PIBS COUPONS – Q&A

The 2016 Annual Report & Accounts state that the Society's ICG was met but that the Combined Buffer is not met as at 31 December 2016. What does this mean?

Financial institutions such as Manchester Building Society have to meet regulatory requirements for capital as set out in the Capital Requirements Directive IV ("CRD IV").

One of these requirements is to have a certain amount of total regulatory capital. This is set by the Prudential Regulation Authority ("PRA") as the Individual Capital Guidance ("ICG"). The Society's total regulatory capital comprises its reserves, Profit Participating Deferred Shares ("PPDS"), Permanent Interest Bearing Shares ("PIBS") and Subordinated Debt. As at 31 December 2016 the Society has sufficient total regulatory capital to meet the ICG requirement in total capital terms.

There is another regulatory requirement for the Society to have a certain amount of Common Equity Tier 1 ("CET1") capital. This is capital that meets certain criteria, including it being fully loss absorbing. The Society's CET1 capital comprises its reserves and PPDS.

There is a minimum CET1 requirement and also an additional "buffer" requirement. Buffers that apply to the Society are the Capital Conservation Buffer and the Countercyclical Capital Buffer. Together these are known as the "Combined Buffer'. As at 31 December 2016 the Society has insufficient CET1 capital to meet the Combined Buffer requirements.

Why can't the Society pay the PIBS coupons if it has enough capital?

As at 31 December 2016 the Society met its ICG but as a result of the loss in the period has a CET1 regulatory capital shortfall against its Combined Buffer requirement.

The Society will therefore not be paying the April 2017 coupon on the PIBS as, in order to conserve capital, such a distribution is prohibited under CRD IV article 141.

What gives the Society the right to stop paying interest on the PIBS?

Under the Special Conditions of Issue of the PIBS (as set out in the Offering Circular for each class of PIBS), interest shall not be paid for any interest period if the payment would cause or contribute to the Society failing to meet its capital adequacy requirements, which currently include those set out in CRD IV.

The Risk Factors section of the Offering Circulars for each class of PIBS stated that "interest in respect of the PIBS will not be payable where to make payments would result in the Society's capital falling below prescribed levels."

Will the Society pay the April 2017 coupon at some future date if it gets enough capital?

PIBS coupons are not cumulative so any interest payments on the PIBS which are not paid are permanently cancelled and will not become due at a future date.

Will the Society be paying future PIBS coupons?

There is uncertainty over the Society's ability to make PIBS coupon payments due after April 2017 given the risks facing the business as explained in the Society's Annual Report & Accounts for the year ended 31 December 2016, which are available on the Society's website.

Any further non-payment of PIBS coupons will be announced to the market.

Are PIBS protected by the FSCS?

PIBS are not protected deposits covered by the Financial Services Compensation Scheme (the "FSCS").

There is no expectation of repayment of the PIBS unlike normal deposits with the Society. PIBS are subordinated to all other liabilities of the Society, other than liabilities in respect of Profit Participating Deferred Shares ("PPDS"). In a liquidation of the Society the PIBS rank behind all other creditors of the Society (other than PPDS). In order to realise the investment in PIBS, an investor must either sell the PIBS in the market or make a private sale.

Should I hold or sell my PIBS holding?

The Society is not authorised to give financial advice on your PIBS holding. PIBS holders should seek independent financial advice.

What is in the Capital Conservation Plan?

CRD IV article 142 sets out the required content of the Capital Conservation Plan.

This includes estimates of income and expenditure and a forecast balance sheet; measures to increase the capital ratios of the institution; a plan and timeframe for the increase of own funds with the objective of meeting fully the combined buffer requirement; and any other information that the PRA considers to be necessary.

The revised and updated Capital Conservation Plan will also address the potential risk that the Society will not meet the regulatory requirement to hold 4.5% of CET1 capital against risk weighted assets.

Why does the Society have to prepare a revised and updated Capital Conservation Plan and submit that to the PRA?

As at 30 June 2016 the Society had insufficient CET1 capital to meet the Combined Buffer requirements. Therefore the Society was required by CRD IV article 142 to submit a Capital Conservation Plan to the PRA setting out proposed measures to improve the regulatory capital position. The Society submitted the Capital Conservation Plan to the PRA in October 2016.

At the request of the PRA the Capital Conservation Plan is being revised and updated to reflect the 2016 results and review further the potential measures for addressing the shortfall to the CET1 capital requirements.

What happens after the revised and updated Capital Conservation Plan has been submitted? Will the PIBS coupons then be paid?

The Board expects to discuss and consult with the PRA on the revised and updated Capital Conservation Plan. At present the outcome and timing of this regulatory process is uncertain.

The PRA will assess the revised and updated Capital Conservation Plan, and will approve the plan if it considers that the plan, if implemented, would be reasonably likely to conserve or raise sufficient capital to enable the Society to meet its combined buffer requirements within a period which the PRA considers appropriate.

PIBS coupons are not cumulative so any interest payments on the PIBS which are not paid are permanently cancelled and will not become due at a future date.