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Recapitalization of Caixa Geral de Depósitos

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ABSTRACT

This thesis presents a case study about the 2017 recapitalization of Portuguese bank Caixa Geral de Depósitos (CGD). The case starts by presenting CGD's situation and what led to its urgent capital needs. Furthermore, the case presents an analysis of new capital regulations coming out of Basel III and how banks use a combination of hybrid securities such as Contingent Convertible and Perpetual Notes to comply with such regulations. Finally, there is an in depth analysis of the recent issuance of Additional Tier 1 Capital Write Down Notes by CGD, and what it represents to the state owned bank's future.

Keywords: Banking, Regulation, Basel, Contingent Capital

Caixa Geral de Depósitos S.A.

"If we fail, we will hardly be given another comparable chance" – Paulo Macedo, CEO, Caixa Geral de Depósitos, 1/2/2017

On Monday the 30th of March 2017, Paulo Macedo, recently appointed CEO of Caixa Geral de Depósitos (CGD), sat in his office, dwelling on whether he should feel pleased that the Portuguese state owned bank had successfully concluded the capital injection €2.5 billion – the second stage of CGD's recapitalization plan – or anxious about the bank's future, now that instructions from Brussels were to be complied with. He had just put down the phone, talking with Portuguese Finance Minister Mário Centeno, where he expressed his thoughts about the realization of the issuance of Subordinated Perpetual Debt and Contingent Convertible Bonds (CoCos), which Centeno considered a success, but failed to understand how CGD would pay almost €100 million of interest in a year's time, when projected profits for CGD anticipated by himself and the remainder of his team for the future were still nothing but wishful thinking. Centeno's only concern was how this recapitalization would impact the state's deficit and was weary of formulating any sort of prediction. According to Centeno, the operation was not to be treated as state aid, and Eurostat – a Directorate-General of the European Commission – should consider it an investment, rather than a state expense.

The Situation

Almeida, a small town neighboring Spain, rarely makes national news, and when it does, it's not for the best of reasons. Dreaded with the drawbacks but enjoying the perks of isolation, on the 12th of April 2017, this quiet town burst up in protest regarding the closing of Caixa Geral de Depósitos' local office. As part of its restructuring process amid financial distress, CGD planned to reduce a number of branches as well as 'optimize' headcount, and the town of Almeida was not pleased. "We will go wherever we have to" an elderly lady bellowed at the TV crew. "If we have to, we'll go to Lisbon" she persisted. Where she unquestionably didn't want to go, was Vilar Formoso, nearly 18 kilometers away, where the nearest CGD branch was located. The reason was clear: Almeida's ageing population, lack of efficient public transport and low levels of income made the journey to Vilar Formoso for pension collection an extensive and challenging accomplishment. The goal of the protest was ultimately to overturn the bank's decision to close the branch, however, unsurprisingly, the outcome failed to meet their desire. Two weeks later, on the day the closing was scheduled, a group of people, including the town's mayor António Ribeiro, stood within the branch's small grounds in despair, and refused to leave until the bank's decision was reversed. Their efforts were in ineffective, as were the many similar protests that broke out around rural Portugal. This closely depicted CGD's situation, and how the bank had their hands tied behind their backs. The situation was alarming.

CGD's Background

Established in 1876 under the name Junta de Crédito Público, and shortly after merged with Caixa Económica Portuguesa, a bank for the lower income classes in Portugal, CGD's purpose was to battle the financial and banking crisis in Portugal at the time. The bank was known to take advantage of private citizen's savings and taxpayer money to fund Government spending, which, to this day, some question if it still happens.

Circa 1932, António Oliveira Salazar took control of the country through a prolonged dictatorship. Throughout this time, CGD became of imperative importance to fulfil what the Dictator labelled as the country's financial regeneration. The bank was then intended to act as a vehicle for the social, agricultural, and industrial transformation that Portugal was due to undergo under Salazar's political authority. Whilst suppressing the media's freedom, Salazar reformed CGD to lend capital solely to private investors and the State in order to regulate the market and intervene accordingly, in a prospering economy. Some would say his price fixing policies and production limits were exclusively imposed to serve the welfares of the State and certain individuals – and CGD was a part of it. Years later, CGD became what was designated as a state owned company, however operating in the same fashion, only now under the influence of Marcelo Caetano, the last President of the Council of Ministers of Salazar's regime.

1992 marks an important milestone in CGD's history, as the bank becomes a public limited company after the fallen dictatorship in 1974, and must now comply with regulations where other private company's operating in the banking sector are subject to. As a public limited company, common designations would allow individuals to buy and sell shares freely, but not for CGD. The state was to be the sole proprietor of CGD's shares, from that moment, thereafter. Some would agree that holding the status of a public limited company, the bank would in fact remain more independent and self-governing from the state, however this turned out untrue, and CGD would somewhat be responsible for the large debt burden that the

Portuguese economy undertook, by providing easy access credit to private individuals and for the State's infrastructure investments. This was manageable during the time where the world economy, and in particular, the Portuguese economy, prospered and interest rates were favorable (**Exhibit 1**), but, amidst a mood of eerie calmness, in 2008, the global financial sector was brought down to its knees, and so was the whole of the Portuguese economy.

Even though Portuguese banks were not on the limelight of the subprime crisis amongst the European banking sector, most Euro area pertaining countries, namely those of southern Europe, were quickly engulfed in an overblown sovereign debt crisis. This was essentially due to years of governmental overspending – known in Portugal as the financing of public-private partnerships led by then Portuguese Prime Minister José Socrates, later investigated and charged with colossal counts of corruption – and, more recently the necessity of governments to bail out much of their respective banking sectors. It was in 2011 that Portugal's economy had to resort to a €79 billion bailout and consequent austerity programme from the International Monetary Fund (IMF). This would hit Banco Espírito Santo (BES) – also investigated for corruption – substantially hard, leading to its demise. It was only a mere 3 years later that *Público* – a local news agency – reported that CGD held more that €300 million in exposure to BES assets. This would trigger an urgent need for a recapitalization plan for the state owned banking giant.

Capital Regulatory Framework

Following the turmoil of the largest global financial crisis since the Great Depression, Central Banks, Governments and Regulators came together to establish new procedures to be carried out by financial institutions to avoid such havoc to take place in the future. Amongst several of the measures established, Banks' capital requirements and type were at the center of discussion. Since a bank's capital base was the foundation of the bank's assets and daily activities, a larger and more robust capital structure would withstand and mitigate most losses in which a bank could incur from asset write downs, non-performing loans, or complacent clients. Aside from most banks foolish, or bullish, behavior in the years prior to the crisis, it was also apparent that most banks did not hold a sufficiently stable and healthy capital structure to take on the losses incurred in 2008. This lead to the Basel committee to formulate reforms on the Basel II agreement. These reforms aimed at raising "both the quality and quantity of the regulatory capital base" and were intended on enhancing "the risk coverage of the capital framework."

From Basel I to Basel III

From its founding documents, in 1988, the Basel Committee on Bank Supervision (BCBS) established their initial set on banking regulations with regards to capital, market and operational risk as a form of setting an adequacy on capital standards for both national and international banks and regulators. Their original mission, as stated, was to increase "financial stability by improving supervisory knowhow and the quality of banking supervision worldwide".

Basel I, often referred to as the Basel Capital Accord, set the standard for banking regulation where banks would have to structure their capital framework based on four different types of capital: Common equity; Tier 1 capital; Tier 2 Capital; and Total Capital. Common equity was simply the book value of the bank's equity and also the most expensive form of capital. Tier 1 equity, which included common stock, hybrid securities, preferred stock, and perpetual debt was the second most expensive form of capital. Tier 2 equity was essentially highly junior and subordinated debt, often with hybrid like features likewise, was the least expensive form of capital, but also the one that offered the least loss protection for investors. Basel I also predefined what risks each of the assets on a bank's balance sheet were to bear, and how much capital was required to cover such risks. The higher the Risk Weighted Asset (RWA), the higher amount of capital would be required by regulators to offset potential losses and reduce risk of insolvency.

Basel I set regulations to consist that banks should hold a minimum of 8% of Total Capital of their RWA, where common equity would be set to a minimum of 2% of RWA and Tier 1 type capital was set to be a minimum of 4% RWA.

By mid 2004, Basel II was introduced as a way of making the existing agreement more robust and mitigate the flaws of the previous agreement. These reforms covered three key areas of banking regulation: Market Risk; Market Discipline and Supervisory Review. All three areas of the agreement were essentially focused on the how banks would determine their Capital requirement levels, and how they would assess and compute their asset and balance sheet risk to determine their capital requirements. Basel II also proposed that regulations were extended to other sectors of banks' operations, and allowed banks to opt for external risk weighting evaluation through the main rating agencies, or choose to develop and use their own risk weighting frameworks. Only 5 years later, the agreement was revised and tweaked to overcome the flaws exposed by the Subprime crisis, even before the tragic demise of US's fourth largest investment bank, Lehman Brothers. This revision covered how banks evaluated and conducted risk management practices and suggested new capital requirements, and would set the new benchmark for a Basel III agreement to be implemented from 2013 to 2019.

Basel III was to expand the quantity as well as increase the quality of capital that banks were previously required to hold. This would translate into holding higher amounts of bank equity as well as Total Capital to fulfil new requirements regarding RWA. Furthermore, parameters on what would be considered the different types of capital would be tightened to ensure capital quality. Basel III would be revised to the following capital requirements:

- Common Equity Tier 1 to be increased to 4.5%
- Tier 1 Capital to be increased to 6%
- Total Capital Outstanding maintained at 8%

Moreover, as an extension of the framework, a series of innovations were put in stake:

- Inclusion of a Capital Conservation Buffer (common equity) of 2.5% further to the CET1 threshold, aimed at absorbing losses during financial and economic downturns by restricting staff bonus and dividend payouts, as well as share buybacks to impede violation of minimum equity requirements,
- A Countercyclical Capital Buffer – as an extension of the capital conservation buffer (between 0 and 2.5% of common equity) restricting banks' exposure during national economic booms and protecting them in downfalls
- Leverage Ratio of 3% – (Capital/Assets) defined loss absorbing amounts of capital in terms of the banks' balance sheet, intended to limit absolute growth in banks' balance sheets. In this case, assets are not risk weighted, and a number of what would be considered off-BS assets are included.
- The Liquidity Coverage Ratio (LCR) intended to cover the liquidity requirements over a 30-day period of strain (short term) – guaranteeing high quality and liquid assets.
- The Net Stable Funding Ratio (NSFR), projected to correct maturity mismatches over the banks' balance sheet in the longer term, by guaranteeing equity or debt financing that would mature in more than a year in order to cover longer term illiquid assets on the banks' balance sheet.

Exhibit 2 details Basel capital requirements' evolution.

Still, banks had a long way to come until they were able to meet these new capital requirements, as projected by global consulting firm McKinsey & Company, "European banks would need to come up with €1.1 trillion in equity by 2019" and "American banks would have to raise $870 billion".

The Recapitalization Plan

After a turbulent 2014, where CGD closed the year with a €348 million loss in its Earnings, the bank momentarily returned to a profit, mid-2015, after selling nearly all of Caixa Seguros to Chinese private equity firm Fosun International, liquidating its stakes in insurers Fidelidade, Multicare, Seguros de Saúde, Cares and Companhia de Seguros. The deal yielded just over €1.2 billion to CGD, as a result of a previous dividend distribution of €208.9 million, however, the bank closed the year with a €171.5 million loss. This figure did represent just under half the losses in the previous year, however, this was also coming from a source of income the bank would not be able to resort to in the future.

Come 2016, CGD was, once again, in urgent need for capital after rumors began circulating that the bank would report €2.3 billion in impairments, or in other words, irrecoverable capital investments. Some argued that this was unsustainable, and that, if in fact CGD was a private company, it should file for bankruptcy. When asked to comment on the situation, the Ministry of Finance mentioned that when CGD was previously recapitalized back in 2012 (**Exhibit 3**), all loans had been exhaustively reviewed by the Bank of Portugal and Troika – a cooperation between the European Central Bank (ECB), the European Commission (EC) and the International Monetary Fund (IMF) – and if there was any sort of inaccuracy when analyzing such loans, it should have been reported back then. Moreover, it was mentioned that the "required due diligence that was deemed appropriate, in particular in the field of civil and criminal liability, was carried out". The impairments were in fact reported, and the urge of a capital injection was more than apparent, largely due to lacking levels of provisions against loan losses. Moreover, Paulo Macedo and his team defended, that "the recapitalization was necessary, but not sufficient", so in addition to the recapitalization plan (**Exhibit 4**), they began formulating a restructuring plan (**Exhibit 5**).

The first stage of the plan, accomplished in January 2017, was comprised of the Portuguese State selling its 49% stake in one of CGD's subsidiaries, Parcaixa, a holding company for CGD. This stake would amount to €500 million and would be the first tranche of contributing capital injections. Furthermore, the Portuguese State additionally converted €900 million worth of Subordinated Contingent Convertible Notes (CoCos) it held in CGD in order to boost Additional Tier 1 (AT1) capital requirements by regulators. Moreover, CGD would also conduct a "capital increase through the issuance of ordinary shares, to be solely subscribed by the State, totaling €2.5 billion". Finally, the last part of the recapitalization plan, with the objective of strengthening its capital position through private placements and sources, CGD decided to issue, under market conditions, €930 million worth of Fixed Rate Perpetual Additional Tier 1 Capital Temporary Write Down Notes, in two tranches: Initially, €500 million on March 2017, and a further €430 million 18 months later.

This was to be paired with a restructuring plan, from 2017 to 2020, with the objective of addressing the obvious weaknesses of CGD's balance sheet and operations, and ensuring the long term financial stability of the bank. Paulo Macedo's aim, was to make CGD return to profitability by the end of 2018, guaranteeing that the Portuguese State benefits from a return on its investment, just like what any private investor would expect to under normal market conditions. This was to be conducted by solidifying its solvency through structural reforms within its risk management approach, taking into consideration that interest rates were expected to be maintained below zero until 2020. Also, the bank was set to undergo deep cost cutting, through headcount reduction and branch closures; reformulating its domestic operations, making its commercial banking division more competitive; revaluating outstanding non-performing loans; and revising the bank's governance conditions and compensation packages to those in line with the rest of the private industry.

Contingent Capital

Contingent Capital securities (CoCos) first came up in the early 2000's, but only became popular among banks in mid 2010 after the subprime and sovereign debt shook the world economy. Structurally speaking, this class of capital was designed to bolster banks' capital needs during times of stress. These were securities that carried hybrid-like features: they were debt instruments, that would be converted into equity whenever and if some "trigger" event occurred. However, these instruments, contrarily to what happens with regular convertible bonds, in that they generally converted with the appreciation of the underlying security's price, would be converted should the bank's capital fall below a predefined ratio level established by

Basel III frameworks and local regulators. In other words, this was capital that would only materialize, depending on the banks' needs. This raised a few questions from the investor and issuer point of view, as mentioned by Wilson Ervin, Chief Risk Officer at Credit Suisse, on issuing contingent capital: "You can't sell an instrument with equity downside and fixed income upside", he believed, adding that the risk return profile of the instruments was closely monitored by investors, "this will need to have a double digit yield", he mentioned when Credit Suisse issued CoCos in late 2010.

Contingent Capital Notes were formulated essentially on three main characteristics: The investor base, the "trigger", and the conversion. Firstly, for a higher degree of debt subordination, investors would require higher returns on their bonds. Secondly, the "trigger" that would allow for the conversion to take place would be dependent on either the bank's book value of equity, the market value of equity, a predefined "trigger" established by a regulatory entity, or even an arrangement of the three. Determining the "trigger" based on book values was usually not a suitable metric, as they were somewhat unreliable in reflecting the real financial health of an institution. An example of this is Lehman Brothers' Tier 1 healthy capital ratio of 11%, prior to its bankruptcy. For some, market triggers are more attractive since market discipline is commonly considered less tolerant than regulatory discipline. Finally, the conversion of the notes is specifically designed to sustain loss absorbing features whenever the "trigger" occurred. In case of conversion, either there would be an effective conversion into common equity shares, where the investor would be able to hold some sort of upside in retaining equity but at a cost of dilution, or there would be a write down of the notes, essentially making the investor sustain the losses of the value of debt.

As part of its previous recapitalization plan, dated 29th of June 2012, CGD undertook a direct capital injection from the Portuguese State of €750 million through the issuance of 150 million ordinary shares at €5 each, and an "issuance of hybrid financial instruments, eligible for Core Tier 1 Equity, in the total amount of €900 million" with a surprising 8.5% coupon rate, "fully subscribed by the Portuguese State". Come January 2017, CGD decided to convert the issued CoCos which were due to be repaid to the Portuguese State in June 2017, an obligation CGD knew it wasn't going to be able to fulfil. This would alleviate the burden of having to pay interest on the debt, which in 2015 alone rose to about €81 million.

Perpetuating Financing

Dating back to the 18th century, Perpetual bonds were first issued by the British government as an alternative to the more common Sovereign Treasury bonds. Today, they remain largely popular among Sovereign States and Banks.

In an attempt to fulfil regulatory requirements of Tier 1 capital, many banks, namely within the public sector, have resorted to perpetual bond issuances, referred to as Additional Tier 1 (AT1) bonds. As a rule of thumb, surprisingly AT1 bonds present higher yields than Tier 2 capital bonds. “While a AAA-rated tier II bond of a public sector bank may have an interest rate of 7.5% per annum, its AT1 bond can carry a rate of around 9% per annum.”

AT1 bonds, by definition, have no specified maturity. In other words, they pay coupon payments indefinitely, until the security’s issuer decides to call back the bond and/or deliver the principal at a predefined date. They are also largely appealing to institutional investors due to their high yields when compared to regular senior debt, however they also offer a substantial amount of risk. These downsides can at times come in several ways: the issuer may call back the bond; the bank may revoke the coupon; the bond may be written down at the issuer’s discretion or converted into equity. Due to these features, as well as being a highly subordinated type of debt, some would find it hard to even classify this type of instrument as debt.

On Wednesday the 22nd of March 2017, Paulo Macedo was arriving in Lisbon after attending investor roadshows in London and Paris to promote CGD’s perpetual debt issuance. He knew the AT1 bond issue was a necessary condition when carrying out the bank’s recapitalization imposed by the European Directorate-General for Competition to ensure the €980 million debt issuance does not classify as state aid.

Paulo Macedo was surprised at how successful the roadshow had been, gathering over 120 institutional investors across the three cities, but was apprehensive on the investors’ reactions towards the bond’s rates. He knew that investors wouldn’t accept anything lower that a 10% rate on the bonds. He reckoned this was especially influenced by the fact that CGD is not publicly listed leaving investors blind eyed, and "due to the absence of similar bond issuances by state-owned banks, making it hard to compare, and, above all, to the intrinsic risks of such instruments". Moreover, this issuance was highly conditioned by macroeconomic factors, and investors were still weary by what happened to senior bondholders of Novo Banco in 2015. Pimco and BlackRock had also announced they would be taking legal action against the Portuguese Central Bank making matters worse. Paulo Macedo, having been Executive

Director of private owned bank Millennium BCP, also knew that having the Portuguese State as the sole shareholder of CGD would raise a lot of questions on whether the bank would have the ability to comply with the strategic plan to guarantee its "perpetual" success.

The AT1 Challenge

The issued notes would be underwritten by Caixa Geral de Depósitos S.A. on the 23rd of March 2017 (**Exhibit 7**) on the Luxembourg Stock Exchange, denominated Fixed Rate Reset Perpetual Additional Tier 1 Capital Temporary Write Down Notes. The Notes would carry a 10.75% coupon rate per annum, and sold at 100% of the principal amount of the Notes. Further to the aforementioned rate, it would be payable quarterly up to the first call date of the notes (after 5 years), and such rate will be reset on at the call date, and on each fifth anniversary "as the sum of the applicable 5-Year Mid-Swap Rate plus a margin of 10.925%". This was an unusually high coupon rate for a State Bank bond sale, but pricing power had laid strongly in the hands of investors. Moreover, Fitch was rating the bonds as 'junk' leaving investors especially weary. The securities would be constituted "undated, direct, unsecured and subordinated obligations of the Issuer", "without any preference among themselves".

As with most types of hybrid securities, these notes would include their respective "trigger" with a Write Down feature: if at any time the CET1 Ratio of any of the Issuer and/or the Group has fallen below 5.125%, then the Notes' outstanding principal amount would be, from the occurrence of the relevant "Trigger" event, without no investor consent required, permanently reduced by the relevant write down amount. and "canceled all interest accrued to (but excluding) the Write Down date". This relevant write down would amount to either a value that the issuer deems adequate to write down to restore CET1 Ratio values, or the amount necessary to reduce the outstanding amount of each Note to one cent of Euro. As part of its issuance's objective, the Notes would also hold Loss Absorbing Features that would limit the bank's liability towards investors. In any case, such write down would only take place to the point where the bank is able to restore the relevant CET1 Ratio that matched the Trigger level. Moreover, these notes would hold a Discretionary Reinstatement feature, where, following a possible Write Down, at CGD's own discretion, the outstanding principal amount of the Notes could be increased, not exceeding the original amount, nor could it lead to another Trigger Event, or exceed the maximum write up amount.

Looking Forward

After the success of the issuance of the first tranche of Perpetual Notes, CGD seemed to be looking at brighter days and the sentiment was that in September 2018 the second tranche would follow a similar path in terms of demand for the Notes. On the other hand, CGD's management was still dwelling on the long term future of the bank after it had registered record losses in the latest financial year, and it wasn't looking to return to profitability in the foreseeable future. Still, Paulo Macedo's team believed it had made good progress in working towards reassuring the market of the bank's solidity whilst complying with regulations. Some still resided on the fact that theoretically, the recapitalization plan had constituted state aid which didn't look good in the eyes of investors as it could lead to governance issues, but Brussels was confident in the market's reaction and CGD's ability to get back on its feet to profitability. Could CGD offset the market's opinion on State Aid? Could the bank distance itself from the Portuguese economy's performance, or how different would it be to invest in a Treasury bond? What would become of CGD's future if it failed to get back on its feet following the recapitalization?

TEACHING NOTE

Caixa Geral de Depósitos S.A.

Pressing Issues

Caixa Geral de Depósitos (CGD) is Portugal's state owned bank and largest financial institution in terms with the highest market shares in major areas such as general deposits, loans, mortgages, insurance, mutual funds and real estate leasing (11.4%). After a series of arguably poor management decisions and loan delinquencies, coupled with deep domestic and global economic distress periods, the bank was reporting record losses year after year. Following the recapitalization of the bank in 2012, it became evident that CGD would have to undergo a new recapitalization process, given that the previous one was far from enough. This was to be combined with a restructuring plan to realign the bank's objectives and allow it to return to profitability. Further to the urgent need for capital alone, the bank, under the supervision of European regulators would now have to comply with the new Basel III Capital requirements, whilst containing the amount of capital that could be considered state aid. To do so, the Portuguese State decided to sell its 49% stake in one of CGD's subsidiaries, Parcaixa, a holding company for CGD; as well as convert €900 million worth of Subordinated Contingent Convertible Notes (CoCos) it held in CGD. Further to this, and to comply with Basel III regulations, CGD also led a capital increase through the issuance of ordinary shares, solely subscribed by the State valued at €2.5 billion as well as issuing €930 million worth of Fixed Rate Perpetual Additional Tier 1 Capital Temporary Write Down Notes. Are these instruments, namely the debt issuance to private investors, a good idea when considering CGD's objectives? Are contingent convertible instruments the best solution to CGD's urgent capital needs? Should CGD have issued regular CoCos, similar to what other European banks done in the past, or were the Perpetual Notes a better financing solution? Are they convertible to Equity, or solely write down notes? Is the trigger adequate as a regulatory capital trigger or should it be market equity dictated considering CGD's shareholder situation? Is the yield fair? What are other possible solutions to this financing, and what costs and benefits, do they offer as opposed to CGD's decision?

Learning Opportunities

Caixa Geral de Depósitos is a typical restructuring case written for Masters level students that wish to address Capital Structure in a banking, financial restructuring, or advanced corporate finance framework. Due to the nature of the underlying instruments covered in the case, it may also be used in some derivatives courses.

Depending on the aim the instructor wishes the course to take, this case should focus essentially on the hybrid securities presented, taking into consideration that these differ from similar securities issued by non-banking institutions and how these are affected by an extensive presence of regulators. It is also recommended that students spend time on how these securities could potentially be priced and analyzing them from the perspective of both the issuer and the investor. The analysis of this case should essentially consist of students:

1. Discussing how bank capital differs to non-banking institutions capital and why there must be regulation of the former. Students must also compare current banking capital structures to other companies' typical capital frameworks and discuss the importance of such capital difference.

2. Discuss how the worldwide crises that erupted in 2008 lead to tighter regulatory frameworks in particular by the Basel Committee. There should also be an analysis of CGD's capital situation given the new standards even though it had undergone a recapitalization recently.

3. Students must elaborate on the different solutions to comply with capital requirements and discuss the features of different hybrid instruments that make up a bank's capital. There should also be detailed analysis on how hybrid instruments are advantageous to both regulators and issuers in a banking context.

4. Compare the similarities differences between both hybrid instruments presented in the case (CoCos and Perpetual Debt instruments) and how these could be different to better serve the interests of CGD. Furthermore, students should discuss how these instruments could be of interest to other organizations that do not operate within the banking industry.

5. Discussing the terms on which the Perpetual notes were issued, especially taking into consideration they were sold to private institutional investors, however, the Portuguese State is to remain the sole owner of CGD equity. How does this affect investor appetite, and

more specifically, discuss how this may lead to conflict of interest between the bank, the State and the investors.

6. Analyze how adequate the “trigger” level is and how fair the coupon rate stated on the notes is. Students must also recall the fact that the notes have loss absorbing features (variable write down amount; with a write up possibility at a future date) and were very low rated by the rating agencies. Throughout the analysis, students may also attempt to present a payoff sketch to the investor.

Students are also encouraged to discuss how they believe this strategic recapitalization plan will affect the future of CGD, as well as the banking sector in Portugal, and how they feel about the effectiveness of such plan. Should CGD have done anything differently? Were there any other solutions?

As a first stage, it is important to understand why bank capital must be regulated, how the framework has changed over time and why this change was necessary. Following this, students must analyze what gave way to CGD’s urgent capital needs and how these must comply with regulators’ demands. Furthermore, the discussion should attempt to discuss the different instruments that can be used to finance bank capital as well as their differences and uses, taking CGD’s case to greater detail from an analytical point of view, and how these differ from other firms’ means of financing.

Analyzing Bank Capital Frameworks

In an ordinary, nonfinancial company, Capital is simply the sum of both equity and debt. For simplicity, the company will borrow money and issue (mostly) regular equity to fund its operations and invest in infrastructure or R&D. In the banking industry, there is a finer line between equity and debt. Banks’ gross form of debt is heavily dependent on deposits. These are, in essence, cheap forms of debt but with high operational costs, that at any point in time may be demanded back by depositors, making them risky from a liquidity standpoint. Further to this, banks rely on central banks, as well as other banks for debt financing, the latter representing also a high amount of liquidity risk due to the systemic nature of the baking industry. It is therefore important to define the objective use of bank capital: absorb any potential losses, at any given time, without jeopardizing the bank’s ability to repay depositors and lenders (interbank loans). This is especially important when addressing the fact that a bank’s operation and stability, as well as the overall financial solidity of the banking industry is heavily dependent on the depositors’ perspective and sentiment. It is therefore of imperative importance that bank capital, as well as risk management practices, are consistently monitored by banks themselves, and regulators.

Need for Banking Regulation

"When in doubt, bail it out?" asked investors who suffered large capital losses after the demise of Lehman Brothers in September 2008. Following the subprime crises and consequently the European sovereign crisis that erupted worldwide in 2007, capital and liquidity requirements came under the spotlight as they proved to be a large risk within financial markets and the global economy as a whole. As a result, the Basel committee had to intervene by setting a series of new reforms on banking regulation in terms of capital and liquidity adequacy, since previously, these had proven not to be enough to absorb losses incurred by the banks amidst distress. Its objective was clear: improve bank solvability, reduce balance sheet risk and increase the ability to endure economic downturns without having to resort to bankruptcy or bail outs that would cost taxpayers astronomical amounts of money. As a result of this, banks were forced to comply with new levels of capital, leverage and liquidity ratios and conservation buffers.

Southern Europe, mostly due to their weak economies, suffered the most with the sovereign crisis. Coupled with poor management decisions, and high risk investments on the balance sheet, CGD found itself in urgent capital needs. As a state owned bank, one would expect the taxpayers to inevitably recapitalize the bank, placing a large burden on an already alarming amount of government budget balance. Since this was already under scrutiny by European regulators, CGD found itself having to look at private investors to reinstate healthy capital levels ahead of a planned out strategic plan, as outlined by the case.

Financing Bank Capital

A Bank's typical capital structure consists of Common Equity Tier 1 (CET1) Capital, Additional Tier 1 (AT1) Capital, Upper Tier 1 and Tier 2 Capital. Tier 1 capital consists of both CET1 and AT1 Capital. CET1, the bank's primary source of capital, and the one that assesses the bank's solvency, is comprised of common shares, subsidiaries and retained earnings. The CET1 ratio, a common "trigger" for AT1 capital, is calculated against the bank's risk weighted assets, and is often the better measure of the bank's health. AT1 Capital is any other form of capital and instrument that does not qualify as common equity due to its maturity nature, but are qualified to be a part of this tier. Any AT1 capital instrument must have no fixed maturity nor must the issuer have any incentive to redeem these perpetual instruments to qualify as such, examples of these instruments are the contingent convertible (CoCo) AT1 bonds, or Perpetual Write Down Bonds, as seen in the presented case. In the event of a bank winding-up, AT1 instrument claimants will rank above common equity shareholders, but will be subordinated to Tier 2 instrument holders and senior creditors. What is often verified is that whenever the CET1 ratio drops below the stipulated regulatory minimum ratio, the bank's capital must be built up to this threshold or risk bankruptcy. If this is verified, common equity holders will be the first to bear losses, followed by the other tiers of capital holders. To prevent this, holders of AT1 and Tier 2 capital instruments are frequently impaired, with their instruments being effectively converted into equity (much less valuable that when the bank was not in distress) or simply written down to absorb losses and preventing a bankruptcy.

A recent example of this is when Banco Santander acquired Banco Popular in mid 2017, where both AT1 and Tier 2 capital holders saw their assets written down, while more senior bondholders were left unaffected. This presents the real challenge of the banking industry: amidst distress, looking to the future whilst holding more junior and subordinated assets is scathed with uncertainty. For this reason, investors will always require high yields for these instruments, given their risk-reward profile.

Funding AT1 Capital

As indicated previously, corporate and financial hybrid instruments are typically bonds or notes issued by banks, non-financial institutions or even insurance companies that carry both equity and debt like features. Some refer to them as quasi-equity instruments in that they are more similar to equity than debt. Further to this, and congruent with CGD's note issue, most of these hybrids have tax-deductible coupon payments, one of the debt features these instruments hold, but from a balance sheet point of view, these are mostly treated as equity due to their high subordination and loss absorbing features. Further to this, another structural feature of the notes or bonds that resembles equity is the right for the issuer to defer (optional or mandatorily) coupon payments under certain conditions, much like how a company chooses to pay out dividends to shareholders or not. CGD's perpetual notes are consistent with this in that the issuer "may elect at any time, in its sole and full discretion, to cancel (in whole or in part) any payment of interest otherwise scheduled to be paid on an Interest Payment Date for an unlimited period of time and on a non-cumulative basis", without triggering a default, or should the CET1 ratio fall below 5.125%, where a mandatory write down takes place. It is also important that students note that interest payment deferrals may have an accrual or non-cumulative feature. Furthermore, most hybrid bond have perpetual maturities, in that they do not have a specified redemption date, but can usually be called back by the issuer. For equity characteristics to hold and be retained, there is no room for the investor to terminate the bond or note. In CGD's particular situation, the notes are callable by the issuer on the fifth anniversary of the issue date and at every coupon reset date. The notes will pay a 10.75% coupon per annum for the first 5 years, and then will reset (on every fifth anniversary starting at the call date) to a Mid-Swap Rate plus a margin of 10.925%. It is important for students to note that this coupon step-up clause (mid-swap rates in the European banking context are expected to rise from 2017 onwards) is common among hybrid securities, in that they are designed to encourage the issuer to redeem the hybrid security on the first call date, essentially making it a 5-year bond. What is expected as an outcome for these notes, is that calling the instrument, will fundamentally commit the issuer to refinance the stipulated capital or replace it with *pari passu* or subordinated securities. This is primarily conducted to ensure the instruments retain their equity like structures. As a side remark, contrarily to CGD's issue, some hybrid instruments carry defensive change of control clauses, should there be any merger or acquisition involving the issuer, to protect the investor. Since it is known that CGD is to remain fully State owned, this is not applicable.

Banks vs. Regulators

Why is AT1 capital (Perpetual write down debt and/or CoCo bonds) so attractive to banks? Essentially, banks are, under regulatory supervision, being obliged to comply with equity minimums and are therefore required to raise more equity that what is beneficial to their own shareholders (even if the State is its sole shareholder). They are also hopeful that the stipulated trigger is never actually hit, to prevent either write downs or raising further equity. Moreover, issuing these types of securities, allows CGD to protect itself in that they pre-negotiate the terms of any equity requirements in the future. Even though CGD has undergone a troubling path, it is still easier to negotiate any capital requirement terms at that given moment (months preceding the issuing of notes), than at any other moment where the trigger is actually met, in that it would represent a worse "state of nature" than the initial one, as opposed to having to raise equity once the CET1 ratio dropped lower than 5.125%. It is also relevant to understand that there is also a clear advantage for the bank to issue this distress "insurance policy" when the probability of default is high, but inaccurate (having Fitch rating it as "junk" or non-investment grade), making this pre-commitment to equity raising at an early stage much more advantageous, when equated to issuing equity later, at the trigger event. Furthermore, in this scenario, AT1 capital will be sold at the expected value of equity of the bank and depending on investor appetite should the trigger be met, which at the time of the issue is mostly unclear. Suppose that the bank was to issue equity at the time of the trigger event, the value of equity would be much clearer and investor appetite for this equity would be significantly diminished due to its distressed nature, probably making this equity raise substantially more expensive for the bank.

For regulators, there are also some upsides to this form of capital. If regulators want banks to maintain healthy capital levels, would it not be easier to demand banks to raise more common equity, to comply with Basel III agreements? Why would banks be receptive to these kinds of hybrid instruments?

For one, these hybrid instruments represent a compromise between both banks and regulators. As the Basel Committee demands higher capital requirements for banking institutions (from Basel II to Basel III), banks, regulators and researchers divide their opinions on how much equity these institutions should hold. Some even argue that capital should exceed 20% to prevent banking failure and the associated systemic risk of the whole of the banking industry. This is particularly true in countries where the banking industry is large relative to the domestic economy as verified in Switzerland and the UK, and where any bail out or bankruptcy can have fatal effects on the economy. For reference, Swiss banks must hold 10% of their assets on balance sheet as common equity, further to a 9% as AT1 capital. If all countries followed suit to these rules, the amount of capital that would need to be raised would be astronomical. On the other hand, in such a global economy if countries do not adopt these practices, some banks face substantially higher costs of funding, losing competitive advantage to other banks, namely within the US, where regulations are much looser.

Differing Aspects of AT1 Capital

We have discussed how AT1 capital is important to banks and regulators, and the case presents more than one form of these loss absorbing instruments. Having understood how these instruments work, it is important to distinguish the main feature of CGD’s capital instruments: CoCos convert to equity, but the perpetual notes write down in the event of the trigger. The easiest way to create new equity is to simply write down the debt instrument, which often happens in cases of bankruptcy, where the associated liability is plainly liquidated. By doing so, the remaining amount of outstanding equity will increase in value. On the other hand, the debt instrument may also be directly converted to equity, where, likewise, debt ceases to exist, and new equity is added to the previous amount of it. In both cases, the outcome is similar, in that there will be higher equity to debt ratio. The major difference between both methods is the ownership of the new debt in case of conversion. If the debt is written down, all equity will remain in the hands of existing shareholders and these will benefit from a gain. When the instrument is converted, new shareholders of the bank emerge, and if the debt is converted down at fair values (equal to that of a write down), all shareholders will be equally as well off. From this, it is natural that there are no incentives to either force a conversion or a write down, since all parties neither gain or lose from it, unless the terms are unfavorable in a conversion. It is also important to address that there might occur a dilution of existing shareholders of the bank, depending on what the terms of conversion were. In CGD's case, as previously stated, since the Portuguese State was to remain sole owner of the bank's equity, there would be no room for a plausible conversion, as new investors would become shareholders in the event of the trigger.

What about investor appetite? With such high risk and such deeply subordinated debt, CGD's 10.75% coupon rate is the highest coupon for a benchmark euro AT1 capital increase since Banco Popular Español's €500m 11.5% deal in 2013. Further to this, CGD's investment circumstance is heavily impacted by the general economic panorama in Portugal, with some investors describing as "uninvestable". With rating agencies having negative outlooks on the country's banking sector, along with increased pressure on capital from weak profits and asset quality in a highly indebted, low growth economy, investors were especially skeptical and demanded high coupon rates. Moreover, it is important to note that high additional funding costs for AT1 capital can contribute to CGD's difficulty in carrying out its strategic plan and returning to profitability, taking into account the bank's successive losses in previous years. Could anything have really be done different? As stated in the case, the pricing power of these bonds has rested well on investors hands, with CGD having theirs tied behind their backs and regulators increasingly concerned, funding such expensive AT1 capital was really CGD's only viable option. Furthermore, investors were unsure how different investing in CGD would be as opposed to investing in Portuguese treasury bonds given the bank's shareholder restrictions.

Bond Value

When attempting to present a payoff for the Notes, it is important to highlight the complex nature of such payoff, and the example presented in this case is particularly simplified for the sake of teaching purposes. As mentioned earlier, due to the unique characteristics of perpetual AT1 capital, and CGD's issuance in particular, these notes are designed to be essentially 5 year bonds, since there is a strong possibility they will be called back by the issuer after this time. When attempting to analyze these bonds, students may try to do so in more than one way:

Students may attempt to present a 5 step binomial tree:

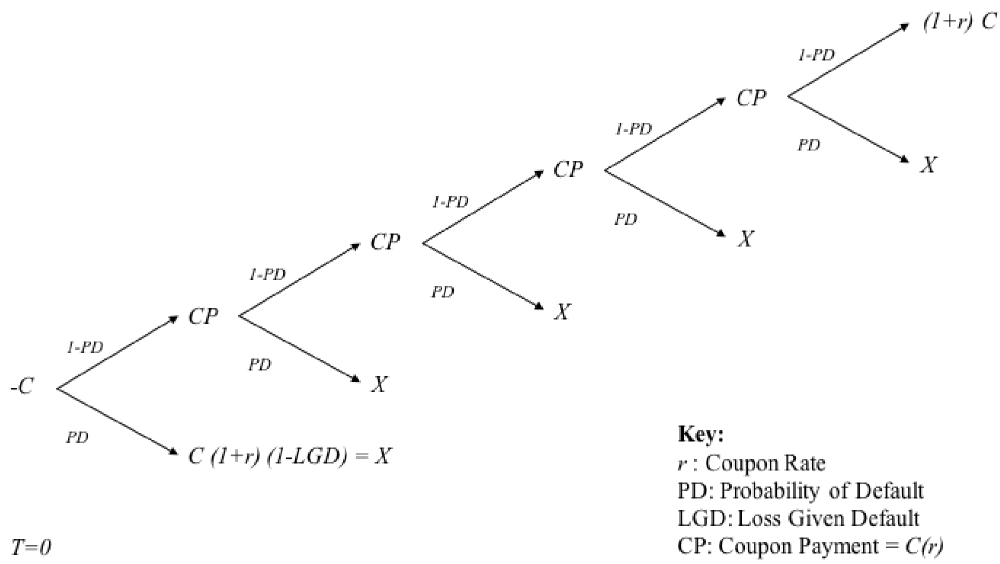

Figure 1 - Perpetual Notes Payoff Diagram

Assuming the bond is held for 5 years, at any given time, in the event of an up move (i.e. no default, given by 1 minus the probability of default) the investor will receive the value of the coupon (10.75% of the principal amount). Should at any point there be a down movement (default, CET1 ratio falls below the trigger level) the notes are written down and the investor receives nothing, specified by the Loss Given Default. After 5 years, when the bond is called, the investor will receive the coupon value plus the principal amount of the note. The notes are denominated as perpetual, in that after 5 years there is a reset to a higher coupon rate for an additional 5 years, however this is highly unlikely to occur, and would make the valuation of the bond significantly more complex.

One other way to look at the notes is the addition value in holding an option on a bond:

$$V^{Rf} = \sum_{t}^{n} \frac{10.75\%}{(1 + y_{Bunds})^t} + \frac{100\%}{(1 + y_{Bunds})^T}$$

The value of the option is therefore given by:

$$Option = V_T - 100\%$$

Since it represents the additional value to hold the option as opposed to a regular, equal maturity bond (i.e. a 5 year German Bund).

It is important for students to address the fact that, since this is an American like option, the Black-Scholes model would be unsuitable to value this option.

It is also interesting to look at the option from CGD's viewpoint. For one, the option could be thought of as a put option on the bank's equity value (the underlying asset), in that when it decreases past a predefined "strike", the bank holds the option to default and absorb losses in order to reinstate the minimum amount of equity that the "strike" value had established. A put option holder (i.e. CGD), inevitably holds the option when it anticipates a loss in the underlying asset's value. This can be illustrated in the following diagram:

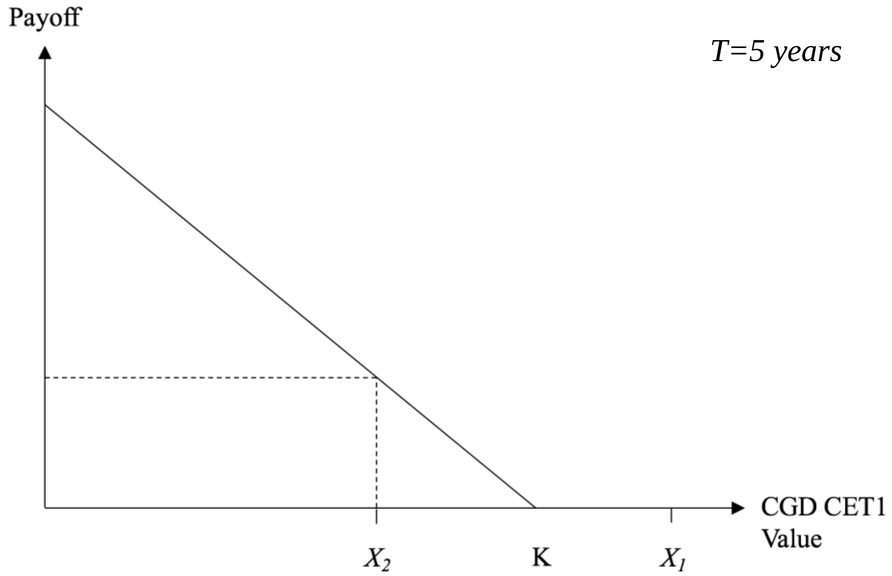

Figure 2 - Option to Default Payoff

When looking at this illustrative example, students must firstly identify the option as an American put option, in that, at any given moment, the bank "chooses to default". If for instance, the CET1 value of the bank decreases from X_1 to X_2, then the put option to default will inevitable be exercised at "strike" K, where *K= regulatory CET1 ratio x RWA*, or in a practical manner, *K = 5.125% x RWA*, in order to restore minimum capital requirements. The bank therefore "gains" by absorbing losses, and the investor loses by bearing these same losses with a total or partial write down of the notes. It is also relevant to note that the payoff of the option will be as a percentage of the asset's par (100% being its maximum). In the event of an exercise, it is worth mentioning that this situation is purely illustrative, since a bail-in of other financial instruments is highly probable, affecting the payoff structure of this particular asset.

Students should attempt to analyze this option from an academic point of view, bearing in mind that there are many variables at stake deeming an accurate approach very complex to carry out.

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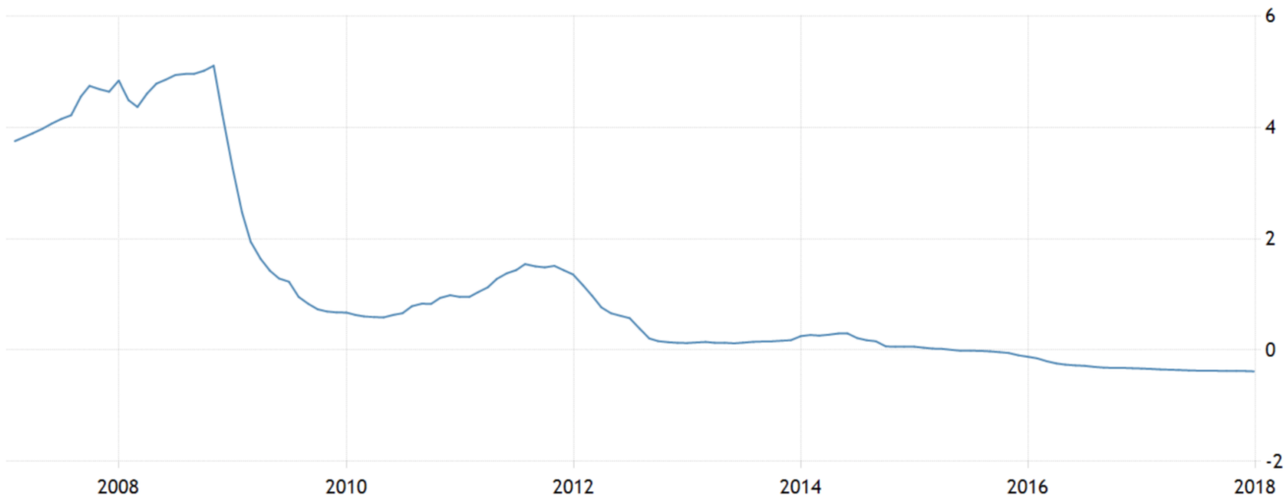
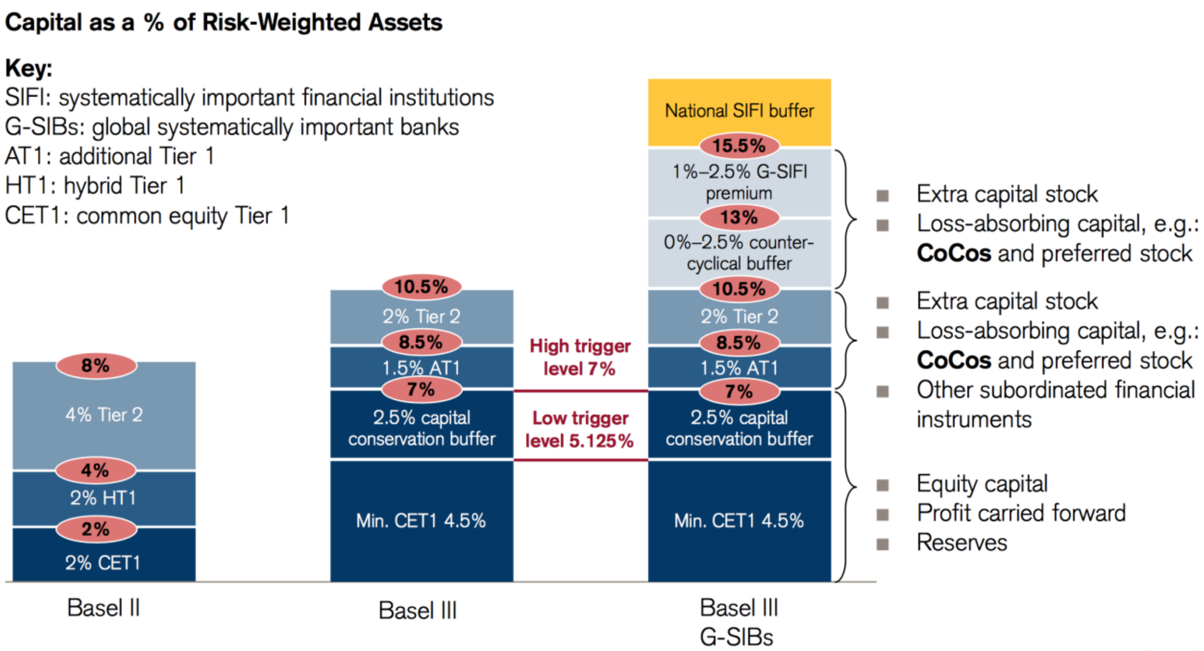
Exhibit 1: Euro LIBOR Three Month Rate (Interbank Rate) Evolution



Source: Trading Economics, accessed December 2017

Exhibit 2: Basel Capital Requirements



Source: Micheal Schmid "Investing in Contingent Convertibles" – Credit Suisse, August 2014

Exhibit 3: CGD 2012 Recapitalization Plan

In June 2012, the Portuguese State, as the Issuer's sole shareholder, approved a recapitalization plan in the amount of €1,650 million, which included:

- a capital increase by its shareholder in the amount of €750 million; and
- an issuance of hybrid financial instruments, eligible as core tier 1 capital amounting to €900 million, fully subscribed by the Portuguese State.

The capital injection by the Portuguese State was considered State Aid and subject to an individual State Aid decision by the European Commission (Decision SA.35062 (2012/N)).

Source: Caixa Geral de Depósitos AT1 Capital Temporary Write Down Notes Prospectus

Exhibit 4: CGD 2017 Recapitalization Plan

The Issuer has posted losses after 2012, mostly due to subdued growth in the Portuguese economy that affected credit concession by banks, but also due to the impact of provisions and impairments related to non-performing loans.

In order to be able to continue its activities and also to comply with increasing capital requirements, the Portuguese State, being the Issuer's sole shareholder, and the European Commission's Directorate General for Competition ("**DG Comp**") approved a further recapitalization plan (the "**2017 Recapitalization Plan**"). The plan (which was specifically designed so as not to trigger State Aid rules) had four main components of which the final requirements are as follows:

- a capital increase in-kind of an estimated amount of €500 million by delivery to the Issuer of the 49 per cent. stake held by Parpública (a Portuguese State holding company) in Parcaixa, SGPS, S.A.;
- a capital increase in-kind of an estimated amount of €900 million plus accrued unpaid interest by delivery to the Issuer of the hybrid financial instruments issued in 2012 (and referred to above);
  a capital increase in cash by the Portuguese State (the final figure of which has been agreed at €2,500 million);
- the issue of subordinated debt instruments, the final figure of which has been agreed at a principal amount of €930 million (€500 million being the Notes which are the subject of this Offering Circular) to investors not related to the Portuguese State or Portuguese State entities with the issue of the Notes to occur at the same time as the capital increase in cash by the Portuguese State.

The first two components were completed in January 2012 (see – "Risks relating to State ownership and State Aid - Completion of First Part of the **2017 Recapitalization Plan**").

In order not to trigger State Aid rules, the 2017 Recapitalization Plan has two conditions which have to be met: (i) that the Issuer is able to sell the issue of subordinated debt instruments to private investors, and (ii) that the Issuer implements a strategic plan (the "**Strategic Plan**") between 2017 and 2020, designed to improve the Issuer's profitability and sustainability and to create value for the shareholder on terms similar to those that which would be demanded by private investors in current market circumstances.

The 2017 Recapitalization Plan and the Strategic Plan were approved by both the European Commission and the Portuguese State without triggering State Aid rules, as confirmed by a public communication issued on 10 March 2017 by the European Commission (the "2017 Press Release"). Accordingly, no State Aid or other similar restrictions apply to the Issuer or the Group. Furthermore, the European Commission stated that it has accepted the early termination of the Issuer's commitment not to pay discretionary coupons on subordinated debt.

Source: Caixa Geral de Depósitos AT1 Capital Temporary Write Down Notes Prospectus

Exhibit 5: Strategic Plan

The goal of the measures contained in the Strategic Plan is to improve the overall performance of the Issuer in order to ensure its long-term sustainability and the creation of value for its shareholder. As such, it builds on the following principles:

- Maintaining the Issuer's current leading position in the Portuguese market without fundamentally changing its current business model as a global bank;
- Increasing the operational efficiency of its domestic operations, combining it with the simplification of the group structure and the restructuring of the international portfolio;
- Targeting attractive returns for the shareholder (greater than 5 per cent. as of 2018 and greater than 9 per cent. as of 2020);
- Strengthening the Group's solvency levels to aim for CET1 above 12 per cent. as of 2018 and above 14 per cent. as of 2020 on a consolidated basis;
- Maintaining an independent and accountable governance and management model.

Source: Caixa Geral de Depósitos AT1 Capital Temporary Write Down Notes Prospectus

Exhibit 6: GCD Capital Ratios

Consolidated Capital Ratios (CRD IV/CRR) (€ millions)

	Phasing - in			
	31.12.2016	01.01.2017	01.01.2017*	01.01.2017**
Own funds				
Common equity tier I (CETI)	3,849.24	3,488.69	3,984.75	6,729.17
Tier I	3,849.82	3,530.55	4,027.67	7,274.27
Total	4,428.51	4,123.97	4,622.13	7,870.93
Risk Weighted Assets	**55,000.06**	**54,938.17**	**55,104.34**	**55,871.57**
Ratios				
CET I	7.0%	6.4%	7.2%	12.0%
Tier I	7.0%	6.4%	7.3%	13.0%
Total	8.1%	7.5%	8.4%	14.1%
	Fully implemented			
Ratios	31.12.2016	01.01.2017	01.01.2017*	01.01.2017**
CET I	5.5%	5.5%	6.6%	11.8%
Tier I	5.5%	5.5%	6.7%	12.7%
Total	5.7%	5.7%	6.9%	12.9%

* **Proforma 1**: in addition to 1 Jan 2017 phasing-in, incorporates the effects of Parcaixa, CoCos and capital reduction of 4 Jan 2017
** **Proforma 2**: in addition to Proforma 1, incorporates effects of capital increase and AT1

Source: Caixa Geral de Depósitos AT1 Capital Temporary Write Down Notes Prospectus

Exhibit 7: CGD Write Down Notes

Issuer and paying agent	Caixa Geral de Depósitos, S.A. (the "Issuer" and together with its consolidated subsidiaries, the "Group")
Rating	The Notes are expected to be rated B- by Fitch
Notes	€500,000,000 Fixed Rate Reset Perpetual Additional Tier 1 Capital Temporary Write Down Notes issued at 100 per cent of the principal amount of the Notes.
Status and Subordination	The Notes will constitute undated, direct, unsecured and subordinated obligations of the Issuer, will at all times rank pari passu without any preference among themselves. Claims in respect of the Notes (including claims for damages in respect of any breach of the Issuer's obligations thereunder) shall at all times, including in the event of a Winding-Up of the Issuer, rank (a) pari passu without any preference among themselves and with claims in respect of Parity Securities; (b) in priority to claims in respect of Junior Securities; and (c) junior to any present or future claims of Senior Creditors.
Redemption	The Notes have no fixed maturity date. Subject to the conditions set out herein, the Issuer may, upon giving not less than 30 nor more than 60 days' notice to Holders, in its sole discretion (and without the requirement for the consent or approval of the Holders) elect to redeem the Notes in whole (but not in part): (i) on 30 March 2022 (the "First Call Date") or any Interest Payment Date thereafter, subject to the proviso below; or (ii) at any time upon the occurrence of a Tax Event or a Capital Event, in each case at their Redemption Amount; provided, however, that if at any time the Notes have been Written Down pursuant to Condition 7 (Loss Absorption Following a Trigger Event), the Issuer shall not be entitled to exercise its option under (i) above until the principal amount of the Notes so Written Down has been fully reinstated pursuant to Condition 8 (Discretionary Reinstatement of the Notes).

Interest	The Notes will bear interest on their Outstanding Principal Amount from time to time at the relevant rate of interest, payable quarterly in arrear on 30 March, 30 June, 30 September and 30 December in each year from (and including) 30 June 2017 (each such date for the payment of interest being an "Interest Payment Date"). The initial rate of interest shall be 10.75 per cent. per annum, which shall apply from (and including) the Issue Date to (but excluding) the First Call Date. Such rate will be reset on the First Call Date and on each fifth anniversary of the First Call Date (together with the First Call Date, each a "Reset Date") as the sum of the applicable 5-Year Mid-Swap Rate (calculated as set out in the Conditions) plus a margin of 10.925 per cent. (the "Margin").
Capital Adequacy Trigger Event	If at any time the CET1 Ratio of any of the Issuer and/or the Group has fallen below 5.125 per cent. (calculated and determined as provided in the Conditions) (such calculation being binding on the Holders) (a "Trigger Event"), then the Issuer shall immediately notify the Competent Authority and, without delay and by no later than one month (or such other period as the Competent Authority may then require) from the occurrence of the relevant Trigger Event, shall: (i) cancel all interest accrued to (but excluding) the Write Down Date (whether or not such interest has become due for payment and including any interest scheduled for payment on the Write Down Date); and (ii) (without the need for the consent of the Holders) irrevocably and mandatorily reduce the then Outstanding Principal Amount of each Note by the relevant Write Down Amount (such reduction, a "Write Down" and "Written Down" being construed accordingly).
Principal Loss Absorption	Write Down of the Notes will be effected, save as may otherwise be required by the Competent Authority, pro rata with (a) the concurrent Write Down of the other Notes and (b) the concurrent (or substantially concurrent) write down or conversion into equity, as the case may be, of any Loss Absorbing Instruments (based on the prevailing principal amount of the relevant Loss Absorbing Instrument), provided, however, that: (1) with respect to each Loss Absorbing Instrument (if any), such pro rata write down or conversion shall only be taken into account to the extent required to restore the relevant CET1 Ratio(s) to the lower of (i) such

	Loss Absorbing Instrument's trigger level and (ii) 5.125 per cent. (being the level at which a Trigger Event occurs in respect of the Notes); and (2) if for any reason the Issuer is unable to effect the concurrent (or substantially concurrent) write down or conversion of any given Loss Absorbing Instruments within the period required by the Competent Authority, the Notes will be Written Down notwithstanding that the relevant Loss Absorbing Instruments are not also written down or converted.
Write Down Amount	"Write Down Amount" means, with respect to each Note, save as may otherwise be required by the Capital Regulations, the lower of (i) and (ii) below: (i) the amount per Note which is determined by the Issuer to be necessary (in conjunction with (a) the concurrent Write Down of the other Notes and (b) the concurrent (or substantially concurrent) write down or conversion into equity of, or other loss absorption measures taken in respect of, any other Loss Absorbing Instruments, in each case in the manner and to the extent provided above under "Loss Absorbing Instruments" to restore each of the Issuer's and/or the Group's (as applicable) CET1 Ratio to at least 5.125 per cent. and so that the lower of such CET1 Ratio is 5.125 per cent.; and (ii) the amount necessary to reduce the Outstanding Principal Amount of each Note to one cent (and all references to the "one cent floor" in respect of the Notes shall be construed accordingly). The Outstanding Principal Amount of a Note shall not at any time be reduced to below one cent as a result of a Write Down. "Calculation Amount" means €200,000 in principal amount of each Note.

Source: Caixa Geral de Depósitos AT1 Capital Temporary Write Down Notes Prospectus

Exhibit 8a: CGD Consolidated Balance Sheet

(€ millions) **ASSETS**	December 2014	December 2015
Cash and cash equivalents at central banks	2,118.0	2,879.6
Cash balances at other credit institutions	878.3	773.2
Loans and advances to credit institutions	2,133.7	4,011.5
	5,130.0	7,664.3
Financial assets at fair value through profit or loss	3,073.6	3,365.9
Available-for-sale financial assets	15,898.4	15,620.4
Financial assets with repurchase agreement	1,281.1	1,081.2
Hedging derivatives	78.0	46.5
	20,331.1	20,114.0
Loans and advances to customers	66,863.6	65,759.0
Non-current assets held for sale	804.4	830.4
Investment properties	1,189.2	1,125.0
Other tangible assets	666.3	619.4
Intangible assets	161.7	135.0
Investments in associates and jointly controlled entities	318.8	277.5
Current tax assets	54.9	37.1
Deferred tax assets	1,425.2	1,473.9
Other assets	3,206.7	2,865.8
Total Assets	100,152.0	100,901.5

Source: Caixa Geral de Depósitos AT1 Capital Temporary Write Down Notes Prospectus

Exhibit 8b: CGD Consolidated Balance Sheet

(€ millions) **LIABILITIES AND EQUITY**	December 2014	December 2015
Resources of central banks and other credit institutions	6,001.7	5,433.1
Customer resources and other loans	71,134.2	73,426.3
Debt securities	7,174.5	6,700.1
	84,310.3	85,559.4
Financial liabilities at fair value through profit or loss	2,121.1	1,738.6
Hedging derivatives	20.0	10.8
Non-current liabilities held for sale	1.9	-
Provisions for employee benefits	572.4	643.0
Provisions for other risks	269.3	349.5
Current tax liabilities	38.5	15.9
Deferred tax liabilities	370.4	253.2
Other subordinated liabilities	2,427.9	2,428.9
Other liabilities	3,527.4	3,718.5
Total Liabilities	93,659.3	94,717.8
Share capital	5,900.0	5,900.0
Fair value reserves	411.8	258.8
Other reserves and retained earnings	(437.9)	(690.7)
Net income attributable to the shareholder of CGD	(348.0)	(171.5)
Equity attributable to the shareholder of CGD	5,525.8	5,296.7
Non-controlling interests	966.9	887.0
Total Equity	6,492.8	6,183.7
Total Liabilities and Equity	100,152.0	100,901.5

Source: Caixa Geral de Depósitos AT1 Capital Temporary Write Down Notes Prospectus

Exhibit 9: CGD Consolidated Income Statement

(€ millions)

	December 2014	December 2015
Interest and similar income	3,339.2	2,958.1
Interest and similar expenses	(2,350.5)	(1,844.4)
Income from equity instruments	49.6	74.3
NET INTEREST INCOME	1,038.3	1,187.9
Income from services rendered and commissions	659.1	642.0
Cost of services and commissions	(144.0)	(130.5)
Results from financial operations	201.7	350.0
Other operating income	(16.5)	(7.4)
TOTAL OPERATING INCOME	1,738.4	2,042.0
Employee costs	(729.6)	(820.0)
Other administrative costs	(487.4)	(466.4)
Depreciation and amortisation	(110.7)	(105.9)
Provisions net of reversals	62.8	(37.2)
Loan impairment net of reversals and recoveries	(854.1)	(557.3)
Other assets impairment net of reversals and recoveries	(158.3)	(122.0)
Results of subsidiaries held for sale	285.9	(1.6)
Results of associates and jointly controlled entities	19.4	47.1
INCOME BEFORE TAX AND NON CONTROLLING INTERESTS	(233.5)	(21.3)
Income tax		
Current	(67.6)	(152.8)
Deferred	37.9	92.6
	(29.8)	(60.2)
CONSOLIDATED NET INCOME FOR THE YEAR, of which:	(263.3)	(81.5)
Non-controlling interests	(84.7)	(90.0)
NET INCOME ATTRIBUTABLE TO THE SHAREHOLDER OF CGD	(348.0)	(171.5)
Average number of ordinary shares outstanding	1,180,000,000	1,180,000,000
Earnings per share (in Euros)	(0.29)	(0.15)

Source: Caixa Geral de Depósitos AT1 Capital Temporary Write Down Notes Prospectus