

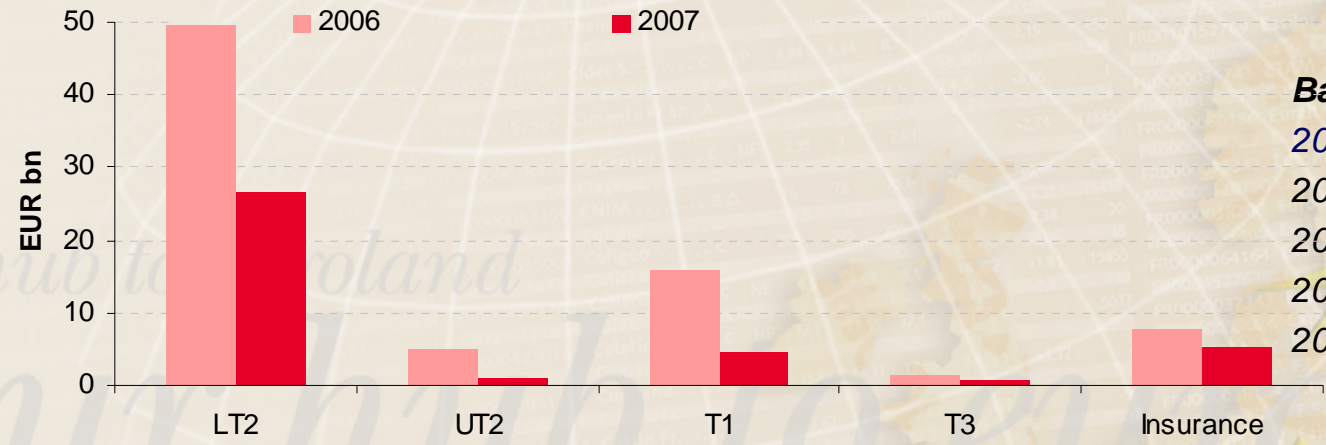
Challenges and opportunities for Hybrid Capital

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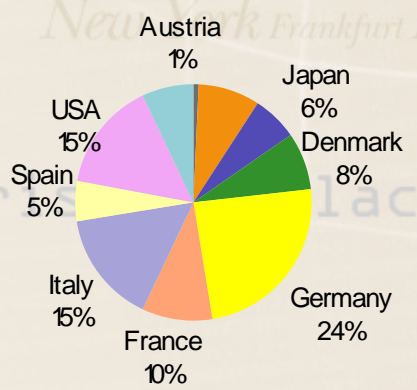
Overview of the hybrid market

FINANCIAL INSTITUTIONS

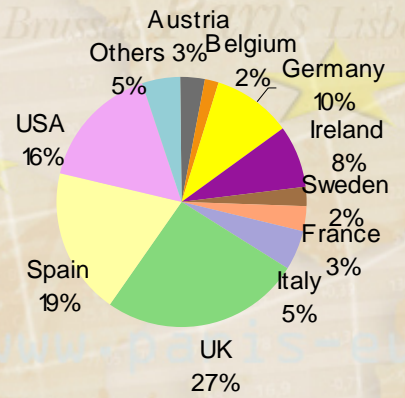


Banks & Ins T1 €
 2007 YTD: 6.05bn
 2006: 23.4bn
 2005: 28bn
 2004: 21.5bn
 2003: 10bn

Banks & Insurance T1



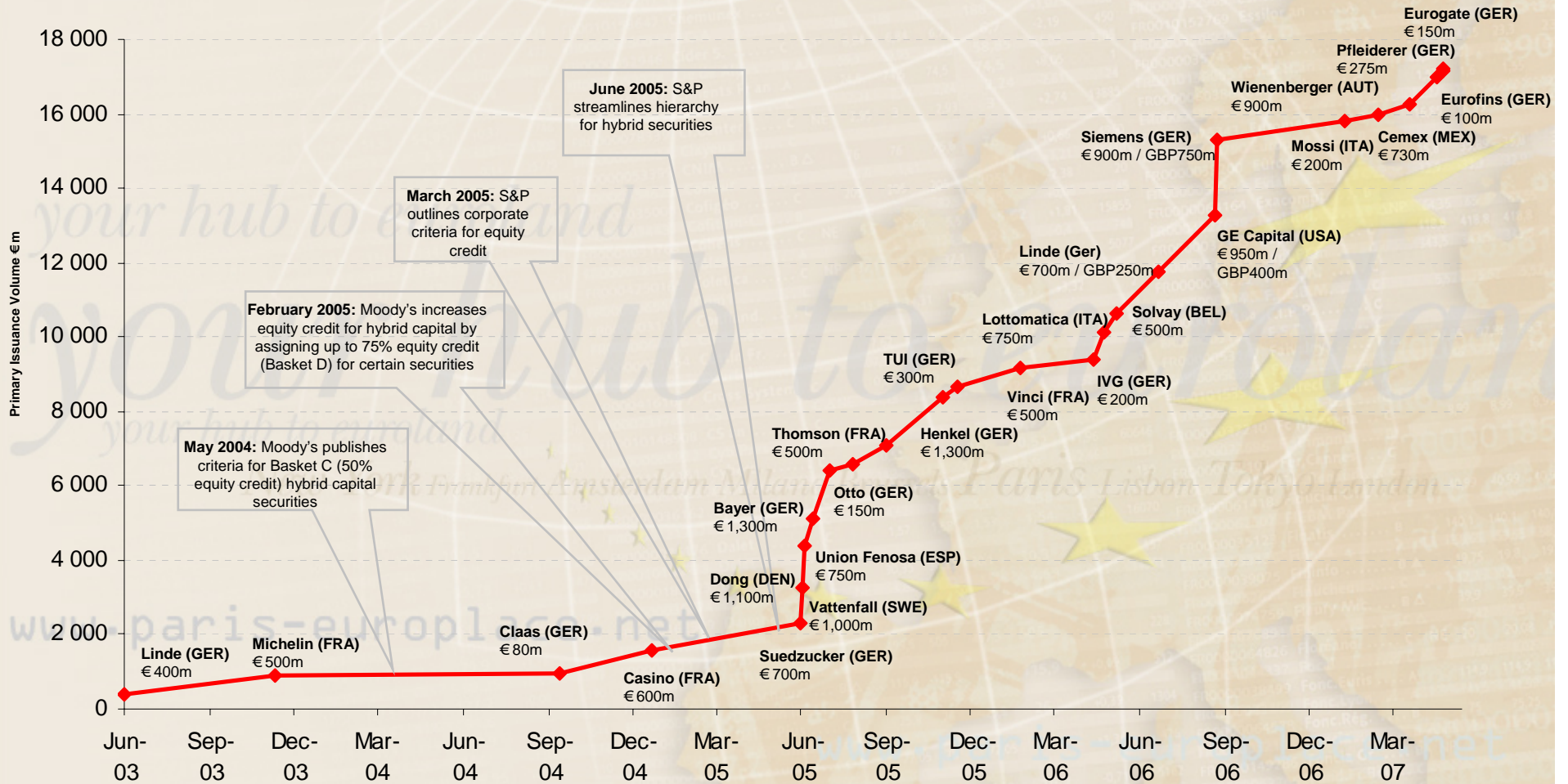
Banks & Insurance T2



Banks & Ins Tier 2 €
 2007 YTD: 17.4bn
 2006: 55bn
 2005: 43.8bn
 2004: 40.7bn
 2003: 20bn

Overview of the hybrid market

CORPORATES : 16 bn € issued to date

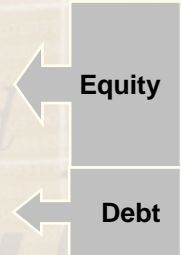


Hybrid: What is it?

- A Liability capital markets instrument
- Structured to be a proxy to Equity
- With generally 4 main features
 - Ranking : Junior to all debt obligations
 - Maturity : Undated or very long dated (60 years)
 - Right of payment : Tailored to be a proxy to a dividend, i.e. discretionary in most cases
 - Callable : Synthetic maturity (typically at year 10)
- And 3 key objectives pursued by issuers
 - Strengthen their financial structure
 - At a reasonable price
 - And in a non-dilutive way

Debt to Equity continuum

Accounting treatment (IFRS)	
Ordinary shares	Equity
Hybrid instrument	Equity
Senior debt	Debt



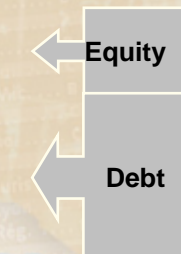
Legal treatment	
Ordinary shares	Equity
Hybrid instrument	Subordinated: senior to ordinary shares only
Senior debt	Senior debt: no subordination



Rating treatment	
Ordinary shares	100% Equity
Hybrid instrument	50% Equity
	50% Debt
Senior debt	100% Debt



Fiscal treatment	
Ordinary shares	Dividend payment - not tax deductible
Hybrid instrument	Interest payment - tax deductible
Senior debt	Interest payment - tax deductible



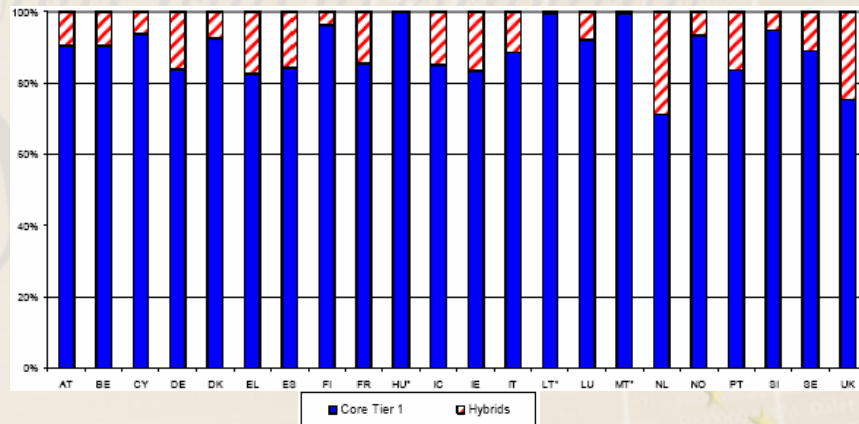
Hybrid Capital vs other capital instruments

	Senior	Convertible	Hybrid	Capital
Post Tax cost	😊	😊	😊	😞
Dilution	😊	😐	😊	😞
Regulatory Treatment	😞	😞	😊	😊
Equity Credit	😞	😞	😊	😊
Accounting treatment	😞	😞	😊	😊

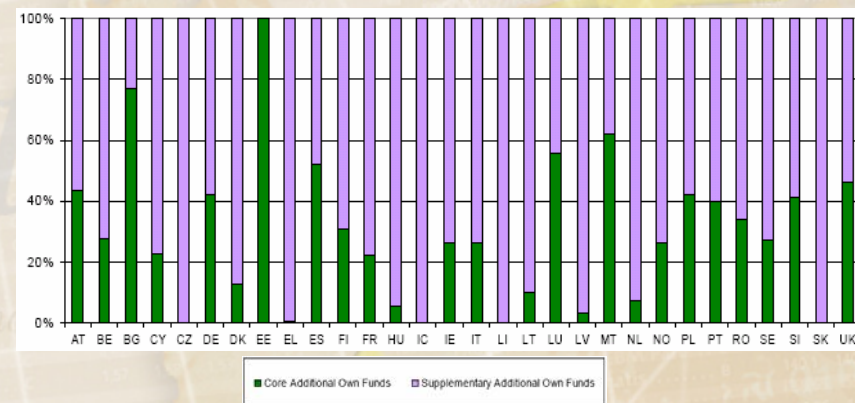
Fls: A key component of regulatory capital

- On an aggregate basis “Hybrids Tier 1” represents 15% of banks own funds
- Hybrids Tier 1 are mainly composed by innovative instruments (2/3)

Structure of Tier 1 by country



Structure of additional own funds by country



- Going forward the main issues are:
 - Development of non innovative structures
 - Harmonisation of Tier 1 eligibility criteria across Europe

Corporates: main rationale for issuance

- **To retain financial flexibility**
 - Claas, Südzucker, Vattenfall, DONG, Wienerberger
- **To refinance existing debt**
 - Bayer, Thomson
- **To consolidate company's financial structure**
 - Union Fenosa, Mossi & Ghisolfi, Eurofins
- **To finance pension deficits**
 - Henkel
- **To (re)finance an acquisition**
 - Vinci, Porsche, TUI, Lottomatica, Solvay, Linde, Siemens, Cemex, Rexam
- **To lower cost of capital**
 - GECC

A continuously evolving market

- **Progressive standardization on one hand...**
 - Guidelines from regulators, rating agencies and, to an extent, from accountants
 - Beginning of standardization of certain terms
 - Investor's education
 - Quantitative pricing models developed (convergence in the making)

- **... But the quest of the holy grail continue**
 - **Regulatory environment**
 - CEBS / CEIOPS / Solvency II
 - Non Innovative Tier 1
 - Tier 1 for insurance companies in anticipation of future regulation
 - **Complexification of instruments' features**
 - Optional/Mandatory Interest Deferrals
 - ACSM : Share settlement, APSM, PIK
 - Replacement language binding and non-binding
 - Early redemption call

A continuously evolving market

- **... therefore new frontiers are continuously tested**
 - First hybrid transaction by a non investment grade issuer for TUI
 - First perpetual Exchangeable hybrid Bond for MOL
 - First non investment grade issue by an investment grade issuer for Lottomatica
 - First non-rating compliant hybrid for Cemex
 - A growing market for unrated/unlisted issuers (Mossi & Ghisolfi, Eurogate, Eurofins, etc.)

Structuring: what are the drivers ?

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Structuring challenges

Regulator

Tax & Legal

Accountants

Rating
Agencies

Investors

- **Regulatory constraints (features, thresholds)**
- **Issuer / Issue corporate law**
- **Tax considerations**
- **Accounting treatment (equity/debt)**
- **Rating of the issue and equity content**
- **Investors perception & impact on credit premium**

Structuring : the French case

LEGAL ASPECTS

- Perpetual obligations can be structured under French law
- Deeply Subordinated Bond (*Titres Super Subordonnés*) ranked hybrid instrument just senior to equity
- Interest deferral is achievable but the mechanism should take into account legal / regulatory constraints (dividend pusher, ACSM)

TAX ASPECTS

- French tax rules stick to the legal analysis of the securities issued
- TSS are defined as debt securities and therefore interest payment are fully tax deductible

ACCOUNTING ASPECTS

- Equity treatment depending on the lack of obligation to deliver cash or financial assets
 - No maturity
 - Option to settle in cash does not create a liability
 - Interest payment optional only (dividend pusher possible)

Hybrid instruments can be efficiently structured from a tax, legal & accounting perspective... in most European jurisdiction !

AXA EUR 1 bn 5.777% undated / 2016

● **Issuer :**

AXA SA

Direct issue

● **Issuer rating :**

A2, A, A+

● **Issue rating :**

Baa1, BBB, A

● **Size :**

EUR 1 bn

● **Maturity :**

Undated non call 10 ans

● **Coupon :**

5.777%

Regulator / Rating agencies

AXA EUR 1 bn 5.777% undated / 2016

- To finance Winterthur, AXA has chosen to:
 - Anticipate future Tier 1 regulation for insurance companies
 - Optimize the benefits of the issue from a rating agencies angle

Corporate law issue / issuer:	French / English
Regulatory aspects:	Banking Tier 1 format in anticipation of future insurance rules
Tax:	Tax deductible
Accounting:	Equity under IFRS
Equity content:	100% S&P / 75% Moody's
Investors perception:	Oversubscription 4.4 x

Linde EUR 700 mn 7.375% 2066 / 2016

● **Issuer :**

Linde Finance BV

Undirect issue

● **Guarantor :**

Linde AG

● **Issuer rating :**

A3, BBB+ (Moody's, S&P)

● **Issue rating :**

Baa2, BBB-

● **Size :**

EUR 700 mn

Negative watch at the time of the issue

● **Maturity :**

2066 non call 10 ans

● **Coupon :**

7.375%

IFRS debt treatment

Linde EUR 700 mn 7.375% 2066 / 2016

- In the context of BOC acquisition Linde launched its second hybrid:
 - To increase financial flexibility thanks to the equity content
 - To limit dilution by reducing the equity increase

Corporate law issue / issuer:	German / English
Regulatory aspects:	None
Tax:	Tax deductible
Accounting:	Debt under IFRS
Equity content:	50% S&P and Moody's
Investors perception:	Oversubscription 9 x

Differing features for the same substance

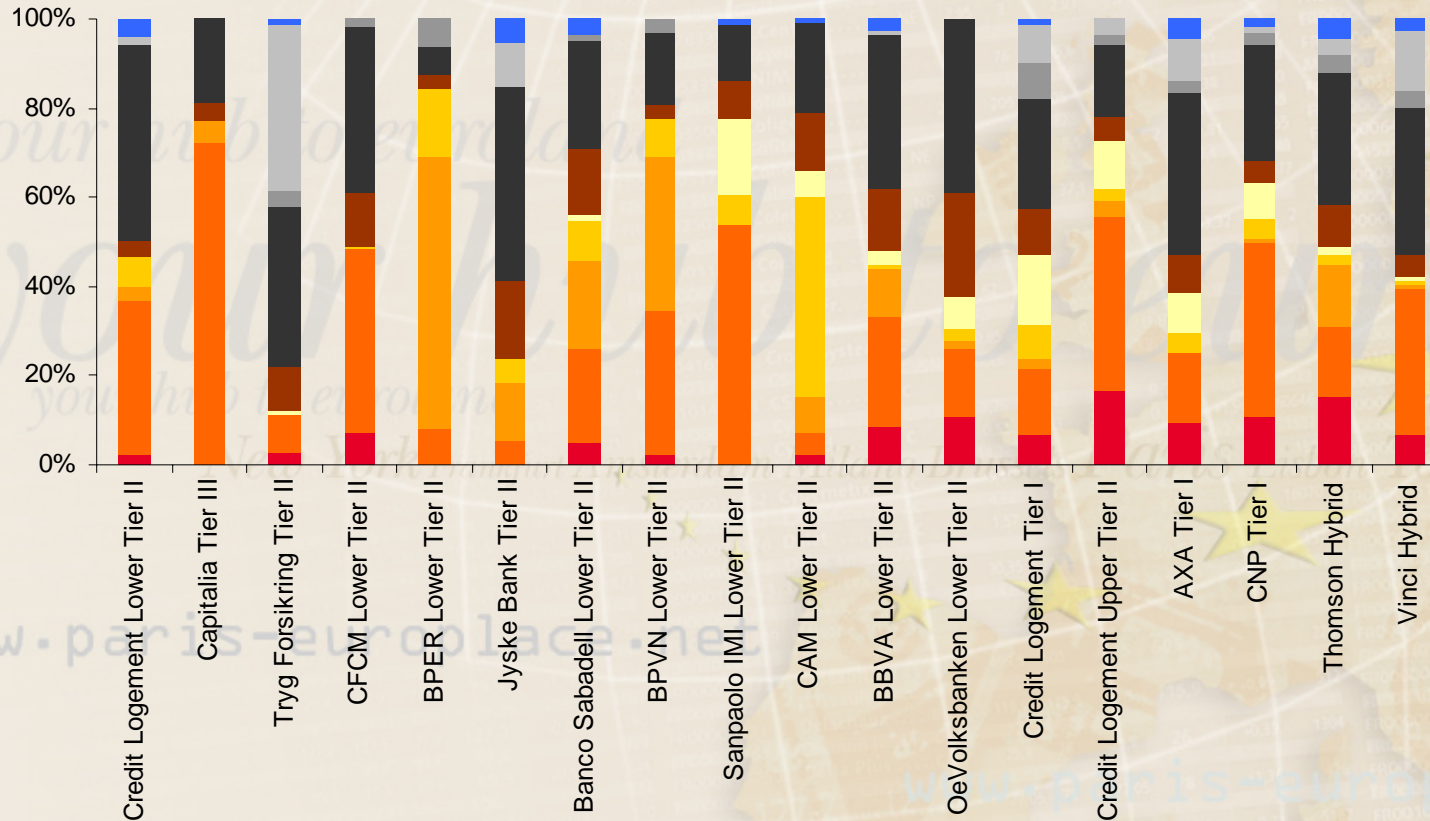
	AXA Tier 1	Linde Hybride
Regulator	Insurance company regulated by « ACAM »	Corporate, non regulated
Tax & Legal	Direct issue	Indirect issue
Accountants	Undated	Dated
Rating Agencies	Equity IFRS 75 % equity content Moody's 100% equity credit S&P	Dette IFRS 50 % equity content Moody's 50% equity credit S&P
Investors	-2 notches Moody's -3 notches S&P	-2 notches Moody's -2 notches S&P

Who are the investors ?

Germany France Italy Spain Netherlands Other EU UK Switzerland Scandinavia Others

65% 58% 62% 59% 39% 90% 91% 65% 100% 55% 99% 77% 85% 61% 84% 61% 84% 67%

% distributed out of home market

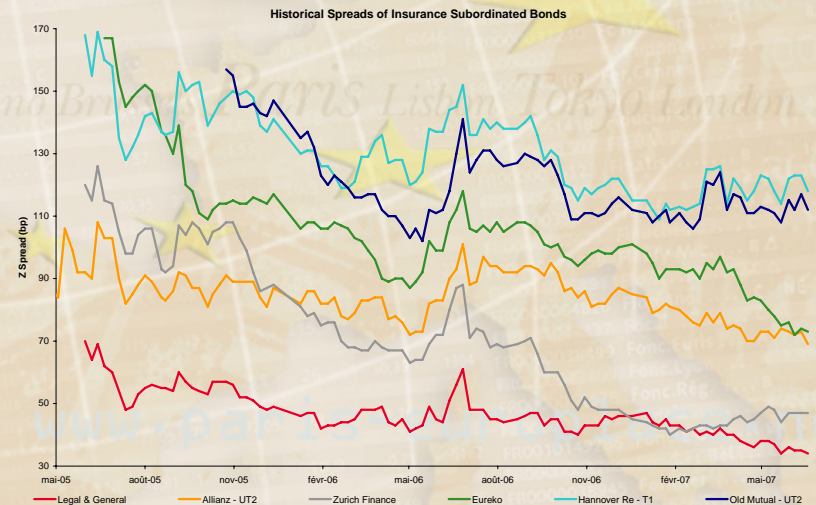
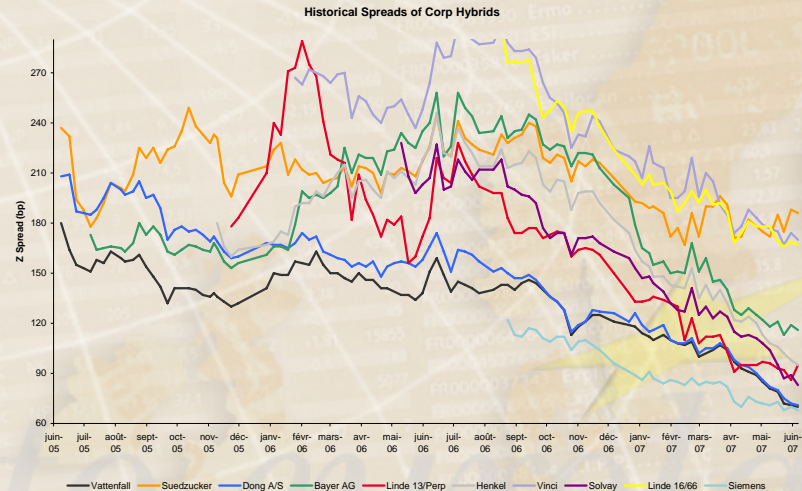


What's in for investors

- **Features of hybrids make them attractive to investors**
 - Characteristics of debt with fixed coupon and scheduled maturity
 - Highest yielding bonds that fund managers can buy
 - Mainly issued by IG companies with a low probability of default
 - Strong performance in the recent years

- **Nevertheless, hybrids carry a number of risk for investors**
 - Subordination, coupon deferral, extension, volatility

- **Therefore the relevant question is : « are they fairly paid for these risks » ?**



P A R I S
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Pavillon d'Armenonville

Thursday July 5 & Friday 6, 2007

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