AT1 Securities: Further Increase in MDA Hurdle

Over the third quarter, major European AT1 issuers generally maintained or improved their capital positions. More noteworthy, however, was the disclosure by some banks of their changing capital requirements for 2018, in particular Pillar 2 requirements. Based on the Supervisory Review and Evaluation Process (SREP), Pillar 2 requirements are subject to regular review.

We highlight that all banks will see the continued phasing-in of the capital conservation buffer. Some will also face the ongoing phase-in of relevant G-SIB, systemic risk and/or countercyclical buffers. Further ahead, we note that the recently finalized Basel III reforms include leverage requirements for G-SIBs that will also become relevant for assessing whether AT1 coupons may be restricted.

Higher Pillar 2 and countercyclical buffer requirements

Around the release of Q3 results, the major UK banks were notified of their Pillar 2 requirements (P2A) for 2018. While some banks saw modest increases of 20-30 bps (Barclays, RBS), others saw more material ones (Lloyds up 90bps to 5.5% and HSBC up 70 bps to 3%).

Some ECB-supervised banks have started to disclose their Pillar 2 requirements for next year (e.g. Unicredit). In the coming months, we expect further disclosures.

DNB also experienced a slight increase in its Pillar 2 requirement to 1.6% from 1.5%. The more material change for DNB, however, will be the flagged increase in the countercyclical buffer rate for Norwegian exposures to 2% from 1.5%. The group, however, will not be subject to the entire buffer as about 20% of its exposures are non-domestic.

Meanwhile, the UK countercyclical buffer rate will increase to 1% from 0.5%, effective November 2018. The Bank of England (BoE) will further review whether the 1% countercyclical buffer rate remains appropriate in 1H 2018. Unlike in other countries, the UK has taken the approach of setting a countercyclical buffer rate of around 1% in a “standard” domestic risk environment, to allow for greater flexibility as conditions change.

Other issuers to see some relief

Recently, the Financial Stability Board updated its list of G-SIBs, with BNP dropping to the 1.5% bucket from 2% and Credit Suisse dropping to the 1% bucket from 1.5%. Looking at the indicators used to determine the rankings and which are based on year-end 2016 figures, we see that both banks saw material declines in key areas – BNP in complexity and interconnectedness and Credit Suisse in cross-jurisdictional activity and complexity.

For Credit Suisse and UBS, the Swiss regulator, FINMA announced in October 2017 that measures taken by the two banks as of end-2016 improved their recoverability and resolvability, meriting rebates in their gone-concern requirements. FINMA makes the assessment annually and has granted approximately one-third of the maximum rebate to both banks, to be phased-in until January 2020. The maximum rebates are up to 2% for leverage and up to 5.7% for RWAs.

The concepts of the combined buffer requirement and the maximum distributable amount (MDA) do not apply as the Swiss banks are not bound by CRD IV. However, the banks are prohibited from making coupon payments on their AT1 securities if they do not meet all applicable minimum capital adequacy requirements. Under the Swiss SRB capital framework, this includes both going and gone concern requirements on both a RWA and leverage exposure basis.

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Related Research

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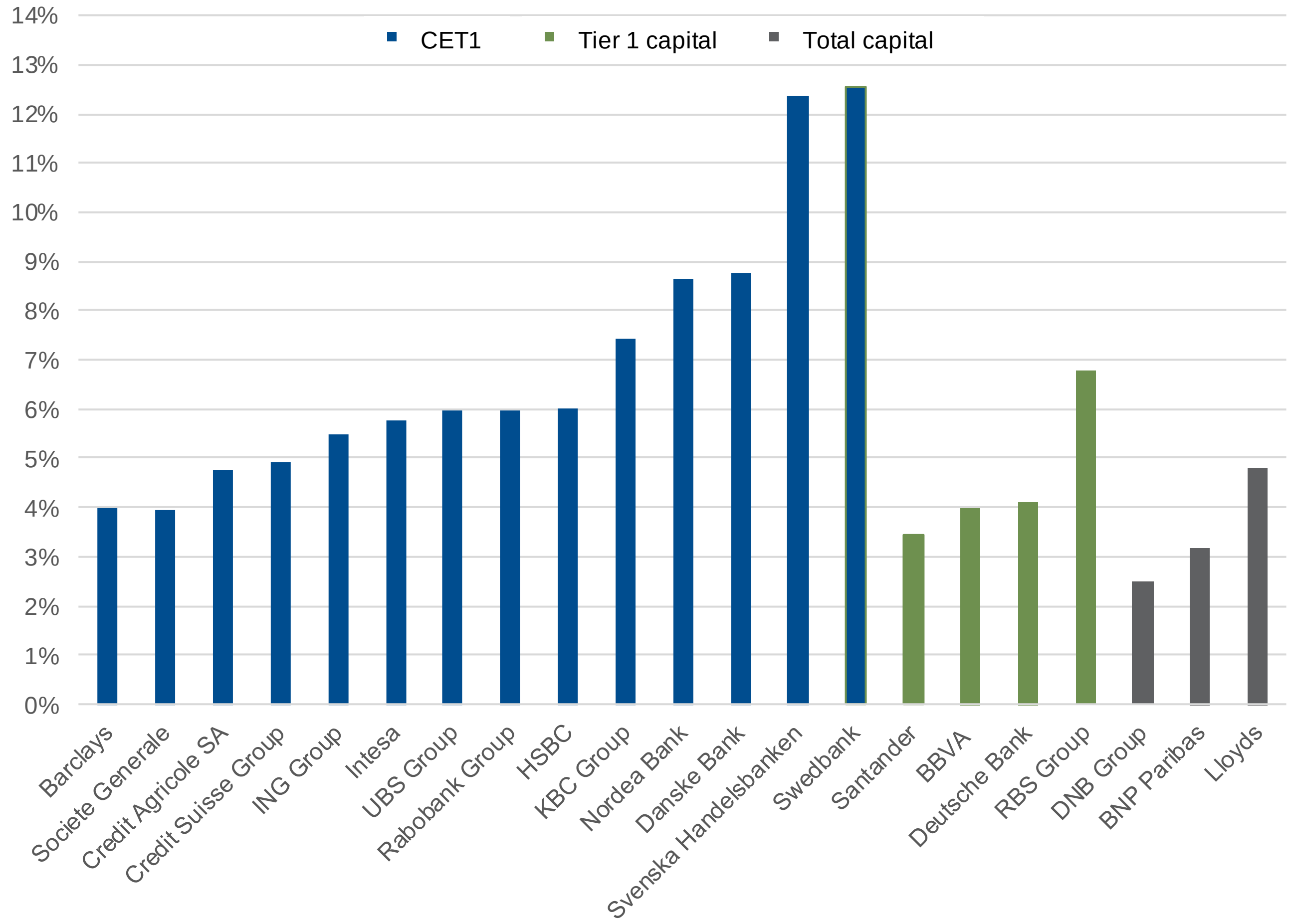
Beware not only of CET1 requirements

For ECB supervised banks, meeting the MDA hurdle currently means complying with CET1, Tier 1 and Tier 2 requirements on a RWA basis. As we have noted before, the narrowest headroom to the MDA hurdle may not be CET1 but Tier 1 or total capital.

Figure 1: Narrowest headroom to MDA relevant requirements



Note: Based on capital figures as of 3Q 2017 except for Rabobank which is based on capital figures as of 2Q 2017.
Source: Company data, Scope Ratings

Leverage requirements to be become relevant for G-SIBs

On a global level, we see a move towards the Swiss approach where both RWA and leverage exposure requirements are relevant for the MDA hurdle. The recently finalised Basel III reforms introduce a leverage ratio buffer for G-SIBs from January 2022, to be met with Tier 1 capital and set at 50% of the risk-weighted G-SIB buffer. For example, a G-SIB in the 2% bucket would be subject to a 1% leverage ratio buffer requirement.

Further, a G-SIB which does not meet both the RWA and leverage exposure requirements would be subject to capital distribution constraints – depending on the magnitude of the breach these would be equivalent to 0%, 40%, 60%, 80% or 100% of earnings.

Appendix:

Headroom to MDA relevant CET1 requirements

		2017	2Q 2017		3Q 2017			
	Basis	Req CET1	2Q17 CET1	Gap %	3Q17 CET1	Gap %	Currency	Gap bn
Barclays	Fully loaded	9.1%	13.1%	4.0%	13.1%	4.0%	GBP	13.0
BBVA	Transitional	7.6%	11.8%	4.1%	11.9%	4.2%	EUR	15.5
BNP Paribas	Transitional	8.0%	11.8%	3.8%	11.9%	3.9%	EUR	24.8
Credit Agricole Group	Transitional	7.8%	15.0%	7.2%	14.9%	7.1%	EUR	36.9
Credit Agricole SA	Transitional	7.3%	12.5%	5.3%	12.0%	4.8%	EUR	14.0
Credit Suisse Group	Transitional	9.0%	14.1%	5.1%	13.9%	4.9%	CHF	13.1
Danske Bank	Transitional	8.0%	16.2%	8.2%	16.7%	8.8%	DKK	67.3
Deutsche Bank	Transitional	9.5%	12.6%	3.1%	14.6%	5.1%	EUR	18.0
DNB Group	Transitional	13.6%	15.8%	2.2%	16.3%	2.7%	NOK	28.4
HSBC	Fully loaded	8.6%	14.7%	6.1%	14.6%	6.0%	USD	53.6
ING Group	Transitional	9.0%	14.5%	5.4%	14.5%	5.5%	EUR	17.0
Intesa	Transitional	7.3%	12.5%	5.2%	13.0%	5.8%	EUR	16.8
KBC Group	Transitional	8.7%	15.8%	7.2%	16.1%	7.4%	EUR	6.8
Lloyds	Fully loaded	8.3%	14.1%	5.8%	14.1%	5.8%	GBP	12.6
Nordea Bank	Fully loaded	10.6%	19.2%	8.6%	19.2%	8.6%	EUR	11.1
Rabobank Group	Transitional	9.0%	15.0%	6.0%	15.0%	6.0%	EUR	12.4
RBS Group	Fully loaded	8.4%	15.5%	7.1%	15.5%	7.1%	GBP	14.9
Santander	Transitional	7.8%	11.0%	3.2%	12.2%	4.4%	EUR	27.6
Societe Generale	Transitional	7.8%	11.9%	4.2%	11.7%	4.0%	EUR	13.9
Svenska Handelsbanken	Fully loaded	11.2%	23.4%	12.2%	23.6%	12.4%	SEK	62.7
Swedbank	Fully loaded	11.3%	24.6%	13.3%	23.9%	12.6%	SEK	52.7
UBS Group	Transitional	9.1%	14.8%	5.7%	15.1%	6.0%	CHF	14.3

Source: Company data, Scope Ratings

Headroom to writedown/conversion trigger

			2016		2Q 2017		3Q 2017	
	Basis	Trigger	FYE CET1	Gap %	2Q17 CET1	Gap %	3Q17 CET1	Gap %
Barclays	Fully loaded	7.00%	12.4%	5.4%	13.1%	6.1%	13.1%	6.1%
BBVA	Transitional	5.125%	12.2%	7.1%	11.8%	6.6%	11.9%	6.8%
BNP Paribas	Transitional	5.125%	11.6%	6.5%	11.8%	6.7%	11.9%	6.8%
Credit Agricole Group	Transitional	7.00%	14.4%	7.4%	15.0%	8.0%	14.9%	7.9%
Credit Agricole SA	Transitional	5.125%	12.1%	7.0%	12.5%	7.4%	12.0%	6.9%
Credit Suisse Group	Transitional	7.00%	13.4%	6.4%	14.1%	7.1%	13.9%	6.9%
Danske Bank	Transitional	7.00%	16.3%	9.3%	16.2%	9.2%	16.7%	9.7%
Deutsche Bank	Transitional	5.125%	13.4%	8.3%	12.6%	7.4%	14.6%	9.5%
DNB Group	Transitional	5.125%	16.0%	10.9%	15.8%	10.7%	16.3%	11.2%
HSBC	Fully loaded	7.00%	13.6%	6.6%	14.7%	7.7%	14.6%	7.6%
ING Group	Transitional	7.00%	14.1%	7.1%	14.5%	7.5%	14.5%	7.5%
Intesa	Transitional	5.125%	12.7%	7.5%	12.5%	7.4%	13.0%	7.9%
KBC Group	Transitional	5.125%	16.2%	11.0%	15.8%	10.7%	16.1%	11.0%
Lloyds	Fully loaded	7.00%	13.6%	6.6%	14.1%	7.1%	14.1%	7.1%
Nordea Bank	Fully loaded	8.00%	18.4%	10.4%	19.2%	11.2%	19.2%	11.2%
Rabobank Group	Transitional	7.00%	14.0%	7.0%	15.0%	8.0%	15.0%	8.0%
RBS Group	Fully loaded	7.00%	13.4%	6.4%	15.5%	8.5%	15.5%	8.5%
Santander	Transitional	5.125%	12.5%	7.4%	11.0%	5.9%	12.2%	7.1%
Societe Generale	Transitional	5.125%	11.8%	6.7%	11.9%	6.8%	11.7%	6.6%
Svenska Handelsbanken	Fully loaded	8.00%	25.1%	17.1%	23.4%	15.4%	23.6%	15.6%
Swedbank	Fully loaded	8.00%	25.0%	17.0%	24.6%	16.6%	23.9%	15.9%
UBS Group	Transitional	7.00%	16.8%	9.8%	14.8%	7.8%	15.1%	8.1%

Source: Company data, Scope Ratings

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