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Prior to entering into a transaction, you should understand the product and its associated risks in order to determine whether the product is suitable for you in light of your experience, objectives, financial position and other relevant circumstances. This document does not constitute nor deem to constitute an offer to sell any product, nor an offer to enter into any transaction.

## Checklist

## HYBRID SECURITIES

**1. What are Hybrid Securities?** ☐

- Hybrid Securities are a group of securities that usually combine the elements of the two broader groups of securities, debt and equity. Prices of hybrid securities may behave at times like that of the underlying debt or that of the underlying equity.

- These may be structured for specific capital, legal, regulatory or tax requirements of the issuer. At the same time, these also attract different capital market participants for their various investment needs.

**2. What are some examples of Hybrid Securities?** ☐

- Perpetuals
  i. Perpetual securities are fixed income instruments which pay a dividend at a fixed/floating rate. They do not have a stated maturity, so theoretically they may never be redeemed by the issuer; however they are usually callable solely at the discretion of the issuer. Callback would depend on various factors, including but not limited to prevailing interest rate environment at the time of call and refinance cost.
  ii. Perpetual securities can also have a step up feature wherein the dividend rate steps up if at a particular date, the security is not called by Issuer. They are typically issued by Banks or Financial Institutions.
  iii. Perpetual securities are usually subordinate to all debts of the issuer, implying that no repayments to creditors will be made upon default/insolvency until all higher ranking creditors are paid in full. This makes them riskier than senior bonds.
  iv. Issuer may suspend/defer coupon/dividend on a perpetual security. In such a scenario, company is usually not permitted to pay dividends to common shareholders/preferred stock. Coupon payments may be cumulative or non-cumulative. For cumulative perpetuals, coupon payments may be deferred and paid along with later coupons. For

noncumulative perpetuals, coupon payments that are unpaid or omitted will not be paid back later.

v. Perpetual securities, as they are very long term securities, are also more volatile in their prices when interest rates move. This makes them generally riskier than bonds with shorter tenure / duration.

- Preferred securities
  i. Preferred securities or preferred shares/stocks or preference shares are a part of the equity base of the issuer. A preference share has the first right to dividends and seniority over common stock upon liquidation of the company. In terms of priority of repayment in the event of insolvency of the issuer preference shares are ranked above ordinary shares (i.e. common stock) and below debt obligations.
  ii. These securities typically pay a dividend which is specified at the time of issuance and may be fixed or floating and cumulative or non-cumulative. In cumulative preferred stock, dividend may be deferred and paid along with later dividends. Before a dividend can be declared on the common stock, any dividend obligation to preferred stocks must be satisfied. Preferred stock may also be callable or non-callable at the issuer's discretion and may be convertible or non-convertible to the issuer's common stock.

- Convertible bonds
  i. Convertible bonds combine characteristics of a bond with an element of equity participation through an embedded equity call option which allows the investor or the issuer to convert the bonds to equity at a fixed price. Investors initially invest in a bond but have the option to convert the bond into a pre- determined number of stocks at future dates. Convertible bonds usually have coupons that are lower than bonds and are normally unrated by credit rating agencies. At times such convertible bonds may have zero coupon rates. The tenor of convertibles is also usually longer than vanilla bonds.
  ii. Convertible bonds may be callable at a specific price, usually the par value of the bond, at the discretion of the issuer. This call option can limit the upside potential of the bondholder from the appreciation of the underlying common stock. They can also have put options which may be linked to a "change of control" (of the company ownership) that give the investor the right to sell back the bonds to the issuer at par. At maturity, if the investor does not convert the bond to shares and issuer has not called back the bond, investors typically receive their principal back.
  iii. Convertible bonds have a conversion price which is the price at which underlying shares can be indirectly purchased (conversion price=notional amount/conversion ratio).

**Checklist**

**3. What are some differences between perpetuals, preferred securities and convertible bonds?**

| | Perpetuals | Preferred Securities | Convertible Bonds |
|---|---|---|---|
| Coupons / Dividends | Coupons must be paid if conditions for payment are met. | Dividend payments are at management's discretion. | Coupons must be paid on the bonds unless it has zero coupon rates. However, once the bonds are converted into stock, dividend payments are at management's discretion. |
| Priority of claim in the event of insolvency | Senior or equal rank to preferred securities. | Subordinated or equal rank to perpetuals. | Bonds are senior to perpetuals and preferred securities. However, once converted into stock, it is subordinated to perpetuals and preferred securities. |
| Balance Sheet Treatment | Long term borrowing | Equity | Bonds are long term borrowing but when converted into stock, it is treated as equity. |

**4. What are additional risks to hybrid securities compared to traditional fixed income securities?**

- Additional risks to investing in Perpetuals:
  i. No stated maturity – Perpetuals usually have no stated maturity and there are no obligations on the issuers to redeem the perpetual securities.
  ii. Subordination risk – Perpetuals are usually subordinated to all debt and have priority of claim only over equity. This could result in no repayment to holders until all higher ranking creditors are repaid in full. In addition, there remains a risk that these issues may be subject to claim elimination and suffer principal losses through various means such as principal write downs or equity conversion even if such provisions are not expressly written in the governing terms as local laws and regulations changes.
  iii. Coupon deferral risk – Certain provisions may allow the issuer to defer interest and principal payments and it may be non-cumulative in which case the investor would not receive the deferred coupon payments and may add to his liquidity constraints.
  iv. Price volatility risk – Prices of perpetuals tend to be more volatile than senior debt and lead to larger price swings.
  v. Non-call risk – These securities are usually callable solely at the discretion of the issuer. If the perpetual is not called, there may be no stated maturity for investors to recover their principal. In such a case, investors can only sell the security in the secondary market and be exposed to market price fluctuations and dependency on secondary market liquidity. These could result in the loss of some or all of the principal originally invested.
  vi. Conversion risk – Perpetual securities may in certain circumstances as detailed in the prospectus be converted to other securities such as preferred shares, long-term subordinated debt etc. Such conversions are usually at the sole discretion of the issuer and in some situations may require consent from the investors.

- Additional risks to investing in preferred securities:
  i. No stated maturity – Preferred securities usually have no stated maturity.

ii. Subordination risk – Preferred securities usually subordinated to all debt and have priority of claim only over common equity. This could result in no repayment to holders until all higher ranking creditors are repaid in full. In addition, there remains a risk that these issues may be subject to claim elimination and suffer principal losses through various means such as principal write downs or equity conversion even if such provisions are not expressly written in the governing terms as local laws and regulations changes.
iii. Dividend lost/deferral risk – Certain provisions may allow the issuer to defer dividend payments and it may be non-cumulative in which case payments will not be paid back later, and may add to liquidity constraints of investors.
iv. Price volatility risk – Prices of preferred securities tend to be more volatile than junior and senior debt and lead to larger price swings.
v. Non-call risk – These securities are usually callable solely at the discretion of the issuer. If the perpetual is not called, there may be no stated maturity for investors to recover their principal. In such a case, investors can only sell the security in the secondary market and be exposed to market price fluctuations and dependency on secondary market liquidity. These could result in the loss of some or all of the principal originally invested.
vi. Conversion risk – Preferred securities may in certain circumstances as detailed in the prospectus be converted to other securities such as issuer's common stock etc. Such conversions are usually at the sole discretion of the issuer and in some situations may require consent from the investors.

- Additional risks of investing in convertible bonds:
  i. Equity volatility risk – The market price of the convertible bond is likely to be affected by fluctuations in the market price of the underlying stock. Trading prices of stock will be influenced by, among other things, the financial and the results of operations of the issuer, and political, economic, financial and other factors. Any decline in the price of the stock may have an adverse effect on the market price of the convertible bonds. The issuer can also at times reset the pre-determined conversion strike price to encourage investors to convert the bond into shares thereby impacting the secondary market price of the convertible bond.
  ii. Exchange rate risk – Convertible bonds issued in relation to an underlying stock which has a different currency vis-à-vis the bond will carry foreign exchange risk. For example, convertible bonds issued in US Dollar by Indian corporates, where the underlying stocks are usually quoted in Rupees on the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE). Fluctuations in the exchange rate between the Rupee and the US Dollar may have material adverse effect on the value of the convertible bonds or the stock deliverable upon conversion of the bonds.
  iii. Conversion risk – There can be a delay between the time that the investor requests for conversion of security and the final delivery of stock. During this time the price of stock/FX spot rate may move adversely causing potential losses to the investor. It is also possible that the issuer may choose to replace the underlying stock with alternate securities such as American Depository Receipts/Global Depository Receipts etc, which can adversely affect the investors' ability to realize returns as per the original terms of conversion.
  iv. Limited anti-dilution protection - The conversion price of the convertible bond may be adjusted upon the occurrence of certain corporate events of the issuer, but only in the circumstances and only to the extent provided in the terms and conditions of the convertible bonds. There is no requirement that there should be an adjustment for every corporate or other event that may affect the value of the shares. Events in respect of which no adjustment is made may adversely affect the value of the shares and, therefore, adversely affect the value of the convertible bonds

v. No voting rights - Unless and until the investors acquire the underlying upon conversion of the convertible bonds, they will have no rights with respect to the underlying, including any voting rights or rights to receive any regular dividends or other distributions with respect to the underlying.

- Other risk factors which are common to conventional bonds such as investment risk, market risk, credit risk, foreign exchange risk, inflation risk, liquidity risk, re-investment risk, regulatory risks generally also apply to hybrid securities.

## CLAIM ELIMINATION SECURITIES (CES)

*[Remark: GCG business unit can consider removing all references to Claim Elimination Securities (CES) if these are not offered in your respective jurisdictions]*

**5. What are Claim Elimination Securities?**

- Claim Elimination Securities (CES) are also often referred to as contingent convertible notes also known as CoCo, contingent capital securities, or Basel III compliant capital securities.

- CES are capital securities issued by banks, insurance companies and other financial institutions where the governing terms expressly provide for the elimination or diminution of the holder's economic claims upon certain trigger events. For example, the principal amount of the bond may be written down to zero, or by a fixed percentage of par value, or the bond could be converted to equity, if the Issuer's capital ratio falls below a certain trigger level. Alternatively the bond holder may be subject to such principal losses or conversion when the banking regulator has determined that the bank has reached the Point of Non-Viability (PONV): that is, the point at which an entity fails or is likely to fail to meet certain threshold conditions for which there is no prospect that it will return to viability in the opinion of the relevant regulator.

- Some CES may be issued with a stated maturity date or without a stated maturity date i.e. as perpetual securities, may have call features and so on. Therefore CES may also have features and risks of hybrid/perpetual securities

- Some of the features that may be present in the CES are:
    i. Contractual trigger – built in triggers that automatically triggers losses when the capital ratio of the issuer falls below a pre-specified trigger level
    ii. Loss absorption mechanism – such bond can absorb losses either through conversion to equity or principal write downs
    iii. Ranking in liquidation – the bond ranking under a liquidation event will determine the extent of recovery for the bond holder
    iv. PONV – in addition to contractual triggers, there may be triggers based on regulatory determination that the issuer has reached PONV upon which the bond will absorb losses
    v. Coupon deferral – may have features where coupon payment is at the issuer's discretion and may have restrictions on coupon payment if the issuer is deemed to have insufficient capital or does not meet certain thresholds
    vi. May or may not have a stated maturity date

**6. What are additional risks to CES relative to traditional fixed income securities?**

- Write-down or mandatory conversion – The principal amount of the bond may be written down to zero, or a fixed proportion of par value or the bond could be converted to equity if the issuer's capital ratios falls below a certain trigger level or upon a declaration of non-viability event by the applicable regulator. In the event of mandatory conversion to common stock, investor may be subject to additional risks such as foreign exchange risk when the common stock is denominated in a different currency to the CES or liquidity risk whereby the common stock may not be bought and sold with ease therefore imposing additional losses to the investor.

**Checklist**

- Contingent loss absorption event risk – There may be provisions that enable the issuer to cancel any accrued but unpaid interest and write down the prevailing principal amount of the securities or exchange the principal amount into equity securities. Once the principal amount has been written down or converted, the loss is permanent.

- Subordination risk – CES are usually subordinated to senior debt and have priority of claim only over equity. This could result in no repayment to holders until all higher ranking creditors are repaid in full.

- High Trigger CES – depending on where the explicit trigger level is set, CES with higher trigger levels may be at higher risk of breaching the trigger level compared to CES with lower trigger levels.

- There may be restrictions on coupon payment such as mandatory coupon deferral if the issuer is deemed to have insufficient capital or issuer may have discretion to defer coupon payments.

- Although CES are similar in some ways to prior -hybrid capital securities, it contains new forms of claim elimination provisions and may present additional or different risks to those which investors are familiar with. In particular for CES, in instances where the issuing entity moves towards non-viability, the traditional relationship between common stock holders and hybrid security holders may be reversed such that holders of these securities may have their claims partially or fully eliminated ahead of common stock holders.

- There would be increased price volatility in the event of adverse sentiment in the financial markets.

Other risk factors common to conventional bonds such as investment risk, market risk, credit risk, foreign exchange risk, inflation risk, liquidity risk, re-investment risk, regulatory risks generally also apply to CES.

**Checklist**

| General Disclosures |
|---|
| Hybrid Securities / CES are (i) Not insured by any government agency; (ii) Not a deposit or other obligation of, or guaranteed by, the depository institution nor Citigroup Inc. and its subsidiaries and affiliates (unless expressly provided for); and (iii) Subject to investment risks, including possible loss of the principal amount invested. |

| Client Acknowledgement |
|---|
| I/We have read and understood the educational materials and content on Hybrid Securities / CES as detailed in this document. I/We acknowledge that the risks, disclosures and other information set out herein are not an exhaustive description of the risks involved in a transaction and will consult my legal, regulatory, tax, financial and/or accounting advisors to the extent I consider necessary. I/We have also read the brochure and/or all other marketing materials pertaining to the specific product prior to entering into a financial transaction.<br><br>Client Signature ______________________________ Date ________________________ |

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|---|
| **RP Acknowledgement**<br>I acknowledge having utilized the above materials to educate the client(s)/authorized representative for the referenced Product Category.<br><br>RP Signature ________________________________ Date ________________________ |

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