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Will not call their EUR T1s

As expected, UBI won't call their €T1 8.17%

UBI have confirmed that they will *not* be calling (at least not at the first call date) the UBIIM8.17% (originally issued by Banca Lombarda). These bonds were quoted at 97/100 this morning. Following the last fixed coupon payment in March, the bonds will now pay €L+337.5bps. They are now callable quarterly so it depends now on one's view as to when the bonds will actually be called. Valuing the bonds to 10 years beyond the call date, we get a fair value of 91.5%, using a 10% discount rate. That could represent a floor valuation potentially, as the bonds may well be redeemed prior to that. Valued as perps, however, they are worth only 78%. We think they should trade down at least 5 points from here. Our recommendation on the 8.17% is accordingly Underweight-70% which also reflects the fact that quasi-perpetual bonds with quarterly calls are an unattractive structure for most investors.

Reason: Basel 3 confusion

UBI cites the 'uncertainty caused by the expected introduction of new regulations for the calculation of capital' i.e. Basel 3 – as the reason for this. Far from forcing the hand of banks to redeem their T1, then, Basel 3 appears to be having the opposite effect, at least in this example. This is in line with our expectations, as outlined previously in our note, *The Rhinoceros*, 13th January 2010. We understand that the bank will redeem its €UT2 at its maturity on the 23rd February 2010.

Read across for the sector: largely negative

The bulls will argue that UBI is a relatively small Italian bank (it isn't and it's actually one of the better regionals with strong capital, in our view: core Tier 1 of 7.3% in September last year) and that the bank did warn that it may not exercise the call at the time of its exchange offer for the bonds in 2Q09. This misses the point: the bank is not adducing the exchange offer as the reason to not call. In our opinion, Basel 3 has created considerably uncertainty with respect to calls of bank capital, in the context of a European banking sector that is largely undercapitalised.

Other banks have called - but that could change

Societe Generale has already called its T1s this year, as have Swedbank and Standard Chartered. These banks have already replacement capital through rights issues or other T1 issuance. Swedbank's done two rights issues recently. Yet the market has become far too complacent as to call risk, in our view. We believe that this action undermines high cash prices for T1s with imminent calls. Investors potentially have very limited downside in shorting these and potentially a number of points of upside. EUR bonds with near term calls that were trading around par this morning are shown in Table 1. This appears to be less of an issue for GBP T1 for now owing to few bonds callable in the next 12-18 months.



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Table 1: EUR T1 bonds trading around par with calls in the near future

BACR 7.5% *
BNP 6.625%
CS 7.974% *
CS 6.905%,
DNB NOR 7.068%
HSBC 8.03%
ISPIM 8.126% *
ISPIM 6.988%
MONTE 7.99%
PMIIM 8.393%
UBIIM 8.364%
UBIIM 9%
UBS 8.836%
UCGIM 8.048% *

Source: BofA Merrill Lynch Global Research * denotes 2010 call

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Important Disclosures

Opinion history

BPB / UBIM

Security	Date [^]	Action	Recommendation
8.364, Tier 1, EUR, Perp/2049	31-Jan-2009		Overweight-30%
8.17, EUR, 2049	31-Jan-2009		Overweight-30%

Table reflects credit opinion history as of previous business day's close. [^]First date of recommendation within last 12 months. **The BofAML Credit Opinion key is contained below.**

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BofAML Credit Opinion Key

Recommendation	Investor Action Points (Cash and/or CDS)	Primary Investment Return Driver
Overweight-100%	Up to 100% Overweight of investor's guidelines	Compelling spread tightening potential
Overweight-70%	Up to 70% Overweight of investor's guidelines	Carry, plus some spread tightening expected
Overweight-30%	Up to 30% Overweight of investor's guidelines	Good carry, but little spread tightening expected
Underweight-30%	Down to 30% Underweight of investor's guidelines	Unattractive carry, but spreads unlikely to widen
Underweight-70%	Down to 70% Underweight of investor's guidelines	Expected spread underperformance
Underweight-100%	Down to 100% Underweight of investor's guidelines	Material spread widening expected

Time horizon – our recommendations have a 3 month trade horizon.

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