange offer, see page 37, Chapter 5 (*Bank Tax Deductible Non-Operating Subsidiary Tier 1 Instruments*).

was announced in August 2009 in relation to six series of the group's US dollar denominated Tier 1 hybrid securities for new Tier 1 hybrid securities to be issued by Banco Santander. In total, the group restructured up to €9.1 billion of Tier 1 and upper Tier 2 capital in 2009.

- In April 2009, ***Barclays GBP Financing Limited***, a wholly owned subsidiary of ***Barclays Bank plc*** launched an invitation to holders of certain existing Upper Tier 2 securities issued by Barclays to offer to exchange any or all of such securities for new lower Tier 2 securities to be issued by Barclays. The existing notes comprised of the following pounds sterling denominated notes: £100 million 9 percent permanent interest bearing capital notes; £150 million 9.25 percent perpetual subordinated notes; £650 million 6.875 percent undated subordinated notes; £465 million 6.375 percent undated subordinated notes; £525 million 7.125 percent undated subordinated notes; £550 million 6.125 percent undated subordinated notes and £1 billion 8.25 percent undated subordinated notes. The new notes issued comprised pounds sterling denominated subordinated notes issued with an aggregate nominal value of £1,961,347,000. As a result of the exchange offers, Barclays announced that it expected to realise a net pre-tax gain of approximately £800 million, which enhanced the core Tier 1 capital of the group.

- In October 2009, ***BBVA International Preferred, S.A. Unipersonal*** invited holders of three series of Tier 1 securities to exchange such securities for £251,050,000 and €644,650,000 non-step-up fixed/floating rate non-cumulative perpetual preferred securities, guaranteed by ***Banco Bilbao Vizcaya Argentaria, S.A.***[72] The new securities are redeemable at the option of the issuer if the securities cease to qualify as Tier 1 capital of the banking group.

- In July 2009, ***BPCE***, the central body of ***Groupe BPCE*** announced seven separate exchange offers. Groupe BPCE was formed in August 2009 as a result of a merger between Banques Populaires and Caisse Nationale des Caisses d'Epargne. BPCE invited all holders of certain hybrid euro and US dollar denominated Tier 1 securities issued by ***Natixis S.A.***, NBP Capital Trust I and NBP Capital Trust III to exchange such securities for new BPCE securities. The new securities consist of two series of euro denominated notes and two series of US dollar denominated. The announced purpose of the exchange offers was to increase the Tier 1 capital of the banking group. The new notes are treated as Tier 1 capital for French bank regulatory purposes. At the time of the exchange offers, BPCE announced, that it expected its core Tier 1 ratio to increase by 0.2 percentage points, as a result of the offers.

- In November 2009 ***BNP Paribas*** invited holders of three series of US dollar denominated perpetual subordinated floating rate notes with a aggregate nominal value of US$1.1 billion to exchange such securities for either new perpetual

[72] For a description of the features of the hybrid securities issued pursuant to the exchange offer, see page 37, Chapter 5 (*Bank Tax Deductible Non-Operating Subsidiary Tier 1 Instruments*).

floating subordinated notes or perpetual subordinated fixed-to- floating rate notes. Holders of the existing securities also had the option of tendering such notes for cash. See *Selected 2009-2010 tender offers* below for information on the tender offer portion of this transaction.

- In September 2009, ***Citizens Republic Bancorp, Inc.*** offered to exchange up to 500,000,000 in common shares for its outstanding subordinated notes and outstanding enhanced trust preferred securities of Citizens Funding Trust I. The announced purpose of the exchange offers was stated to be to strengthen Tier 1 common equity and reduce indebtedness for borrowed money.

- In August 2009, ***Doral Financial Corporation*** offered to exchange up to 8,235,294 shares of its common stock for up to US$100,000,000 of its outstanding 4.75 percent Perpetual Cumulative Convertible Preferred Stock and solicited proxies for certain amendments to the preferred stock's certificate of designation resulting in US$52,200,000 of stock exchanged. The transaction increased Doral Financial's Tier 1 common capital to risk weighted assets by 85 bps and tangible common equity to tangible assets by 52 bps. In February 2010, Doral Financial Corporation launched a follow on offer to exchange up to 16,500,000 shares of its common stock for its outstanding 7.00 percent Non-cumulative Monthly Income Preferred Stock, Series A, 8.35 percent Non-cumulative Monthly Income Preferred Stock, Series B, 7.25 percent Non-cumulative Monthly Income Preferred Stock, Series C, and remaining 4.75 percent Perpetual Cumulative Convertible Preferred Stock.

- In May 2009, ***Friends Provident plc*** invited holders of its £300 million step-up Tier 1 capital securities and £500 million step-up Tier 1 capital securities to offer to exchange such hybrid securities for £300 million subordinated notes. The rationale for the exchange offer was to strengthen the capital position of the group in advance of its demerger with F&C Asset Management plc. The exchange was popular with investors and the issuer increased the amount of existing securities which could be accepted for exchange above the target exchange amount.

- In February 2010, ***GE Capital Trust I,*** a Delaware trust established by ***General Electric Capital Corporation***, a savings and loan holding company, which is not subject to minimum capital requirements, launched an offer to exchange US$2.5 billion fixed-to-floating rate of its cumulative trust preferred securities for outstanding fixed-to-floating rate subordinated debentures issued by General Electric Capital Corporation. The exchange offer was premised on the belief that marketplace participants would view the trust preferred securities as a favorable component of the capital structure of the corporation.

- In November 2009, various subsidiaries of ***Lloyds Banking Group plc*** launched an exchange offer as part of a wider package of proposals (which included a £13.5 billion rights issue), whereby the group aimed to generate at least £7.5 billion in core Tier 1 and/or nominal value of contingent core Tier 1 capital. The holders of the existing target securities (comprising 52 series of upper Tier 2 securities in an

aggregate principal amount of £2.52 billion, innovative Tier 1 securities in an aggregate principal amount of £7.68 billion and preference shares or equivalents with an aggregate liquidation preference of £4.09 billion) were invited to exchange their securities for certain ECNs which are treated as lower Tier 2 capital but which will be automatically convertible into ordinary shares of Lloyds Banking Group plc if the published consolidated core Tier 1 capital ratio of the group falls to less than 5 percent.[73] The ECNs have a ten-year term and pay fixed, non-deferrable interest.

A separate exchange offer was conducted with respect to the United States in relation to six series of outstanding upper Tier 2 securities.

- In January 2009, ***Lloyds TSB*** launched the then largest capital exchange offer ever undertaken by a European financial institution. The basis of the transaction was the exchange of a number of existing Upper Tier 2 debt securities issued by Lloyds TSB and Bank of Scotland for three new series of innovative Tier 1 securities issued by Lloyds TSB Bank. The exchange offer was conditional on achieving a minimum threshold for each new series of innovative Tier 1 securities and the completion of the acquisition of HBOS by Lloyds TSB. Approximately 75 percent of eligible Upper Tier 2 securities were exchanged creating additional higher quality regulatory capital for Lloyds TSB, without the need to source new investors in the public markets. The transaction also succeeded in removing a number of smaller, illiquid securities and replacing them with fewer more liquid securities. Securities not tendered for exchange pursuant to this transaction were included in the March 2009 exchange offer by Lloyds TSB referred to below.

  In March 2009, ***Lloyds TSB*** invited holders of certain upper Tier 2 securities to exchange any or all of their existing securities, valued at more than £7.5 billion into senior unsecured debt. Lloyds TSB exchanged the securities for 45 to 80 percent of face value in a transaction designed to create additional Tier 1 capital. The transaction consisted of two separate exchange offers: (i) phase 1, a voluntary offer to exchange selected pounds sterling and euro denominated existing notes and (ii) phase 2, a voluntary offer to exchange two series of euro denominated existing notes and selected US dollar denominated existing notes.

- In August 2009, ***Popular, Inc.*** offered to exchange up to 390,000,000 newly issued common stock for all outstanding trust preferred securities of various Delaware statutory trusts and for all outstanding preferred stock of the issuer. The announced purpose of the exchange offers was to increase the Tier 1 common equity of the group by approximately US$1.1 billion.

- In May 2009, ***Rabobank Nederland*** invited holders of two series of US dollar denominated trust preferred securities, with an aggregate outstanding principal value of US$3.25 billion, to exchange such securities for US dollar denominated

[73] For a description of the features of the hybrid securities issued pursuant to the exchange offer, see page 227, Chapter 11 (*Bank Contingent Capital Instruments*).

fixed to floating rate perpetual (callable in 10 years) noncumulative capital securities, with the aim of further strengthening the Tier 1 capital base of Rabobank Nederland. Approximately, 52.2 percent of eligible hybrid capital securities were tendered for exchange. The terms of the exchange offers allowed Rabobank Nederland to enhance its Tier 1 capital by issuing additional new capital securities for cash during the exchange offers. On June 18, 2009, US$3,612,000 fixed to floating rare perpetual additional capital securities were consolidated with the US$2,868,297,000 securities offered pursuant to the exchange offers.

- In June 2009, ***Regions Financial Corporation, Inc.*** invited holders of trust preferred securities of Regions Financing Trust II to exchange such securities for common stock of Regions Financial Corporation, Inc. The exchange offer was part of a wider package of measures aimed to increase the issuer's Tier 1 common equity by US$2.5 billion, of which at least US$400 million would be new Tier 1 equity.

- In January 2010, ***Banco Santander, S.A.,*** invited holders of perpetual subordinated notes issued by amongst other Abbey National plc to tender such securities for purchase by Banco Santander.

  In February 2010, ***Banco Santander, S.A.,*** invited holders of perpetual subordinated notes issued by Santander Perpetual, S.A.U. for a total nominal amount of US$1,500 million (of which Banco Santander held approximately US$350 million) to tender any or all of the securities for purchase by Banco Santander for cash. The aggregate nominal amount of securities accepted for purchase was approximately US$ 1,092.55 million, representing 95 percent of the outstanding notes not held by Santander.

- In June 2009, ***Bank of Ireland*** invited holders of 4 series of certain euro and pounds sterling denominated perpetual preferred securities to tender such securities for cash. The tender offer consisted of €600,000,000 7.40 percent Guaranteed Step-up Callable Perpetual Preferred Securities issued by ***Bank of Ireland UK Holdings plc***, €600,000,000 Fixed Rate/Variable Rate Guaranteed Non-voting Non-cumulative Perpetual Preferred Securities issued by BOI Capital Funding (No.1) LP, £350,000,000 6.25 percent Guaranteed Callable Perpetual Preferred Securities issued by Bank of Ireland UK Holdings plc £500,000,000 Fixed Rate/Floating Rate Guaranteed Non-voting Non-cumulative Perpetual Preferred Securities issued by ***BOI Capital Funding (No. 4) LP***. 50 percent of the €600,000,000 7.40 percent Guaranteed Step-up Callable Perpetual Preferred Securities tendered were accepted. All other securities were accepted in full. The announced purpose of the transaction was to increase the equity accretion of the group.

- In November 2009, **BNP Paribas** invited holders of three series of US dollar denominated perpetual subordinated floating rate notes with a aggregate nominal value of US$1.1 billion to tender such notes for cash.

- In September 2009, ***KBC Bank*** announced two tender offers in relation to three series of US dollar and euro denominated noncumulative guaranteed trust preferred securities of ***KBC Bank Funding Trust III*** and £525 million directly issued Tier 1 perpetual debt securities of KBC Bank. The tender offers were made in order to create additional core Tier 1 capital in the capital structure of KBC Bank and the group.

- In July 2009, ***National Australia Bank Limited*** invited holders of US$250 million perpetual subordinated floating rate notes to tender such notes for cash. The purchase price pursuant to the tender offer was US$6,250 per US$10,000 in principal amount of the notes accepted by National Australia Bank Limited. The announced purpose of the tender offer was to assist the banking group in managing its liability and capital. Following the expiration of the tender offer, National Australia Bank Limited accepted for purchase US$82,500,000 in aggregate principal amount of the notes.

- In March 2009, ***RBS Financing Limited***, a subsidiary of ***The Royal Bank of Scotland*** launched a cash tender offer for any and all of the outstanding securities of multiple series of US dollar and euro denominated hybrid capital and subordinated debt securities issued by The Royal Bank of Scotland and certain of its affiliates between July 1985 and September 2007. Simultaneously, The Royal Bank of Scotland launched an offer to exchange multiple series of pounds sterling denominated subordinated debt securities issued by The Royal Bank of Scotland and its affiliates for pounds sterling denominated senior unsecured debt securities issued by The Royal Bank of Scotland plc. The announced purpose of the transaction was to create additional core Tier 1 capital in the capital structure of the group and to further strengthen the quality of the group's capital base.

- In March 2009, ***UBS*** announced a cash tender offer relating to four series of its lower Tier 2 securities. The four subordinated notes targeted in the transaction traded at a significant discount to their original issuance price at the time of the tender offer announcement and the announced purpose of the transaction was to realize a pre-tax gain by purchasing and cancelling the securities for less than par, thereby increasing UBS's core Tier 1 ratio.

- In January 2010, ***Unicredit Bank AG*** (formerly, HypoVereinsbank AG) announced separate cash tender offers for certain pounds sterling, euro and US dollar denominated hybrid Tier 1 non-cumulative trust preferred securities and non-cumulative dated silent partnership certificates issued by various Delaware trust issuing entities. The announced purpose of the tender offers was to support the bank's strategy of optimizing its capital structure.

APPENDIX A

BASEL COMMITTEE AND US REGULATORY INNOVATIVE TIER 1 CAPITAL REQUIREMENTS

APPENDIX A

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SAN FRANCISCO
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FOUNDED 1866

March 2010

BASEL COMMITTEE AND US REGULATORY INNOVATIVE TIER 1 CAPITAL REQUIREMENTS

Capital has long been a matter of fundamental importance to financial institutions. A strong capital position gives a financial institution the credibility needed to raise money from lenders, depositors and investors and pursue new business opportunities. From a regulatory standpoint, a bank's capital position dictates the levels of permissible loans to a single borrower,[1] investment in bank properties,[2] and the extent of its banking and nonbanking activities.[3] It is therefore absolutely essential for a financial institution to maintain a satisfactory capital position in order to meet the challenges and exploit the opportunities of today's expanding financial services environment.

Prior to the global financial crisis, innovative Tier 1 capital instruments, including trust and real estate investment trusts or "REIT" preferred securities, were a particularly attractive alternative for US financial institutions in meeting regulatory capital requirements. This was primarily because of their hybrid nature – trust preferred securities are considered equity for regulatory capital purposes while considered debt for tax purposes and REIT preferred securities provide the parent with the ability to pay preferred dividends in pre-tax dollars.

As a result of the global financial crisis, banking regulators are more focused on tangible common equity as a measure of a financial institution's financial strength. Consistent with this focus, in December 2009 the Basel Committee published two consultative documents, colloquially referred to as Basel III which, among other things, call for innovative capital instruments, such as US-style trust preferred securities, to be phased out as Tier 1 capital. The United States bank regulatory agencies are reviewing, but have not yet publicly announced their views on, the Basel III proposals, including the extent to which affected innovative capital instruments will be grandfathered if such proposals are finalized and are subsequently

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1 See, *e.g.*, 12 USC. § 84; 12 C.F.R. § 32.3 (national bank lending limits).

2 See, *e.g.*, N.Y. Banking Law § 235(9)(a)(1) (limiting state savings bank investment in real property used for banking activities to 5 percent of the assets of the savings bank).

3 Pursuant to the Gramm-Leach-Bliley Act, a bank holding company must keep its subsidiary depository institutions "well-capitalized" in order to qualify as a financial holding company and engage in permissible nonbanking activities. 12 USC. § 1843(l).

implemented in the United States. Banking institutions that are considering issuing such instruments should closely monitor the progress of the Basel III proposals.

This memorandum discusses Basel and US regulatory requirements pertaining to innovative Tier 1 capital instruments. Part I briefly explains the requirements of the capital adequacy guidelines, as currently implemented by the Basel Committee on Banking Supervision ("Basel Committee") and followed by G-10 central banks, including the US federal banking regulators. Part I concludes with some observations on the Basel II changes to these guidelines and the Basel III proposals. Part II reviews the current Basel and US regulatory guidelines applicable to innovative Tier 1 capital instruments.

I. Capital Adequacy Guidelines

The Federal Reserve Board ("FRB"), the Office of the Comptroller of the Currency ("OCC"), the Federal Deposit Insurance Corporation ("FDIC"), and the Office of Thrift Supervision ("OTS") (the "Agencies") have all adopted risk-based capital guidelines[4] primarily based upon the risk-based capital adequacy framework adopted by the Basel Committee in 1988 (the "1988 Basel Accord or "Basel I") (see Part II below).[5]

With minor differences among the guidelines promulgated by the federal bank regulators, all four guidelines incorporate a uniform method of evaluating the capital adequacy of a banking organization.[6] Determining whether a banking organization's risk-based capital ratio complies with the guidelines merely requires that its qualifying total capital be divided by its risk-weighted assets.

Qualifying total capital for banks and bank holding companies ("BHCs") (including financial holding companies) consists of both Tier 1 or core capital (shareholders' equity, retained earnings, noncumulative perpetual preferred stock and minority interests in the equity accounts of consolidated subsidiaries) and Tier 2 or supplementary capital (loan loss reserves, cumulative perpetual preferred stock, hybrid capital instruments including certain mandatory convertible debt, term subordinated debt and intermediate-term preferred stock having an original weighted average maturity of at least five years). For BHCs, qualifying Tier 1 capital also includes certain cumulative perpetual preferred stock, as described below (see Part III.A).

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4 The FRB's capital guidelines apply to state-chartered banks that are members of the Federal Reserve System (state member banks) and bank holding companies (including financial holding companies) on a consolidated basis. See 12 C.F.R. pt. 208 (Appendix A); 12 C.F.R. pt. 225 (Appendix A). The OCC capital guidelines apply to national banks and are similar to the Reserve Board's guidelines. See 12 C.F.R. pt. 3 (Appendix A). The FDIC's capital guidelines apply to FDIC-insured state-chartered banks that are not members of the Federal Reserve System (state nonmember banks). See 12 C.F.R. pt. 325. The OTS's capital adequacy guidelines apply to federally-chartered savings associations. See 12 C.F.R. § 567.5.

5 For the text of the 1998 Basel Accord, see http://www.bis.org/publ/bcbsc111.htm.

6 See Exhibit A for a description of variations in capital treatment of preferred securities by the federal bank regulators.

The second step in calculating a banking organization's risk-based capital ratio is to determine the value of the bank's risk-weighted assets. Under Basel I-based rules, this requires calculating the risk-weighted value of both on-and-off-balance sheet items. Depending upon the credit risk of the obligor, the type of collateral involved, if any, and whether there is a guarantor, a bank asset may be assigned to one of four broad risk categories: 0 percent, 20 percent, 50 percent and 100 percent.[7] A bank's off-balance-sheet items are first multiplied by one of four credit conversion factors – 0 percent, 20 percent, 50 percent or 100 percent – before being assigned to an appropriate risk-weight category.[8] Failure by a banking organization to maintain compliance with the applicable guidelines could qualify as an unsafe and unsound banking practice and result in the appropriate federal banking agency placing restraints on its operations.

In the years since Basel I, innovations in financial products and services and advances in risk measurement and management practices have led to the adoption by the Basel Committee in June 2004 of a more risk-sensitive capital adequacy framework entitled: "International Convergence of Capital Measurement and Capital Standards: A Revised Framework" ("Basel II"). Basel II is comprised of three mutually reinforcing "pillars:" minimum regulatory capital requirements (pillar 1), supervisory review (pillar 2), and market discipline through enhanced public disclosure (pillar 3). Pillar 1 modifies the Basel I definition of risk-weighted assets by requiring a banking institution to calculate capital requirements for exposure to both credit risk and operational risk (and market risk for institutions with significant trading activity).[9] For both credit and operational risk, Basel II provides several methodologies for determining risk-based capital requirements. For credit risk, there are (1) the standardized approach (a modified Basel I framework) and (2) two internal ratings-based approaches which uses an institution's internal estimates of key risk parameters for exposures in combination with specified risk-based capital formulas: (a) the foundation IRB approach which uses risk parameters that are provided partly by supervisors and partly by the institutions and (b) the advanced IRB approach which allows institutions to provide all of the risk parameters. For operational risk, there are the basic indicator approach, the standardized approach and the advanced measurement approach.

In December 2007, the US federal bank regulators issued a final rule for banks implementing the advanced IRB approach for credit risk and the advance measurement approach for operational risk (the "advanced approaches") under Basel II (the "Basel II Final Rule").[10]

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7 Basel II (see item II.D. below) requires that loans considered past-due be risk weighted at 150 percent, unless a threshold amount of specific provisions has already been set aside by the bank against the past-due loan and introduces, among other things, a new 10 percent risk category for certain on-balance sheet items.

8 Basel II (see item II. D. below) purports to change the calculation of risk weights for banks' assets and introduces the concept of "operational risk" into the capital adequacy ratio.

9 Basel II does not change the definition of what qualifies as regulatory capital, the minimum risk-based capital ratio, or the methodology for determining capital charges for market risk. Basel II only changes the definition of risk-weighted assets.

10 The FRB's capital adequacy guidelines for state member banks and bank holding companies applying the advanced approaches are found in 12 C.F.R. pt. 208 (Appendix F) and 12 C.F.R. pt. 225 (Appendix G), respectively. The OCC capital adequacy guidelines for national banks applying the advanced approaches

The Basel II Final Rule is mandatory for "core banks" (*i.e.*, large, internationally active banking organizations with at least US$250 billion in total consolidated assets or at least US$10 billion in foreign exposure) ("Core Banks"). Non-core banks may voluntarily adopt the advanced approaches under the Basel II Final Rule if they meet the qualifying criteria. Banks that do not adopt the Basel II Final Rule remain subject to the general risk-based capital rules based on Basel I. More recently in June 2008, as an optional alternative to the Basel I-based general risk-based capital rules, the US federal bank regulators issued a proposed rule which would implement a standardized risk-based capital framework based on Basel II's standardized approach for credit risk and the basic indicator approach for operational risk (the "Basel II Standardized NPR").

On September 3, 2009, the US Treasury Department issued a policy statement (the "Policy Statement") entitled "Principles for Reforming the US and International Regulatory Capital Framework for Banking Firms," which contemplates changes to the existing United States regulatory capital regime that would involve substantial revisions of major parts of the Basel I and Basel II frameworks.[11] The contemplated changes are driven in part by the recent financial crisis, including the fact that many of the firms that failed or required extraordinary government assistance during the crisis qualified as "well capitalized" under the existing capital regime. Among other things, the Policy Statement calls for stronger capital requirements for all banking firms and suggests that changes in the regulatory capital framework be phased in over several years. The recommended schedule provides for a comprehensive international agreement by December 31, 2010, with implementation by December 31, 2012.

On December 17, 2009, the Basel Committee issued two consultative documents which are sometimes referred to as Basel III, that propose significant reforms to bank capital and liquidity requirements, similar, in some respects to those contemplated by the US Treasury Department in the Policy Statement.[12] The capital proposals would, among other things, (i) emphasize that common equity should be the predominant component of Tier 1 capital by (A) adding a minimum common equity to risk-weighted assets ratio and (B) requiring goodwill, general intangibles and certain other items, which currently must be deducted from Tier 1 capital, instead to be deducted from common equity as a component of Tier 1 capital; (ii) disqualify from Tier 1 status certain innovative capital instruments – including US-style trust preferred securities, and other instruments (such as cumulative perpetual preferred stock) that pay cumulative dividends or have certain other features, (iii) strengthen the risk coverage of the

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are found in 12 C.F.R. pt. 3 (Appendix C). The FDIC's capital adequacy guidelines for FDIC-insured state-chartered banks that are not members of the Federal Reserve System (state non-member banks) applying the advanced approaches are found in 12 C.F.R. pt. 325 (Appendix D). The OTS's capital adequacy guidelines for federally-chartered savings associations applying the advanced approaches are found in 12 C.F.R. pt. 567 (Appendix C).

11 Available at http://www.treas.gov/press/releases/docs/capital-statement_090309.pdf.

12 The text of the consultative documents is available at http://www.bis.org/publ/bcbs164.pdf and http://www.bis.org/publ/bcbs165.pdf.

capital framework, particularly as regards counterparty risk exposures that arise from derivatives, repos and securities financing activities; (iv) introduce a non-risk adjusted leverage ratio requirement as an international standard; and (v) introduce measures to promote the build up of capital buffers in good times that can be drawn upon in times of stress. The capital proposals do not specify a percentage for the new ratio of common equity to risk-weighted assets. They also leave open the possibility that the Basel Committee will recommend changes to the minimum Tier 1 capital and total capital ratios, which are currently 4% and 8% respectively.

The liquidity proposals have three main features, including implementation of (i) a "liquidity coverage ratio" which is designed to ensure that a bank maintains an adequate level of unencumbered, high-quality assets sufficient to meet the bank's liquidity needs over a 30-day time horizon under an acute liquidity stress scenario, (ii) a "net stable funding ratio" designed to promote more medium- and long-term funding of the assets and activities of banks over a one-year time horizon, and (iii) a set of monitoring tools that the Basel Committee states should be considered as the minimum types of information that banks should report to supervisors.

Comments on the capital and liquidity proposals are due by April 16, 2010. The Basel Committee stated that it expects that it will release a comprehensive set of final provisions by December 31, 2010 and that the final provisions will be implemented by December 31, 2012. Ultimate implementation of the final provisions in each country, including the United States, will be subject to the discretion of the bank regulators in such country, and any implementing regulations may differ from such final provisions.

II. The Basel Capital Accord and Treatment of Innovative Capital Instruments

A. Brief History

The 1988 Basel Accord went into effect in March 1989 for all G-10 countries,[13] and required banks to maintain capital equal to 8 percent of "risk-adjusted assets" by the end of 1992. The major impetus for Basel I was the concern that the capital of the world's major banks had become dangerously low after persistent erosion through competition. Therefore, the goals of Basel I were to tailor regulatory capital adequacy requirements to the risk inherent in a bank's portfolio and to create incentives to hold more low-risk assets. Further, Basel I sought to remove competitive inequalities in international banking which would result from different countries imposing different regulatory capital standards.

The keystone of Basel I was its explicit link between a bank's level of risk and the amount of capital Basel I required it to maintain. Among other things, Basel I set forth the

[13] Group of Ten (G-10) countries include Belgium, Canada, France, Germany, Italy, the Netherlands, Japan, Sweden, Switzerland, the UK, and the US. Switzerland became a full member in 1984, bringing the group to eleven members. The G-10 countries plus Luxembourg and Spain comprise the Basel Committee which issues the Basel Accords.

constituents of "capital" and adopted a portfolio approach measure of risk associated with bank assets (as discussed above).

For the first time, capital was divided into Tier 1 or core capital and Tier 2 or supplementary capital. Tier 1 capital was initially comprised of permanent shareholders' equity (common stock and perpetual non-cumulative preference shares) and disclosed reserves (created or increased by appropriations of retained earnings or other surplus, *e.g.*, share premiums, retained profit, general reserves and legal reserves). In the case of consolidated accounts, this also included minority interests in the equity of subsidiaries which are less than wholly owned. This basic definition of capital excluded cumulative preference shares.

Under Basel I, Tier 2 capital was comprised of:

(1) undisclosed reserves consisting of that part of the accumulated after-tax surplus of retained profits which banks in some countries may be permitted to maintain;

(2) loan-loss reserves held against future, presently unidentified losses;

(3) hybrid capital instruments, including cumulative preferred shares;[14] and

(4) subordinated term debt.

Basel I has been supplemented a number of times, with most changes dealing with the treatment of off-balance-sheet activities. A significant amendment was enacted in October 1996, when the Basel Committee introduced a measure whereby trading positions in bonds, equities, foreign exchange and commodities were removed from the credit risk framework and given explicit capital charges related to the bank's open position in each instrument.

B. 1998 Basel Release

A major amendment relating to the definition of "Tier 1 capital" came after a long battle between bankers and bank regulators in October 1998, when the Basel Committee announced it would accept certain types of synthetic hybrid instruments as Tier 1 capital for the first time. In the October 1998 release, the Basel Committee announced that it would consider it acceptable

[14] According to Basel I, such instruments had to meet the following requirements: (1) unsecured, subordinated and fully paid-up; (2) not redeemable at the initiative of the holder or without the prior consent of the supervisory authority; (3) available to participate in losses without the bank being obliged to cease trading (unlike conventional subordinated debt); and (4) although the capital instrument may carry an obligation to pay interest that cannot permanently be reduced or waived (unlike dividends on ordinary shareholders' equity), it should allow service obligations to be deferred (as with cumulative preference shares) where the profitability of the bank would not support payment.

for banks to issue certain "innovative capital instruments," which the Committee limited to 15 percent of Tier 1 capital.[15]

The primary impetus for the 1998 release was a 1996 decision of the FRB that allowed bank holding companies (which are not subject to the Basel guidelines) to issue trust preferred securities for Tier 1 capital (see Part III.A). Since banking groups in most other G-10 countries were not part of bank holding company structures, the Basel Committee's hand was pushed to change its rules for the sake of a level playing field.

In order to protect the integrity of Tier 1 capital, the Basel Committee determined that minority interests in equity accounts of consolidated subsidiaries that take the form of special purposes vehicles ("SPVs") should only be included in Tier 1 capital if the underlying instruments have the equity-like characteristics of being:

- issued and fully paid;
- noncumulative;
- able to absorb losses within the bank on a going-concern basis;
- junior to depositors, general creditors and subordinated debt of the bank;
- permanent;
- neither secured nor covered by a guarantee of the issuer or related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis bank creditors; and
- callable at the initiative of the issuer only after a minimum of five years with supervisory approval and under the condition that it will be replaced with capital of same or better quality unless the supervisor determines that the bank has capital that is more than adequate to its risks.

In addition, to qualify as a Tier 1 instrument the following conditions also must be fulfilled:

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[15] For the October 1998 release, see http://www.bis.org/press Basel II clarifies the calculation of the 15 percent limitation on innovative instruments by (1) requiring that Tier 1 capital be construed net of good will, and (2) requiring that in determining the allowable amount of innovative instruments, banking institutions and their supervisors should multiply the amount of non-innovative Tier I by 17.65 percent.

- the main features of such instruments must be easily understood and publicly disclosed;

- proceeds must be immediately available without limitation to the issuing bank, or if proceeds are immediately and fully available only to the issuing SPV, they must be made available to the bank (*e.g.*, through conversion into a direct issuance of the bank that is of higher quality or of the same quality at the same terms) at a predetermined trigger point, well before serious deterioration in the bank's financial position;

- the bank must have discretion over the amount and timing of distributions on the instrument, subject only to prior waiver of distributions on the bank's common stock, and banks must have full access to waived distributions; and

- distributions can only be paid out of distributable items, and where distributions are pre-set, they may not be reset based on the credit standing of the issuer.

According to the 1998 Basel release, moderate step-ups in instruments issued through SPVs are permitted, in conjunction with a call option, only if the moderate step-up occurs at a minimum of ten years after the issue date and if it results in an increase over the initial rate that is no greater than, at national supervisory discretion, either: (i) 100 basis points, less the swap spread between the initial index basis and the stepped-up index basis; or (ii) 50 percent of the initial credit spread, less the swap spread between the initial index basis and the stepped-up index basis.

The terms of the instrument should provide for no more than one rate step-up over the life of the instrument. The swap spread should be fixed as of the pricing date and reflect the differential in pricing on that date between the initial reference security or rate and the stepped-up reference security or rate.

The Basel Committee has left it up to the individual central banks to determine how to implement the general ruling and indicate what, exactly, is to be included in the 15 percent basket. For instance, there is enough leeway in the Basel Committee's statement for any non-common stock instruments to be included in the 15 percent basket because the announcement does not explicitly state whether the 15 percent limit refers to all forms of SPVs, to dated or callable instruments or to step-ups.

C. Disclosure Guidelines

On January 18, 2000, the Basel Committee issued a paper proposing guidelines for the disclosures which banks should make to advance the role of market discipline in promoting bank capital adequacy. The three areas of proposed disclosure were (i) structure of capital, (ii) risk exposures and (iii) capital adequacy. Among the Basel Committee's recommendations were that banks should publicly disclose summary information about investments in innovative, complex, and hybrid capital instruments at least annually, because the characteristics of such instruments

may have a significant impact on the market's assessment of the strength and integrity of a bank's capital.

As discussed below, the FRB has approved trust preferred securities as Tier 1 capital for bank holding companies subject to certain limitations. The OCC was the first federal banking agency to follow the Basel Committee's 1998 release, when it approved a capital securities arrangement involving LLC preferred securities for national banks in October 2000 and another involving trust preferred securities for national banks in December 2000.

D. Basel II

In the years since Basel I introduced an unprecedented degree of conformity to the international banking regulatory world, a number of dramatic developments in areas of globalization, technology, and innovation have occurred. These developments have led to a world financial system that is far more complex than that addressed by Basel I. Indeed, the increasing complexity has led to the realization that Basel I is insufficiently structured to address recent developments in financial products, advances in risk measurement and management practices, or precisely assess capital charges in relation to risk.[16]

In June 2004, the Basel Committee issued Basel II. A "comprehensive version" of the text was published in June 2006. Basel II is composed of three mutually reinforcing "pillars:" minimum regulatory capital requirements, supervisory review, and market discipline. The Basel Committee intends that the interplay between these pillars will: continue to promote safety and soundness and at least maintain the current overall level of capital in the world financial system; continue to enhance competitive equality; establish a more comprehensive approach to address risk; contain approaches to capital adequacy that are appropriately sensitive to risk; and focus on internationally active banks (although its underlying principles should be suitable for application to all banking organizations).

Pillar 1 modifies the Basel I definition of risk-weighted assets by requiring a banking institution to calculate capital requirements for exposure to both credit risk and operational risk (and market risk for institutions with significant trading activity). Basel II does not change the definition of what qualifies as regulatory capital, the minimum risk-based capital ratio, or the methodology for determining capital charges for market risk. Basel II only changes the definition of risk-weighted assets.

Credit risk is calculated either according to the standardized approach (which is essentially a set of modifications to the Basel I requirements) or the internal ratings-based ("IRB") approach (which relies on a banking institution's internal estimates of key risk drivers to derive capital requirements). The IRB approach is further divided between two IRB

[16] OCC, FRB, FDIC, OTS, Joint Request for Comment on Risk-Based Capital Guidelines; Implementation of the New Basel Accord, Aug. 4, 2003; See also, FRB Speech, Ferguson, Concerns and Considerations for the Practical Implementation of the New Basel Accord, Dec. 2, 2003.

methodologies: the Foundation IRB Approach and the Advanced IRB Approach. The Foundation IRB Approach relies upon both the input of certain risk components by supervisors and other risk components provided by the banking institutions. The Advanced IRB Approach relies more upon the banking institutions for the input of risk components. In each case the inputs are organized according to formula designed to translate the risk inputs into specific capital requirements. A banking institution will be allowed to use the standardized approach or either the Foundation IRB Approach or the Advanced IRB Approach depending on its level of sophistication, with smaller, less sophisticated institutions being allowed to use only the standardized approach.

Operational risk is a new concept introduced by Basel II. Basel II defines operational risk as the risk of losses resulting from inadequate or failed internal processes, people and systems, or external events. Operational Risk is calculated according to one of three different methodologies: the Basic Indicator Approach, the Standardized Approach and the Advanced Measurement Approach. The Basic Indicator Approach arrives at its capital requirement by multiplying a bank's average annual gross income over the past three years by a factor of 0.15. The Standardized Approach calculates capital requirements for each of a banking institutions' business lines by multiplying the banking institution's gross income by factors determined by the Basel Committee. Thus, under the Standardized Approach a banking institution's total operational risk capital requirement is the summation of each of the banking institution's business lines capital requirements. The Advanced Measurement Approach ("AMA") allows banking institutions to use their own comprehensive and systematic method for assessing their exposure to operational risk.[17] A banking institution may, however, use a combination of AMA and either the Basic Indicator Approach or the Standardized Approach for different parts of its operations so long as the combination effectively accounts for all material risks of a banking institution on a global, consolidated basis.

Pillar 2 focuses on supervisory review. Basel II seeks to address the need for banks to assess their capital adequacy positions relative to their overall risk position. Currently risk and capital adequacy are judged by reference to a banking institution's compliance with its minimum capital requirements. Basel II wants supervisors to play an active role in a comprehensive assessment of a banking institution's capital adequacy levels and take appropriate actions when shortcomings are detected. A comprehensive supervisory review process will also act as a check against the inevitable lag that regulation suffers in the face of the ever changing risk profiles of complex banking institutions.

Pillar 3 seeks to complement the substantive regulations and supervisory oversight of Pillars 1 and 2 by addressing market discipline through the development of a set of disclosure requirements. The disclosure requirements are designed to allow market participants to assess

[17] Banking Institutions relying upon the Basic Indicator Approach or the Standardized Approach to calculate their operational risk are foreclosed from recognizing any risk mitigation provided by insurance. However, the banking institutions relying upon AMA may do so subject to certain conditions.

key information about a banking institution's risk profile and level of capitalization.[18] Pillar 3 contemplates a series of qualitative and quantitative disclosures that cover the following aspects of a given banking institution:

- scope of application: Pillar 3 applies to the top consolidated level of the banking institution in question;
- capital structure: covers the amounts of Tier 1, Tier 2 and Tier 3 capital;
- capital adequacy: covers the capital requirements of the various risk calculations;
- credit risk: general disclosures;
- credit risk for portfolios subject to the standardized approach;
- credit risk for portfolios subject to IRB approaches;
- equities: disclosures for banking book positions;
- credit risk mitigation: disclosures for standardized and IRB approaches;
- securitization: disclosure for standardized and IRB approaches;
- market risk: disclosures for banking institutions using the standardized approach;
- market risk: disclosures for banking institutions using the internal models approach for trading portfolios;
- operational risk;
- equity risk: disclosures for banking book positions; and
- interest rate risk in the banking book.

In July 2009, the Basel Committee issued three new releases aimed at strengthening the Basel II capital framework. The enhancements aim to ensure that the risks inherent in banks' portfolios related to trading activities, securitizations and exposures to off balance sheet vehicles are better reflected in minimum capital requirements, risk management practices and accompanying disclosures to the public. The changes address: (i) trading book exposures, including securitizations and complex and illiquid credit products; (ii) "resecuritizations" (e.g., collateralized debt obligations of ABS); and (iii) heightened Pillar 3 disclosures for

[18] Basel II is cognizant of the need to coordinate with national accounting standards in order to avoid conflicts with any broader accounting disclosure standards with which a banking institution must comply.

securitizations and sponsorship of off balance sheet vehicles. The changes should be implemented no later than December 31, 2010. The Committee also agreed to keep in place the Basel I capital floors beyond the end of 2009.

In the United States, there have been significant developments in the implementation of Basel II. In 2003, the US banking regulators issued a joint request for comment concerning Basel II's risk based capital guidelines and the manner of Basel II's implementation in the United States.[19] The request for comment followed congressional hearings before the House Committee on Financial Services and analysis of Basel II by the various US banking regulators. The House Committee, the regulators and many commentators have voiced several concerns about Basel II including the following:[20]

- that a comprehensive application of Basel II would have negative impacts on the competitive structure of the US dual banking system;
- Basel II's allowance for large banking institutions to reduce their capital reserves may result in a significant decrease in the aggregate level of capital in the US banking system;
- that Basel II's Pillar I approach to operational risk may be impossible to implement because the assessment of operational risk requires a degree subjective judgment resistant to accurate quantification;
- Basel II is overly complex; and
- Basel II's complexity would increase regulatory arbitrage opportunities because sophisticated regulatory regimes with strong resources would only be likely to adequately supervise Basel II's requirements.

Despite these initial concerns, after several years of collaboration and release of proposed rules for comment, the Agencies issued a final rule on December 7, 2007 (the "Basel II Final Rule") setting forth a new risk-based regulatory capital framework for US banks based on Basel II. The Basel II Final Rule is intended to produce capital requirements that are more closely aligned with actual risks than the existing general risk-based capital rules, which are based on Basel I.

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19 OCC, FRB, FDIC, OTS, Joint Request for Comment on Risk-Based Capital Guidelines; Implementation of the New Basel Accord, Aug. 4, 2003.

20 US House of Representatives, Committee on Financial Services, Comments Regarding Basel II, dated Nov. 3, 2003; FRB: Speech by Roger W. Ferguson, Jr. – Concerns and Considerations for the Practical Implementation of the New Basel Accord, dated Dec. 2, 2003; OCC: Speech by John D. Hawke, Jr., dated March 3, 2003; OTS: Testimony on Basel II Capital Accord by James E. Gilleran before the Subcommittee on Financial Institutions and Consumer Credit of the House Financial Services Committee, dated June 19, 2003.

The Basel II Final Rule is only mandatory for Core Banks. While Basel II includes several methods for calculating risk-based capital requirements, the Core Banks are required to use the advanced internal ratings-based approach to determine credit risk and the advanced measurement approach to determine operational risk. Other banks may voluntarily decide to adopt the advance approaches ("Opt-In Banks"). The term "banks" include banks, savings associations and bank holding companies. Both Core Banks and Opt-In Banks must first meet certain qualification requirements to the satisfaction of their primary regulators before they can apply the advanced approaches.

The Basel II Final Rule maintains the current Basel I minimum risk-based capital ratio requirements; the elements of Tier 1 and Tier 2 capital also generally remain unchanged. The primary difference is in the methodologies used to calculate risk-weighted assets. Under the Basel II Final Rule, banks would generally use their internal risk measurement systems to determine the inputs for calculating the risk-weighted asset amounts for (1) general credit risk (includes wholesale and retail exposures), (2) securitization exposures, (3) equity exposures, and (4) operational risk. However, in some cases, the bank must use external ratings or supervisory risk weights for risk-weighted asset amounts. Banks are also subject to a supervisory review process under Pillar 2 and certain disclosure requirements under Pillar 3.

The Basel II Final Rule adopts a number of safeguards, including the requirement that a bank satisfactorily complete at least a four consecutive calendar-quarter parallel run period, beginning no sooner than January 1, 2008, before operating under the Basel II framework. Following a successful parallel run, a bank would progress through three transitional periods, each lasting at least one year during which there would be floors on potential declines in risk-based capital requirements relative to the current rules under Basel I (5 percent during the first period, 10 percent during the second period and 15 percent during the third period). The Basel II Final Rule also retains the existing leverage ratio and prompt correction action (PCA) requirements. Therefore, during the transitional floor periods, a bank would report five regulatory capital ratios: two floor-adjusted risk-based capital ratios, two advanced approaches risk-based capital ratios, and one leverage ratio. A bank would need approval from its primary federal supervisor to move to each new transitional period, and at the end of the three transition periods, to fully operate under Basel II risk-based capital rules.

Since the Basel II Final Rule became effective on April 1, 2008, the Agencies have issued a joint statement on July 8, 2008, outlining the qualification process for banking organizations that are required or planning to implement the advanced approaches risk-based capital framework in the United States. The qualification process consists of three major stages: (1) adoption of an implementation plan approved by the bank's board of directors; (2) completion of a satisfactory parallel run; and (3) advancement through three distinct transitional floor periods. In addition, the statement sets forth other matters that banks may need to address with their primary Federal supervisor such as validation of bank models and systems, exemptions from the advanced approaches, mergers and acquisitions, and supervisory approval for use of specific processes or methodology.

On July 31, 2008, the Agencies published guidance on the supervisory review process for capital adequacy (*i.e.*, Pillar 2 of the Basel II advanced approaches in the Basel II Final Rule). The guidance outlines Agencies' standards in considering, among other things, whether each institution: (1) satisfies the qualification requirements for implementing the advanced approaches, (2) addresses the limitations on the minimum risk-based capital requirements for credit risk and operational risk, (3) adopts a rigorous process for assessing its overall capital adequacy in relation to risk profile and a comprehensive strategy for maintaining appropriate capital levels (internal capital adequacy assessment process or ICAAP), and (4) maintains a satisfactory risk management and control structure. As a result of the supervisory review process, a bank's primary Federal supervisor may require the bank to address identified supervisory concerns such as hold additional capital commensurate with the bank's risk profile, to modify or enhance risk-management and internal control processes, reduce the bank's risk exposure or take any other action deemed necessary by the supervisor.

For banks that do not adopt the advanced approaches, in 2006 the Agencies issued a proposed rule for public comment that proposed modifications to the general risk-based capital rules for US banks under Basel I in order to better align the capital requirements with risk (the "Basel IA NPR"). After considering the comments, the Agencies decided not to finalize the Basel IA NPR. Instead, on July 29, 2008 the Agencies published a proposed rule for public comment to implement the standardized approach for credit risk and the basic indicator approach for operational risk based on the Basel II framework (the "Basel II Standardized NPR"). Comments were due by October 27, 2008.

Generally, the Basel II Standardized NPR is consistent with the standardized approach and basic indicator approach set forth in the Basel II framework, but in some cases incorporate a more risk sensitive treatment, most notably in the treatment of residential mortgages and equity exposures. The framework under the proposed rule ("standardized framework") is optional for banks that do not use the advance approaches subject to prior written notification to their Federal primary supervisor. If these banks do not adopt the standardized framework, they may opt to remain under the general risk-based capital rules. Additionally, if these banks opt to use the standardized framework, they may return to the general risk-based capital rules but only after prior written notification to their Federal primary supervisor. As with the general risk-based capital rules for bank holding companies, small bank holding companies with total consolidated assets of less than US$500 million in assets are exempt from applying the standardized framework at the parent company level.

The Basel II Standardized NPR seeks to enhance risk sensitivity compared to Basel I without imposing undue burden on the banks. The primary difference between the Basel II Standardized NPR and the general risk-based capital rules is in the method for calculating the risk-weighted assets. Under the Basel II Standardized NPR, banks would determine risk-weighted asset amounts for general credit risk, unsettled transactions, securitization exposures, equity exposures and operational risk. Banks that use the market risk rule would factor their market risk-equivalent assets into their total risk-weighted assets. All banks would continue to be

subject to applicable tier 1 leverage ratio requirements and each depository institution would continue to be subject to prompt corrective action thresholds.

The Basel II Standardized NPR also increases the number of risk-weight categories, expands the use of external ratings, uses loan-to-value ratios to risk weight most residential mortgages to enhance the risk sensitivity of the capital requirement, provides a capital charge for operations risk using the basic indicator approach under Basel II, emphasizes the importance of a bank's assessment of its overall risk profile and capital adequacy, and provides for supervisory review of capital adequacy (Pillar 2) and market discipline through enhanced public disclosure requirements (Pillar 3).

E. Basel III

As discussed above, on December 17, 2009 the Basel Committee issued its Basel III proposals, which would effect significant reforms to bank capital requirements, with the most significant changes being changes to Tier 1 capital.

Among other things, the proposals would:

- require that Tier 1 capital consist predominantly of common equity, which the proposals generally define as common shares (and except in limited circumstances, only voting common shares) and related capital and surplus;

- emphasize such predominance requirement by adding a minimum common equity to risk-weighted asset ratio requirement and requiring that items that currently are deducted from Tier 1 capital be deducted from common equity;

- introduce a non-risk weighted leverage ratio as an international standard. Although the United States already imposes a Tier 1 leverage ratio requirement, the Basel Committee leverage ratio requirement could change the way in which the numerator or denominator of the US leverage ratio will be calculated;

- disqualify certain instruments, including non-cumulative instruments, dated instruments and instruments with step-up features from Tier 1 capital status, with the result that US-style trust preferred securities and cumulative perpetual preferred stock (which currently count as Tier 1 capital for US bank holding companies subject to certain limitations) would no longer qualify as Tier 1 capital;

- require that any shortfall in loan loss provisioning relative to expected future losses be deducted from Tier 1 capital;

- provide additional flexibility for issuing Tier 2 capital by eliminating all Tier 2 subcategories and the restriction under the current capital framework that Tier 2 capital may not exceed Tier 1 capital, with the result that there would be no limitation

on the amount of subordinated debt or trust preferred securities which could count as Tier 2 capital;

- eliminate Tier 3 capital (which is currently used to cover market risk) altogether; and

- require that investments by a bank in the capital instruments of other unconsolidated banks, financial institutions or insurance companies be deducted from the same form of capital of the investing bank.

The Basel Committee proposes to introduce these changes in a manner that does not prove disruptive for the capital instruments that are currently outstanding, *i.e.* through grandfathering provisions, although there is no clarity yet as to what those provisions would be. The Basel Committee intends to discuss specific proposals at its meeting in July 2010 on the role of contingent capital, convertible capital instruments and instruments with write-down features.

III. Current US Regulatory Treatment of Preferred Capital Instruments

A. Federal Reserve Board

1. Generally

Bank Holding Companies – Prior to April 2005

On October 21, 1996, the FRB, the federal regulator of BHCs and state member banks, approved the use of trust preferred instruments as Tier 1 regulatory capital for BHCs on the theory that they qualify as minority interests in consolidated subsidiaries. According to FRB guidelines, to be eligible as Tier 1 capital:

- the preferred securities must provide for a minimum 5 year consecutive deferral period;

- the intercompany loan must be deeply subordinated (subordinated to all subordinated debt) and have the longest feasible maturity (typically 30 years);

- the preferred securities must be redeemable only upon the approval of the FRB; and

- the amount, together with other cumulative preferred stock issued by the bank holding company, must be limited to 25 percent of the bank holding company's total Tier 1 capital.

Bank Holding Companies – After April 2005

The FRB's premise that trust preferred securities constitute minority interests in a bank holding company subsidiary was altered when, in January of 2003, the Financial Accounting Standards Board ("FASB") issued interpretation No.46 ("FIN 46") that interprets Accounting Research Bulletin No.51. FIN 46 addresses the consolidation by business enterprises of "variable interest entities" and requires companies that control another entity to consolidate the controlled entity for financial purposes. FIN 46 also implies, however, that a bank holding company's trust preferred issuing trust subsidiary should be de-consolidated from its parent for accounting purposes. This de-consolidation means that the bank holding company and its trust subsidiary have a relationship based exclusively on a debt interest. As a result of this new relationship, the junior subordinated debentures issued to the trust in a trust preferred transaction (which were previously eliminated in consolidation) are treated as a liability on the bank holding company's consolidated balance sheet, in contrast to the equity treatment given to the trust preferred securities prior to de-consolidation, and the "related expense [is] recorded as an interest expense on the income statement rather than as a minority interest in the income of its [trust] subsidiary." In December 2003, the FASB revised FIN 46 stating that trust preferred securities issued by trust subsidiaries of bank holding companies must be de-consolidated as of December 31, 2003.

In June 2009, the FASB further revised FIN 46 by issuing Statement of Financial Accounting Standards No. 167 ("SFAS 167") which, among other things, changed the test for determining whether a VIE should be consolidated with another entity from a quantitative test to a more qualitative test that focuses on identifying which enterprise has the power to direct the activities of a VIE that most significantly impacts the VIE's economic performance and (1) the obligation to absorb losses of the entity or (2) the right to receive benefits from the VIE. This change, however, does not appear to have changed the position under FIN 46(R) that a bank holding company's trust preferred issuing trust subsidiary should be de-consolidated from its parent for accounting purposes.

In May 2004, the FRB reacted to the adoption of FIN 46 by proposing new regulations on the treatment of trust preferred securities as regulatory capital and the definition of capital for bank holding companies.

On March 1, 2005, the FRB issued its long-awaited final regulations on trust preferred securities and the definition of capital. The final regulations adopted, with minor modifications, the FRB's May 2004 proposed regulations on the subject. The final regulations became effective on April 11, 2005.

Summarized below are the major provisions of the final regulations.

Continued Inclusion of Trust Preferred in Tier 1 Capital. The final regulations allow for the inclusion of trust preferred securities in bank holding company Tier 1 capital, subject to quantitative and qualitative requirements, notwithstanding that, as a result of FIN 46, trust preferred securities no longer give rise to a minority interest in the equity accounts of a consolidated subsidiary. In adopting the final regulations, the FRB considered, but rejected, the view of the Federal Deposit Insurance Corporation, contained in a comment letter from its

chairman, that trust preferred securities should no longer be eligible for inclusion in bank holding company Tier 1 capital.

General Quantitative Limitation. As in the proposed regulations, the final regulations tighten the quantitative limitations applicable to the inclusion of trust preferred securities in bank holding company Tier 1 capital. Under the final regulations, restricted core capital elements (including trust preferred securities) includable in bank holding company Tier 1 capital are limited to 25 percent (15 percent in the case of "internationally active banking organizations") of the sum of core capital elements (including restricted core capital elements), net of goodwill less any associated deferred tax liability. "Restricted core capital elements" are defined to include qualifying cumulative perpetual preferred stock (including related surplus), minority interest related to qualifying cumulative perpetual preferred stock directly issued by a consolidated US depository institution or foreign bank subsidiary, minority interest related to qualifying common stockholders' equity or perpetual preferred stock issued by a consolidated subsidiary that is neither a US depository institution nor a foreign bank, and qualifying trust preferred securities. "Core capital elements" are defined to include qualifying common stockholders' equity, qualifying noncumulative perpetual preferred stock (including related surplus), minority interest related to qualifying common or noncumulative perpetual preferred stock directly issued by a consolidated US depository institution or foreign bank subsidiary, and restricted core capital elements.

Goodwill. The FRB declined in the final regulations to eliminate the deduction of goodwill from core capital elements in calculating the Tier 1 capital limitation for restricted core capital elements, noting that the restricted core capital elements' limits should be keyed more closely to tangible equity. However, the final regulations modify the goodwill deduction as originally proposed by allowing any associated deferred tax liability to be netted from the amount of goodwill deducted.

Application of the 15 percent Limitation on Restricted Core Capital Elements. The proposed regulations did not provide a precise definition of "internationally active banking organization" to which the more constraining 15 percent limitation on restricted core capital elements, referred to above, would apply. In response to comments, the final regulations define an "internationally active banking organization" as a banking organization that (i) as of its most recent year-end FR Y 9-C report has total consolidated assets equal to US$250 billion or more or (ii) on a consolidated basis, reports total on-balance-sheet foreign exposure of US$10 billion or more on its most recent year-end FFIEC 009 Country Exposure Report. This is similar to the definition previously proposed by the FRB for determining which banking organizations must mandatorily adopt the Basel II Capital Accord provisions which will apply in the United States. Significantly, the final regulations make clear that the 15 percent limitation on restricted core capital elements will not apply to bank holding companies that choose to opt into the Basel II framework (*i.e.*, are not mandatory Basel II adopters) in the United States. However, the FRB indicates that it will generally expect and strongly encourage opt-in bank holding companies to plan for, and come into compliance with, the 15 percent limitation on restricted core capital

elements as they approach the definitional criteria for being considered internationally active banking organizations.

The final regulations exempt qualifying mandatory convertible preferred securities from the 15 percent limitation on restricted core capital elements applicable to internationally active banking organizations. Accordingly, under the final regulations, the aggregate amount of restricted core capital elements (excluding mandatory convertible preferred securities) that a bank holding company which is an internationally active banking organization may include in Tier 1 capital may not exceed the 15 percent limit applicable to such banking organizations, whereas the aggregate amount of restricted core capital elements (including mandatory convertible preferred securities) that a bank holding company which is an internationally active banking organization may include in tier 1 capital may not exceed the 25 percent limitation applicable to all bank holding companies. The FRB indicates that bank holding companies desiring to issue mandatory convertible preferred securities should seek review of such preferred securities by FRB staff prior to issuance to ensure that they do not contain features that detract from their high capital quality.

On January 23, 2006, the FRB issued a letter to Wachovia Corporation which confirmed that trust preferred securities that convert into noncumulative perpetual preferred stock (instead of common stock) constitute qualifying mandatory convertible preferred securities within the meaning of the FRB's capital guidelines. Accordingly, such securities would be exempt from the 15 percent limitation on restricted core capital elements applicable to internationally active banking organizations and are instead subject to the limitation that an internationally active banking organization may include restricted core capital elements in Tier 1 capital up to 25 percent of Tier 1 capital so long as restricted core capital elements that exceed 15 percent of Tier 1 capital are in the form of qualifying mandatory convertible securities.

Transition Period. The revised quantitative limitations contained in the final regulations were originally scheduled to become effective on March 31, 2009. However, due to the continuing stressed conditions in the financial markets and in order to promote stability in the financial markets and the banking industry as a whole, effective March 23, 2009, the Federal Reserve Board decided to delay their implementation until March 31, 2011. Prior to March 31, 2011, a bank holding company that has restricted core capital elements exceeding the revised quantitative limitations must consult with the Federal Reserve on a plan for ensuring that it is not unduly relying on these elements in its capital base.

Non-Voting Instruments Includable in Tier 1 Capital. The final regulations retain the standard that voting common stock should be the dominant form of a bank holding company's Tier 1 capital and continue to caution that excessive non-voting elements generally will be reallocated to Tier 2 capital.

Specific Provisions. The final regulations expressly cover the following provisions:

- Step-Ups. Notwithstanding industry comments urging the FRB to conform its position on allowable rate step-up provisions to the October 27, 1998

Basel Committee release on instruments eligible for inclusion in Tier 1 capital, the final regulations continue to prohibit rate step-up provisions in Tier 1 capital instruments and in Tier 2 subordinated debt. The final regulations are silent as to the circumstances under which fixed/floating rate provisions are permitted in Tier 1 and Tier 2 capital instruments.

- Elimination of Call Option Requirement. The final regulations eliminate the FRB's long-standing requirement for the presence of a call option in qualifying trust preferred securities.

Technical Requirements for Underlying Junior Subordinated Debt. The final regulations require that the underlying junior subordinated debt have a minimum maturity of 30 years, be subordinated to all debt of the sponsoring banking organization (subject to certain exceptions noted below), and otherwise comply with the FRB's policy statement with regard to subordinated debt securities includable in capital. Qualifying trust preferred securities which are backed by such junior subordinated debt must allow for dividends to be deferred for at least 20 consecutive quarterly periods.

The final regulations clarify that:

- a deferral notice period of up to 15 business days before a payment date is permissible;

- junior subordinated debt does not have to be subordinated to, and may rank *pari passu* with, trade creditors and may also rank pari passu with junior subordinated debt underlying another issue of trust preferred securities, and *pari passu* with or senior to deeply subordinated debt that the FRB may in the future authorize for inclusion in Tier 1 capital;

- junior subordinated debt must be subordinated to senior obligations not only with regard to priority in bankruptcy, but also with regard to priority of interest payments on other debt while the bank holding company is a going concern;

- in addition to bankruptcy of the bank holding company or receivership of a major banking subsidiary, defaults which are authorized to trigger acceleration may include (i) nonpayment of interest for 20 or more consecutive quarters and (ii) the trust issuing the preferred securities going into bankruptcy or being dissolved, unless the junior subordinated debt has been redeemed or distributed to the trust preferred securities' investors or the obligation is assumed by a successor bank holding company; and

- provisions that prohibit interest deferral on junior subordinated debt if a default has occurred are permissible only if the default is one that is authorized to trigger acceleration of principal and interest.

The final regulations provide that in the last five years before the maturity of the junior subordinated debt, the outstanding amount of the associated trust preferred securities must be excluded from Tier 1 capital, but may be included in Tier 2 capital subject to the amortization provisions and quantitative restrictions applicable to the inclusion of limited-life preferred stock in Tier 2 capital.

Extension of Grandfather Date. The final regulations extended the grandfathering date for junior subordinated debt with nonconforming provisions, but satisfying the grandfather criteria, to April 15, 2005 (from May 31, 2004, the originally proposed grandfather date).

Financial Holding Companies

Furthermore, under the Gramm-Leach-Bliley Act ("GLBA"), one of the criterion for a foreign bank to qualify as a financial holding company and therefore to engage in expanded US nonbanking activities is for it to be "well capitalized." The GLBA provides that a foreign bank is well-capitalized if:

- its home-country supervisor has adopted risk-based capital standards consistent with the 1988 Basel Accord;
- the foreign bank maintains a Tier 1 capital to total risk-based assets ratio of 6 percent and a total capital to total risk-based assets ratio of 10 percent, as calculated under its home-country standard; and
- the foreign bank's capital is comparable to the capital required of a US bank owned by a financial holding company.

In determining whether a foreign bank is well-capitalized, the FRB will also take into account the foreign bank's Tier 1 capital to total assets leverage ratio. Therefore, if the home country supervisor of a foreign bank with a branch or agency in the United States treats a preferred capital product as Tier 1 capital, it is likely that the FRB will do the same.

State Member Banks

Under the FRB's capital regulations applicable to state member banks, noncumulative perpetual preferred stock qualifies as Tier 1 capital, but cumulative preferred stock may only be counted as Tier 2 capital. The FRB has not yet *approved* trust preferred securities (either cumulative or noncumulative) as Tier 1 capital at the bank level.

2. Derivative Contracts Hedging Trust Preferred Stock

In its supervisory letter dated March 28, 2002 ("SR 02-10"), the FRB noted that some BHCs seeking to hedge interest rate risk on issues of trust preferred stock had been offered derivative contracts with terms that have the effect of contravening the strict conditions for the inclusion of trust preferred stock in Tier 1 capital. The terms in question were said to take effect

when the BHC defers dividend payments on the trust preferred stock subject to the hedge. When such a deferral event occurs, the contracts provide that the derivative counterparty will defer on a cumulative basis its swaps payments due to the banking organization while the BHC continues to make payments to the derivative counterparty. The FRB expressed supervisory concerns where the contract terms for deferral on swap payments are not symmetrical and require the banking organization to make payments to the swap counterparty without receiving payments from the counterparty. The FRB noted that contracts structured in this manner undermine the loss-absorbing capacity of the hedged trust preferred stock and, consequently, its eligibility for Tier 1 capital treatment.

B. Office of the Comptroller of the Currency

1. Capital Treatment

Under the OCC's capital guidelines, which are applicable to national banks, noncumulative perpetual preferred stock qualifies as Tier 1 capital, but cumulative preferred stock may only be counted as Tier 2 capital.

Although the OCC (the primary regulator of national banks) does not generally permit trust preferred securities to count as Tier 1 capital at the bank level, on December 22, 2000, the OCC approved certain uniquely structured non-cumulative trust preferred securities as Tier 1 capital at the bank level. In addition, in October 2000 the OCC approved the inclusion of certain noncumulative, perpetual, fixed-rate preferred securities issued by a limited liability company subsidiary of a national bank as Tier 1 capital.

The OCC permits REIT non-cumulative perpetual preferred securities to qualify as Tier 1 capital for up to 25 percent of the bank's Tier 1 capital, as long as REIT preferred shares are automatically exchangeable for preferred shares of the parent bank in the event the OCC directs the bank to make the conversion because:

- the bank is "undercapitalized" under prompt corrective action regulations;
- the bank is placed in conservatorship or receivership; or
- the OCC, in its sole discretion, anticipates the bank becoming undercapitalized in the near term.

2. Investment Securities

On April 8, 1997, the staff of the OCC issued Interpretive Letter 777 ("Letter 777"), which concluded that national banks may purchase trust preferred securities as Type III securities,[21] if they meet the applicable rating and marketability requirements of Part 1 of the

[21] Type III securities are defined as "investment securities that do not qualify as Type I, II, IV, or V securities,

OCC's regulations.[22] To meet these requirements, Letter 777 provides that a trust preferred security and a corresponding debenture should be:

- investment grade (as defined in the OCC's Part 1 regulation) or the credit equivalent of a security rated investment grade, and therefore not predominantly speculative in nature; and

- registered under the Securities Act of 1933, or offered and sold pursuant to Rule 144A, or can be sold with reasonable promptness at a price that corresponds reasonably to its fair value.

In Letter 777, OCC staff observed that trust preferred securities possess many characteristics typically associated with debt obligations, such as corporate bonds and municipal revenue bonds. For example, holders of trust preferred securities, like holders of debt, do not share in any appreciation in the value of the issuer trust, and are protected from changes in the value of the principal of the instruments (except credit risk). Also, like holders of debt, holders of trust preferred securities do not have voting rights in the management or the ordinary course of business of the issuer trust. Furthermore, like debt, trust preferred securities are not perpetual and distributions on trust preferred securities resemble the periodic interest payments on debt. The OCC supported this conclusion with a no-action letter issued by the staff of the Securities and Exchange Commission that did not object to a bank holding company treating trust preferred securities as debt under Generally Accepted Accounting Principles (even if the bank holding company classified the securities as minority interests in consolidated subsidiaries for regulatory reporting purposes).

On November 3, 1999, just before enactment of the GLBA, which gave banks broad securities underwriting/dealing powers, the OCC gave an operating subsidiary of a national bank special permission to privately place trust preferred securities and to engage in secondary market transactions as a dealer in trust preferred securities issued by unaffiliated bank holding companies.[23]

On April 23, 2001, the OCC issued Interpretive Letter 908 ("Letter 908"). Letter 908 expands the OCC's approval of trust preferred securities contained in Letter 777 by concluding that because trust preferred securities qualify as debt obligations they may be purchased and held as loans under the authority to discount and negotiate evidences of debt even if the securities do not meet the rating and marketability requirements of Part 1 of the OCC regulations.[24] This

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such as corporate bonds and municipal revenue bonds." 12 C.F.R. § 1.2(k).

22 OCC Interpretive Letter No. 777, Apr. 8, 1997.

23 OCC Conditional Approval Letter No. 331, Nov. 3, 1999.

24 OCC Interpretive Letter No. 908, April 23, 2001.

departure from the OCC's previous conclusions in Letter 777 is attributable to the increasing emphasis placed on trust preferred securities' similarity to traditional debt instruments.

In Letter 908, the OCC held that the purchase of trust preferred securities by a national bank must:

- comply with the lending limit restrictions of 12 USC 84;[25]
- not purchase an amount of trust preferred securities in excess of 15 percent of its capital and surplus; and
- the prudential requirements in Banking Circular No.181.[26]

These requirements are very much the typical standards for debt investment safety incumbent upon all of a national bank's usual debt investments. However, the OCC did require that national banks must assure that they have continual access to appropriate credit and portfolio performance data as long as they hold trust preferred securities.

On May 22, 2002, the OCC issued supplemental guidance concerning unsafe and unsound investment portfolio practices. The OCC was concerned that trust preferred securities could be an area where national bank's would engage in the unsafe and unsound practice of "yield chasing." Yield chasing typically occurs when a national bank suffers a large decline in asset yields, they ignore prudent investing practices and assume dangerously high levels of risk. Among other areas, the OCC considered how certain investment securities could create high risk by their combination of credit, interest rate and liquidity risk.[27]

The OCC noted its belief that many national banks have acquired large amounts of trust preferred securities but have failed to appreciate such securities' inherent risks. The OCC first noted that many national banks have failed to appreciate that trust preferred securities are not the obligation of a bank but rather of a bank holding company's trust subsidiary. The failure to appreciate this difference had led some such banks to mistakenly believe that trust preferred securities were the functional equivalent of federal funds sold to a bank. This mistake caused such banks to overlook the risks associated with the facts that trust preferred securities contain an

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[25] 12 USC 84 requires that a bank's total loans to a person outstanding at one time and not fully secured by collateral having a market value at least equal to the amount of the loan shall not exceed 15 percent of the unimpaired capital and unimpaired surplus of the association; and in the case of fully secured readily marketable collateral having a market value at least equal to the amount of funds outstanding shall not be greater than 10 percent of the unimpaired capital and unimpaired surplus of the association.

[26] OCC Banking Circular 181, August 2, 1984. The prudential requirements of BC-181 are somewhat relative to a given bank's formal lending policy. However, most such policies require: the complete analysis and documentation of the credit quality of obligations to be purchased; an analysis of the value and lien status of the collateral; and the maintenance of full credit information on the obligor during the term of the loan.

[27] OCC Bulletin 2002-19, May 22, 2002.

option that allows the issuer to defer payment of dividends for up to five years without representing an event of default, and that unlike federal funds trust preferred securities, if not called, generally represent a 30-year bullet maturity. The OCC believes that credit risks are associated with trust preferred securities given their long maturities. The securities' price sensitivity can negatively affect the bank's interest rate risk profile. Finally, the fact that some trust preferred securities did not increase in value when interest rates declined indicates generally poor liquidity.

C. Federal Deposit Insurance Corporation

1. Capital Treatment

Under the FDIC capital guidelines applicable to state non-member banks, noncumulative perpetual preferred stock qualifies as Tier 1 capital, but cumulative preferred stock may only be counted as Tier 2 capital. The FDIC has not yet approved trust preferred securities as Tier 1 capital at the bank level.

The FDIC permits noncumulative perpetual preferred REIT stock to qualify as Tier 1 bank capital for up to 25 percent of a bank's Tier 1 capital, as long as the minority interests arising from the preferred stock are automatically exchangeable for Tier 1 equity instruments of the parent bank upon the occurrence of a conversion event, including where:

- the bank becomes "undercapitalized" under the FDIC's prompt corrective action rule;
- the bank is placed into bankruptcy, reorganization, conservatorship, or receivership; or
- the FDIC, in its sole discretion, directs the exchange in anticipation of the bank becoming undercapitalized in the near term.

In addition, the FDIC must give consent for the redemption or retirement of the REIT preferred stock. Similarly, preferred stock to be issued by a REIT subsidiary of an FDIC-supervised bank should include a disclosure in the prospectus and any related preferred stock agreements that such preferred stock cannot be redeemed unless the parent bank receives prior written consent from the FDIC.

2. Investment Securities

On February 19, 1999, the FDIC opined that state banks, like national banks, may invest in trust preferred securities, provided that state law so permits and that the trust preferred securities meet the investment quality and marketability requirements applicable to "investment

securities" under the OCC's Part 1 regulations.[28] In addition, the FDIC clarified that the 10 percent per issuer diversity limit that is applicable to national banks' investment in Type III securities does not apply to state non-member banks. The only limit imposed are general safety and soundness limitations and limitations imposed by state law.

D. Office of Thrift Supervision

1. Capital Treatment

Like the FDIC, the Office of Thrift Supervision ("OTS"), the primary regulator of federally-chartered savings associations, has not yet approved trust preferred securities as Tier 1 capital at the bank level. On December 18, 2001, the OTS issued Thrift Bulletin No. 73a ("Bulletin 73a"), which states that because deferred payment on trust preferred securities are cumulative, trust preferred securities may not count toward Tier 1 capital. Also, since thrifts are limited on the amount of dividends that they may pay as a percentage of their annual income, a thrift holding company's ability to rely on receipt of dividends from its thrift subsidiary to make payments on an issue of trust preferred securities may be jeopardized. Bulletin 73a indicates, however, that if a thrift holding company issues trust preferred securities and invests the proceeds in a thrift subsidiary, those funds may qualify as capital at the thrift level. (Note that, while thrift holding companies are generally not subject to capital requirements, some have issued trust preferred securities in anticipation of future capital requirements for thrift holding companies.)

The OTS also permits noncumulative perpetual preferred REIT stock to qualify as Tier 1 bank capital for up to 25 percent of a bank's Tier 1 capital, as long as the minority interests arising from the preferred stock are automatically exchangeable for Tier equity instruments of the parent bank upon the occurrence of a conversion event, including where:

- the bank becomes "undercapitalized" under the OTS's prompt corrective action rule;
- the bank is placed into bankruptcy, reorganization, conservatorship, or receivership; or
- the OTS, in its sole discretion, directs the exchange in anticipation of the bank becoming undercapitalized in the near term.

In addition, the OTS must give consent for the redemption of REIT preferred stock.

[28] FDIC Interpretive Letter 99-16, Feb. 19, 1999.

2. Investment Securities

Bulletin 73a concludes that federal savings associations may invest in trust preferred securities that meet the requirement of corporate debt securities set forth at 12 C.F.R. § 560.40.[29] Section 560.40 provides that a savings association investment in such securities must:

- be able to be sold with reasonable promptness at a price that corresponds reasonably to their fair value;
- be rated in one of the four highest categories by a nationally recognized rating service; and
- meet general "loan to one borrower" lending limits.

Moreover, thrifts may make pass-through, equity-type investments in entities such as limited partnerships, trusts, and similar entities so long as the underlying investments are permissible for federal savings associations.[30]

Bulletin 73a notes that trust preferred securities may pose certain risks that are generally higher than the risks associated with traditional corporate debt securities. The OTS notes the following issues of particular concern:

- trust preferred securities typically allow an issuer to defer payments for up to five years without declaring an event of default, thus thrift holders are foreclosed from taking action against the issuer during such time;
- some 30- year trust preferred issues allow the issuer to extend the maturity of the issue for an additional 20-years without the thrift holders' approval;
- an institution may raise capital without substantively changing its financial condition by issuing trust preferred securities, counting them toward capital, then using the proceeds of the sale to purchase similar securities from other issuers;
- many issuers of trust preferred securities are bank holding companies rated in one of the two lower investment grades; and
- there is little data on the performance of trust preferred securities over time, yet such securities have long maturities.

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29 OTS Thrift Bulletin No. 73a, Dec. 18, 2001; *clarifying* OTS Thrift Bulletin No. 73, Nov. 4, 1998.

30 See, 12 CFR 560.32.

Due to such concerns, the OTS has concluded that both federally- and state-chartered savings associations that invest in trust preferred securities or similar securities should ensure that such investment meet the following additional limitations and requirements:

- savings associations' aggregate investment in trust preferred securities and similar securities should be limited to 15 percent of total capital;
- savings associations should not enter into formal or informal reciprocal agreements or understandings with other issuers or brokers to purchase the securities of other issuers;
- savings associations should not invest in securities whose maturity can be unilaterally extended by issuers beyond 30 years; and
- savings associations should only purchase trust preferred securities that are public offerings (because of liquidity concerns).

Bulletin 73a also provides that if a savings association wants to invest more than 15 percent of its capital in trust preferred securities or similar securities, it must obtain approval from its OTS Regional Office prior to its purchase or commitment. The OTS Regional Office will approve such a request only if it determines that the proposed investment poses no greater risk than an investment in a non-subordinated, investment grade corporate debt security.

Bulletin 73a indicates that trust preferred securities must be 100 percent risk weighted by the investing thrift for risk-based capital purposes.

Any questions or queries relating to this memorandum should be addressed to any of the following lawyers at Sidley Austin LLP:

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EXHIBIT A

CAPITAL TREATMENT OF PREFERRED STOCK BY THE FEDERAL BANK REGULATORS

I. Introduction

The purpose of the following summary and the attached matrix is to identify differences among the federal bank regulators in the treatment of various capital instruments as Tier 1 and Tier 2 capital. The chart does not attempt to identify all potential differences in classification of capital instruments, but focuses on those that are clear from the basic capital statements of each of the four regulators.

II. Summary

- Banking organizations regulated by the Federal Reserve Board ("FRB"), the Office of the Comptroller of the Currency ("OCC"), the Federal Deposit Insurance Corporation ("FDIC"), and the Office of Thrift Supervision ("OTS") may include *noncumulative perpetual* preferred stock ("PPS") in Tier 1 capital, although these agencies provide that it is desirable from a supervisory standpoint that common stockholders' equity remain the dominant form of Tier 1 capital.

- The FRB provides that US bank holding companies ("BHCs") may also include *cumulative* PPS as a restricted core capital element in Tier 1 capital.

- All banking organizations and BHCs may include *PPS (cumulative and noncumulative)* and long-term preferred stock in Tier 2 capital, without limit.

- BHCs and banking organizations regulated by the FRB, OCC, and FDIC may include *intermediate-term preferred stock* in Tier 2 capital, which together with term subordinated debt is limited to 50 percent of Tier 1 capital. OTS institutions are not subject to the 50 percent limit.

- BHCs and banking organizations regulated by the FRB, OCC, and FDIC may include *hybrid capital instruments* that satisfy certain criteria in Tier 2 capital. The OTS is silent on this matter.

TIER 1 CAPITAL				
FRB (BHCs)	**FRB (State Member Banks)**	**OCC (National Banks)**	**FDIC (State Non-Member Banks)**	**OTS (Savings Associations)**
Noncumulative Perpetual Preferred Stock (including related surplus).[31, 32, 33]	**Noncumulative Perpetual Preferred Stock (including related surplus).**[34, 35]	**Noncumulative Perpetual Preferred Stock (including related surplus).**[36]	**Noncumulative Perpetual Preferred Stock (including related surplus).**[37]	**Noncumulative Perpetual Preferred Stock (including related surplus).**[38]

31 Perpetual preferred stock is defined as preferred stock that does not have a maturity date, that cannot be redeemed at the option of the holder of the instrument, and that has no other provisions that will require future redemption of the issue. Perpetual preferred stock in which the dividend is reset periodically based, in whole or in part, upon the banking organization's current credit standing, that is auction rate perpetual preferred stock, including so called Dutch auction money market and remarketable preferred, will not qualify for inclusion in Tier 1 capital. Such instruments, however, qualify for inclusion in Tier 2 capital.

32 While the guidelines allow for the inclusion of noncumulative perpetual preferred stock and limited amounts of cumulative perpetual preferred stock in Tier 1, it is desirable from a supervisory standpoint that voting common equity remain the dominant form of Tier 1 capital. Thus, bank holding companies and banks should avoid overreliance on preferred stock or nonvoting equity elements within Tier 1.

33 Senior perpetual preferred stock issued to the United States Department of the Treasury under the Troubled Asset Relief Program ("TARP") established by the Emergency Economic Stabilization Act of 2008 is considered qualifying non cumulative perpetual preferred stock. See Appendix A to 12 C.F.R. Part 225.

34 Perpetual preferred stock is defined as preferred stock that does not have a maturity date, that cannot be redeemed at the option of the holder of the instrument, and that has no other provisions that will require future redemption of the issue. Perpetual preferred stock in which the dividend is reset periodically based, in whole or in part, upon the banking organization's current credit standing, that is auction rate perpetual preferred stock, including so called Dutch auction money market and remarketable preferred, will not qualify for inclusion in Tier 1 capital. Such instruments, however, qualify for inclusion in Tier 2 capital.

35 While the guidelines allow for the inclusion of noncumulative perpetual preferred stock and limited amounts of cumulative perpetual preferred stock in Tier 1, it is desirable from a supervisory standpoint that voting common equity remain the dominant form of Tier 1 capital. Thus, bank holding companies and banks should avoid overreliance on preferred stock or nonvoting equity elements within Tier 1.

36 Preferred stock issues where the dividend is reset periodically based upon current market conditions and the bank's current credit rating, including but not limited to, auction rate, money market or remarketable preferred stock, are assigned to Tier 2 capital regardless of whether the dividends are cumulative or noncumulative.

37 Preferred stock issues where the dividend is reset periodically based upon current market conditions and the bank's current credit rating, including but not limited to, auction rate, money market or remarketable preferred stock, are assigned to Tier 2 capital regardless of whether the dividends are cumulative or noncumulative.

38 Stock issued by subsidiaries that may not be counted by the parent savings association on the Thrift Financial Report, likewise shall not be considered in calculating capital. For example, preferred stock issued by a savings association or a subsidiary that is, in effect, collateralized by assets of the savings association or one of its subsidiaries shall not be included in capital. Similarly, common stock with mandatorily redeemable provisions is not includable in core capital.

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TIER 1 CAPITAL				
FRB (BHCs)	**FRB (State Member Banks)**	**OCC (National Banks)**	**FDIC (State Non-Member Banks)**	**OTS (Savings Associations)**
The following limitations apply to all perpetual preferred stock ("**PPS**") for Tier 1 purposes: • Issuer redemption is subject to prior FRB approval. • No provisions restricting issuer's ability or legal right to defer or eliminate preferred dividends.				

EXHIBIT A

TIER 1 CAPITAL				
FRB (BHCs)	**FRB (State Member Banks)**	**OCC (National Banks)**	**FDIC (State Non-Member Banks)**	**OTS (Savings Associations)**
Qualifying Cumulative Perpetual Preferred Stock (including related surplus).[39] Restricted core capital elements (including Cumulative PPS) includable in a BHC's Tier 1 capital are limited to: (1). 25 percent (15 percent in the case of "internationally active banking organizations") of the sum core capital elements (including restricted core capital elements), net of goodwill less any associated deferred tax	Not permitted.	Not permitted.	Not permitted.	Not permitted.

[39] For BHCs, both cumulative and noncumulative perpetual preferred stock qualify for inclusion in Tier 1. However, the aggregate amount of cumulative perpetual preferred stock that may be included in a holding company's Tier 1 is limited to one-third of the sum of the core capital elements, excluding the cumulative perpetual preferred stock, net of goodwill less any associated deferred tax liability. Stated differently, the aggregate amount may not exceed 25 percent of the sum of all core capital elements, including perpetual preferred stock, net of goodwill less any associated deferred tax liability. Any cumulative perpetual preferred stock outstanding in excess of this limit may be included in Tier 2 capital without any sub-limits within that Tier.

TIER 1 CAPITAL				
FRB (BHCs)	**FRB (State Member Banks)**	**OCC (National Banks)**	**FDIC (State Non-Member Banks)**	**OTS (Savings Associations)**
liabilities; or (2). 1/3 of the sum of core capital elements (excluding restricted core capital elements) net of goodwill less any associated deferred tax liability.[40]				

[40] Restricted core capital elements include: qualifying cumulative PPS, minority interest related to qualifying cumulative PPS directed issued by a consolidated US depository institution or foreign bank subsidiary, minority interest related to qualifying common stockholders' equity or perpetual preferred stock issued by a consolidated subsidiary that is neither a US depository institution nor a foreign bank, and qualifying trust preferred securities.

EXHIBIT A

TIER 2 CAPITAL				
FRB (BHCs)	**FRB (State Member Banks)**	**OCC (National Banks)**	**FDIC (State Non-Member Banks)**	**OTS (Savings Associations)**
Perpetual Preferred Stock (including related surplus).	**Perpetual Preferred Stock (including related surplus).**	**Perpetual Preferred Stock (including related surplus).** Cumulative PPS may be without limit if the issuer has option to defer payment of dividends.	**Perpetual Preferred Stock (including related surplus).** Cumulative PPS may be without limit if the issuer has option to defer payment of dividends.	**Perpetual Preferred Stock (including related surplus).**[41]

[41] Preferred stock issued by subsidiaries that may not be counted by the parent savings association on the Thrift Financial Report, likewise shall not be considered in calculating capital. For example, preferred stock issued by a savings association or a subsidiary that is, in effect, collateralized by assets of the savings association or one of its subsidiaries shall not be included in capital.

EXHIBIT A

TIER 2 CAPITAL				
FRB (BHCs)	**FRB (State Member Banks)**	**OCC (National Banks)**	**FDIC (State Non-Member Banks)**	**OTS (Savings Associations)**
Long-Term Preferred Stock (including related surplus). Must have original maturity of 20 years or more.[42]	**Long-Term Preferred Stock (including related surplus).** Must have original maturity of 20 years or more.[43]	**Long-Term Preferred Stock (including related surplus).** • May be included without limit if the issuer has option to defer payment of dividends. • Amount eligible in Tier 2 is reduced by 20 percent of the original amount at the beginning of each of the last 5 years of the life of the instrument.	**Long Term Preferred Stock (including related surplus).** • May be without limit if the issuer has option to defer payment of dividends. • Must have original maturity of 20 years or more. • May not be redeemable at the option of the holder prior to maturity, except with the prior approval of FDIC.	Silent
Intermediate-Term Preferred Stock (including related surplus). • Aggregate amount with term subordinated debt is limited to 50 percent	**Intermediate-Term Preferred Stock (including related surplus).** • Aggregate amount with term subordinated debt is limited to 50 percent	**Intermediate-Term Preferred Stock (including related surplus).** • Aggregate amount with term subordinated debt is limited to 50 percent	**Intermediate-Term Preferred Stock (including related surplus).** • Aggregate amount with term subordinated debt is limited to 50 percent	**Intermediate-Term Preferred Stock (including related surplus).** • Amount eligible in Tier 2 is reduced by 20 percent of the original

[42] If the holder of such an instrument has a right to require the issuer to redeem, repay, or repurchase the instrument prior to the original stated maturity, maturity would be defined, for risk-based capital purposes, as the earliest possible date on which the holder can put the instrument back to the issuing banking organization.

[43] If the holder of such an instrument has a right to require the issuer to redeem, repay, or repurchase the instrument prior to the original stated maturity, maturity would be defined, for risk-based capital purposes, as the earliest possible date on which the holder can put the instrument back to the issuing banking organization.

EXHIBIT A

TIER 2 CAPITAL				
FRB (BHCs)	**FRB (State Member Banks)**	**OCC (National Banks)**	**FDIC (State Non-Member Banks)**	**OTS (Savings Associations)**
of Tier 1 capital (net of goodwill and other intangible assets).[44] • Original weighted average maturity of at least 5 years.	of Tier 1 capital (net of goodwill and other intangible assets).[45] • Original weighted average maturity of at least 5 years.	of Tier 1 capital (net of goodwill, other intangible assets and certain deferred tax assets). • Amount eligible in Tier 2 is reduced by 20 percent of the original amount at the beginning of each of the last 5 years of the life of the instrument (net of redemptions).	of Tier 1 capital. • Original average maturity of at least 5 years. • May not be redeemable at the option of the holder prior to maturity, except with the prior approval of FDIC.	amount at the beginning of each of the last 5 years of the life of the instrument (net of redemptions); or • Only the aggregate amount of maturing capital instruments that mature in any one year during the 7 years immediately prior to an instrument's maturity that does not exceed 20 percent of an institution's capital qualifies as Tier 2 capital.

[44] Amounts in excess of these limits may be issued and while not included in the ratio calculation, will be taken into account in the overall assessment of an organization's funding and financial condition.

[45] Amounts in excess of these limits may be issued and while not included in the ratio calculation, will be taken into account in the overall assessment of an organization's funding and financial condition.

EXHIBIT A

TIER 2 CAPITAL				
FRB (BHCs)	**FRB (State Member Banks)**	**OCC (National Banks)**	**FDIC (State Non-Member Banks)**	**OTS (Savings Associations)**
Hybrid Capital Instruments. Must satisfy the following criteria: • convertible to common stock or PPS;[46] • unsecured; • fully paid-up and subordinated to general creditors; • may not be redeemable at the option of the holder prior to maturity, except with the prior approval of FRB; and • option for the issuer to defer interest payments under certain conditions. [47]	**Hybrid Capital Instruments.** Must satisfy the following criteria: • convertible to common stock or PPS;[48] • unsecured; • fully paid-up and subordinated to general creditors; • may not be redeemable at the option of the holder prior to maturity, except with the prior approval of FRB; and • option for the issuer to defer interest payments under certain conditions.[49]	**Hybrid Capital Instruments.** Must satisfy the following criteria: • convertible to common stock or PPS;[50] • unsecured; • fully paid-up and subordinated to general creditors; • may not be redeemable at the option of the holder prior to maturity, except with the prior approval of OCC; and • option for the issuer to defer principal and interest payments under certain conditions.[51]	**Hybrid Capital Instruments.** Must satisfy the following criteria: • convertible to common stock or PPS;[52] • unsecured; • fully paid-up and subordinated to general creditors; • may not be redeemable at the option of the holder prior to maturity, except with the prior approval of FDIC; and • option for the issuer to defer principal and interest payments under certain conditions.[53]	Silent

46 Instruments which have characteristics of both debt and equity should convert to common or perpetual preferred stock in the event that the accumulated losses exceed the sum of the retained earnings and capital surplus accounts of the issuer.

47 The instrument must provide the option for the issuer to defer interest payments if: (1) the issuer does not report a profit in the preceding annual period (defined as combined profits for the most recent four quarters) and (2) the issuer eliminates cash dividends on common and preferred stock.

48 Instruments which have characteristics of both debt and equity should convert to common or perpetual preferred stock in the event that the accumulated losses exceed the sum of the retained earnings and capital surplus accounts of the issuer.

49 The instrument must provide the option for the issuer to defer interest payments if: (1) the issuer does not report a profit in the preceding annual period (defined as combined profits for the most recent four quarters) and (2) the issuer eliminates cash dividends on common and preferred stock.

50 Instruments which have characteristics of both debt and equity should convert to common or perpetual preferred stock in the event that the accumulated losses exceed the sum of the retained earnings and capital surplus accounts of the issuer.

EXHIBIT A

TIER 2 CAPITAL				
FRB (BHCs)	**FRB (State Member Banks)**	**OCC (National Banks)**	**FDIC (State Non-Member Banks)**	**OTS (Savings Associations)**
Silent	Silent	**Convertible Preferred Stock (including related surplus).** May be without limit if the issuer has option to defer payment of dividends.	Silent	Silent

51 The instrument must provide the option for the issuer to defer interest payments if: (1) the issuer does not report a profit in the preceding annual period (defined as combined profits for the most recent four quarters) and (2) the issuer eliminates cash dividends on common and preferred stock.

52 Instruments which have characteristics of both debt and equity should convert to common or perpetual preferred stock in the event that the accumulated losses exceed the sum of the retained earnings and capital surplus accounts of the issuer.

53 The instrument must provide the option for the issuer to defer interest payments if: (1) the issuer does not report a profit in the preceding annual period (defined as combined profits for the most recent four quarters) and (2) the issuer eliminates cash dividends on common and preferred stock.

APPENDIX B

SELECTED US BANK REGULATORY ISSUES APPLICABLE TO INNOVATIVE CAPITAL SECURITIES OFFERINGS

APPENDIX B

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FOUNDED 1866

March 2010

SELECTED US BANK REGULATORY ISSUES APPLICABLE TO INNOVATIVE CAPITAL SECURITIES OFFERINGS

This memorandum discusses some of the US bank regulatory issues that parties should consider when structuring capital securities offerings that involve US banking organizations or US branches or agencies of foreign banks.

I. Affiliate Transaction Restrictions

Structuring capital securities offerings for a US bank may involve transactions between the US bank and its affiliates. Accordingly, it is essential to consider whether any of the component transactions of such an offering would be subject to the affiliate transaction limitations prescribed under sections 23A and 23B of the Federal Reserve Act ("FRA"). Intercompany transactions are a principal concern of the federal banking regulators primarily due to their concern that, in times of severe financial stress, bank holding companies will be tempted to divert resources from their bank subsidiaries to their nonbanking affiliates. Sections 23A and 23B of the FRA seek to safeguard against such conduct by imposing restrictions on transactions involving banks and their affiliates.

On October 31, 2002 the Board of Governors of the Federal Reserve (the "Board") issued a final rule ("Regulation W")[1] that implemented sections 23A and 23B of the FRA. Over the years the Board has issued various interpretations and staff opinions to guide banks in their compliance with sections 23A and 23B. With the adoption of Regulation W, the Board placed all of its significant interpretations of sections 23A and 23B into one document. Regulation W became effective on April 1, 2003.[2]

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1 12 C.F.R. 223.

2 FRB Supervisory Letter SR 03-2, Jan. 9, 2003.

Section 23A

Section 23A is designed to protect insured depository institutions from abuses that may result from lending and asset purchase transactions with their affiliates. As clarified by Regulation W, section 23A prohibits a US bank[3] or any of its subsidiaries from engaging in "covered transactions" with an affiliate *if the bank's total covered transactions with <u>that</u> affiliate would exceed 10 percent of the bank's capital and surplus*.[4]

A 20 percent aggregate limit is imposed on the total amount of covered transactions by a bank or any of its subsidiaries with all affiliates. Section 23A defines "covered transaction" to mean, with respect to an affiliate of a bank:

(1) a loan or extension of credit to the affiliate;

(2) a purchase of or an investment in securities[5] issued by the affiliate;

(3) a purchase of assets from the affiliate;

(4) the acceptance of securities issued by the affiliate as collateral for a loan or extension of credit; or

(5) the issuance of a guarantee, acceptance, or letter of credit on behalf of an affiliate.[6]

Regulation W defines "affiliate" for section 23A purposes to include:

(1) any company that controls the bank and any other company that is controlled by the company that controls the bank;

(2) a bank subsidiary of the bank;

(3) any company, including a real estate investment trust, that is sponsored and advised on a contractual basis by the bank or any subsidiary or affiliate of the bank;

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3 Although section 23A, by its terms, applies only to Federal Reserve member banks, the Federal Deposit Insurance Act applies section 23A to all nonmember insured banks (12 USC. § 1828(j)), and the Home Owners' Loan Act applies section 23A to savings associations (12 USC. § 1468(a)).

4 An insured depository institution's capital stock and surplus for purposes of section 23A is: (1) Tier 1 and Tier 2 capital included in an institution's risk-based capital under the capital guidelines of the appropriate federal banking agency, based on the institution's most recent consolidated Report of Condition and Income; and (2) the balance of an institution's allowance for loan and lease losses not included in its Tier 2 capital for purposes of the calculation of risk-based capital by the appropriate federal banking agency, based on the institution's most recent consolidated Report of Condition and Income.

5 The term "securities" means stocks, bonds, debentures, notes, or other similar obligations. 12 USC. § 371c(b)(9).

6 12 USC. § 371c(b)(7).

(4) any unregistered investment fund, if the bank or any bank affiliate serves as an investment advisor to the fund and the bank and its affiliates, in the aggregate, own more than 5 percent of any class of voting shares of the fund or of the equity capital of the fund;

(5) a financial subsidiary of the bank; and

(6) companies held under merchant banking or insurance company investment authority.

Thus, under Regulation W transactions between a bank and its financial subsidiary, as well as other affiliates, are subject to sections 23A and 23B. A "financial subsidiary" is defined as any subsidiary of a national or state-chartered bank that engages in an activity not permissible for national banks to conduct directly.

Section 23A, as further clarified by Regulation W, also places restrictions on transactions between US branches or agencies of foreign banks and their US affiliates that are engaged in insurance underwriting, securities underwriting and dealing, merchant banking, or insurance company investment activities. The regulation also applies sections 23A and 23B to transactions between a US branch or agency of a foreign bank and any portfolio company controlled by a foreign bank or an affiliate as a merchant banking investment.[7]

Regulation W subjects derivative transactions between banks and their affiliates to the market terms requirement of section 23B and requires banks to establish policies and procedures to manage credit exposure arising from such transactions in a safe and sound manner. Additionally, Regulation W treats a credit derivative transaction between a bank and a non-affiliate as a covered transaction (a guarantee), if the transaction requires the bank to protect the counterparty from a default on, or decline in value of, an obligation of an affiliate of the bank.

Under Regulation W, intraday extensions of credit by a bank to an affiliate are covered transactions. However, any such transaction is exempt from the requirements of section 23A, except the safety and soundness requirement, if the bank has no reason to believe that the affiliate will have difficulty repaying the loan in accordance with its terms and has adopted policies and procedures to manage the credit exposure arising from such extensions of credit in a safe and sound manner. The policies and procedures must provide for monitoring and controlling credit exposure arising at any one time from the bank's intraday extensions of credit to affiliates and ensuring that any such transactions are subject to the market terms requirement of section 23B. Any intraday extension of credit to an affiliate that exists at the end of the bank's US business day will be treated as a non-exempt covered transaction.

In addition to the transaction limits described above, all transactions between a US bank and its affiliate must be on terms and conditions consistent with safe and sound banking

[7] 12 CFR § 223.61.

practices, and, in particular, a bank may not purchase low-quality assets[8] from the bank's affiliate. Section 23A also requires that all credit exposures to an affiliate be secured by a statutorily defined amount of collateral.[9]

Section 23B

Section 23B[10] of the FRA applies to certain types of transactions with an "affiliate," as that term is defined in section 23A, but excludes other banks from the term. The types of transactions include: (1) any covered transaction with an affiliate as defined in Section 23A; (2) the sale of securities or other assets to an affiliate, including assets subject to an agreement to repurchase; (3) the payment of money or the furnishing of services to an affiliate under contract, lease, or otherwise; (4) any transaction in which an affiliate acts as an agent or broker or receives a fee for its services to the bank or to any other person; and (5) any transaction or series of transactions with a third party (a) if an affiliate has a financial interest in the third party, or (b) if an affiliate is a participant in such transaction or series of transactions. It imposes an arm's length standard requiring that transactions be on terms and under circumstances, including credit standards, that are substantially the same, or at least as favorable to the bank, as those prevailing at the time for comparable transactions with or involving other nonaffiliated companies.

Discussion

In structuring a capital securities offering, care should be taken to ensure that none of its component transactions are covered transactions under FRA sections 23A/23B. To accomplish this, structures should avoid involving US banks as parents to SPV issuers. For example, in a multi-tiered trust preferred securities offering involving a foreign bank with a US bank subsidiary, the trust SPV should either be held by the parent foreign bank or one of its nonbank affiliates. This way, where there is an issuance of capital securities by an affiliate of the US bank to the SPV in exchange for cash proceeds, this component transaction would not be subject to the FRA sections 23A/23B limitations, because the SPV is not a bank or a bank subsidiary.

II. Potential Prohibition of Branch/Agency of Non-US Bank Holding Equity Interest

Under a final rule that became effective on October 26, 2001, the Office of the Comptroller of the Currency ("OCC") decided to allow a federal branch or agency of a foreign bank to set up and hold an equity interest in an *operating* subsidiary in generally the same manner that a national bank may acquire and hold such a subsidiary.[11]

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8 The term "low-quality asset" means an asset that falls in any one or more of the following categories: (1) an asset classified as "substandard", "doubtful", or "loss" or treated as "other loans especially mentioned" in the most recent report of examination or inspection of an affiliate prepared by either a Federal or State supervisory agency; (2) an asset in a nonaccrual status; (3) an asset on which principal or interest payments are more than thirty days past due; or (4) an asset whose terms have been renegotiated or compromised due to the deteriorating financial condition of the obligor. 12 USC. § 371c(b)(10).

9 *Id*. § 371c(c).

10 12 USC. § 371c-1.

11 See 66 Fed. Reg. 49093 (Sept. 26, 2001).

Previously, the OCC prohibited federal branches and agencies of non-US banks from holding equity interests in subsidiaries. This prohibition was based on the principle that, because branches and agencies are offices of foreign banks rather than separately incorporated entities, only the parent corporation and not the branch/agency itself would hold equity in a subsidiary.[12] The OCC had not further opined on the applicability of this to securities offerings where a branch or agency of a foreign bank "holds" equity in a special purpose vehicle issuer ("SPV"). Adoption of the final rule now removes the risk that that the regulators will take action against a branch or agency that merely holds an equity interest in an SPV.

III. Asset Pledge Requirements

In a trust preferred securities offering involving a New York stated-licensed branch or agency of a non-US bank, parties should consider how the transaction would alter a branch's or agency's liabilities and what implications that would have on the asset pledge required by the New York Banking Law ("NYBL").

The New York asset pledge requirement mandates that all state-licensed branches and agencies of foreign banking organizations maintain certain assets at an approved depository in New York in an amount determined by the New York Superintendent of Banks ("Superintendent"). Part 322 of the Superintendent's Regulations identifies eligible assets and sets forth conditions relating to the New York asset pledge requirement.

Since December 18, 2002, the pledge amount for foreign banking organizations has been equal to the greater of: (a) 1 percent of the average total liabilities (the "covered liabilities") for the previous month of the branch or agency, including liabilities of an international banking facility maintained by the branch or agency, but excluding amounts due and liabilities to other offices, agencies, branches and affiliates (as defined below) of the foreign banking corporation; or (b) $2 million. The pledge was capped at $400 million for "well-rated" institutions. On January 24, 2007, the Superintendent adopted amendments to Part 322 requiring that for "well-rated" institutions, the pledge amount be based on a sliding scale calculated as follows: 1 percent of the first $1 billion of covered liabilities; ¾ of 1 percent of the next $4 billion of covered liabilities; ½ of 1 percent of the next $5 billion of covered liabilities; and ¼ of 1 percent of the remaining covered liabilities, up to a cap of $100 million. The minimum pledge remains at $2 million. The calculation of liabilities subject to the pledge is based on a monthly average of the Wednesday Call Report figures. Liabilities arising under "qualified financial contracts" as defined in the NYBL may be excluded from the calculation of covered liabilities to the extent they are secured by collateral.

The NYBL defines "affiliate" as "any person, or group of persons acting in concert, that controls, is controlled by or is under common control with such foreign banking corporation."[13] Eligible assets consist of specified types of government obligations, US dollar deposits, investment-grade commercial paper, obligations of certain international financial institutions and other specified obligations. All institutions are allowed to use additional assets which have an

[12] See OCC Interpretive Letter No. 476, 1989.

[13] See, NYBL §202-b (2)(i); Superintendent's Regulations §322.6(a).

investment grade rating for up to one half of the requirement. The pledge of obligations issued or guaranteed by entities from the home country of the foreign banking organization is, however, not permitted.

If a trust preferred securities offering includes the issuance of debt securities, parties must determine if such securities constitute debts that would affect the asset pledge requirement. In structures where the debt is only issued to branch "affiliates," as that term is defined under the NYBL, such liabilities should be excluded from the asset pledge requirement. Where it is not clear that an entity receiving the debt is an affiliate, parties should notify the New York State Banking Department for interpretation.

Any questions or queries relating to this memorandum should be addressed to any of the following lawyers at Sidley Austin LLP:

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APPENDIX C

TIER 1 CAPITAL RULES FOR BANKS IN THE UNITED KINGDOM

APPENDIX C

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March 2010

TIER 1 CAPITAL RULES FOR BANKS IN THE UNITED KINGDOM

Introduction

The capital adequacy rules in the United Kingdom ("UK"), as with the rest of the European Union ("EU"), are based on the Banking Consolidation Directive (Directive 2006/48/EC) and the Capital Adequacy Directive (Directive 2006/49/EC) (together the Capital Requirements Directive or "CRD"). The CRD implements in the EU the Basel II framework.

UK implementation and timing

The UK implemented the CRD January 1, 2007, but with a transitional period so that firms[1] could continue to utilise most of the existing framework until January 1, 2008.

The CRD has been implemented in the UK as part of the Handbook of the Financial Services Authority ("FSA"). The relevant "sourcebooks" within the Handbook, in respect of regulatory capital, are:

(a) the General Prudential Sourcebook ("GENPRU") – the GENPRU sets out the basic rules relating to the constituents of a firm's capital; and

(b) the Prudential Sourcebook For Banks, Building Societies and Investment Firms ("BIPRU") – the BIPRU sets out the approaches to calculating capital for exposures and also sets out the rules relating to consolidated supervision and solo-consolidation.

As discussed in the section on "Upcoming changes" below, changes to the CRD introduced in 2009 will have to be implemented by December 31, 2010 and thus GENPRU and will need to be amended by that date.

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[1] In this memorandum, "firm" and "bank" are used interchangeably.

Constituents of Tier 1 capital

The FSA's general approach to tier one capital is that tier one capital should have the following characteristics:[2]

(a) it is able to absorb losses;

(b) it is permanent;

(c) it ranks for repayment upon winding up, administration or similar procedure after all other debts and liabilities; and

(d) it has no fixed costs, that is, there is no inescapable obligation to pay dividends or interest.

GENPRU 2.2 provides that tier one capital for a bank consists of:

(a) core tier one capital, which consists of:

  (i) permanent share capital;

  (ii) profit and loss account and other reserves (taking into account interim net losses);

  (iii) eligible partnership capital;

  (iv) eligible limited liability partnership members' capital;

  (v) share premium account; and

  (vi) externally verified interim net profits

(b) perpetual non-cumulative preference shares; and

(c) innovative tier one capital.

The following are deducted from tier one capital:

(a) investments in own shares;

(b) intangible assets;

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[2] GENPRU 2.2.9G.

(c) excess of drawings over profits for partnerships and limited liability partnerships; and

(d) net losses on equities held in the available-for-sale financial asset category.

GENPRU 2.2.65R is an example of the general principle in GENPRU 2.2.1 (Purposive interpretation). Its purpose is to emphasise that an item of capital does not meet the conditions for inclusion in tier one capital if in isolation it does meet those requirements, but fails to meet those requirements when other transactions are taken into account. Examples of such connected transactions might include guarantees or any other side agreement provided to the holders of the capital instrument by the firm or a connected party or a related transaction designed, for example, to enhance their security or to achieve a tax benefit, but which may compromise the loss absorption capacity or permanence of the original capital item.

At least 50 percent of a bank's tier one capital (net of tier one capital deductions) must be made up of core tier one capital which provides maximum loss absorbency on a going concern basis to protect the bank from insolvency.[3] The FSA considers that, although perpetual noncumulative preference shares or permanent interest-bearing shares ("PIBS") are in legal form shares, they behave in many ways like perpetual fixed interest debt instruments.[4]

Within the 50 percent limit on non-core tier one capital, the FSA imposes a further sub-limit (15 percent) on the amount of innovative tier one capital that a bank may include in its tier one capital resources.[5] The FSA considers that this limit is necessary to ensure that most of a bank's tier one capital comprises items of capital of the highest quality.[6]

Redemption requirements

Tier one capital is characterised, amongst other things, by its permanence. In this regard, one of the conditions applicable to tier one capital is that it cannot be redeemed at all or can only be redeemed on a winding up of the bank or, if redeemable other than in a winding up, it is redeemable only at the option of the bank and not before the fifth anniversary of the date of issue of the tier one instrument.[7] The rules provide for a limited right of early redemption (*e.g.* for tax calls) with the consent of the FSA (in the form of a waiver).[8]

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3 *Id*. at 2.2.29R.
4 *Id*. at 2.2.31G.
5 *Id*. at 2.2.30R.
6 *Id.* at 2.2.29R.
7 *Id*. at 2.2.64R(3) and 2.2.70(R)
8 *Id*. at 2.2.71R.

Perpetual non-cumulative preference shares

A security may be considered to be a "perpetual non-cumulative preference share" for the purposes of tier one capital if it satisfies the following conditions[9]:

(a) any coupon on it is not cumulative, and the bank is under no obligation to pay a coupon in any circumstances; and

(b) it is not an innovative tier one instrument.

Innovative tier one instruments

In respect of innovative tier one instruments, any feature that in conjunction with a call would make a bank more likely to redeem a tier one instrument, other than a PIBS, would normally result in classification as innovative tier one capital resources. Innovative tier one instruments include but are not limited to those incorporating a step-up or principal stock settlement. The rules provide that if a potential tier one instrument, other than a PIBS, is or may become subject to a step-up; and that potential tier one instrument is redeemable at any time (whether before, at or after the time of the step-up), that potential tier one instrument is an innovative tier one instrument.[10]

There is a general requirement that innovative tier one instruments must satisfy certain loss absorbency conditions. In essence, the holder of an innovative tier one instrument should agree that the bank has no liability (including any contingent or prospective liability) to pay any amount to the extent to which that liability would cause the bank to become insolvent if it made the payment or to the extent that its liabilities exceed its assets or would do if the payment were made. The terms of the instrument should be such that the directors can continue to trade in the best interests of the senior creditors even if this prejudices the interests of the holders of the instrument.[11]

In addition, a bank may not include an innovative tier one instrument, unless it is a preference share, in its tier one capital resources unless it has obtained a properly reasoned independent legal opinion from an "appropriately qualified individual" confirming that the loss absorption criteria are met.[12] Unlike the pre-GENPRU/BIPRU regime, which required that the legal opinion be delivered by a Queen's counsel, the legal opinion can now even be given by an

9 *Id*. at 2.2.109R
10 *Id*. 2.2.121R.
11 *Id*. 2.2.117G.
12 *Id*. at 2.2.118R.

employee (presumably an in-house counsel) of the bank, so long as that employee is not part of the business unit responsible for the transaction.[13]

The FSA had stated in November 2003[14] that issuances such as Tier One Notes ("TONS"), Reserve Capital Instruments ("RCIs") and Mandatory Convertible Securities would be considered (at best) to be innovative tier one instruments and not core tier one capital.

Step-ups

The general rule for step-ups is set out in GENPRU 2.2.147R, as follows: A bank may not include in its tier one capital resources a tier one instrument that is or may be subject to a step-up that does not meet the definition of moderate in the press release of the Basel Committee on Banking Supervision of 27 October, 1998 called "Instruments eligible for inclusion in Tier 1 capital". The effect of GENPRU 2.2.147R is that for inclusion in tier one capital resources, step-ups in instruments should be moderate.

Solo consolidation

The CRD and FSA capital rules recognise the concept of solo consolidation, where a bank's subsidiary is included in the supervision on a consolidated basis of the bank (which is the parent undertaking). The CRD states that competent authorities (here, the FSA) may allow solo consolidation "on a case-by-case basis".[15] The CRD also states that a bank must "demonstrate fully" to the competent authority that there are no material impediments to transferring own funds promptly or repaying liabilities when due.[16] In light of this, the FSA decided that banks wishing to solo consolidate new subsidiaries from 1 January, 2007 would need to apply for a waiver. In addition, banks will need to review their existing solo consolidated subsidiaries and notify the FSA of those they wish to continue to solo consolidate, provided that they meet the new conditions.

The conditions to solo consolidation are found in BIPRU 2.1. In line with the FSA's general policy on the implementation of EU directives, the FSA has used an "intelligent copy-out" approach for the solo consolidation conditions. The only exception is that while Article 69(1)(d) requires that a parent hold only 50 percent of the voting rights in the subsidiary, the FSA rule (in BIPRU 2.1.21R) requires a higher threshold of 75 percent.

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13 *Id*. at 2.2.119G.

14 *Policy Statement 155: Tier 1 Capital for Banks: Update to IPRU(BANK)*, November 2003.

15 RBCD Article 70.

16 *Ibid*.

Upcoming changes

In November 2009, amendments to the CRD were adopted and published in the Official Journal of the EU. The amendments covered several areas, including hybrid capital, large exposures, 5 percent risk retention, due diligence and disclosure for securitisation transactions. In relation to hybrid capital, the amendments seek to improve the quality of bank's capital by specifying clear EU-wide criteria for assessing whether hybrid capital is eligible to be counted as part of a bank's overall capital. The changes take effect as from December 31, 2010, but there is a general grandfathering (for 30 years) for capital instruments issued up till that date. Unlike the December 2009 Basel Committee consultative paper[17] (which requires that Tier 1 instruments be perpetual and have no incentives to redeem), the amendments to the CRD allow for 30 year instruments with "moderate" incentives to redeem (after the tenth year). Depending on the result of the Basel consultation, there is a possibility that the CRD in the EU may be amended again in order to be consistent with the Basel position. That may raise questions as to how grandfathered transactions under the CRD will be treated (*e.g.* whether the grandfathering somehow be revoked).

The amendments to the CRD require the Committee of European Banking Supervisors (CEBS) to elaborate guidelines for the convergence of supervisory practices with regard to hybrid capital instruments, and monitor their application. As a result, on December 10, 2009, CEBS published its a consultation paper on its implementation guidelines on hybrid capital instruments. The paper is structured in five main parts, covering the topics of permanence, flexibility of payments, loss absorbency, limits and hybrid instruments issued through special purpose vehicles. Regarding permanence, guidance is provided on incentives to redeem, the approval process for redemptions and the buy-back of hybrid instruments.

In December 2009, the FSA published its consultation paper on its proposals for implementing changes made to the CRD, "Strengthening Capital Standards 3".[18] In line with its "intelligent copy-out" approach to implementing EU directives, the FSA has taken the CRD amendments and made minimal conforming changes in order to have them fit within the FSA rules in GENPRU and BIPRU. Significantly, the FSA has observed in its consultation paper that "preference shares and PIBS, which are currently classified as non-core tier one, are unlikely to meet the hybrid capital requirements" and thus not be eligible as tier one capital.

Comments are invited until March 10, 2010 and a feedback statement is expected in the third quarter of 2010.

Sidley Austin LLP

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17 "Strengthening the resilience of the banking sector", Basel Committee, December 2009.

18 Available at http://www.fsa.gov.uk/pubs/cp/cp09_29.pdf.

APPENDIX D

USE OF TRUST STRUCTURES IN TIER 1 PREFERRED SECURITIES AND OTHER CAPITAL MARKETS TRANSACTIONS – FOREIGN TRUST TAX ISSUES

APPENDIX D

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March 2010

USE OF TRUST STRUCTURES IN TIER 1 PREFERRED SECURITIES AND OTHER CAPITAL MARKETS TRANSACTIONS – FOREIGN TRUST TAX ISSUES

Many Tier 1 preferred securities structures (and other capital market transactions) include a US trust. In several recent transactions, there has been substantial confusion over the application of the Internal Revenue Code of 1986, as amended (the "Code"), and the foreign trust reporting rules to these structures. The confusion arises because a trust formed under US law can be considered a foreign trust under the foreign trust reporting rules. This memorandum discusses the foreign trust reporting rules and describes several structures designed to ensure that a trust is a domestic trust for federal income tax purposes.

Background

The current capital markets confusion is an unintended offshoot of congressional attempts to attack tax avoidance transactions usually involving foreign grantor trusts with individual grantors. As part of the Small Business Job Protection Act of 1996 (the "1996 Act"), Congress enacted sweeping new rules designed to curb the use of foreign trusts. According to the Joint Committee on Taxation:

> The Congress was informed that certain US settlors established foreign trusts, including grantor trusts, in tax haven jurisdictions. Income from such foreign grantor trusts was taxable on a current basis to the US grantor, but the Congress understood that there was noncompliance in this regard. The Congress was concerned that the prior law civil penalties for failure to comply with the reporting requirements applicable to foreign trusts established by US persons had proven to be ineffective. In order to deter noncompliance, the Congress believed that it is appropriate to expand the reporting requirements relating to activities of foreign trusts with US grantors or US beneficiaries and to increase the civil penalties applicable to a failure to comply with such reporting requirements.[1]

[1] Joint Committee on Taxation, 104th Cong., Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in the 104th Congress (1996).

In order to curb the perceived abuse, Congress adopted an objective test for determining whether a trust is a foreign trust under the Code. However, the most important change made by the 1996 Act, from a capital markets standpoint, was increased penalties for failing to report transfers of property (including money) to a foreign trust. Before the 1996 Act, such penalties were generally insubstantial. Now, the penalties can be severe. As a result, there is an increased focus on the distinction between foreign trusts and domestic trusts. As one might imagine, these definitions were aimed at personal trusts. When applied to trusts used in capital markets transactions, they tend not to work in the exact manner intended.

Foreign Trust Reporting Rule – the Stakes

Under the 1996 Act, transfers of property (including cash) to a foreign trust by a US person are subject to special Internal Revenue Service ("IRS") reporting requirements and possible penalties.[2] Additionally, distributions to US persons from foreign trusts are also subject to special reporting requirements and possible penalties.[3] The penalties range up to 35 percent of the unreported amount. For example, if an investor pays $100,000 for an interest in a foreign trust and does not report the transaction, the penalty could technically be as high as $35,000.

Summary of the Foreign Trust Reporting Rules

The reporting rules generally only apply to the creation of a foreign trust by a US person and the transfer (directly or indirectly) of money or property by a US person to a foreign trust.[4] In a capital markets transaction, the initial purchasers of interests in the trust (or perhaps the sponsor) may be considered to have transferred property (*i.e.*, money) to the trust. The reporting rules could also cause a US person that is treated as the owner of any portion of a foreign trust to be responsible for ensuring that the trust files a return and furnishes information to its US owners.[5]

Thus, the distinction between a foreign trust and a domestic trust is of critical importance. Under the revised 1996 Act definition, the default treatment is classification as a foreign trust. A trust is only treated as a US person, and thus a domestic trust, if it meets both the "court test" and the "control test."

The court test is satisfied if a court within the United States is able to exercise primary supervision over trust administration.[6] Normally this will be the case where the trust is established under the laws of one of the United States (including the District of Columbia) and the trust agreement is expressly made subject to the laws of such State.[7]

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2 I.R.C. § 6048(a) (imposing reporting obligation); I.R.C. § 6677 (imposing civil penalties). Additionally, I.R.C. § 7203 enables the IRS to assert criminal penalties under certain circumstances.

3 I.R.C. § 6048(c) (imposing reporting obligation); I.R.C. § 6677 (imposing civil penalties).

4 I.R.C. § 6048(a)(3)(A).

5 I.R.C. § 6048(b).

6 I.R.C. § 7701(a)(30)(E)(i); Treas. Reg. §§ 301.7701-7(a)(i), 301.7701-7(c).

7 While not essential to classification as a domestic trust, a trust will qualify for a safe harbor provision and satisfy the court test if (i) the trust instrument does not direct that the trust be administered outside the United States, (ii) the trust in fact is administered exclusively in the United States, and (iii) the trust is not subject to an automatic migration provision. Treas. Reg. § 301.7701-7(c). For this purpose, the term

The control test is satisfied if one or more US persons have the power, by vote or otherwise, to control all substantial decisions of the trust with no other person having the power to veto any of the substantial decisions.[8] Substantial decisions include, but are not limited to, decisions concerning:[9]

1. Whether and when to distribute income or corpus;
2. The amount of any distributions;
3. The selection of a beneficiary;
4. Whether a receipt is allocable to income or principal;
5. Whether to terminate the trust;
6. Whether to compromise, arbitrate, or abandon claims of the trust;
7. Whether to sue on behalf of the trust or to defend suits against the trust;
8. Whether to remove, add or replace a trustee;
9. Whether to appoint a successor trustee to succeed a trustee who has died, resigned or otherwise ceased to act as a trustee, even if such power is unaccompanied by an unrestricted power to remove a trustee, unless the appointment power is limited such that it cannot be exercised in a manner that would change the trust's residency from foreign to domestic; or vice versa); and
10. Investment decisions.

On August 8, 2001, the US Treasury Department finalized certain regulations (the "Regulations") that alter the control test in the case of certain investment trusts.[10] Under the Regulations, an investment trust will be deemed to satisfy the control test if, (i) all trustees are United States Persons,[11] (ii) at least one trustee is a domestic bank (or United States government-owned agency or government sponsored enterprise), (iii) all sponsors (*i.e.*, persons who exchange investment assets for beneficial interests in the trust with a view to selling such interests), if any, are United States Persons, and (iv) the beneficial interests in the trust are widely offered for sale primarily in the United States to United States Persons.[12] An investment trust that satisfies these conditions will be deemed to satisfy the control test even though one or

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"administration" means the carrying out of the duties imposed by the terms of the trust instrument and applicable law, including maintaining the books and records of the trust, filing tax returns, managing and investing the assets of the trust, defending the trust from suits by creditors, and determining the amount and timing of distributions. Treas. Reg. § 301.7701-7(c)(3)(v).

8 I.R.C. § 7701(a)(30)(E)(ii); Treas. Reg. § 301.7701-7(d).

9 Treas. Reg. § 301.7701-7(d)(1)(ii).

10 Treas. Reg. § 301.7701-7(d)(1)(iv); T.D. 8962 (August 8, 2001), finalizing, Prop. Treas. Reg. §301.7701-7(d)(1)(iv); Reg. 108553-00, published in the Federal Register on October 12, 2000. An investment trust must be treated as a "grantor trust" to be eligible for the application of the Regulations. Trusts used in many capital markets financings will qualify as grantor trusts.

11 A United States Person is (i) a citizen or resident of the United States who is a natural person, (ii) a corporation or partnership, (including an entity treated as a corporation or partnership for United States federal income tax purposes) created or organized in or under the laws of the United States, any state thereof or the District of Columbia, (iii) an estate, the income of which is subject to United States federal income taxation regardless of its source or (iv) a trust if a court within the United States is able to exercise primary supervision over the administration of the trust and one or more United States persons have authority to control all substantial decisions of the trust. I.R.C. § 7701(a)(30); Treas. Reg. § 301.7701-5(a).

12 Treas. Reg. § 301.7701-7(d)(1)(iv)(I).

more foreign persons (who are not trustees) may have the power to make certain substantial decisions with respect to the trust.[13]

The Regulations are effective for taxable years ending on or after August 9, 2001. However, the Regulations state that the portions dealing with investment trusts (described above) may be relied on by trusts for taxable years beginning after December 31, 1996.[14] This means that the Regulations are retroactively effective.

Tax lawyers from Sidley Austin LLP, as well as other commentators, have suggested that the safe harbor in the Regulations is too narrow and does not sufficiently address the unintended application of the foreign trust reporting requirements contained in section 6048 of the Code and the related penalty provisions to "Widely Held Fixed Investment Trusts" ("WHFITs") in the context of contemporary capital markets transactions.[15]

Specifically, the tax lawyers from Sidley Austin LLP commented that the safe harbor provided by the Regulations does not, for example, protect US investors who invest in WHFITs that are marketed primarily to foreign investors or are organized outside the United States. Our tax lawyers noted that the rules simply were not drafted with the intent of targeting such trusts, but rather were enacted by Congress to combat perceived noncompliance by individual grantors transferring or receiving property to or from foreign trusts. Our tax lawyers urged the IRS to issue new guidance limiting the potential imposition of penalties to the situations Congress intended to address and broadening the safe harbor to avoid imposing an undue hardship on capital markets participants and discouraging capital markets transactions.

On January 23, 2006, the Treasury Department issued final regulations (the "Final Regulations")[16] which define WHFITs and clarify the reporting obligations of trustees and middlemen connected with these trusts, and provide for the communication of tax information to beneficial owners of trust interests in such WHFITs.

For purposes of the Final Regulations, a WHFIT is an arrangement classified as a trust under Treasury regulation section 301.7701-4(c), provided that (i) such trust is a United States person under section 7701(a)(30)(E), (ii) the beneficial owners of the trust are treated as owners under the grantor trust rules and (iii) at least one interest in the trust is held by a "middleman."[17] A "middleman," as defined in Final Regulation section 1.671-5(b)(10), is any "trust interest holder" (*i.e.*, any person who holds a direct or indirect interest, including a beneficial interest, in

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13 Treas. Reg. § 301.7701-7(d)(1)(iv).

14 Treas. Reg. § 301.7701-7(e)(3).

15 See, Letter from Nicholas R. Brown and Jacob J. Amato III, Sidley Austin Brown & Wood LLP (September 16, 2002) (2002 TNT 188-23). See also, Letter from Saul M. Rosen, Securities Industry Association, to Treasury Department (Mar. 23, 2001) (2001 TNT 70-29); Letter from Mark Perwien and John Dickey, Salomon Smith Barney, to Treasury Department (Apr. 9, 2001) (2001 TNT 75-26); Letter from James M. Peaslee and Linda M. Beale, Cleary, Gottlieb, Steen & Hamilton, to Treasury Department (Aug. 14, 2000) (2000 TNT 185-17).

16 Treas. Reg. § 1.671-5, T.D. 9241, published in the Federal Register on January 23, 2006. These Final Regulations are based on proposed regulations issued by the Treasury in 1998, REG-209813-96 published in the Federal Register on August 13, 1998, revoked and subsequently re-proposed in 2002, REG-106871-00, published in the Federal Register on June 20, 2002.

17 Treas. Reg. § 1.671-5(b)(22).

a WHFIT at any time during the calendar year, or simply a "TIH"), other than a qualified intermediary (as defined in Treasury regulation section 1.1031(k)-1(g)), who at any time during the calendar year, holds an interest in a WHFIT on behalf of, or for the account of, another TIH, or who otherwise acts in a capacity as an intermediary for the account of another person. A middleman includes, but is not limited to, (i) a custodian of a person's account, such as a bank, financial institution, or brokerage firm acting as a custodian of an account; (ii) a nominee; (iii) a joint owner of an account or instrument other than (A) a joint owner who is the spouse of the other owner, and (B) a joint owner who is the beneficial owner and whose name appears on the Form 1099 filed with respect to the trust interest under Treasury regulation section 1.671-5(d); and (iv) a broker (as defined in section 6045(c)(1) of the Code and Treasury regulation section 1.6045-1(a)(1)), holding an interest for a customer in street name.

From the definition of WHFIT, the Final Regulations apply only to trusts who are United States Persons under section 7701(a)(30)(E) of the Code. Therefore trusts that are not United States Persons and trustees and middlemen connected to such trusts are not subject to these reporting provisions, but remain subject to the existing reporting obligations under Code section 6048, discussed above.[18] However, in the preamble to the Final Regulations, the IRS and the Treasury Department announced that they would continue to study proposals made with regard to the application of reporting rules to foreign WHFITs and promised to provide guidance on this subject.

In general, pursuant to Treasury regulation section 1.671-5(d)(1)(i), (A) a trustee of a WHFIT must file with the IRS the appropriate Form 1099 with respect to any TIH who holds an interest in the WHFIT directly and not through a middleman, and (B) every middleman must file with the IRS the appropriate Form 1099 with respect to any TIH on whose behalf or account the middleman holds an interest in the WHFIT or acts as an intermediary, in each case reporting the information specified in Treasury regulation section 1.671-5(d)(2). Pursuant to Treasury regulation section 1.671-5(d)(2), the information which has to be reported includes but is not limited to information regarding the person filing the Form 1099, items of gross income (including original issue discount) attributable to a TIH for the calendar year, information regarding non-pro rata partial principal payments, certain trust sale proceeds attributable to the TIH, sales asset proceeds paid to the TIH for the sale of a trust interest or interests on a secondary market established for the WHFIT for the calendar year and any other information required by Form 1099.

In addition, every trustee or middleman required to file the appropriate Forms 1099 under Treasury regulation section 1.671-5(d) with respect to a TIH must furnish to that TIH a written tax information statement showing the information described in Treasury regulation section 1.671-5(e)(2).[19] The amount of a trust item reported to a TIH under this Treasury regulation section 1.671-5(e) must be consistent with the information reported to the IRS with respect to the TIH under Treasury regulation section 1.671-5(d). The written tax information statement must include, among other things, the name and the identifying number of the WHFIT, identifying information with respect to the person furnishing the statement, information regarding items of income, expense and credit that are attributable to the TIH for the calendar year and any other

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18 See, the Preamble to T.D. 9241, January 23, 2006, VI.

19 Treas. Reg. § 1.671-5(e).

information necessary to the TIH to report, with reasonable accuracy for the calendar year, the items, as defined in Treasury regulation section 1.671-5(b)(9), attributable to the portion of the trust treated as owned by the TIH under the grantor trust rules.

Pursuant to Treasury regulation section 1.671-5(d)(1)(ii), generally no Form 1099 is required with respect to a TIH who is an "exempt recipient." Notwithstanding the preceding sentence, if the trustee or middleman backup withholds under section 3406 of the Code on payments made to an exempt recipient (because, for example, the exempt recipient has failed to furnish a Form W-9 on request), then the trustee or middleman is required to file Form 1099 with the IRS unless the trustee or middleman refunds the amount withheld in accordance with Treasury regulation section 31.6413(a)-3. Pursuant to Treasury regulation section 1.671-5(b)(7), an exempt recipient is (i) any person described in Treasury regulation section 1.6049-4(c)(1)(ii), (ii) a middleman, (iii) a real estate mortgage investment conduit (as defined in section 860(D)(a)), (iv) a WHFIT or (v) a trust or an estate for which the trustee or middleman of the WHFIT is also required to file a Form 1041 "US Income Tax Return for Estates and Trusts" in its capacity as a fiduciary of that trust or estate. Persons described in Treasury regulation section 1.6049-4(c)(1)(ii), and therefore persons that are exempt recipients (within the meaning of Treasury regulation section 1.671-5(b)(7) for purposes of the Final Regulations), include, among other persons, (a) corporations, (b) certain tax exempt entities, (c) individual retirement plans, (d) the United States government and any wholly-owned agency or instrumentality thereof, a State, the District of Columbia, a possession of the United States or a political subdivision of any of the foregoing, (e) securities and commodities dealers, (f) real estate investment trusts, (g) entities registered under the Investment Company Act of 1940, (h) nominees or custodians, (i) brokers (as defined in section 6045(c)), and (j) swap dealers.

Notwithstanding the preceding, a beneficial owner who is an exempt recipient must obtain WHFIT information and must include the items of the WHFIT in computing its taxable income on its federal income tax return. Treasury regulation section 1.671-5(c)(3) and (j) provide rules for exempt recipients to obtain information from a WHFIT.

Notwithstanding the preceding sentence, a trustee and a middleman of a WHFIT must report, pursuant to Treasury regulation section 1.671-5(c) and (h), to an exempt recipient and to any other requesting person (*i.e.*, (i) a middleman; (ii) a beneficial owner who is a broker; (iii) a beneficial owner who is an exempt recipient who holds a trust interest directly and not through a middleman; (iv) a noncalendar-year beneficial owner who holds a trust interest directly and not through a middleman; or (v) a representative or agent of a person described in (i) through (iv) above)) the information described in Treasury regulation section 1.671(5)(c)(2).[20] The information described in Treasury regulation section 1.671-5(c)(2) includes the trust identification and calculation period chosen; items of income, expense and credit; information regarding non pro-rata partial principal payments; asset sales and dispositions; redemption and sales of WHFIT interests; information regarding bond premium, market discount and generally any other information necessary for a beneficial owner of a trust interest to report, with reasonable accuracy, the items attributable to the portion of the trust treated as owned by the beneficial owner under the grantor trust rules.

[20] See IRS Notice 2010-4, 2010-2 IRB (December 18, 2009) for recent guidance regarding the WHFIT reporting rules contained in Treas. Reg. 1.671-8.

In addition, Treasury regulation section 1.671-5(d)(1)(iii) provides that with respect to WHFIT items attributable to a TIH who is not a United States person, such items do not have to be reported under Treasury regulation section 1.671-5(d). Instead such items must be reported, and amounts must be withheld, as provided under Code sections 1441 through 1464 and the regulations promulgated thereunder.

In addition, pursuant to Treasury regulation section 1.671-5(l), every trustee and middleman required to file a Form 1099 under the Final Regulations is a payor within the meaning of Treasury regulation section 31.3406(a)-2, and must backup withhold as required under Code section 3406 and any regulations thereunder.

Suggested Structures

A. Requirements for All Trusts

1. General

In order to ensure that a trust used in a "Tier 1" or other capital markets transaction is a domestic trust there are some basic ground rules. First, the trust should be formed under US law, *e.g.*, as a Delaware business trust or a common law trust under state law. Second, the governing documents should clearly provide that the trust is to be administered in the United States. Third, the trust should not have an "automatic migration" provision, *i.e.*, a provision that causes the trust to migrate from the United States if a US court attempts to assert jurisdiction or otherwise supervise the trust's administration. Fourth, all trustees should be United States Persons.[21] If this is not possible, then a majority of the trustees (including replacements) must be United States Persons and the foreign trustees cannot have a right to veto substantial decisions (*i.e.*, the US trustees must be able to act through a majority vote).

2. Hat-Check Trusts

Some financing structures make use of a foreign entity known as a "hat-check" trust. The intended benefit is that a totally offshore structure may be able to avoid the foreign trust reporting rules. This benefit is obtained because the hat-check trust is not a trust at all but a custodial or depositary arrangement. In a typical structure, the underlying securities are held in a custodial account or depository account and the beneficial owners (the investors) receive a claim check in the form of a custody receipt or certificate. The investors can remove the securities from the account at any time. US structures, on the other hand, normally make use of a statutory business trust, under a document entitled "Trust Agreement" and issue "Trust Certificates" or "Trust Securities." These facts may make it difficult to persuade the IRS that the trust is actually a custodial arrangement. Thus, "hat-check" trust structures in the United States are trusts that qualify as domestic grantor trusts for federal income tax purposes. The typical structure involves a Delaware Business Trust that has no

[21] In the case of investment decisions, a trust may employ the services of an investment advisor that is a non-United States Person provided that the trust may terminate the foreign investment advisor at will.

common securities. In such a structure, the trust has only two trustees, both US financial institutions and the power to remove and replace trustees resides in the domestic LLC already in use in the structure. Thus, all substantial decisions reside with United States Persons.

B. Special Considerations for Trusts with Common and Preferred Interests

There are special considerations when a trust has two classes of securities, preferred and common. In this case, there are several possible solutions, depending on the answers to the following questions. These solutions should be implemented with the features listed above under "Requirements for All Trusts -- General".

1. Does the Structure Include a Domestic LLC or Limited Partnership? If the structure includes a domestic LLC or domestic limited partnership (an "LP") already, then the LLC or LP can hold the trust common securities. In this case, the domestic LLC or LP is a United States Person for US federal income tax purposes. Therefore, all of the substantial decisions will be made by United States Persons. For this option to work, the LLC or LP must either be a partnership for US federal income tax purposes (*i.e.*, have more than one member or partner) or (less likely) it must elect to be treated as a corporation for US federal income tax purposes under the check-the-box regulations.

2. Can the Common Securities Be Held by a United States Person? If there is no LLC or LP in the structure but the trust common securities can be held by a United States Person, then the solution is to either create a special purpose vehicle (an "SPV") to hold the trust common securities or find an existing United States Person to hold the trust common securities. If an SPV is utilized, the SPV can be a (i) corporation, or (ii) a trust, LLC or partnership under state law that, in each case, elects to be treated as a corporation or a partnership for US federal tax purposes. Again, United States Persons will make all substantial decisions in that: the US trustees will have the authority to control all substantial decisions of the trust except the power to remove and replace trustees and the SPV, as holder of the trust common securities, will have the power to remove and replace trustees.

3. Must a Foreign Person Hold the Trust Common Securities? If a foreign person must hold the trust common securities, then there are two possible solutions:

    a. The trust agreement should be drafted so that there is no power to remove the trustees, but only a power to replace trustees who die, resign or fail to act. This power could be held by a foreign person provided the replacement parameters were limited such that only a United States Person could be appointed.

    b. Alternatively, under the Regulations, the trust could be established so that (i) at least one trustee is a domestic banking institution, (ii) all trustees (and potential replacements) qualify as United States Persons, (iii) the sponsors (*i.e.*, persons who exchange investment assets for beneficial

interests in the trust), if any, are United States Persons, and (iv) the beneficial interests in the trust are widely offered for sale primarily in the United States to United States Persons.[22] If these conditions are satisfied, it is acceptable to give the owner of the trust common securities (even if such person is a non-United States Person) certain powers which would normally be considered a power to make "substantial decisions" (*e.g.*, a power to remove and replace trustees).

[22] This last requirement does not prohibit reliance upon the Regulations in situations where the offering is 144A and Reg. S. However, in such a situation, the 144A portion must be substantial in comparison to the Reg. S portion of the offering.

APPENDIX E

2003 LAW TEMPORARILY REDUCED INDIVIDUAL INCOME TAX RATES ON US AND FOREIGN CORPORATE DIVIDENDS AND CAPITAL GAINS TO 15 PERCENT

APPENDIX E

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March 2010

2003 LAW TEMPORARILY REDUCED INDIVIDUAL INCOME TAX RATES ON US AND FOREIGN CORPORATE DIVIDENDS AND CAPITAL GAINS TO 15 PERCENT

On May 28, 2003, President Bush signed the Jobs and Growth Tax Relief Reconciliation Act of 2003 (the "Act"). The Act amended the Internal Revenue Code of 1986 (the "Code") to, among other things, reduce the federal income tax rates for individuals with respect to dividend income to 15 percent, effective retroactively to January 1, 2003.[1]

One of the Act's features is that dividends from certain foreign corporations are eligible for the preferential 15 percent rate. This should create an opportunity for non-US issuers to sell certain Tier 1 capital instruments to US individual investors.[2] The remainder of this memorandum describes the provisions of the Act that afford the reduced US tax rates on dividends and capital gains and what steps must be taken to assure that Tier 1 capital products qualify for such rates.[3]

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1 Technically the Act treated qualified dividend income as net capital gain for tax rate purposes, then stated that dividends received during the taxable year shall be treated as earned on or after May 6, 2003. The net effect is that dividends received by individual calendar year taxpayers beginning January 1, 2003 will be eligible for the 15 percent rate.

2 It is also possible that the treatment of the Tier 1 security in the issuer's home jurisdiction may provide tax benefits in such jurisdiction. For example, an issuer might be entitled to deduct distributions on some Tier 1 securities in its home jurisdiction. In this case, the home jurisdiction tax deduction coupled with the 15 percent US federal income tax on dividends could be an attractive combination. Conversely, certain Tier 1 capital securities issued by US institutions (*e.g.*, "trust preferreds") have historically been treated as debt for federal income tax purposes. Thus, individual US investors will be subject to tax on interest on such securities at rates up to a maximum of 35 percent.

3 The other provisions of the Act, including provisions that increased the amounts of corporate depreciation deductions, increased expensing limits, and accelerated certain previously enacted tax reductions for individuals, are discussed in a separate memorandum which you may obtain by contacting a member of the Tax Practice Group.

A. Background

Over the past two decades the world banking industry has led the way in developing innovative capital securities. With the advent of the 1988 Basel Accord and, later, the 1998 Basel Release, Tier 1 capital products have become ever more popular and sophisticated. Tier 1 capital product development to date has focused primarily on non-dilutive, fixed income, non-voting securities that raise capital at a lower cost than traditional common and, to the extent available to the bank, preferred shares. However, a bank's strategic requirements or particular tax situation are instrumental in Tier 1 product selection and development. For example, a bank might need "upper" Tier 1 capital to obtain more equity credit with the rating agencies in connection with an acquisition or due to recent significant losses. Another bank may need "upper" Tier 1 capital because its 15 percent innovative capital basket is full. Also, a bank may want an income tax deduction in a high tax jurisdiction where a branch or subsidiary has significant taxable income, may have capital needs at a particular branch or subsidiary or may simply find it otherwise more capital or tax efficient to raise capital through a particular branch or subsidiary.

A primary purpose of Tier 1 capital products developed to date has been to lower a bank's cost of capital, in particular by introducing features that make the securities offered more tax efficient. The costs of capital may apply to the instruments themselves, such as withholding tax on dividends paid to foreign investors, or to the bank that issues them, such as having to pay dividends out of after-tax profits. Accordingly, the most important issues in the development of Tier 1 capital products arise as these products must satisfy both the loss absorption and other requirements of the bank regulators on the one hand and the tax objectives of the bank on the other. The tension between these two competing goals is exacerbated because both the bank regulators and investors in the capital markets, where most Tier 1 capital products are sold, require a tax analysis with a high degree of certainty – for bank regulators because, among other things, of the requirement that Tier 1 capital be permanent and for investors because of the pricing of the product.

B. Reduction of Tax Rates on Dividends Under the Act[4]

Generally, the Act provided that "qualified dividend income" received by an individual will be taxed at long-term capital gain rates rather than at ordinary rates.[5] Additionally, the Act reduced the 20 percent individual long-term capital gain tax rate to 15 percent.[6] Thus, the Act effectively reduced the income tax rate applicable to qualified dividend income earned by an individual from the previous top bracket rate of 38.6 percent to 15 percent.[7] However, the

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4 Unless otherwise noted, all section references are to the Code.

5 Section 402 of the Working Families Tax Relief Act of 2004, P.L. 108-311, clarified that dividends derived by partners or beneficiaries of partnerships, S corporations, estates and trusts, regulated investment companies, real estate investment trusts and common trust funds, through such entities, and which otherwise constitute qualified dividend income, are entitled to the reduced rates for qualified dividend income. Thus qualified dividend income is passed through to the partners or beneficiaries of such entities, who will then be taxed at the reduced rates.

6 In addition, the capital gains tax rate for lower income taxpayers, currently 10 percent, is reduced to 5 percent (or 0 percent for tax years beginning after 2007).

7 The Act did not restrict an individual's ability to borrow funds to purchase dividend paying securities and still qualify for the 15 percent preferential dividend rate. Interest on such borrowing would, however, be

provisions that reduced taxes on long-term capital gains and dividends are temporary and will not apply to taxable years beginning after December 31, 2010.[8] The Act did not change the state tax treatment of dividends. Because Congress chose to simply lower the dividend tax rate, rather than create a dividend exclusion from gross income, state taxes on dividends will be the same as before the Act.

The term "qualified dividend income" is defined in section 1(h)(11)(B) as dividends[9] received during a taxable year from domestic corporations and "qualified foreign corporations," other than (i) dividends from corporations exempt from tax under sections 501 or 521,[10] (ii) any amount allowed as a deduction under section 591,[11] and (iii) any dividend described in section 404(k).[12] An individual or entity that is not otherwise subject to United States income tax and that receives qualified dividend income is not eligible for the 15 percent rate.[13]

Dividend income is not "qualified dividend income" if the dividends are paid on stock with respect to which a 60-day holding period requirement is not met,[14] or to the extent the taxpayer is under an obligation (whether pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property. [15]

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subject to the Code's investment interest limitation rules. For purposes of the investment interest limit, qualified dividend income is not treated as investment income although the Act did provide for an election to treat such dividend income as investment income provided the taxpayer foregoes the 15 percent tax rate. The net effect of these rules is that a taxpayer can borrow funds to purchase dividend paying securities, receive the 15 percent preferential tax rate, and deduct the interest to the extent the taxpayer has other investment income.

8 Originally the Act provided for the preferential 15 percent rate until December 31, 2008, but the availability of such rate was extended to December 31, 2010 by the Tax Increase Prevention and Reconciliation Act of 2005. Importantly, payments "in lieu of" dividends received from lending stock are not eligible for the reduced rates and instead will be taxed at the individual rates applicable to ordinary income (35 percent maximum). Under prior law, it made no difference for an individual whether he or she received payments in lieu of dividends or dividends – both were taxed at individual ordinary income rates. Now, it will make a significant difference to an individual whether he or she is receiving payments in lieu of dividends or actual dividends.

9 The Act effectively incorporated the Code's current "dividend" definition, basically, any distribution of property made by a corporation to its shareholders out of either current year or accumulated earnings and profits, as determined for federal income tax purposes.

10 Section 501 contains general rules relating to the tax-exempt status of certain corporations and trusts. Section 521 exempts farmers' cooperatives from tax.

11 Section 591 allows a dividends paid deduction to mutual savings banks, cooperative banks and certain other savings institutions.

12 Section 404(k) allows a dividends paid deduction to corporations paying dividends to participants in deferred payment plans, provided certain requirements are satisfied.

13 Thus, the Act did not change the United States statutory withholding tax rate of 30 percent which applies to dividends paid to certain non-United States persons.

14 In order to claim a corporate dividends-received deduction, section 246(c) requires that stock be held by a corporate taxpayer for more than 45 days during the 91-day period beginning on the date which is 45 days before the date on which the stock becomes ex-dividend with respect to the dividends received. The holding period is tolled for any period during which the taxpayer has diminished its risk of loss with respect to the stock. For income to be "qualified dividend income" under the Act, section 246(c) is applied by substituting 60 days for 45 days and 121 days for 91 days.

15 Section 1(h)(11)(B)(iii).

On March 23, 2007, House Ways and Means Select Revenue Measures Subcommittee Chairman Richard Neal (D-Mass.) introduced a bill (H.R. 1672) to prevent dividends paid by certain foreign corporations from enjoying the preferential 15 percent rate if the corporations would have received favorable tax treatment in the country where they were headquartered. The bill would have added any "nonqualified dividend from a foreign corporation" to the list of dividends excluded from the definition of "qualified dividends." The bill defined the term "nonqualified dividend from a foreign corporation" to mean any dividend from a foreign corporation if the foreign corporation would have been exempt from or not subject to tax in the foreign country, the dividend payments would have been deductible in the foreign country, the corporation would have qualified as a passive foreign investment company (even if classified as a controlled foreign corporation) or the dividends would have been paid with respect to an instrument that is not treated as stock in the foreign country. The bill would have also provided that dividends received from foreign corporations with stock which is readily tradable on an established securities market in the United States would have been eligible for the 15 percent qualified dividend rate only if the corporation was created or organized under the laws of a foreign country which had a comprehensive income tax treaty that the Secretary of the Treasury determined was satisfactory for the purposes of the preferential dividends tax rate. The bill was not ultimately enacted into law. It is not possible, however, to predict whether any similar or identical bill will be enacted in the future.

The Act also provided that if an individual receives, from a domestic or foreign corporation, qualified dividend income in amount sufficient to constitute an "extraordinary dividend" within the meaning of the Code, any loss on the sale or exchange of the stock on which the dividends were paid will be treated as long-term capital loss to the extent of such dividends. [16]

In order for dividends received from foreign issuers to qualify for the reduced tax rate such foreign issuer must be a "qualified foreign corporation." A qualified foreign corporation is a foreign corporation that is either incorporated in a possession of the United States or is eligible for the benefits of a comprehensive income tax treaty with the United States (the "Treaty Test"). [17] Additionally, a foreign corporation not otherwise treated as a qualified foreign corporation will nevertheless be treated as such with respect to any dividend paid with respect to a security that is "readily tradable on an established securities market in the United States" (the

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[16] Section 1(h)(11)(D)(ii). Generally, an extraordinary dividend is a dividend with respect to a share of stock held by a taxpayer which equals or exceeds a "threshold percentage" (5 percent in the case of preferred stock; 10 percent for all other stock) of the taxpayer's adjusted basis in such share of stock. Section 1059(c).

[17] Section 1(h)(11)(c)(i) in IRS Notice 2006-101, 2006-47 IRB 930 (October 30, 2006) amplifying and superseding IRS Notice 2003-69, 2003-2 CB 851 (September 30, 2003), the IRS specified the US tax treaties that would satisfy the Treaty Test (the "Approved Treaties"). A list of the Approved Treaties is attached hereto as Exhibit A. Importantly, under Notice 2006-101, a foreign corporation must be eligible for the benefits of one of the Approved Treaties in order to be treated as a qualified foreign corporation. Specifically, the foreign corporation must be a "resident" within the meaning of an Approved Treaty and must satisfy any other requirements of the treaty, including the requirements under any applicable limitation on benefits provision.

"Trading Test").[18] Notwithstanding the above, the term qualified foreign corporation does not include a corporation treated as a passive foreign investment company.[19]

Two of the most prevalent Tier 1 capital structures include (i) direct issue stock settled instruments such as Reserve Capital Instruments ("RCIs") and Perpetual Regulatory Tier 1 Securities ("PROs"), and (ii) tax-deductible non-operating subsidiary preferred. The archetypal tax-deductible subsidiary preferred structure involves a debt obligation (the "Subordinated Note") issued by a non-US bank (the "Bank") to a tax-transparent subsidiary that provides the Bank with an interest deduction for tax purposes in the Bank's home jurisdiction and minority interest treatment for accounting purposes. Where this subsidiary is a partnership for US tax purposes, the partnership subsidiary's preferred securities would normally be issued to a trust, which in turn would issue its securities to investors. In such a structure it is the Bank that must be a "qualified foreign corporation" or the Subordinated Note that must be readily tradable on an established securities market in the United States. Also, the Subordinated Note must be treated as equity for US federal income tax purposes. In other words, in such a structure the distributions on the partnership preferred and trust preferred securities will merely represent a flow-through of the distributions made on the Subordinated Note. Thus, the distributions on the Subordinated Note in this particular structure must constitute "qualified dividend income" in order for individual investors in the partnership preferred or trust preferred securities to avail themselves of the 15 percent tax rate. With respect to the RCI or PRO structures, the security is issued directly by the Bank to the investors. Thus, in this case the Bank must be a qualified foreign corporation or the RCI or PRO (the actual security issued to investors) must be readily tradable on an established securities market in the United States.

C. Qualification of Tier 1 Capital Securities Under the Act

To ensure that a Tier 1 capital security will be eligible for the reduced US tax rate available for qualified dividend income, issuers should consult their tax advisors. However, as a general matter, foreign issuers should verify the following checklist items:

- The issuer must be treated as a corporation for US federal income tax purposes;

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[18] Section 1(h)(11)(c)(ii) in IRS Notice 2003-71, 2003-2 CB 922 (October 3, 2003) provides that common or ordinary stock, or an American depositary receipt in respect of such stock, meets the Trading Test if it is listed on a national securities exchange that is registered under Section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f) or on the Nasdaq Stock Market. As of September 30, 2002, registered national exchanges included the American Stock Exchange, the Boston Stock Exchange, the Cincinnati Stock Exchange, the Chicago Stock Exchange, the New York Stock Exchange, the Philadelphia Stock Exchange, and the Pacific Exchange, Inc. In IRS Notice 2006-3, 2006-3 IRB 306 (December 22, 2005), the IRS announced that it would extend the application of the simplified reporting rules under section 6042, announced in IRS Notice 2003-79, 2003-2 CB 1206 (November 26, 2003) for the year 2003 and extended for the first time in Notice 2004-71, 2004-45 IRB 793 (October 22, 2004) for the year 2004, to the year 2005 and future years.

[19] For guidance regarding the extent to which distributions, inclusions and other amounts received by, or included in the income of, individual shareholders as ordinary income from foreign corporations subject to certain anti-deferral regimes may be treated as "qualified dividend income," see IRS Notice 2004-70, 2004-44 IRB 724 (October 8, 2004). However, every foreign issuer should consult its tax advisor with respect to whether it may be treated as a passive foreign investment company, as the test involved is fact-based.

- The security must be treated as equity for US federal income tax purposes;[20]
- Distributions on the security must be paid out of the issuer's current or accumulated earnings and profits, as determined for US federal income tax purposes;
- Either (i) the issuer must be eligible for the benefits of a comprehensive income tax treaty with the US that includes an exchange of information program (a list of such jurisdictions is attached hereto as Exhibit A), or (ii) the security must be readily tradable on an established securities market in the US;[21]
- The foreign corporation treated as the issuer for US federal income tax purposes must not be treated as a passive foreign investment company.

Any questions or queries relating to this memorandum, or for more information regarding the issues discussed herein, or any tax matters, please contact:

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[20] Whether an instrument is treated as debt or equity for US federal income tax purposes is based on all the facts and circumstances. Some generalizations are possible however. For example, perpetual debt issued by a foreign issuer should be treated as equity for US federal income tax purposes.

[21] In IRS Notice 2003-71, the IRS announced that it was continuing to consider the treatment of dividends with respect to stock that is not listed on a national securities exchange that is registered under Section 6 of the Securities Exchange Act of 1934, and is instead listed in a different manner, such as on the OTC Bulletin Board or on the electronic pink sheets. However, as of the date hereof, the IRS has not issued such guidance.

EXHIBIT A

IRS Notice 2006-101 contains the following list of approved US tax treaties:

Australia
Austria
Bangladesh
Barbados
Belgium
Canada
China
Cyprus
Czech Republic
Denmark
Egypt
Estonia
Finland
France
Germany
Greece
Hungary
Iceland
India
Indonesia
Ireland
Israel
Italy
Jamaica
Japan
Kazakhstan
Korea
Latvia
Lithuania
Luxembourg
Mexico
Morocco
Netherlands
New Zealand
Norway
Pakistan
Philippines
Poland
Portugal
Romania
Russian Federation
Slovak Republic
Slovenia
South Africa
Spain
Sri Lanka
Sweden
Switzerland
Thailand
Trinidad and Tobago
Tunisia
Turkey
Ukraine
United Kingdom
Venezuela

APPENDIX F

THE EU PROSPECTUS DIRECTIVE AND TRANSPARENCY DIRECTIVE

APPENDIX F

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March 2010

THE EU PROSPECTUS DIRECTIVE AND TRANSPARENCY DIRECTIVE

Introduction

The offering of securities of closed-ended issuers in the EU is subject to the regime established by the EU Prospectus Directive[1] (which relates to offers of securities) and the Transparency Directive[2] (which relates to continuing disclosure obligations). The following is a general introduction to these Directives and provides brief information as to the principal effects specific to preferred and capital securities. As noted in the section entitled "Proposed Amendments to the Prospectus" below, certain aspects of these Directives may be amended soon.

The Prospectus Directive

The Prospectus Directive was required to be implemented into EU Member States by July 1, 2005. Where securities are either: (i) offered in the European Economic Area ("EEA"); or (ii) admitted to trading[3] on an EEA regulated market (*e.g.*, the London, Irish or Luxembourg Stock Exchanges),[4] a Prospectus Directive-compliant prospectus must be approved by the competent authority of the issuer's "home member state" in the EEA and "published" before the offer or listing is made unless, in the case of an offer, an exemption applies.

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1 Directive 2003/71/EC of the European Parliament and of the Council of November 4, 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC http://europa.eu.int/eur-lex/pri/en/oj/dat/2003/l_345/l_34520031231en00640089.pdf.

2 Directive 2004/109/EC of the European Parliament and of the Council of December 15, 2004 on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC – http://europa.eu.int/eur-lex/lex/LexUriServ/site/en/oj/2004/l_390/l_39020041231en00380057.pdf.

3 Any reference in this memorandum to "listing" is to an admission of the relevant securities to trading.

4 The UK, Ireland and Luxembourg each have created a listing for securities to which the Prospectus Directive does not apply (the Professional Securities Market in the UK, the Alternative Securities Market in Ireland and the Euro MTF in Luxembourg). Certain EEA institutional investors may not be able to invest in securities listed on these unregulated markets.

Denomination issues

Debt securities with a minimum denomination of at least €50,000 (or equivalent)

If "debt securities" (which term excludes securities carrying rights to shares in the issuer or a group company) are to be offered (and not listed on any regulated market) within the EEA, where the denomination is at least €50,000, then a Prospectus Directive-compliant prospectus is not required. However, if such debt securities are to be listed on an EEA regulated market, a Prospectus Directive-compliant prospectus will still be required.[5]

Debt securities with a denomination of less than €1,000 (or equivalent) and equity securities

A non-EEA issuer (*i.e.*, an issuer whose state of incorporation is a country other than an EEA Member State) who makes any offer in the EEA (*e.g.*, Greece) of (i) debt securities with a denomination of less than €1,000; or (ii) "equity securities" (*i.e.*, shares, securities equivalent to shares and securities carrying rights to shares in the issuer or a group company) may inadvertently fix *forever* its "home member state" (in this example, Greece) and thus its regulator for approving prospectuses for future EEA offers/listings of such securities. Therefore, advice should be taken before offering or listing any debt securities with a denomination less than €1,000 or equity securities within the EEA if the issuer has not already fixed its home Member State for such securities.[6] See, however, "Proposed Amendments to the Prospectus Directive" below.

Debt securities with a denomination of less than €50,000 (or equivalent)

If debt securities are to be offered (and not listed) within the EEA and the denomination is less than €50,000, a Prospectus Directive-compliant prospectus is required unless the distribution (including contemplated subsequent distributions) is in accordance with the general EEA selling restriction circulated by the International Capital Markets Association. However, country specific selling restrictions may be required.

If such debt securities are to be listed on an EEA regulated market, a Prospectus Directive-compliant prospectus will be required, and the selling restrictions should also be included.

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5 Local selling restrictions still may be required for both listed and unlisted securities.

6 See http://www.sidley.com/db30/cgi-bin/pubs/110603-EU%20Prospectus%20ES.pdf for more details.

Risk of liability

A prospectus approved in one EEA state may be "passported" so as to allow sales or listings in other EEA states without further approvals. However, approval of a prospectus by a regulator is unlikely to be a defence (if it ever was) to a claim that an investor has lost money because the party responsible for the prospectus (in some jurisdictions this will include the underwriters) did not comply with the Prospectus Directive.

Contents of a Prospectus Directive prospectus

The information required to be contained in a Prospectus Directive prospectus is the same regardless of which regulator approves it as it is governed by the Annexures to the Prospectus Regulation[7]. The Annexures are specific to particular types of security and require progressively more information for:

- debt with a denomination of at least €50,000
- debt with a denomination of less than €50,000
- "equity securities" (*i.e.*, shares, securities equivalent to shares and securities carrying rights to shares in the issuer or a group company).

Therefore, preference share issues apparently require the greatest level of disclosure. Fortunately, in the UK (and we understand in Ireland and Luxembourg), by concession, if preference shares do not carry a general right to vote or to share in the profits of the issuer and are otherwise more like debt than equity shares they will be treated as debt for the purposes of the requirements. However, there are arguments that the Prospectus Regulation does not give the power to grant such treatment. As a result, it is possible that a prospectus approved on this basis will not be recognised so as to allow sales in another EEA state.

Transparency Directive

The Transparency Directive was required to be implemented into EU Member States by January 20, 2007 and imposes continuing obligations with respect to securities admitted to trading on an EEA regulated market on issuers and, with respect to interests in certain securities (essentially, shares), the holders of such securities.

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[7] Commission Regulation (EC) No 809/2004 of 29 April 2004 on implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements http://europa.eu.int/eur-lex/lex/LexUriServ/LexUriServ.do?uri=OJ:L:2004:215:0003:0103:EN:PDF.

There is a requirement to publish IFRS or equivalent accounts unless the securities are "debt securities" with a denomination of at least €50,000. Unfortunately, debt securities are defined even more narrowly than in the Prospectus Directive and exclude shares and any security equivalent to a share and securities carrying rights to such a security, even in a non-group company. Therefore, the exemption would not appear to be available in the case of preference shares. However, the UK implementation appears to permit preference shares to be treated as "debt securities" for the purposes of the financial reporting requirements under the Transparency Directive.

Provisions requiring notifications by investors of changes of holdings at thresholds of 5, 10, 15, 20, 25, 30, 50 and 75 percent apply to shares to which voting rights are attached (and to the bare voting rights) and direct or indirect holdings in financial instruments that give an entitlement on the holder's initiative alone to already issued such shares.

Another provision requires notification by an issuer of purchases of its own shares at thresholds of 5 and 10 percent.

Proposed Amendments to the Prospectus Directive

On September 23, 2009, the European Commission published a proposal for certain amendments to be made to the Prospectus Directive (and, to a lesser extent, the Transparency Directive).[8] The proposed changes are not intended significantly to change the requirements under the Directive, but rather, in the words of the European Commission, to "simplify and improve the application of the Directive, increasing its efficiency and enhancing the EU's international competitiveness."

The main changes proposed are as follows:

- some types of securities issue will be subject to less comprehensive disclosure requirements (small companies, small lenders, rights issues and government guarantee schemes);
- the format and content of the prospectus summary have been improved;
- there are clearer exemptions from the obligation to publish a prospectus when companies sell through intermediaries ("retail cascades") and for employee share schemes;
- disclosure requirements that currently overlap with the Transparency Directive

[8] See: http://ec.europa.eu/internal_market/securities/docs/prospectus/proposal_240909/proposal_en.pdf.

will be repealed;

- the removal of the €1,000 threshold so that issuers of all non-equity securities will be able to determine their home Member State;

- the definition of "qualified investors" in the Prospectus Directive will be aligned with the one of "professional clients" as defined in the Markets in Financial Instruments Directive (MiFID).

Sidley Austin LLP

APPENDIX G

ERISA CONSIDERATIONS

APPENDIX G

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March 2010

ERISA CONSIDERATIONS

(Preferred Securities Offerings)

The US Employee Retirement Income Security Act of 1974 ("ERISA") applies to any employer engaged in commerce in the United States and to any employee benefit plan that covers the employees of such an employer, other than certain governmental plans, church plans, off-shore plans and unfunded deferred compensation plans for management or highly compensated employees. The fiduciaries of plans subject to Title I of ERISA must satisfy duties of prudence and diversification and, when making investment decisions, must act for the exclusive benefit of the participants and beneficiaries of such plans. If fiduciaries breach their duties, each breaching fiduciary may be *jointly and severally personally liable* to make the plan whole for losses suffered by the plan and to return to the plan any profits made by the fiduciary. Each fiduciary also may be liable for a civil penalty of up to 20 percent of any amount recovered by the plan from the fiduciary.

ERISA and the US Internal Revenue Code (the "Code") also prohibit employee benefit plans subject to ERISA, as well as individual retirement accounts and Keogh and other plans subject to Section 4975 of the Code and any entity whose underlying assets include "plan assets" by reason of any such plan's or account's investment in the entity (collectively, "Plans"), from engaging in investment transactions involving the assets of a Plan with persons who are "parties in interest" under ERISA or "disqualified persons" under the Code (collectively, "Parties in Interest") with respect to such Plan. Violations of these "prohibited transaction" rules may result in the imposition of an excise tax or other penalty upon Parties in Interest and necessitate the unwinding of the transaction, unless exemptive relief is available under an applicable statutory or administrative exemption.

Under ERISA and a regulation issued by the US Department of Labor (collectively, the "Plan Assets Regulation"), the assets of a Tier 1 issuer will be deemed to include the assets of Plans that acquire equity interests in the issuer, unless an exception is applicable. An "equity interest" is defined under the Plan Assets Regulation as any interest in an entity other than an instrument which is treated as indebtedness under applicable local law and which has no substantial equity features. For these purposes, interests in partnerships and trusts and other typical forms of preferred securities will constitute equity interests, even though the underlying securities held by the issuer typically will constitute debt securities for ERISA purposes. Pursuant to an exception contained in the Plan Assets Regulation (the "25 percent Exception"), the assets of an issuer will not be deemed to include Plan assets if, immediately after the most

recent acquisition of any equity interest in the issuer, less than 25 percent of the value of each class of equity interests in the issuer are held by Plans and other entities deemed to be investing the assets of Plans (collectively, "Benefit Plan Investors"). This exception requires ongoing monitoring of the investors in a preferred securities offering and, thus, is difficult or impossible to implement if the securities are not issued in physical form. Pursuant to another exception contained in the Plan Assets Regulation (the "Publicly Offered Securities Exception"), the assets of an issuer will not be deemed to include Plan assets if Benefit Plan Investors acquire securities which are part of a class that has at least 100 unrelated holders at closing, is freely transferable and are covered by a registration statement under the US Securities Exchange Act of 1934.

Under the terms of Plan Assets Regulation, if an issuer were deemed to hold Plan assets by reason of a Plan's investment in preferred securities, the investing Plan's assets would include an undivided interest in the assets held by the issuer (such as any underlying debt securities). In that event, transactions involving the assets of the issuer would be subject to the fiduciary duty requirements and the prohibited transaction rules of ERISA and the Code. Moreover, the person or persons with discretionary responsibility with respect to such assets would become fiduciaries of the investing Plan (and could become subject to a bonding requirement and to a requirement that the indicia of ownership of the Plan's assets be kept within the reach of the US federal courts). If those fiduciaries were affiliated with the financial institution that issued the underlying debt securities, any such discretionary actions taken with respect to the assets of the issuer could be deemed to constitute prohibited transactions under ERISA or the Code (for example, the use of such fiduciary authority or responsibility in circumstances under which such persons have interests that may conflict with the interests of the Plans for which they act and affect the exercise of their best judgment as fiduciaries). For this reason, if an offering of preferred securities cannot be structured to qualify for one of the exceptions to the Plan Assets Regulation (such as the 25 percent Exception or the Publicly Offered Securities Exception), then the issuer often will be structured to eliminate or limit significantly any discretionary actions that the fiduciaries of the issuer may take with respect to the issuer's assets. In such situations, investing Plans also may be required or deemed to direct the fiduciaries of the issuer to invest the assets of the issuer in the underlying securities and to take other necessary actions contemplated by the offering. This approach obviously has limited utility if the fiduciaries of the issuer must retain significant discretion with respect to the assets of the issuer.

A Plan's purchase and holding of preferred securities, as well as certain transactions involving an issuer or contemplated by an offering, could constitute direct or indirect prohibited transactions under ERISA and the Code with respect to a Plan whether or not the assets of the issuer were deemed to include Plan assets. For example, if the guarantor of a preferred security is or becomes a Party in Interest with respect to an investing Plan, indirect extensions of credit between the guarantor and the Plan could be deemed to occur and would likely be prohibited by ERISA and the Code, unless exemptive relief were available under an applicable exemption. The Department of Labor has issued five prohibited transaction class exemptions ("PTCEs") that may provide exemptive relief for direct or indirect prohibited transactions that may arise from the purchase, holding or disposition of preferred securities. Those class exemptions are PTCE 96-23 (for certain transactions determined by in-house asset managers), PTCE 95-60 (for certain transactions involving insurance company general accounts), PTCE 91-38 (for certain transactions involving bank collective investment funds), PTCE 90-1 (for certain transactions involving insurance company pooled separate accounts), and PTCE 84-14 (for certain

transactions determined by independent qualified professional asset managers). These exemptions are frequently referred to as investor-based exemptions, because eligibility for the exemption is largely within the control of (and can be represented to by) the Plan fiduciary that makes the decision to invest in the preferred securities. In addition, Section 408(b)(17) of ERISA and Section 4975(d)(20) of the Code provide a limited exemption for purchases and sales of securities and certain credit transactions involving Plans, provided that neither the counterparty nor any of its affiliates has or exercises any discretionary authority or control or renders any investment advice with respect to the assets of the Plan involved in the transaction and provided further that the Plan pays no more, and receives no less, than adequate consideration in connection with the transaction (the so-called "service provider exemption"). Thus, a Plan investor in preferred securities frequently will be required (in the case of physical securities) or deemed (in the case of global securities) to represent that on each day from the date it holds such preferred securities its purchase, holding and disposition of the securities (and certain related transactions, such as guarantees and conversions) will be exempt from the prohibited transaction rules by reason of PTCE 96-23, 95-60, 91-38, 90-1 or 84-14 or the service provider exemption.

Federal, state or local laws or regulations governing the investment and management of the assets of governmental plans and church plans (which are not subject to ERISA) may contain fiduciary and prohibited transaction requirements substantially similar to those under ERISA and the Code. For this reason, the fiduciaries of governmental plans and church plans frequently are required or deemed to represent that their purchase, holding and disposition of preferred securities (and certain related transactions) will not violate any such similar laws.

APPENDIX H

Sidley Austin LLP
Hybrid Capital Securities Group Directory

SIDLEY AUSTIN LLP

Hybrid Capital Securities Group Directory

Today, our firm is one of the leading legal advisers on a broad range of hybrid capital products, including auction and remarketed preferred, DRD preferred, trust preferred, partnership preferred, pay-in-kind preferred, participating capital instruments and various bank, insurance and corporate regulatory capital instruments. Our hybrid capital group consists of partners, counsel and associates with strong backgrounds in corporate, securities, banking, investment company, tax, ERISA, bankruptcy, structured finance, commodities and futures regulation. Our practice includes US federal and various states and English law. This multi-disciplinary group concentrates on the development and execution of hybrid capital transactions. The group has expanded as hybrid capital transactions have grown in their complexity and areas of application. The senior members of this group have worked for many years with a broad array of investment banks and issuers on hybrid capital transactions designed to achieve a wide array of objectives, including tax regulatory, credit rating and strategic benefits.

RELATIONSHIP PARTNERS AND COUNSEL

DEPARTMENTS

Capital Markets

Bank Regulatory

Insurance Regulatory

Tax

ERISA

Structured Finance

(including CDOs, Leveraged Leases and Repos)

Commodities and Futures Regulation

Bankruptcy

Investment Company Act

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Jacob, a counsel in the New York office, practices in the tax department. His practice concentrates in the areas of mergers and acquisitions, corporate finance and securities as well as derivative and structured financial products including equity, debt and hybrid products, swaps, options, forwards, and monetization transactions.

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Nick devotes a significant portion of his practice to the areas of financial products, corporate finance transactions and mergers and acquisitions. Nick has extensive experience in structuring complex US and international financial products and securities transactions designed to achieve a wide array of objectives, including tax deconsolidation, capital and balance sheet advantages, shifting of tax attributes, monetization of financial positions and tax arbitrage.

Relevant Products: Auction securities, remarketed securities, DRD preferred, convertible securities, trust preferred securities, partnership preferred securities, REIT preferred, STRYPES, STEERS, PRIDES, FELINE PRIDES, MITTS, LYONs TrUEPrS, STRIDES, PHONES and ProGroS and equity, interest rate, credit and other derivatives transactions.

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Frank has worked on a broad range of corporate and securities transactions, including equity and debt offerings by industrial, utility, financial institution and real estate investment trust issuers. He has worked on a variety of transactions and offerings by open-end and closed-end investment companies as both fund and underwriters' counsel, including initial public offerings, rights offerings, preferred stock offerings, debt offerings, asset acquisitions and mergers. Frank also acts as counsel on an ongoing basis to the independent directors of a number of investment companies.

Relevant Products: Investment company auction securities, remarketed securities, preferred securities and convertible securities.

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Craig has extensive experience in corporate finance law and concentrates on structuring complex US and international securities transactions, including transactions by US, Australian, European and Asian entities for capital, funding, tax, deconsolidation, income splitting, balance sheet, defensive and other purposes.

Relevant Products: Auction securities, remarketed securities, convertible preferred and other capital, floater/inverse floaters, DRD preferred, participating capital, trust preferred, partnership preferred, STRYPES, TrUEPrS, ACES, REIT preferred, FELINE PRIDES, PRIDES, PIK preferred, ABCs and various Tier 1 and Tier 2 securities.

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Jonathan is a partner in the International Finance Group in London. Jonathan's practice is focused on structured finance and derivatives work. He represents issuers, underwriters and, occasionally, portfolio managers and trustees in a variety of transactions, including collateralised debt obligation transactions (CBOs and CLOs), Structured Investment Vehicles (SIVs), repackagings, credit-linked notes, synthetic securities, warehousings, accumulation swaps and hedging transactions.

Relevant Products: Synthetic CDOs, structured products and derivatives.

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Connie works primarily on domestic and international bank regulatory matters affecting financial institutions. Her work encompasses advising financial institutional clients on appropriate strategic and transactional responses to capital and financial markets crises, constraints and opportunities and includes global compliance and risk management programs, bank secrecy issues, GDRs/ADRs, CLOs, new product development, and financial institution mergers and acquisitions.

Relevant Products: Various bank Tier 1 and Tier 2 securities, including trust-preferred securities and credit-linked notes.

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Sam has represented both companies and underwriters in a broad range of capital markets activities, with particular emphasis on structured and corporate finance and government securities. Sam has extensive experience in tax-advantaged financial structures and preferred securities products.

Relevant Products: Auction securities, remarketed securities, convertible preferred, trust preferred, partnership preferred, STRYPES, TrUEPrS, REIT preferred, structured notes, mortgage- and asset-backed securities.

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Alex has extensive experience in the tax aspects of corporate finance, pooled investment vehicles and tax-oriented transactions, and the ERISA regulatory issues involved in offering various types of US and foreign securities and structured investment products, including swaps and other derivatives, to the US pension fund market ("ERISA-covered plans").

Relevant Products: Partnership transactions, including floater/inverse floater issues, preferred securities, special purpose issuers, other privately placed structured investment products.

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Mike has extensive experience in the corporate representation of insurance companies and other insurance entities. His practice focuses on acquisitions, divestitures and corporate reorganizations (including demutualization and mutual holding company conversions); the formation, capitalization and corporate financing of insurance companies and related ventures; the regulation of insurance holding company systems and insurance company investment practices; the structure and regulation of alternative risk financing mechanisms and complex reinsurance arrangements; the structure of unique marketing and insurance distribution systems; and captive insurance companies, risk retention groups and other alternative market mechanisms. Mike also represents investment banks, commercial banks, private equity funds, investment advisors, derivatives dealers and other sectors of the financial services industry, with respect to insurance company relationships and transactions.

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Rob has extensive experience in executive compensation, employee benefits and ERISA fiduciary duty matters, particularly in connection with plan asset, public offering, private placement, and merger and acquisition transactions.

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Graeme advises on UK taxes (including taxes on income and capital gains, withholding tax, value added tax and stamp duties) in dealing with the structuring, negotiation and documentation of a range of structured finance transactions, including structured products and securitisations of a wide variety of asset types. The clients whom he advises include a number of banks, a rating agency and a monoline insurer. His practice has a significant international element, which entails working with tax lawyers in the firm's US offices and in other jurisdictions.

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Eric has represented issuers and underwriters in a broad range of equity and debt financings, merger and acquisition transactions and other corporate matters. In addition to working on transactions for industrial companies and financial institutions, Eric has extensive experience with real estate investment trusts.

Relevant Products: Trust preferred and convertible trust preferred securities, remarketed securities, preferred and convertible preferred stock, TECoNs, FELINE PRIDES, STRYPES and LYONS.

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David has extensive experience of acting for arrangers, issuers and trustees on a wide range of capital markets transactions, including plain vanilla eurobonds; euro- and US medium-term note programmes; commercial paper programmes; equity and index-linked products; high-yield debt offerings; debt restructuring, tender offers and buy-back transactions; repackaging and structured issuance programmes; securitisations (including, CMBS, RMBS and synthetic CDO/CLO/CBO structures and receivables financings) and capital instruments. David also has wide experience of acting for lenders, borrowers and security trustees on a wide range of secured and unsecured, syndicated and bilateral euroloan bank finance transactions, including acquisition and asset finance related transactions.

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Brian has worked on a variety of transactions of and offerings by mutual funds as well as on broker-dealer investment programs, including funds. In addition, he has consulted on interpretive issues related to Rule 2a-7 under the Investment Company Act. He has been involved in numerous Investment Company Act status questions for structured financings and various other types of enterprises. Brian was formerly with the SEC's Division of Investment Management and has appeared on several panels relating to legal issues surrounding investment companies and investment advisers.

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Rob is a partner in the New York office, practicing in corporate securities. Rob focuses on corporate financing transactions and has worked on a wide variety of securities transactions, ranging from debt and equity offerings to issuances of convertible and exchangeable securities. Rob has also worked on cross-border offerings involving complex structured securities and has also assisted investment banking clients in the development of structured convertible products. Prior to joining the firm in 1997, Rob worked at the SEC in the Division of Corporation Finance.

Relevant Products: Remarketed securities, convertible and exchangeable securities and various Tier 1 and Tier 2 securities.

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Leonard is a partner in the financial services regulatory group in London. While he has a background in structured finance transactions (in particular, advising lead mangers, issuers and trustees on securitisation transactions), he focuses on financial services regulation in the UK and the EU generally. He advises banks, investment firms, hedge funds and other entities on a wide range of regulatory issues, including: all aspects of the UK Financial Services and Markets Act 2000, its subsidiary legislation and the rules of the Financial Services Authority ("FSA"); the implementation of the EU Financial Services Action Plan (Prospectus Directive, Market Abuse Directive, Transparency Obligations Directive, Markets in Financial Instruments Directive, etc.); structuring securitisation and risk-transfer transactions to achieve desirable regulatory capital treatment; the changes to the regulatory capital landscape brought about by Basel II; regulatory issues raised by mergers and acquisitions of regulated entities; FSA enforcement actions; establishing authorised (regulated) entities in the UK, including banks and investment firms; and complex compliance issues raised by the FSA rules.

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Robin's practice ranges from structured finance and securitisations to consumer finance, but with particular emphasis on restructurings and workouts and acquisition finance. He handled many of the high profile workouts of the 1980s involving cross-border restructurings, debt/equity swaps, success fees and other incentives. High profile restructurings have included acting for the lead bank on Goodman International and acting for Federal Mogul Corporation in connection with the dual Chapter 11 and administration proceedings of its UK subsidiaries. Acquisition finance experience has included buy-backs through schemes of arrangement and bid finance.

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Michael has practiced in the area of mortgage-and asset-backed finance and securitization at the firm since 1981 and has represented underwriters and issuers of publicly and privately offered securities and commercial banks and broker/dealers in various committed and uncommitted lending arrangements.

Relevant Products: Mortgage-and asset-backed securities, derivative products repurchase agreements, revolving credit facilities, warehouse and gestation lending arrangements.

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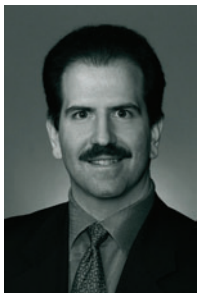

Ed has represented issuers in general corporate matters and has extensive experience in a wide variety of capital market transactions, with a particular emphasis on registered and private securities offerings by various entities including financial institutions and mortgage REITs.

Relevant Products: DRD preferred stock, convertible securities, trust preferred securities, mandatorily tendered remarketed debt securities, US and Euro medium-term note programs (secured and unsecured) and commercial paper programs.

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Michael is a partner in the Insurance and Financial Services group in Sidley's Chicago office and heads the firm's property and casualty alternative risk transfer practice. His practice is concentrated primarily in the corporate and regulatory representation of insurance companies and other insurance entities, with a focus on the structure and regulation of alternative risk transfer mechanisms, including insurance securitization and derivatives; acquisitions, divestitures and corporate reorganizations; the formation, capitalization and corporate financing of insurance companies and related ventures; the regulation of insurance holding company systems and insurance company investment practices, including the use of derivative instruments. His practice also involves the representation of investment banks, hedge funds, private equity funds, investment advisors, derivative dealers and other sectors of the financial services industry, with respect to their insurance industry relationships and transactions.

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Edward, a partner in the New York office, is primarily involved in overseeing the firm's liability management practice, focusing on corporate debt restructurings involving issuer buy-backs of outstanding debt securities. He also advises in connection with issuer and third-party equity buy-backs, including buy-backs involving "going private" transactions.

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Dan is a partner in the New York office where he specializes in corporate securities and securitization, with an emphasis on financial institutions. He represents banks and underwriters in connection with securities offerings, including bank capital instruments and asset-backed securities transactions. Dan is also a member of the firm's financial institutions team.

Relevant Products: Various bank Tier 1 and Tier 2 products, auction securities, remarketed securities, trust preferred securities, credit-linked notes, and mortgage and asset-backed securities.

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John has practiced in the structured securities area for over 20 years as an investment banker and a lawyer. As well as extensive experience of Tier 1 and Tier 2 capital raising products, John has been involved from the outset in credit derivative based products and transactions by emerging market issuers.

Relevant Products: Preferred securities, guaranteed preference shares, auction securities, remarketed securities, ordinary shares and related ADR or GDR programs, MTN programs, CP programs, structured (repackaged) products, CDOs and covered bonds.

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Michael has wide experience in the regulation of forwards, futures and derivatives and the drafting and structuring of swaps and related instruments for use by special purpose vehicles and other end-users.

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Matthew's practice includes corporate financings through global offerings of debt and equity securities, as well as mergers and acquisitions and corporate restructurings. His experience includes transactions involving a broad range of sectors, including real estate, telecommunications, financial institutions, technology, transportation, metals industry, mining, forest products, consumer products, power, oil and gas. Mr. Sheridan has lived and worked in Asia since 1994. He is qualified in New York and Victoria, Australia.

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Mark has extensive experience in international corporate finance and capital markets law. He spent seven years in the firm's New York office, five years in its Hong Kong office and is now based in London. Mark is admitted to practice New York, English and Hong Kong law, and is a member (non-practicing) of the Irish bar. He has worked on a broad range of debt and equity capital markets transactions, including as counsel to some of the larger UK, Irish and other European banks and US and European underwriters.

Relevant Products: Limited partnership securities, ADRs and preference shares, remarketed securities, convertible preferred, floater/inverse floaters, DRD preferred, trust preferred, PIK preferred and various Tier 1 and Tier 2 securities.

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