Credit Research

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Financials 2010 Outlook

Lost in transition

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Contents

Executive summary 3

Financials: 2009 in review 5

Key investment themes for 2010 11
Investment theme No.1: Credit deterioration 11
Will revenues be robust enough to offset asset quality deterioration? 11
Investment theme No.2: Rebuilding the pillars of a new banking system – lost in translation 22
Investment theme No.3: Higher levels and quality of capital 29

Sector fundamentals for 2010: a transitional year 40
New business model and emergence of national champions 40

Primary activity 48
2010 refinancing needs: in decline 48

Sector allocation 51
Setting the scene 51
For the love of credit 51
Sector allocation 53

Relative value 55
Financials have not yet fully recovered 55
Issuer recommendations 64

Financials – Issuer profiles 66
BBVA 68
BNP Paribas 70
Commerzbank 72
Credit Suisse Group 74
Deutsche Bank 76
Intesa Sanpaolo 78
Montepaschi 80
Santander 82
Société Générale 84
UBS 86
Unicredit 88

Appendix 90

Executive summary

Fundamentals: a transitional year, with new business model … reliant on a gradual exit from state support and central banks in an unknown regulatory framework

With the economy on the road to recovery, will 2010 be better than 2009 for European banks? Although in better shape, banks remain vulnerable. They remain reluctant to adopt a more aggressive strategy in H110 given the deterioration in asset quality and the fact that they are facing rising unemployment and uncertainties related to the financial pillars and the timing of exit from the extensive support from central banks (liquidity, low interest rate) and governments.

In such a context and given the lag between the state of the economy and its impact on banks' balance sheets (from 6 to 12 months), the non-performing loans cycle has not yet hit its peak. In addition to a rise in risk-weighted assets due to negative rating migration, core earnings are likely to suffer from constrained volumes combined with margin pressure in a low interest rate environment. Will operating performance be robust enough to offset quality deterioration?

After a strong recovery in 2009, will investment banks be the losers over the coming year? A stricter capital regulatory framework will not be applied before recovery is confirmed. Small and medium-sized banks are likely to remain the main losers as long as the crisis lasts (H110). While business models need to be rebuilt, 2010 is likely to be a transitional year with increasing discrimination among European banks and the emergence of national champions. Retail banks will continue to suffer due to the deterioration in credit and expected low interest rates. All in all, investment banks will continue to be preferred to pure retail banks. Consolidation, slow since the beginning of the crisis, is likely to accelerate, particularly in H210. With pressure to exit from state support, European banks have no real choice but to keep boosting capital while pursuing their de-leveraging. Banks able to raise the quality of their credit profile in the coming transitional year are likely to be the best prepared for a more challenging year post-crisis in 2011.

2010 refinancing needs: in decline

2010 refinancing needs for the European banking sector are likely to be lower than 2009. While enjoying ample liquidity, banks started to refinance their 2010 needs in H209. Growth in deposits has been outpacing growth in loans and total assets. Considering total redemptions of around EUR425bn for 2010, 2010 public primary fixed income market is expected to decline 10-15% versus 2009, depending on fixed income market conditions and the economic climate. Corporates are not expected to be as active during 2010. A total of around EUR450bn in issuance is expected to be launched by European banks during full-year 2010, predominantly through covered bonds and to a lesser extent senior unsecured debt. Banks are expected to be quite active on hybrid segment.

Investment recommendation: financials have not yet fully recovered

While Financials have recovered over the year, the sector still appears very large compared with non-financials. We recommend overweighting Financials – rated two notches higher and offering much lower duration – versus non-financials and limiting exposure to curve steepening.

Given the slow economic recovery with rising unemployment, credit metrics will continue to deteriorate. The exit from government support and quantitative easing is expected to be gradual. Senior unsecured ratings primarily reflect strong government support rather than fundamentals leading downgrades to be limited to one notch at Single A. We are therefore raising the weighting of senior unsecured debt, firstly playing the primary market, which we expect to be dynamic.

With no change in rating approach expected on LT2 (except for UK banks), the LT2 rating will remain correlated to the senior unsecured debt rating. With relatively limited supply, LT2 appears far too large and we maintain our Outperform recommendation.

Despite improving since March, Tier 1 issues remain extremely large. Although they offer very attractive YTM, Tier 1 issues continue to face volatility, reflecting (1) the uncertain impact of the expected stricter regulation framework, (2) concerns regarding banks undergoing a restructuring process, and (3) negative actions from rating agencies (Moody's). With stronger supply expected for hybrid, especially in H210, we have a Marketperform recommendation.

Summary of key exposure for our universe in 2010

			Investment themes					
			1) Asset quality					
	1Y Calyon rating target	Operating performance	Geographic exposure	Business segments	2) Regulation	3) Capital	4) Business model	Overall grade
CZBK	Low A	4	4	5	4	5	5	**5**
UBS	Mid A	5	1	1	5	2	5	**5**
MPS	Low A	3	4	5	2	5	1	**4**
Unicredit	Mid A	3	5	5	3	3	2	**4**
SocGen	High A	3	3	4	4	3	3	**4**
Santander	Low AA	2	4	4	3	2	1	**3**
BBVA	Low AA	2	4	3	3	2	1	**3**
ISPIM	High A	2	4	3	3	2	1	**3**
BNPP	Low AA	2	2	2	4	3	3	**3**
DB	High A	1	1	1	5	4	3	**3**
CSG	High A	1	1	1	5	1	3	**2**

Note: 1 - No material risk; 2 - small risk, but no impact issue; 3 - medium risk, limited impact; 4 - significant risk, potential for strong impact; 5 – major exposure and potential impact

Sources: banks, Calyon, rating agencies, CA Cheuvreux (See Appendix page 90)

Estimated key dates for changes to banks' regulatory framework

	2009	2010	2011	2012	2013
Regulation	- EU proposals on Capital Requirements Directive - consultative BIS report on regulatory framework of December 17th	- December : implementation of BIS enhancements to Basel II (market risk) - IASB draft on hedge accounting - March: FSB proposals on compensation practices - **October : FSB proposals for systematically important financial institutions** - October : CRD proposals to be transposed in national legislation - Implementation of the CEBS proposals on the new capital regime - New provisioning framework - **EU framework on banking regulation (year-end)** - December : implementation of CEBS guidelines on hybrid instruments - BIS impact assessment following proposals to strengthen the global capital framework (H110) - BIS final proposals on the capital framework and minimum capital levels (end-2010) - BIS impact study on correlation trading activities - EU financial supervision framework - EU legislation on derivatives market - G20 commitment on leverage and capital ratios	- June : final project on new accounting standards - Implemetation of EU supervision proposals	- End 2012: OTC market regulation put in place - End 2012: implemen--tation of the BIS global capital framework	- **Implementation of IFRS9 to replace IAS39**
Liquidity	- **December: revised guarantee schemes** - December: 12M ECB refinancing operation as part of quantitative easing	- March : tightened conditions for ABS eligibility for repo operations with ECB - June: potential extension or end of the ECB covered bonds program (EUR60bn) - **G20 proposals on liquidity buffers (by BCBS)** - US government emergency facility ended on April 30th	- New tightening in ABS eligibility for ECB repo operations ("2nd best" rule, March)		
Other		- June, November: G20 meetings			

Source: European Commission, ECB, IASB, G20, Moody's, BIS

Financials: 2009 in review

Highlights

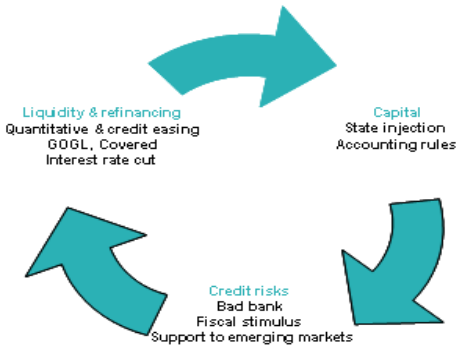
- Unprecedented state support: from hell to a gradual revival
- Are banks ready for the exit from state support and central bank easing?
- Rating agencies: *annus horribilis*, especially for hybrid segment

2009 in review: back to life

Unprecedented state support: from hell to a gradual revival

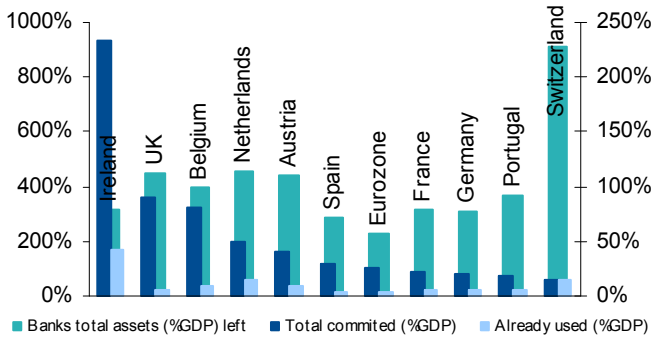
The European banking system has been marked this year by unprecedented state support (around EUR3.5trn), which has succeeded in easing the propagation of the financial crisis to the real economy. Systemic risks have been substantially reduced. Investor confidence has recovered, allowing banks to refinance and raise capital without state support. With more favourable financial markets, banks are also benefiting from better economic prospects.

Massive state intervention to halt the vicious circle



Source: Calyon

Commitment and use of state support

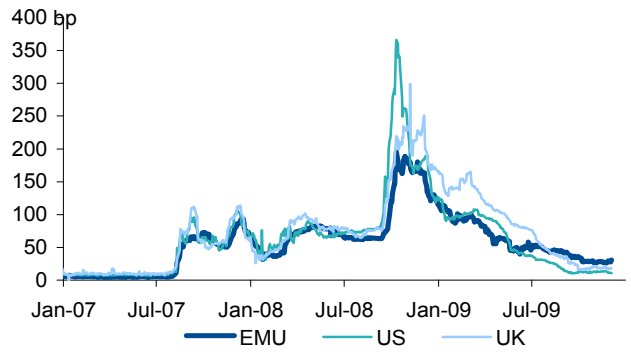


Source: IMF, Central banks, Calyon

Liquidity: nearly back to normal…?

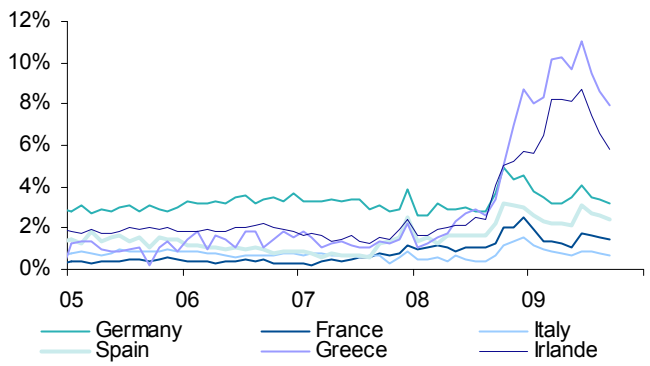
The ample liquidity provided by central banks has helped to drive interbank lending rates in Europe to fresh record-lows. Banks are keener to lend to each other. While the ECB refinancing rate was left unchanged at 1%, the 12M auctions on 15 December will from now on be indexed to future moves in the refinancing rates. This may suppress demand at the auction. The ECB also announced it would end its 6M auctions at the end of Q110 and will continue to provide banks with unlimited funds in its main refinancing operation, at the fixed rate, until at least 13 April next year.

Interbank rates (BOR) and 3M swap rates (OIS)



Source: Bloomberg, Calyon

ECB loans (% of total assets of banks)



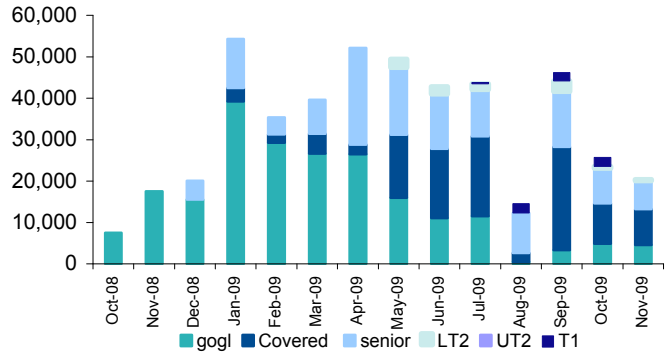
Source: IMF, ECB, CASA

Liquidity nevertheless remains ample, though less generous, and as a consequence favourable to carry trade and trading operations. As long as banks and the economy remain fragile, we see a gradual reduction in rather than a full exit from the extensive liquidity support from the ECB.

Refinancing: are banks ready for the suspension of state guarantees?

After being the main tool for refinancing, the issuance of senior guaranteed debt (gogl) has sharply decelerated since the reopening of the covered bond market in May. Stronger banks also have access to the subordinated and perpetual segments. Only a few banks (troubled, small and not well-known) are unable to refinance without state guarantee.

Primary issuance: guaranteed and traditional funding tools (EURbn)



Source: Bloomberg, Bondware, Calyon (as at 16/11/09)

Scheduled expiry of government debt guarantee programmes

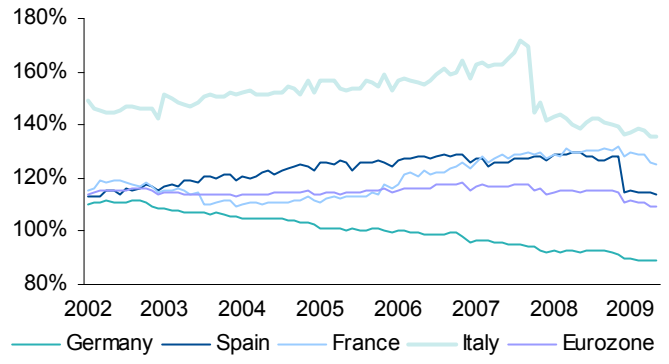
Country	Deadline for issuing guaranteed debt under domestic programme	Deadline for guarantee coverage
Belgium	31 October 2010	31 October 2014
Denmark	31 December 2010	31 December 2013
Finland	31 December 2009	31 December 2014
France	31 December 2009	31 December 2014
Germany	31 December 2009	31 December 2014
Ireland	29 September 2010	1 June 2014
Netherlands	31 December 2009	31 December 2014
Spain	30 June 2010	15 December 2014
Sweden	30 April 2010	31 October 2014
UK	31 December 2009	9 April 2014
US	Main program ended on 31/10/09 Emergency facility ended on 30/04/10	31 December 2012

Source: Moody's, central banks, European Commission

In addition to the ample liquidity provided by central banks and the fixed income markets being in better shape, banks have also used other alternatives:

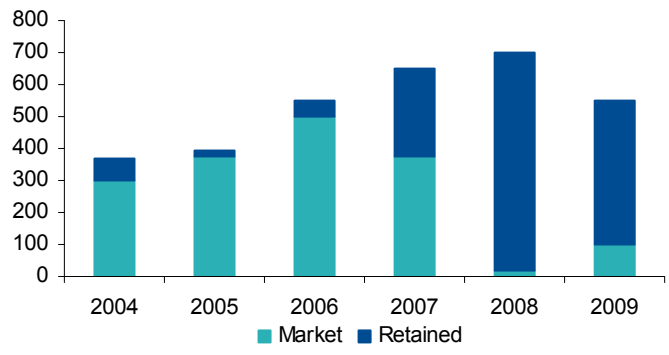
- In addition to the deleveraging process, a stronger focus on deposits with a rising savings rate in the Eurozone (Q109: 15.6% versus 14.9% in Q408).
- Retained securitisation.
- Private placement and retail networks.
- Favourable upward slope of the yield curve.

Loans to deposits ratio (%)



Source: ESCB, Deutsche Bundesbank, Calyon

Securitisation issuance – Europe (USDbn)



Source: IMF Global Financial Stability report, July 09, Calyon

In such a context, the question of the suspension of the state guarantee has become more pressing. As an illustration, at the beginning of October France decided to end the SFEF while Sweden extended its bank guarantee programme to April 2010. The EU is likely to approve the extension of guarantee programmes, at least to H110, largely due to the remaining challenges:

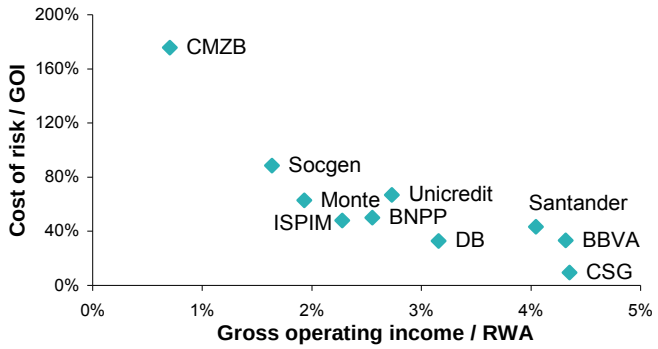
- Securitisation – as an alternative and flexible funding channel, allowing the potential transfer of the lending portfolio and a key funding source for consumer and mortgage lending – has not really restarted yet.

- Large-scale access to wholesale funding and capital markets is still difficult for troubled, small and medium-sized banks.
- Despite a decrease in the duration of issues, a large number of assets have been financed through short-term liabilities and record debt issuance two to three years ahead (USD1.15trn due to mature by 2012 in the Eurozone, UK and US).
- Despite substantial spread tightening, funding issuance remains costly (bank senior 5Y CDS: more than 50bp above pre-crisis level).

Will gross operating income be able to absorb credit risks?

9M09 results showed that a solid operating buffer is crucial for absorbing the surge in the cost of risk, due to the bleak global economy and over EUR600bn of reclassified assets.

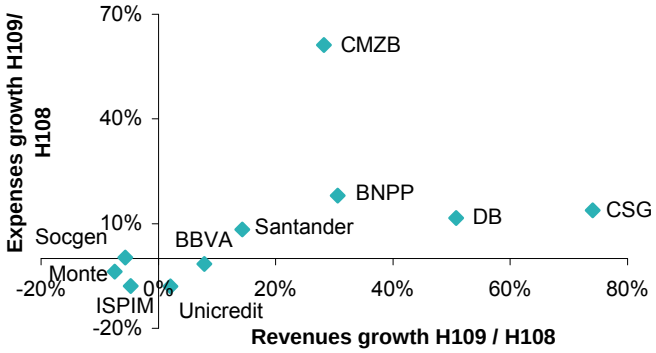
Gross operating income, a crucial buffer for absorbing the cost of risk, H109*



** UBS : gross operating income/RWA: -1% ; cost of risk/GOI: -112%*

Source: Banks, Calyon

Cost-cutting a priority

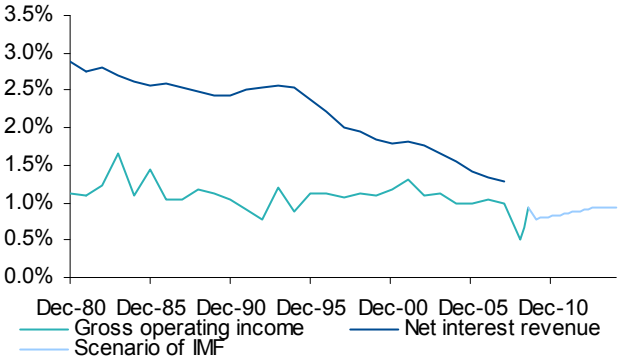


** UBS: expenses growth -15%; revenue growth: 44x higher than H108*

Source: Banks, Calyon

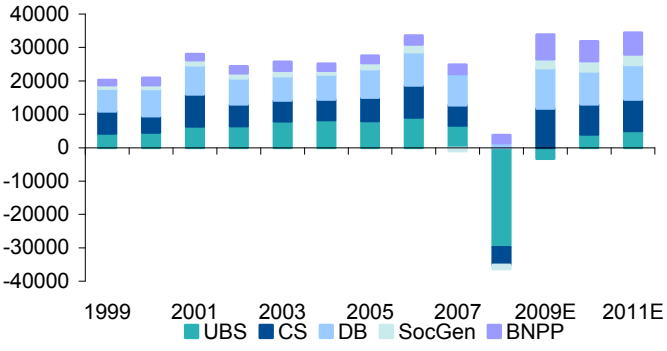
Combined with efforts in cost-cutting and a smaller drop in net interest revenue, earnings have been fuelled by the sharp recovery in fixed income and improvement in equity businesses. Although the recession is entering its final stage, banks remain vulnerable due to the lag between the real economy and its impact on the balance sheet, together with rising unemployment rates and stricter regulation.

Earnings of European banks (% of total assets)



Source: OCDE, IMF staff estimates, Calyon

Fixed income total revenues estimates (EURm)

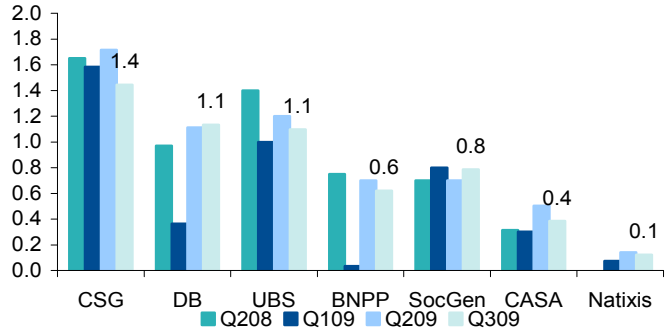


Note: CHFm for UBS and CS

Source: CA Cheuvreux

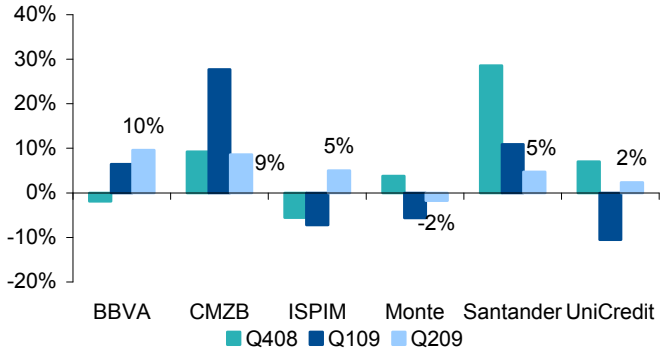
Will operating income be able to absorb the deterioration in asset quality with the pressure to boost capital and reduce risk?

Equities revenues (EURbn)



Source: Banks, Calyon

Net interest income growth QoQ (%)

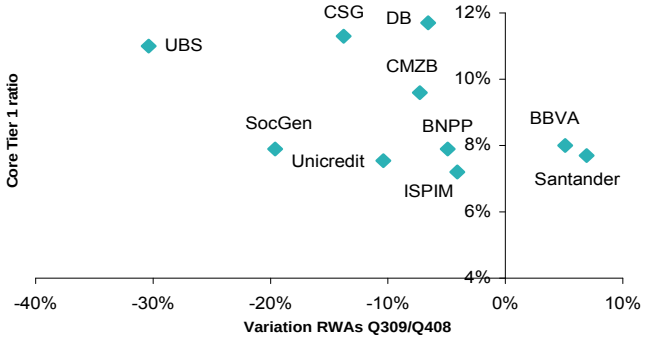


Source: Banks, Calyon

Boosting capital and de-risking has become the priority

While banks' capital ratios have begun to stabilise, strengthening balance sheets and Core Tier 1 ratios will continue to be the priority in order to be prepared for stricter regulation, which will require higher level and better quality of capital while being able to finance the real economy.

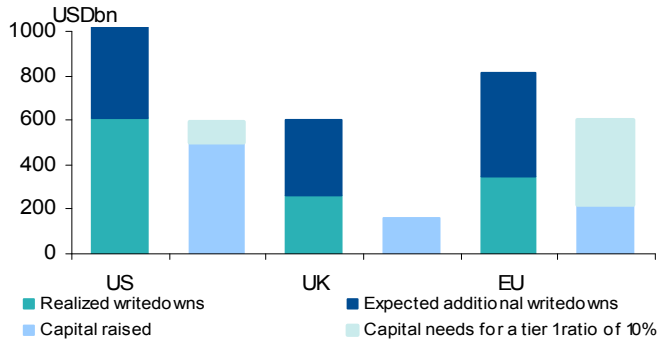
Core Tier 1 ratio and RWA de-risking, 9M09



Note: RWA growth Q209/Q309 for BNPP and Q109/Q309 for CMZB

Source: banks, Calyon

Additional write-downs and capital shortfalls (as of Q209)

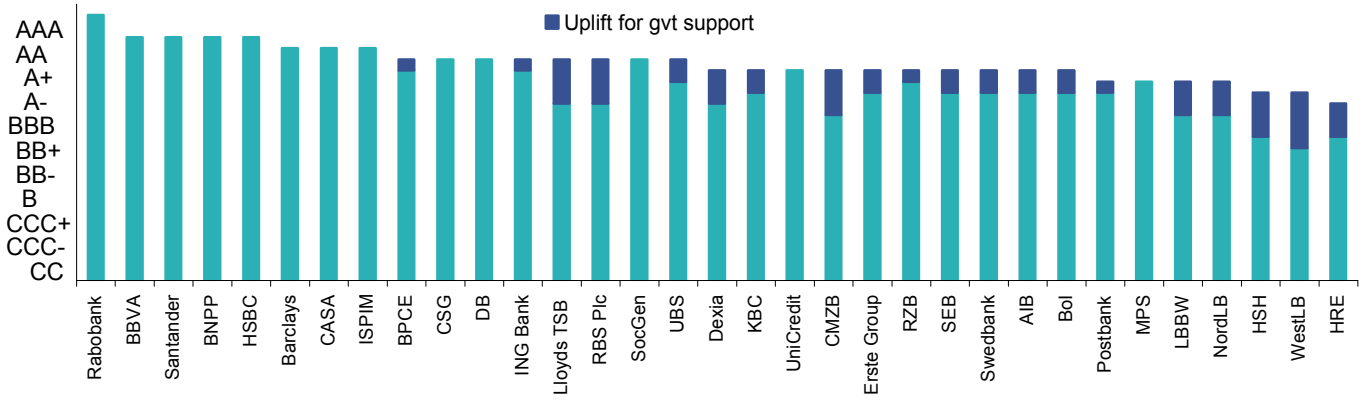


Source: IMF, Calyon

Rating actions: annus horribilis, especially for hybrid segment

Since the crisis began, S&P has cut European banks' ratings by two notches on average to a single-A rating. It could have been worse without the significant level of systemic support, viewed as a rating floor (CMZB, UBS).

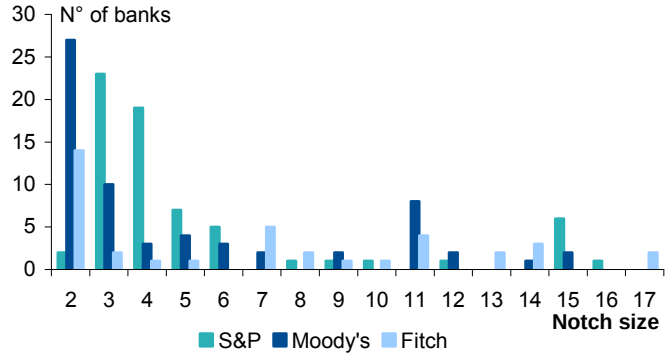
Notches uplift due to government support



Source: S&P, Calyon

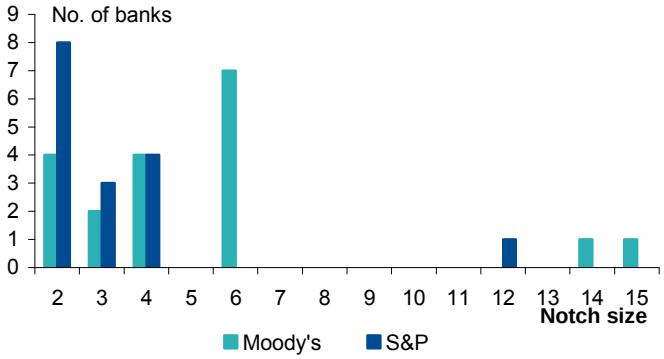
2009 will be an annus horribilis for hybrid debts, predominantly for those issued by banks under restructuring plans. To reflect the increased risk of payment deferral and pressure from the European Commission, rating agencies have reviewed their approach to hybrid debts, whose ratings are now based on intrinsic value.

Tier 1 & senior: number of notches



Source: Rating agencies, Calyon (30/11/2009)

LT2 & senior: number of notches



Source: Rating agencies, Calyon (30/11/2009)

Revised rating approaches: loss absorption concept

	Senior	LT2	Tier 1
S&P	Financial Strength Rating + state notch uplift: counterparty credit rating (CCR)	**One** notch below senior debt for investment grade (IG), reflecting Financial Strength Rating + state notch uplift	**Two** notches below the senior debt for investment grade.
		More than one notch below senior for IG ● **S&P revised methodology** – based on national regulations, new EC requirement and legal frameworks, which could allow or force default on LT2 without triggering non-payment on senior debts – to hit the **UK banks**.	**More than two notches below senior debt for IG,** reflecting increased risk of payment deferral: ● Hybrid rating primarily reflects the standalone financial profile. When CCR > standalone credit (state notch uplift), the gap between hybrid and CCR will be widened. ● Hybrid debts launched by banks that received state support are more vulnerable. **Hybrid rating will be rated four or more notches** below that of the ICR, depending on standalone credit profile, national laws as well the European Commission requirement related to state aid. ● Material net losses recently and the near-term financial prospects are poor. ● Weak capital ratios, breaching minimum regulatory capital requirements or other performance tests. ● Cut or eliminated its common dividend. ● Missing a coupon payment on a hybrid instrument will lead to the rating being downgraded to 'C'.
Moody's	Financial Strength Rating (BFSR) + state notch uplift	**One** notch below senior debt for investment grade, reflecting Financial Strength Rating + state notch uplift	**Two** notches below the senior debt rated above Baa3.
	Sept-09: **lower systemic support in UK, 'living wills'**	**More than one notch below senior for IG** ● State support of senior debt without extending support to LT2 issues: **Danish** and **UK** banks.	Following the revised methodology, hybrid ratings are based on the intrinsic financial strength rating of the bank, **excluding systemic support**. Hybrid ratings will be rated between two and four notches below the senior debt rating.
			Including the EC new requirement related to 'burden sharing', Moody's focuses on: ● The nature of state aid received and the nature and status of approval discussions. ● The type of hybrids and their features, including whether they are cumulative or non-cumulative. ● The intrinsic financial strength of a bank which has received or is waiting to receive state aid.
Fitch	Individual rating + state notch uplift	One notch below senior debt for investment grade, reflecting Financial Strength Rating + state notch uplift	● **One** notch below the senior debt if the latter is ≥ AA- and potential increase to two notches when senior is in the single 'A' range. ● **Two** notches below the senior debt if the latter is < A-, or at least two notches below when senior is in 'BBB' range or less.
			If **senior rating = sovereign support rating floor**, **additional notching** will be implemented on hybrid depending on the individual rating:

Individual rating	Hybrid capital rating*	Bank profile
A, A/B	AA to A range	Strong fundamentals, with a remote prospect of requirement government state capital injection
B, B/C	A range or lower	Strong fundamentals, low prospect of requiring government state capital injection
C	BBB range or lower	Moderate fundamentals, moderate prospects of required government capital injection
C/D, D	BB+ or lower	Weak fundamentals, state capital injection, significant government influence over policy
D/E, E	BB- or lower	Very weak fundamentals, loss making, under government control
E	B/CCCC/CC/C, economic loss expectations	Coupons in deferral

* when the support rating is '1' and the senior long-term rating is at floor of A- or higher.

			Standalone credit profile of the bank EU law regarding state aid: banks that received state aid
			The concept of '**burden sharing**' for European banks where a formal state aid process has not yet been established: ● ≤ 'BB' range with CW negative for a bank subject to a specific restructuring plan ● ≤ B range with CW negative for banks which have received significant state aid and do not fall into the 'fundamentally sound' category. ● Instruments with cumulative deferral features rated a notch higher than those with non-cumulative coupon

Source: rating agencies, Calyon

Key investment themes for 2010

Highlights

- Credit deterioration: will revenues be robust enough to offset deterioration in quality?
- Rebuilding the pillars of a new banking system: lost in translation
- Boosting capital and de-risking will remain the formula
- 2010, a transitional year to reshuffle a new business model with the emergence of national champions

Investment theme No.1: Credit deterioration

Real economy will remain fragile in 2010 …

After the dark days of recession, 2010 is expected to be the year of recovery, which is predicted to be slow however. Despite encouraging signs, the real economy remains fragile with rising unemployment rates, which will undoubtedly hit the non-performing loans cycle, which is not yet at its peak.

…. with rising unemployment rates

The lag between the state of the economy and its impact on banks' balance sheets (from 6 to 12 months) will continue to put balance sheets under pressure in 2010. The reduced impact from stimuli, rising unemployment rates, decline in house prices and weak private consumption and corporate profits are not encouraging banks to ease credit conditions at a time when the priority is de-risking and boosting capital in preparation for a new banking framework. This environment will have the following impact:

Negative impact on asset quality, earning and risk weighted assets

- **Asset quality deterioration**: After benefiting from comfortable coverage ratios built up before the crisis (Spanish banks), reserves have shrunk over 2009, limiting leeway in 2010. With continuing losses and asset impairments (provisions on loans: 1.1% in 2009e by the IMF vs 0.4% in 2007), banks will boost reserves rather than granting new business loans.
- **Rising risk-weighted assets**: After falling in 2009, RWA could register a trend reversal due to negative rating migration (Commerzbank).
- **Pressure on earnings**: After benefiting from ample liquidity and a strong recovery in trading revenues combined with cost-cutting where there is now less leeway, core earnings are likely to suffer from constrained volumes combined with margin pressure.

Will revenues be robust enough to offset asset quality deterioration?

Positive growth in 2010, but unemployment will continue to rise

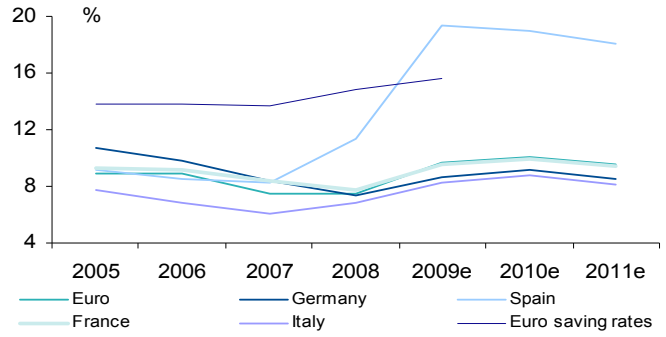
Economies are expected to register positive growth in 2010 with a faster recovery in the US than the UK and Europe. The Eurozone is likely to face a strong divergence as a comparison of Germany (export business) versus Spain can illustrate. Emerging economies are projected to rebound significantly, especially Latin America. Central and Eastern Europe relies on inflows of foreign direct investment and a banking system dominated by the Western European banks.

GDP growth estimates (YoY)

	IMF			Calyon			EU		
	2008	2009f	2010f	2009f	2010f	2011f	2009f	2010f	2011f
Eurozone	**0.7**	**-4.2**	**0.3**	**-3.9**	**1.3**	**1.7**	**-4**	**0.7**	**1.5**
Germany	1.2	-5.3	0.3	-4.8	1.8	1.7	-5	1.2	1.7
France	0.3	-2.4	0.9	-2.3	1.3	1.8	-2.2	1.2	1.5
Italy	-1	-5.1	0.2	-4.8	0.9	1.1	-4.7	0.7	1.4
Spain	0.9	-3.8	-0.7	-3.6	-0.2	1.4	-3.7	-0.8	1
Netherlands	2	-4.2	0.7	-4	1	1.8	-4.5	0.3	1.6
Belgium	1	-3.2	0	-2.9	1	1.8	-2.9	0.6	1.5
UK	0.7	-4.4	0.9	-4.7	0.8	1.9	-4.6	0.9	1.9
Switzerland	1.8	-2	0.5	-2.8	-0.5	0.9	-2.4	-0.1	1.1
US	0.4	-2.7	1.5	-2.5	2.7	3.4	-2.5	2.2	2
Latam	**4.2**	**-2.7**	**3**	**-2.7**	**3**	**3.4**	**-2.5**	**3.1**	**3.4**
Brazil	5.1	-0.7	3.5	0	4	4			
Mexico	1.3	-7.3	3.3	-6.5	2.5	3			
CEE	**2.9**	**-5.2**	**1.8**	**-4.9**	**1.9**	**4**			
Czech Republic	2.7	-4.3	1.3	-3	1	3.5	-4.8	0.8	2.3
Hungary	0.6	-6.7	-0.9	-6	-1.5	2.5	-6.5	-0.5	3.1
Poland	4.9	1	2.2	1	2	3.5	1.2	1.8	3.2
Asia									
China	9	8.5	9	8	8.6	9	8.7	9.6	9.5

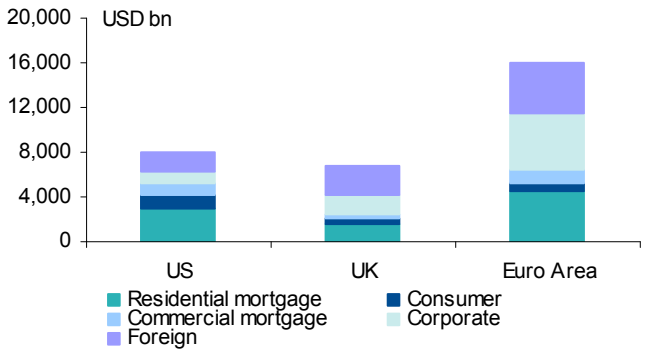
Source: Calyon (as at 17/11/09); EU (as at 04/11/09); IMF (as at 30/09/09)

Unemployment rates and saving rates in Eurozone



Source: Eurostat, Calyon estimates

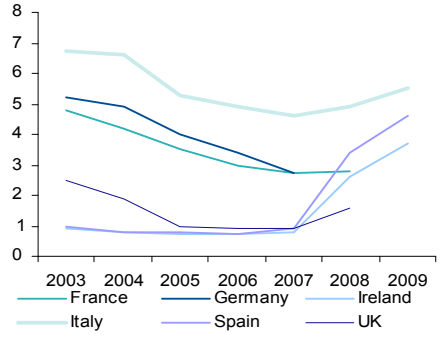
Loans breakdown estimates, 2007-10



Source: IMF, Calyon

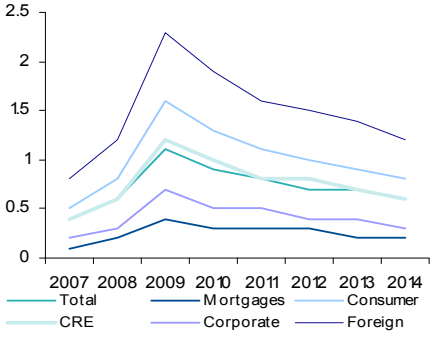
Banking sensitivity to economic cycles differs depending on geographic and business exposure as well as type of clients. While the US and UK banks are suffering more from their real estate exposure, Euro area losses are likely to be concentrated more in corporate (18% of total loans, especially to SMEs) and emerging loans (16% of total loans, CEE exposure).

NPL versus total loan ratios (%)



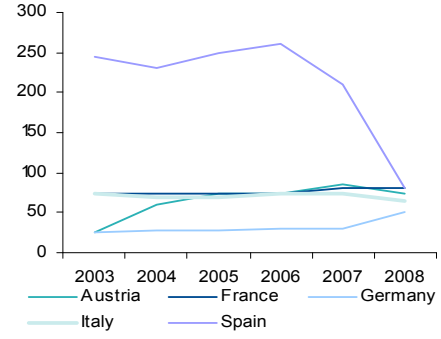
Source: IMF global financial stability, Calyon

Forecast of Euro Area provision by loan type (%)



Source: ECB, WEO, IMF

Loan loss reserves as a % of problem loans



Source: Moody's, Calyon

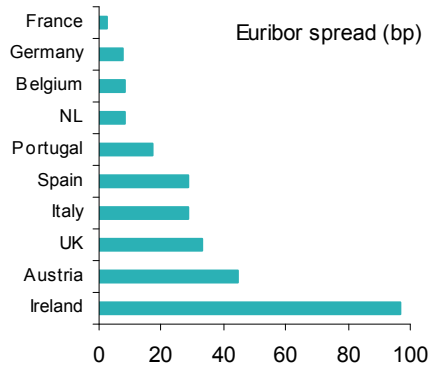
European banks' asset quality deterioration is not expected to hit its peak before H110

Representing less than 10% of total loans, commercial real estate and consumer lending – highly sensitive to credit cycle – will also remain areas of concern. In line with the trend in previous quarters, residential mortgages should remain under control bearing in mind significant variations among countries (Spain, Ireland). By country, the most sensitive are Spain, Ireland and Italy, where provisions for loan losses are above the Euro loss rate. Although bad bank programmes and other government support are softening the negative impact of the crisis, this has now spread to other economic sectors. At the same time, sovereign counterparty risks have increased, with greater concerns over emerging sovereigns (see Credit Focus: European Banks: Exposure to Dubai, 26/11/09). As a whole, the European banking industry's asset quality deterioration has not yet reached its peak.

Sovereign exposure: emerging sovereigns the main concern

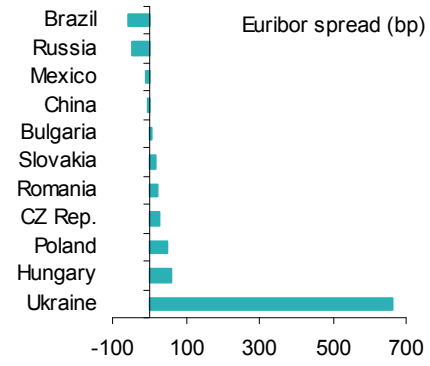
During the crisis, the soundness of governments has deteriorated predominantly due to the extensive support provided to banks and the economy as a whole in order to avoid a credit crunch (see Credit Focus: Financials: Global overview of rescue packages, 18/11/09). This has led rating agencies to downgrade some sovereign ratings (Ireland, UK with outlook negative at S&P, Spain), with Greece among the most recent. Due to the rating agencies' approaches, this has also led to potential pressure on the banking side, notably on senior unsecured debts and as such on LT2 debts. Pressure is likely to remain over the next few quarters for as long as the crisis lasts and unemployment rises.

CDS 5Y European sovereign countries



Source: Bloomberg, Calyon

CDS 5Y emerging sovereign countries



Source: Bloomberg, Calyon

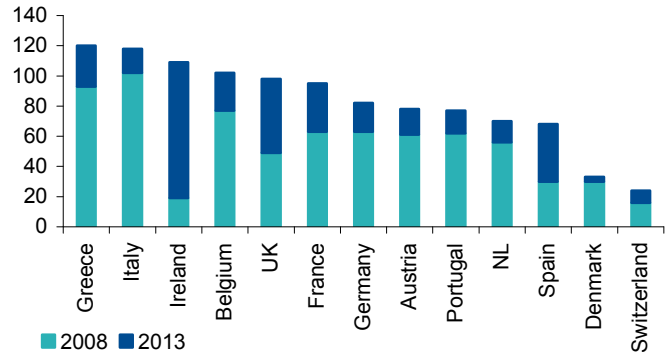
Sovereign issuance on the rise (EURbn, pa)

	2007	2008	2009	2010
Germany	141	146	159	210
France	98	129	165	175
Italy	173.4	186.3	260	250
Spain	25.3	53.1	110	80
Belgium	28	30.2	31	37
Holland	21.1	28.5	48	57
Portugal	9.7	13	14	17
Finland	5	5	8	10
Austria	18.1	10.1	28	26
Greece	31.9	38.6	52	44
Ireland	6	11	35	18

Source: S&P, Calyon

Concerns have risen recently with the Dubai case. At a time when confidence in the European banking system is still fragile, this announcement was not at all welcome even after considering the direct exposure of European banks to Dubai immaterial or limited. Following the announcement, rating agencies withdrew sovereign support for financial entities leading to a wave of downgrades. We do not expect similar rating actions on the European banking system. While this issue is far from comparable to the subprime crisis or Lehman's failure, it will undoubtedly be transferred with additional write-downs and an increase in the cost of risk in Q409, notably for British banks. The Dubai announcement has highlighted the potential vulnerability of emerging sovereigns. While Latin America is not viewed as a major concern, Central and Eastern Europe will continue to be watched closely.

Net government debt guarantee (% of GDP)



Source: central banks, S&P, Calyon

ECB: composition of assets in June 2007 and June 2009

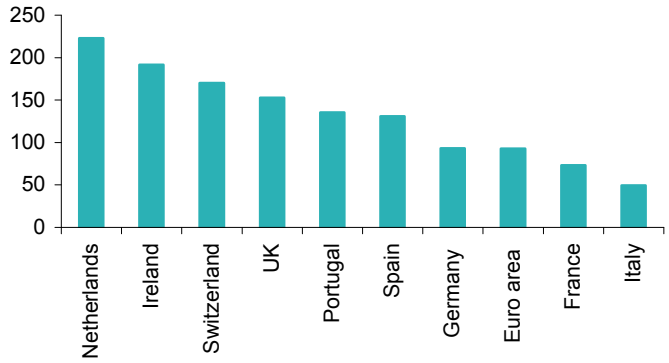
EUR bn	29-Jun-07	26-Jun-09	2009 vs 2007
Gold and foreign currency	338.8	475.5	40%
Main refinancing operations	313.5	167.9	-46%
Long Term refinancing operations	**150.0**	**728.6**	**386%**
Marginal lending facility	1.1	0.3	-70%
Other	405.0	625.0	54%
Total	1208.5	1997.3	65%

Source: ECB, IMF, Calyon

In parallel, and as a result of unconventional intervention, central bank balance sheets have expanded and changed in composition (purchase of assets such as mortgage-backed securities and commercial paper) leading their risk profiles to deteriorate somewhat. However, a careful exit strategy is forecast, as a quick sell-off could disrupt financial markets.

Housing lending business: low volume but losses under control

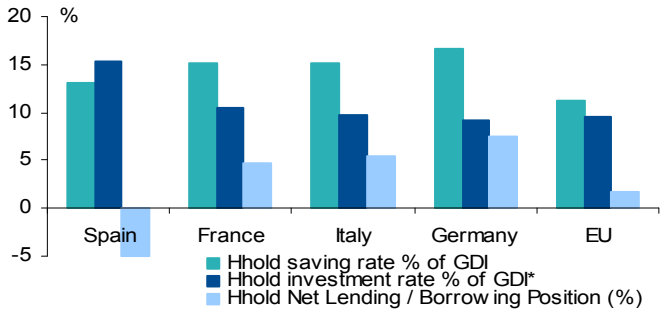
Gross debt to income ratio of households (end-2007)*



** End-2008 for the Euro area*

Source: Eurostat, Calyon

Household creditworthiness at end-2008

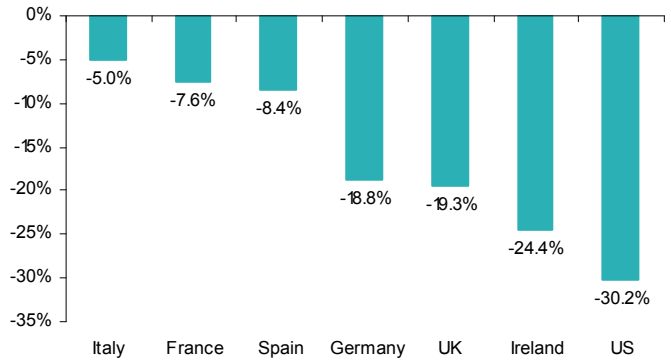


** in 2007 for Spain and Germany*

Source: Eurostat, Calyon

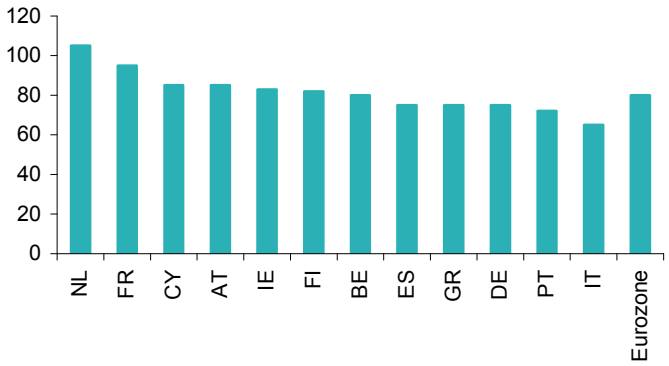
In parallel with the selective lending approach adopted by European banks (LTV below 80%; debt-service ratio below 30% with stricter limits for variable rate mortgages), poor mortgage loan production highlights the limited customer demand.

House price correction from peak



Source: Bloomberg, Calyon

LTV for typical loans for housing purchase, 2007 (%)

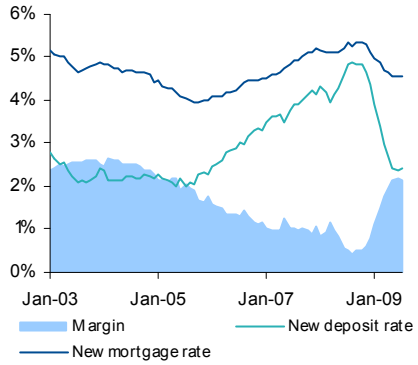


Source: European Central Bank, Calyon

Poor earnings on mortgage business, but the asset quality should remain under control

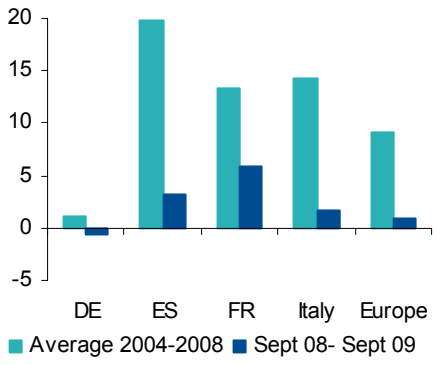
With the end of interest rate cuts (10Y interest rates in December 2010: 4.50% forecast by Calyon vs 3.29% in mid-September 2009, pressure on housing loans with variable rates like in Spain and the UK), no trend reversal for demand is expected in H110. Less fiscal stimulus, a poor housing market combined with the fear of job losses have encouraged households – especially those with high indebtedness – to pursue their de-leveraging and increase their saving levels.

Estimated margin on new mortgages



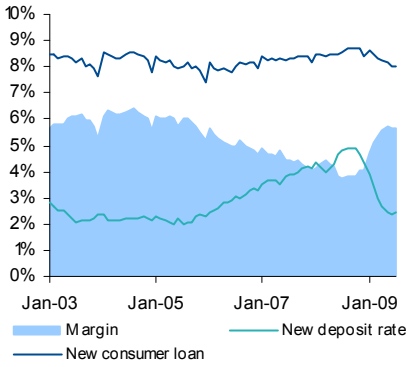
Source: European Central Bank, Calyon

Housing loans (YoY growth %)



Source: European Central Bank, Calyon

Estimated margin on new consumer lending



Source: European Central Bank, Calyon

Overall, and bearing in mind the divergences among European countries, banks are likely to deliver poor earnings on their mortgage businesses, illustrating shrinking leeway on asset repricing (H109: upward slope of the yield curve). Rather than a surge, the asset quality deterioration should remain gradual and under control (0.3% provision for loan losses expected by the IMF in 2010e), with a special focus on countries and banks highly sensitive to the strong correction in housing markets.

Consumer lending: will continue to weaken as unemployment rises

Highly sensitive to rising unemployment, consumer lending will continue to suffer…

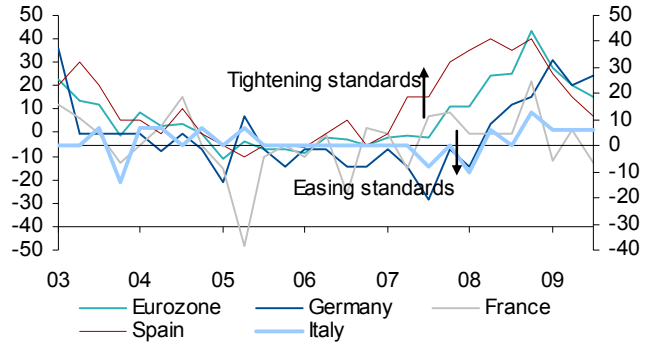
Consumer lending is one of the sectors most sensitive to the economic cycle, since rising unemployment is quickly translated into rising delinquencies. Accounting for 6% of total loans in the Euro area, consumer lending has been severely hit, particularly credit cards (auto loans less impacted), in countries facing strong real estate market corrections. As unemployment continues to rise, no trend reversal is expected before H110, despite better economic prospects and efforts to reinforce loan loss provisions. With very poor customer demand, consumer lending will continue to face a strong tightening of credit conditions in terms of both volume and asset repricing, illustrating banks' de-leveraging process.

…with no trend reversal expected before H110

While some large banks may be opportunistic and try to gain market share in this segment, the latter is not likely to be among the favourites. In addition, European

governments like France may decide to tighten the rules on consumer credit, notably by eliminating interest-only loans.

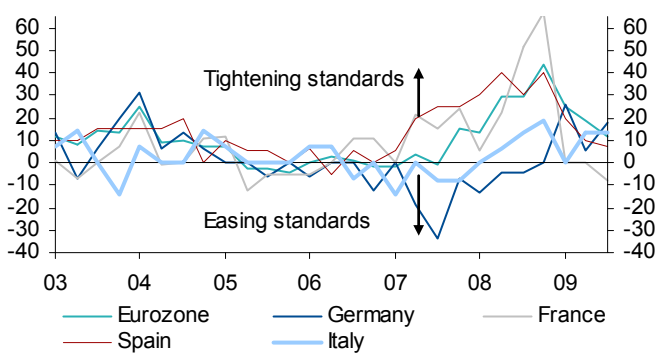
Expected credit standards for consumer lending



Methodology: a positive net percentage indicates that a larger proportion of banks have tightened credit standards. Likewise, the term 'net demand' refers to the difference between the share of banks reporting an increase in loan demand and the share of those reporting a decline. Net demand will therefore be positive if a larger proportion of banks have reported an increase in loan demand.

Source: ECB, Calyon

Expected credit standards for housing loans



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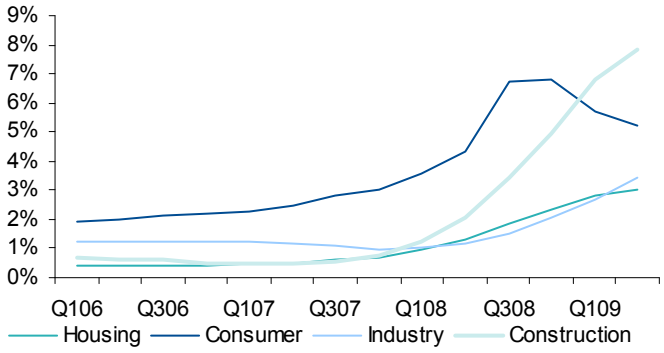
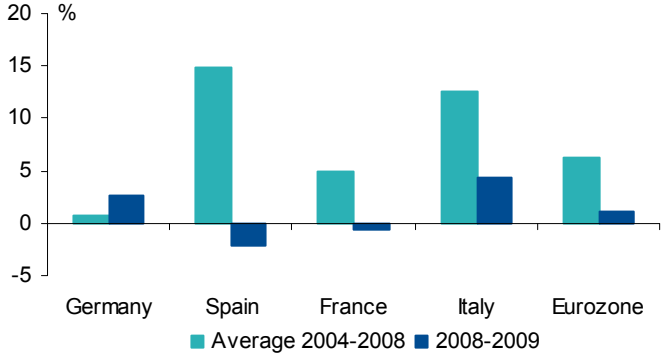
Source: ECB, Calyon

NPL ratios in Spain



Source: Banco de España, Calyon

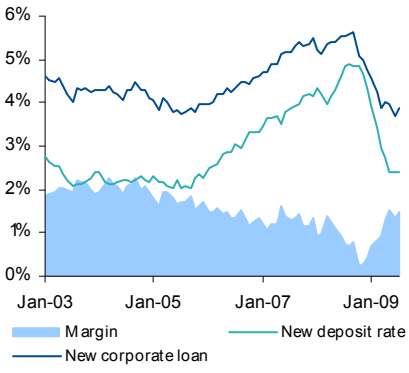
Consumer loans (YoY growth %)



Source: European Central Bank, Calyon

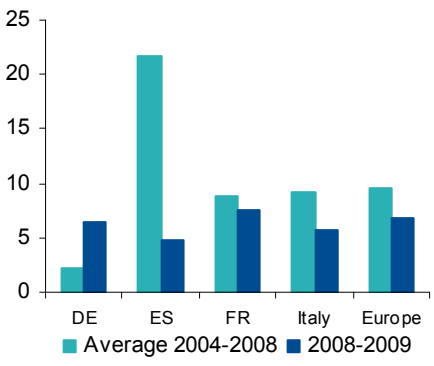
Corporates: a hard time for smaller firms

Estimated margin for new corporate loans



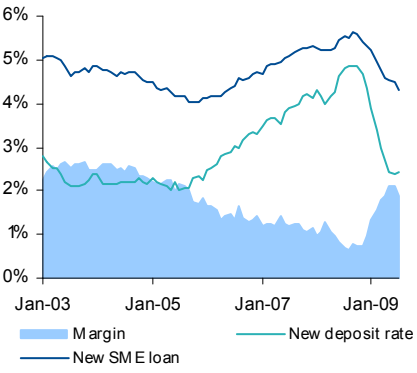
Source: European Central Bank, Calyon

Loan growth for large corporates (YoY %)



Source: ECB, Calyon

Estimated margin on new loans for SMEs

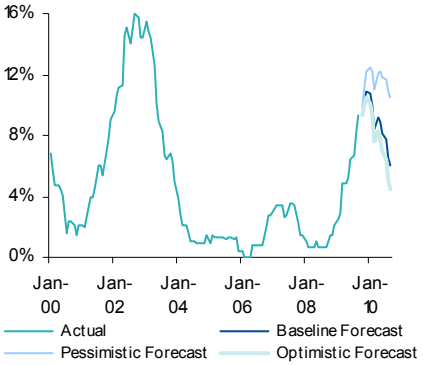


Source: European Central Bank, Calyon

On a positive note, the sharp narrowing of corporate spreads and the record issuance in the primary market by large European corporates (above EUR230bn in 2009) – mostly investment grade – have helped to ease the tightening of credit conditions and, as such, contain the rise in corporate defaults. Having partly

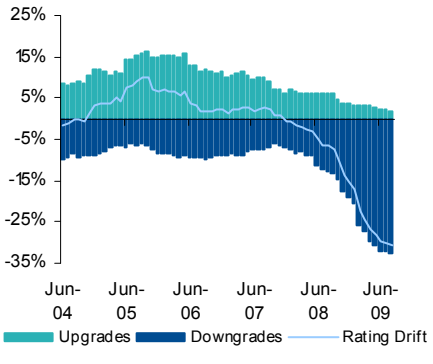
anticipated their 2010 needs, the largest European corporates are not in such a rush regarding their borrowing needs.

Europe speculative grade default rate forecasts



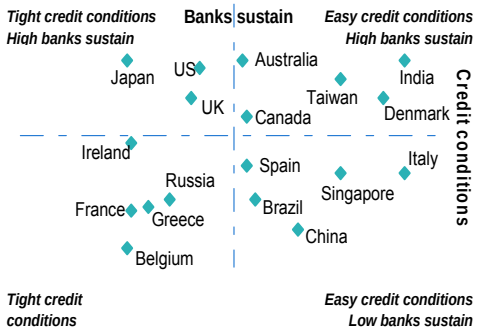
Source: Moody's September report, Calyon

Rating actions on European corporates by Moody's



Source: Moody's, Calyon

Credit conditions as viewed by SMEs



Source: Grant Thompson, l'Agefi, Calyon

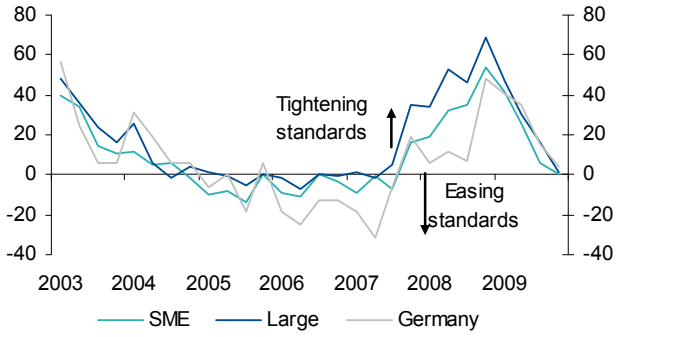
In contrast, small and medium-sized enterprises, with little access to the capital markets, have been strongly penalised by tight credit conditions, despite government support. This segment accounts for around 50% of GDP and employs more than two-thirds of the workforce. Low household consumption, high corporate indebtedness (debt to GDP: c.100% in the Euro area), excess capacity and weak sales are all discouraging new business investment.

Credit demand from non-financials versus bank lending capacity growth (EURbn)

	2009		2010	
		Var (%)		Var (%)
Credit capacity available for the non-financial sector	190	0.9	580	2.7
Total credit demand from the non-financial sector	650	3	820	3.7
o/w Sovereign	*430*	*2.01*	*320*	*1.46*
o/w Private	*220*	*1.01*	*500*	*2.28*
Bank lending capacity growth		-4.6		-2.7

Source: national authorities, IMF

Expected credit standards for loans to companies



Methodology: a positive net percentage indicates that a larger proportion of banks have tightened credit standards, whereas a negative net percentage indicates that a larger proportion of banks have eased credit standards. Likewise, the term 'net demand' refers to the difference between the share of banks reporting an increase in loan demand and the share of those reporting a decline. Net demand will therefore be positive if a larger proportion of banks have reported an increase in loan demand.

Source: ECB, Calyon

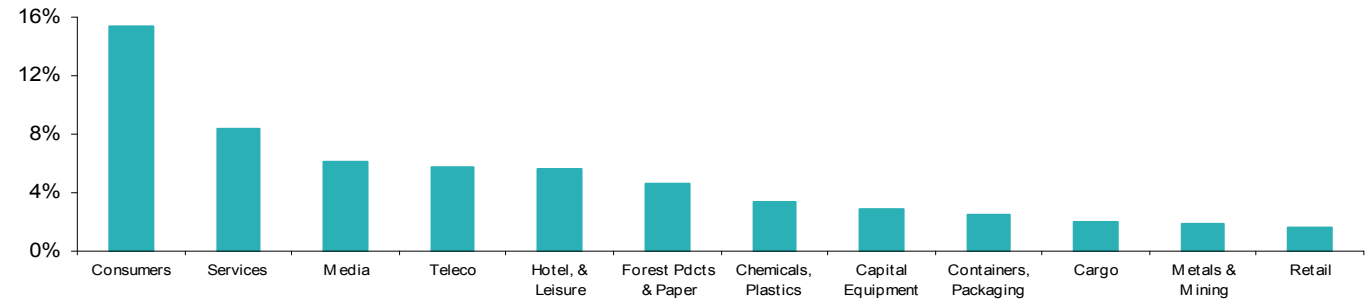
Strong divergence between corporate exposure, highlighting soundness of their fundamentals and their size

Against this backdrop, banks are likely to remain very selective and favour good signatures, less costly in terms of capital under the Basel II approach. The latter will be strengthened to better assess the risk coverage, including trading book, re-securitisations, liquidity lines to ABCP conduits as well as counterparty credit risks. As such, bank lending growth – although improving – could remain insufficient to cover credit demand from corporates. The deterioration in corporate loans (commercial banks and financing business) will strongly hit banks' balance sheets (RWA: rating migration, NPL). Over the coming 12 months, Moody's expects European default rates to reach four-quarter peaks of 10.5% before declining to 6%. Across industries, default rates are expected to be highest in the durable consumer goods sector in Europe. SMEs – accounting for 75% of European banks' loan books – are nearly twice as likely to default as larger corporates, according to IMF forecasts.

SMEs and most cyclical sectors are the most vulnerable

European commercial real estate markets also remain under pressure, although less than in the US, particularly in Ireland, Spain (construction and developers: 8.1% of NPL ratios at end-June 2009), the UK and to a lesser extent Germany; property prices have declined significantly and there are rising vacancy rates. This segment will continue to be a concern for European banks leading to additional write-downs on CMBS and rising non-performing loans.

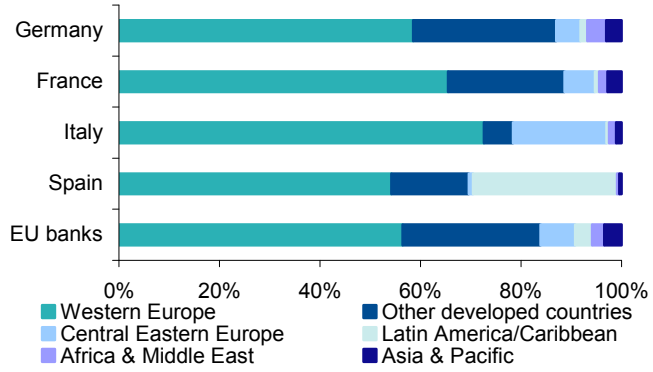
1Y corporate default rate forecasts by industry



Source: Moody's September report, Calyon

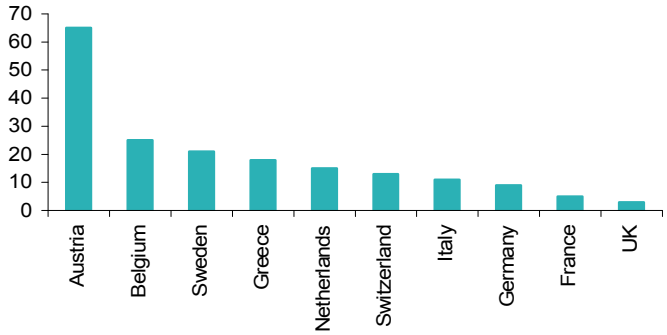
Emerging markets: clouds remain over Central and Eastern Europe

Foreign claims, H109



Source: BIS, Calyon

Banks claims in CEE/2008 GDP (%)

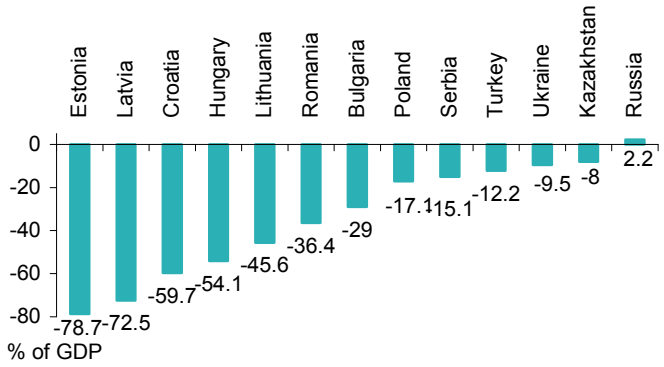


Source: Banks, CA Cheuvreux, Calyon

Strong divergence among Emerging countries

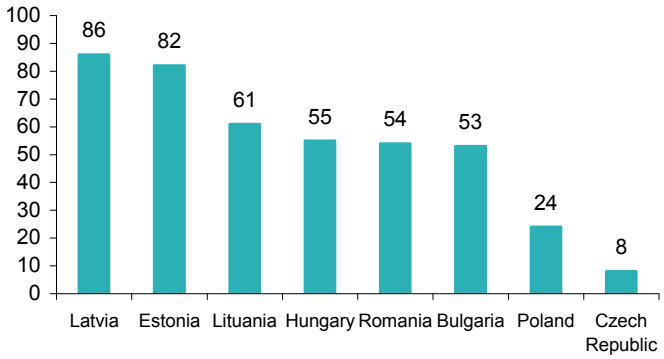
Emerging market risks have been substantially reduced reflecting official initiatives (IMF support) combined with a return of risk appetite. Nevertheless, vulnerabilities remain, especially in Emerging Europe, which is heavily dependent on external financing. Private sector defaults have surged in CEE, and no trend reversal is expected at the beginning of 2010. After being sharply hit in 2009 – especially in Mexico – the outlook is more optimistic in 2010 for the largest Spanish names.

Net external position in CEE, June 2008



Source: BIS, International Financial Statistics, Calyon

Foreign currency loans in CEE countries (% total outstanding amount)

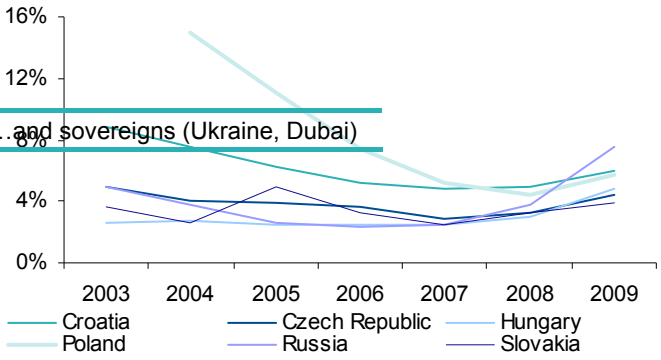


Source: Central Banks, La Tribune

Europe's emerging markets remain clouded

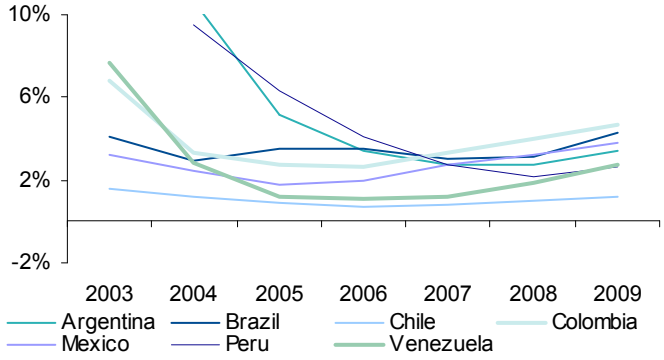
While the worst seems to be behind us, the outlook for Europe's emerging markets remains clouded, with strong divergence among countries (Baltic regions, Russia, Ukraine, Bulgaria, Hungary and Romania). Austrian, Swedish banks, KBC and Unicredit are the most sensitive to Central and Eastern Europe, which previously represented one of their main growth engines. German banks are also exposed indirectly to CEE since the German economy, like Austria, is exposed to CEE through imports and exports. We reiterate our view that most integrated subsidiaries would be better protected by the conservative approach followed by their parent company.

Non performing loan ratios in CEE



Source: National authorities, IMF Global Financial stability

Non performing loan ratios in Latin America



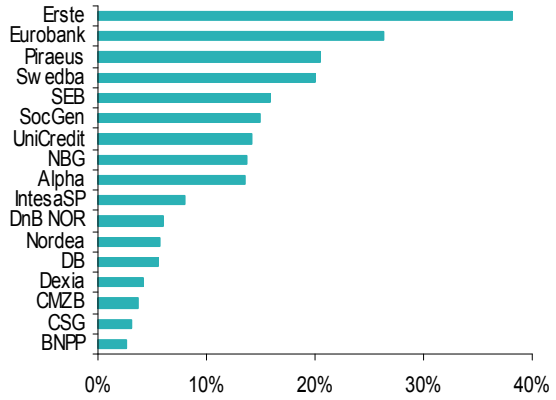
Source: National authorities, IMF Global Financial Stability

Default risks are concentrated in corporate and household (mortgage and consumer lending) …..

…and sovereigns (Ukraine, Dubai)

With high unemployment, a sharp drop in real wages plus real estate price deflation, default risk for both corporates and households (mortgages and consumer lending) will continue to rise. Although some stabilisation is not ruled out after a potential peak at the beginning of 2010, recovery in CEE will depend on the soundness of Western European economies and their banking sectors. As long as parent companies are focusing their efforts on strengthening their balance sheet, boosting their capital ratios and facing pressure from the government to support the domestic real economy, subsidiaries should continue to be affected.

Loans in CEE/total loans, banks exposed to CEE countries (2008)



Note: OTP, Raiffeisen: 100%

Source: Cheuvreux, Calyon

EC forecasts for CEE (%)

	GDP growth				Unemployment rate			
	2008	2009f	2010f	2011f	2008	2009f	2010f	2011f
Hungary	0.6	-6.5	-0.5	3.1	7.8	10.5	11.3	10.5
Poland	5.0	1.2	1.8	3.2	7.1	8.4	9.9	10
Bulgaria	6.0	-5.9	-1.1	3.1	5.6	8.9	8.0	7.2
Croatia	2.4	-5.8	0.2	2.2	8.4	10.0	9.8	9.4
Slovenia	3.5	-7.4	1.3	2.0	4.4	6.7	8.3	8.5
Romania	6.2	-8.0	0.5	2.6	5.8	9.0	8.7	8.5
Macedonia	4.9	-2.0	1.5	2.5	33.8	35.6	36.1	36.4
Slovakia	6.4	-5.8	1.9	2.6	9.5	12.3	12.8	12.6
Russia	5.6	-7.2	2.3	2.7	5.6	7.2	6.8	6.5
Czech Rep	2.5	-4.8	0.8	2.3	4.4	6.9	7.9	7.4

Source: European Commission forecasts (as at 04/11009)

Will emerging businesses become the new growth engine of the Western European banks post-crisis?

At a time when the business model needs to be revised, what will be the role for emerging businesses post-crisis?

- Domestic markets for most European banks are mature, which limits growth in earnings going forward.
- The current deleveraging in CIB – mostly the riskiest businesses requiring higher capital – also limits potential profit growth.
- Similar to developed countries, a bad bank programme could be envisaged in the most troubled emerging countries.
- Post-crisis, the emerging arm is likely to represent the lion's share of growth.
- As a consequence, European banks (Santander: IPO in Brazil) that enjoy expertise in emerging businesses and good capital without state support are likely to reinforce their franchise via organic growth or targeted acquisitions at a time when other banks have to sell assets.

Cumulative credit loss assumptions for domestic loans (2009-11, %)

	Residential mortgage loans	Corporate	All lending segments	Average annual rate 2009-11
Base case				
Germany	0.6	5.5	3.5	1.2
UK	1.6	6	5	1.7
Spain	1.3	4	4.4	1.5
Downside case				
Germany	0.9	8.3	5.2	1.7
UK	4.2	10	8.5	2.8
Spain	2.4	6.2	7	2.3

Source: S&P estimates, Calyon

Geographic exposure (as of Q309, % revenues)

	Domestic	Other Europe	UK	CEE	Latam	US	Asia
Unicredit	49%	21%	-	28%	-	-	-
BBVA	35%	-	-	-	42%	11%	-
Santander	31%	16%	12%	-	43%	-	-
ISPIM	81%	7%	-	12%	-	-	-
CZBK	-		-	9%	-	4%	-
MPS	98%	-	-	-	-	-	-
SocGen	51%	18%	-	17%	-	7%	-
DB	68%		-	3%	1%	21%	6%
BNPP	45%	31%	-	-	-	15%	-
CSG	24%	27%	-	-	-	37%	-
UBS	29%	26%	-	-	1%	36%	7%

Source: banks, rating agencies, Calyon (See appendix – page 90)

Business segments exposure

	Consumer	SME	Corporate cyclical	Corporate	Residential mortgage	Sovereign
MPS	3	5	4	4	3	1
CZBK	2	5	5	3	2	4
Unicredit	3	4	4	4	3	3
Santander	5	3	3	2	4	2
SocGen	4	3	3	3	3	2
ISPIM	2	4	2	4	3	2
BBVA	2	3	3	3	4	2
BNPP	4	2	2	3	2	2
DB	1	2	2	3	2	2
CSG	1	1	3	2	2	3
UBS	1	1	2	2	2	2

Note: 1 - No material risk; 2 - small risk, but no impact issue; 3 - medium risk, limited impact; 4 - significant risk, potential for strong impact; 5 – major exposure and potential impact. Due to lack of consistent information for some segments, grades were given according to available quantitative figures as well as estimates of exposures.

Source: banks, rating agencies, Calyon (See appendix – page 90)

Investment theme No.2: Rebuilding the pillars of a new banking system – lost in translation

Rebuilding financial pillars: necessary to discipline the banking system without constraining the capacity to sustain the economy

The European banking sector is already heavily regulated. However, the crisis has shown that the regulatory framework – even after the implementation of the Basel II rules – has failed to capture all risks, especially in trading books. The crisis also demonstrates the need for capital buffers for most European banks to absorb unexpected losses, and hence maintain market confidence.

To ensure European banks' capacity to sustain the real economy remains the first priority of the authorities. Beyond the crisis, the financial pillars nevertheless have to be strengthened so as to build a more disciplined, robust and less pro-cyclical financial system and as such reduce systemic risk in the future.

No easy issue to regulate further the banking system with global co-ordination and be able to assess the real impact in medium term

How should regulation be fundamentally changed in response to the crisis? Will it be an evolution or a revolution of the European banking system? At first sight, the framework provided by the BIS to strengthen the banking sector seems very constrained and signals a drastic change in the legislation. However, at both domestic and international meetings (G20, Financial Stability Board, BIS…), wide-ranging debates and initiatives are still indicating an attempt to address the appropriate regulatory framework, increases in capital, liquidity buffers and reformed standards for accounting and disclosure, ratings and securitisation with better global co-ordination among countries. While we already have many proposed guidelines, the final measures to be disclosed in 2010 will be the main focus of the year.

Accounting treatment: replacement of IAS 39

Following the amendment to IAS 39 with over EUR600bn of assets to be reclassified, the IASB plans to replace and simplify IAS 39 in order to make it easier for investors to assess bank accounts. While the new rules have not yet been finalized, leading to uncertainty and difficulty in assessing the final impact on banks, the main elements are as follows:

Not the end of fair value

- New classification and measurement requirements apply to **financial assets only**, loosening concerns over the magnitude of impairment losses recognised for debt instruments. Separate measures will be addressed for liabilities.
- Only instruments with **basic loan features** (cash amounts that represent both principal and interest) and **contractual yield basis** will be accounted for at **amortised cost,** and if those instruments are held to collect cash flows rather than to be sold before maturity. In that case financial assets will be subject to a single impairment model, based on expected losses.

Impairment model based on expected losses

- The IASB has **co-ordinated** its approach with FASB in order to be in line with the G20. The G20 has emphasised the need for convergence towards a single set of high-quality, global and independent accounting standards. Viewed as positive, convergence will take time to appear in banks' balance sheet leading to potential distortion.
- For **reclassified assets** following the amendment to IAS 39 at end-2008, there are no special rules.
- The new standard on fair value is planned to be finalised in H110 (impairment methodology and hedge accounting). Any final proposals – classification and measurement – will be available for voluntary application for 2009 year-end financial statements. **Mandatory** application will not be before **2013**.
- New rules are planned to be retroactive, with some transition relief to be provided.

Key changes to IAS 39

	IAS 39	Proposed approach
Classification	Many categories each with different measurement, presentation and impairment methods: fair value, available for sale (AFS), amortised costs (different impairment method)	Two measurement bases: **amortised cost** (one impairment method) and **fair value through the profit and loss**
Measurement		Irrevocable option at initial recognition to present fair value changes of some **equity instruments (not** held for trading) in other comprehensive income (OCI, equity)
Impairment	Different impairment rules depending on category and instrument type	**One single impairment method** for financial assets measured at amortised cost.
Tainting	Tainting rules for held to maturity investments	No tainting rules for assets measured using amortised costs
Reclassification	Some reclassifications permitted / required	No reclassifications, with the rare exception of changes to business model.
Embedded derivatives	Bifurcation of embedded derivatives required in some cases	No separation. Same classification approach (for hybrid with financial hosts).
Fair Value Option (FVO)	Available if specific criteria are met	Available for an accounting mismatch

Source: IASB, Calyon

Liquidity management: limited reliance on short-term borrowing and higher liquidity cushion

While the market is currently giving attention to capital, liquidity is just as important for banks, as illustrated by Northern Rock during the crisis. As the G20 pointed out, rules on liquidity management have to be reinforced. Adding to the CEBS guidelines to boost liquid assets (Credit focus: CEBS pushes banks to boost liquid assets, 10/12/09), the Basel Committee disclosed new standards to complement the current regulatory framework by introducing short-term and stable funding ratios:

While the market is giving attention to capital, liquidity is just as important for banks

- Liquidity is nearly back to normal, however, this reflects the ample liquidity injected by authorities and central banks. The ECB is likely to be measured according to the removal of liquidity. The ECB seems all set to begin tightening its liquidity provision by ending its long-term refinancing operations (one-year term) after last December's auction. Also, the ECB has changed the criteria for accepting ABS collateral for its repo operations (at least two ratings from March 2010, transparency on underlying loans reinforced).
- The target of the new framework is to limit too much reliance from the banking system on short-term borrowings, predominantly from wholesale funding. The BIS addresses this issue by introducing the **net stable funding ratio (NSF)**. Stable funding – including equity, Tier 1 and Tier 2 capital, stable retail deposits (with haircuts from 15% to 30%) – is expected to be a reliable source of funds over a one year time period under conditions of extended stress that must at least cover the liquidity risk profiles of an institution's assets and **off-balance sheet** exposures.

Central banks are becoming less generous in providing liquidity

- In addition to better quality, a **liquidity cushion** should be maintained in order to ensure weather periods of financial market stress and illiquidity. The BIS **liquidity coverage ratio** aims to maintain an adequate level of high quality assets that can be converted into cash to meet the bank's liquidity needs for a 30 day time period during a liquidity stress scenario. In line with the CEBS guidelines, "high quality of assets" (cash, govies at least half of those assets) should be liquid assets in the market during a time of stress, unencumbered and ideally eligible to central banks (such as covered bonds).
- Better transparency related to liquidity management is likely to be required.

Implementation of two BIS liquidity ratios, short-term and stable funding ratios, by end-2012

Extent?

- The FSA has already implemented a new liquidity regulation (at the beginning of December), requiring UK banks to maintain a buffer of highly liquid and high-quality assets (like government bonds). The FSA will also monitor the liquidity of banks under stress scenarios. Also, the haircut to retail funds has been reappraised to 10%. The cost of the increased amount of liquid assets in total assets – assuming an increase to 8% (versus 4.6% on average in 2007) – has been estimated by the FSA at GBP3.3bn.

Liquid asset levels of European banks (EURbn)

	Total assets	Customer deposits	ST wholesale funding	Total liquid assets	Liquid assets as % of total assets	ST wholesale funding as % of total assets	Eligible assets to the ECB (EUR M)
MPS	213.80	81.60	18.46	100.06	47%	9%	18.4
CSG* (CHF bn)	1,064.21	286.07	8.18	294.25	28%	1%	N/A
CMZB	625.20	170.20	65.95	236.15	38%	11%	N/A
Intesa	636.13	217.50	40.52	258.02	41%	6%	39
DB	1,659.56	364.97	857.71	1,222.69	74%	52%	56
SocGen	1,089.12	282.51	479.77	762.28	70%	44%	54.5
Unicredit	1,045.61	388.83	263.87	652.70	62%	25%	40
BNP	2,075.55	413.96	1,128.39	543.12	57%	14%	62.3
BBVA	516.83	267.14	43.97	311.11	60%	9%	50
Santander	1,049.63	378.00	97.57	475.57	45%	9%	83
UBS (CHF bn)	1,974.30	474.80	394.40	869.20	44%	20%	N/A

** As at Q309, other data as at FY08; ST wholesale funding: debt securities with maturity <1Y, short-term borrowings, financial liabilities at FV through P&L, other liabilities with maturity <1Y; Santander: breakdown of liabilities at amortised cost*

Source: banks, IASB, Calyon

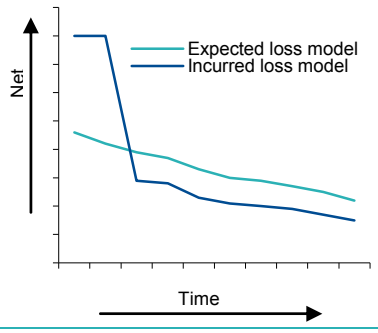
A new provision framework: counter-cyclical treatment

The G20 communiqué and Basel Committee explicitly mention the introduction of anti-cyclical buffers as another range of measures.

BIS proposals: 1/ forward looking provisioning, 2/ the build-up of adequate buffers above minimum requirement and 3/ taking into account excess credit growth

- While **Spain** is facing a tough economic environment with strong corrections in the real estate market, comfortable coverage ratios – encompassing specific and generic provisions linked to growth of the loan book – built up during previous years have helped Spanish banks to counteract asset quality deterioration and as such smooth pressure on net profit and capital ratios.
- **Dynamic provisioning** – based on the Spanish model – would force European banks to build up a provision in good times against future losses, providing a resource which could be drawn on in bad times. The setting up of reserves could also be based on GDP growth rather than growth in the loan book. Such a scheme smoothes results over the cycle and as such eases fears of potential credit crunch. This reserve is not planned to be included within the Tier 1 capital. The framework is expected to be implemented only once the recovery is assured, a context more favourable for shoring up dynamic provisioning. As an indication, between 2000 and 2007, Spanish banks created on average 33bp (over total loans) of pre-tax provisions based on that dynamic model, accounting for two-thirds of their total cost of risk (50bp on average). At an earlier stage, the Basel Committee is working for a regime to adjust the capital buffer range, notably during a period of excess credit growth, and as such avoid taking potentially too much risk.

Revenue recognition under EL



Source: IASB presentation

- A provisioning policy based not only on incurred losses but also on expected losses is being promoted. Moving away from the previous IFRS philosophy, as part of the IAS 39 replacement project the **IASB** is now reappraising the impairment of assets, which will consider an **expected loss model**. The model might be based on a rating approach (rather than the Spanish model). For further details, see our Credit Focus: Financials: Accounting regulation – the IASB takes a new step, 06/11/09. This initiative is supported by the Basel Committee who would provide further incentive to that method by fully deducting provisions over expected losses from common equity (against the current 50% deduction from Tier 1 and 50% from Tier2).
- In addition to more forward-looking provisions, a framework for **counter-cyclical capital buffers** (to be built under good times) above the minimum requirement has been introduced. The scheme proposes to monitor banks through their **earnings distribution capacity** which may include reducing dividend payments, share buy-backs as well as bonus payments. Only banks with capital "well above" the requirements will benefit from a total freedom on pay-outs. As an example, a 40% pay-out would require a 50%-75% excess capital under the new framework.

Trading book: incremental risk charge and stressed VAR

The Basel framework failed to capture all of the risks in trading books, which accounted for the lion's share of the losses during the financial crisis. This issue has been addressed by the adoption in July 2009 of the Basel II market risk framework including:

RWA market risk to be three times higher

- The capital charge for incremental risk (IRC). The capital requirements for market risk were based on VAR models, providing an assessment of the loss on the institution's portfolio that would not be exceeded, with a 99% probability (the confidence level), and over a ten-day horizon. The VAR will now include an incremental risk charge to **estimate the default and credit rating migration risks of unsecuritised credit products** over a one-year capital horizon with a 99.9% confidence level, taking into account the liquidity horizons of individual positions or sets of positions.

Investment banks are the main ones impacted

- The stressed value-at-risk (VAR) capital charge since the current minimum requirements for the trading book have been shown to be too volatile and too low at times of market stress.
- The capital charges for securitisation exposures in the trading book (see below).
- The capital charges resulting from the preferential treatment of liquid and well-diversified equity portfolios under the standardised measurement method to specific risk. The removal of the preferential treatment will result in a uniform standardised specific risk capital charge of 8% of the exposure amount.

Based on a study of data provided by 43 banks across 10 countries, the new scope of market risks – excluding securitisation exposures in the trading book – will lead to an average increase of at least 11.5% of overall capital requirement and a 223.7% increase in market risk capital requirement. It is worth mentioning the reluctance of banks to participate in this study and the strong heterogeneity among banks. A study concentrating on correlation trading activities will be conducted by Basel in 2010. On the basis of that study, the Committee will evaluate a floor for the comprehensive risk capital charge.

Increase in capital charges on implementation of the new market risk framework (mean, as %)

	Share market risk	Incremental risk charge *	Stressed VAR	Re-securitisation **	Equity-specific exposure	Total
As a % of banks' overall capital requirements	7.3	6.2	4.6	5.4	0.2	11.5
As a % of banks' market risk capital requirements	7.3	102.7	110.8	92.7	4.9	223.7

** IRC capital requirements are based on the data provided for a three-month liquidity horizon and a one-year capital horizon*

*** Due to data availability constraints, the current capital requirements for all securitisation exposure had to be deducted from the new requirement for re-securitisation exposure. Therefore, the actual impact will in general be higher.*

Source: BIS, Calyon

Parts of these new measures will be effective for full-year 2010 while the comprehensive revision of the scheme is forecast to be effective for 2011-12. RWA market risk is expected to increase threefold. This would imply additional capital requirements of around EUR46bn for the sector, equal to 7% of current Tier 1 capital. On this basis, the Tier 1 ratio for the sector would drop to 9.1%.

- For investment banks with RWA market risk accounting for 10% of total RWA risk, the net impact is in the range of 200-300bp of Tier 1 capital.
- For universal banks with RWA market risk accounting for 4-5% of total risk, the net impact is close to 60-120bp of Tier 1 capital.
- For retail banks the impact is less than 50bp of Tier 1 capital, since RWA market risk does not account for more than 3% of total RWA risk.
- Smaller banks, for which the impact is negligible, in the range of 10bp.

Impact on RWA of market risk and re-securitisation (EURm)

	Market RWAs	Market risk increase	New market risk RWAs	Total RWA increase
Credit Suisse	14,237	x 2.5	49,828	35,592
Deutsche Bank	31,628	x 2.5	110,698	79,070
UBS	10,839	x 2.5	37,935	27,097
Soc Gen	11,700	x 2.5	35,100	23,400
Commerzbank	16,000	x 2.5	40,000	24,000
BNPP	21,000	x 2.5	63,000	42,000
Santander	39,719	x 2.5	56,600	16,881
Unicredit	11,878	x 2.5	27,023	15,145
MPS	7,786	x 2.5	11,095	3,309
BBVA	12,984	x 2.5	18,502	5,518
ISPIM	17,741	x 2.5	25,281	7,540

Source: CA Cheuvreux (As at Q309)

Securitisation and re-securitisation: end of a golden age?

The securitisation market, and especially complex securitisation exposure, has significantly hurt banks, leading authorities to reinforce the current framework as follows:

Differentiation between securitisation and re-securitisation

- **Re-securitisation positions**: reduced complexity by encouraging then standardisation of structures (smaller number of tranches and less reliance on structural features for credit enhancements) combined with higher capital charges for the re-securitisation products. So far, no distinction is being made between normal securitisation positions and re-securitisation positions such as CDO re-packaging mortgage backed securities.

Given the strong deleveraging process undertaken since the beginning of the crisis …

- A re-securitisation exposure is defined by the Basel Committee as one in which "the risk associated with the underlying pool of assets is tranched and at least one of the underlying assets is itself a securitisation exposure; or where there is an exposure to one or more re-securitisation exposure". The Basel II guidelines explicitly list **CDOs of ABS, CDO-squared and liquidity facilities supporting ABCP conduits** as examples of re-securitisation exposure.

….no material impact is forecast

- **5% retention of all securitisation**: banks issuing securitisation will have to retain a material interest, which will be at least 5% of the total value of the securitised exposure.
- Improvement of the rating methodologies
- The new framework is expected to come into force in 2011 with adoption by the European Commission before the end of 2009. This new framework is positive since it is likely to discourage European banks from investing in the riskiest securitised products. Given the strong deleveraging process undertaken since the beginning of the crisis, no material impact is forecast.
- In addition to the rise bank's capital requirements for trading book exposures, re-securitisations and liquidity lines to ABCP conduits, the Basel proposals released mid-December will also strengthen the capital requirements for counterparty credit risks.
- Here again, **investment banks** will be hardest hit by the increase in weights for re-securitisation.

Increase in weighting of re-securitisation exposure in comparison to simple securitisation

Rating	Internal IRB Senior	Internal IRB Non Senior	Standard Model
AAA to AA-	3 x	2.6 x	2 x
AA+ to A-	3.3 x	3.0 x	2 x
BBB+ to BBB-	2.5 x	3.1 x	2.3 x
BB+ to BB-	1.2 x	1.5 x	1.9 x
B+ and below and not rated exposures for standard method	deducted	deducted	deducted

Source: BIS report, Cheuvreux

OTC credit derivatives: more costly customised derivatives

Failures during the crisis (Bear Sterns, Lehman, AIG) have highlighted that risks associated with derivatives (credit derivatives, interest rate swap, FX derivatives, etc) were not sufficiently mitigated in the OTC part of the market. Following the communication in July 2009, in mid-October the European Banking Commission proposed future measures to strengthen the safety of derivative markets. In order to avoid any risk of regulatory arbitrage and to ensure global co-ordination, these proposals are in line with the G20 Pittsburgh summit. Legislation on the derivatives market will be announced in 2010. The main proposals are as follows:

Which OTC contracts can be regarded as standardised for central clearing?

- Reduce counterparty risk by (1) establishing common standards for central counterparties (CCPs), and (2) providing incentives for standardisation and CCP clearing. This will lead to a substantial rise in capital charges for bilaterally-cleared rather than CCP-cleared transactions.
- Reduce operational risk thanks to greater harmonisation.
- Increase transparency and enhance market integrity.

The European Commission is following steps taken by the US. Whilst attempting to stabilise the financial system, the European Commission has **not defined clearly which contracts can be regarded as standardised** for central clearing.

Greater powers for national authorities and EU with regard to banks

The European Commission has adopted legislative approvals aiming to reinforce financial stability and improve harmonisation between European members. The new framework is planned to be in place in the course of 2010.

- Similar to the US, a systemic risk monitoring body, the **European Systemic Risk Board** (ESRB) has been created. The **ESRB** will be in charge of monitoring the soundness of the financial system so as to provide early warning of systemic risks and issue recommendations if necessary.
- A **European System of Financial Supervisors** (ESFS), encompassing (1) the European Banking Authority (EAB), (2) a European Insurance and Occupational Pensions Authority (EIOPA) and a European Securities and Markets Authority (ESMA), will also be set up. These positive measures may help to harmonise the banking systems among different countries and as such minimise barriers to competition. However, we are far from a single European banking system. Apart from rating agencies and other very specific cases – emergency situations and EU legislation directly applicable to financial situations – financial institutions will continue to be supervised by national supervisors.
- A new EU framework to manage **banking crises, and especially cross-border banking crises**. These tools range from early intervention action by banking supervisors to bank resolution measures which involve the reorganisation of ailing banks around insolvency frameworks under which failed banks are wound up. The Commission's consultation will last for three months and will be followed by a public hearing in February 2010.
- In parallel, the Basel committee is proposing the introduction of a framework that will give greater power to supervisors toward banks to promote capital conservation through their earning capacity distribution.
- Common rules will continue to be applied at a national level with local specificities. During the crisis, national authorities reinforced their powers over the financial system, as the new UK banking law approved in February 2009 can highlight.
- Substantial state support – notably through capital injections – under the conditions of the European Banking Commission in order to avoid competitive distortion is also impacting banks' strategies and as a consequence increasing discrimination among European banks.

Summary of key measures and impact on capital adequacy (EURm)

Measure	Capital shortfall	% of Tier 1 capital	RWA impact	in % of RWAs
10% Tier 1 ratio	34,288	5.6%	0	0.0%
10% Tier 1 ratio, 50% min. core Tier 1	39,948	6.0%	0	0.0%
8% Core Tier 1 ratio target	43,361	18.0%	0	0.0%
Market risk recognition (Stressed vaR, IRC)	32,194	4.8%	289,821	4.8%
Re-securitization	13,771	1.9%	116,265	1.9%
Total	45,965	6.8%	406,086	6.8%
Total including 8% Core Tier 1 requirement	**89,326**	**14.4%***	**406,086**	**6.8%**

Leverage ratio	Capital shortfall	% of Tier 1 capital	% of cumulative profits	Required balance sheet reduction
Asset / Tier 1 ratio = 20x	110,228	17.9%	112.0%	15.5%
Asset / Tier 1 equity ratio = 25x	28,369	4.6%	51.0%	5.0%
Total including 25x leverage ratio	**117,694**	**19.0%**		

** Figure based on the sample of banks used for calculation of market risk RWA impact by Cheuvreux; calculations for different Tier 1 ratio requirements and market risk recognition are based on different samples of banks*

Source: CA Cheuvreux

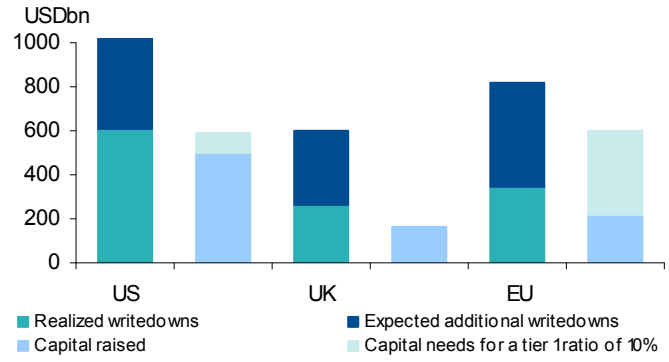
European banks have entered an unknown period since further information has to be disclosed on what final rules will be implemented. The strict BIS guidelines published last December still have to go through impact testing and the final framework could display many changes. More than just a stricter regulatory scheme, the main priority will be to ensure that banks are sufficiently sound to refinance the real economy. The crisis has led European banks – predominantly investment banking businesses – to deleverage and boost capital, and as such to review their business model. This trend will be pursued in the coming quarters, and the stricter regulatory framework should discourage banks from taking too many risks once the recovery is assured. 2010 is likely to be a transitional year in which the main impact is likely to be the implementation of the new scheme in the trading book, and notably the incremental risk charge. Unsurprisingly, investment banks will be the first to be negatively impacted, followed by the universal banking businesses. No material changes are expected for retail banking activities.

Investment theme No.3: Higher levels and quality of capital

While bank capitalisations have begun to stabilise, there is still a need to build capital buffers and strengthen balance sheets to provide adequate credit to the real economy. As well as a stricter framework to capture risks taken by banks, higher levels and quality of capital will also be required post crisis.

Boosting capital and de-risking will remain the formula

Capital needs & additional write-downs



Source: IMF financial Stability Report, Calyon

Capital needs to reach target ratios at end-2010

USDbn	US	Euro	UK
6% Tier 1/RWA	0	0	0
8% Tier 1/RWA	0	150	0
10% Tier 1/RWA	90	380	0
4% TCE/TA (25x leverage)	130	310	120

Source: IMF financial Stability Report, Calyon

Leverage ratios: reducing the gap between IFRS and US GAAP

A maximum leverage ratio (Tier 1 capital to total assets) will be introduced in Europe, such as that already in place in the US and by 2013 in Switzerland (excluding domestic loans). In line with guidelines of the G-20, the Basel Committee proposes a stricter definition of the leverage ratio:

- To curb the expansion of balance sheets.
- To ensure comparability, leverage ratios will have to be harmonised internationally.

One of the main concerns of the European banks, which will be negatively impacted compared to the US

- The leverage ratio requires a reduction in the gap between IFRS and US GAAP. Most European banks highlight that using US GAAP will reduce their CIB balance sheet by close to 50%. US accounting rules allow banks to report their net derivatives exposure; the International Financial Reporting Standards used by most European banks do not (DB: EUR1.2bn positive market values from derivatives under IFRS; EUR128m derivatives post netting under US GAAP pro-forma in December 2008). To have a consistent approach internationally, the leverage ratio definition proposed by BIS does not permit on-balance sheet netting as well as potentially derivatives and repo styles transactions (the use of Basel II netting as an alternative).

Strict definition of the leverage ratio proposed by the BIS (without netting, liquid assets, off-balance sheets…) while taking into account accounting differences between IFRS and US Gaap

- The rigorous inclusion of off-balance-sheet items if final risk is not eliminated has to be strengthened (more stringent under IFRS than US GAAP). In answer to this issue the BIS suggests the inclusion of off-balance sheet items (excluding derivatives) using a 100% credit conversion factor (or the standardised Basel II credit conversion).
- As for securitisations, the accounting data is to be considered by the BIS. Taking the total of all underlying securitised portfolios for the bank's originated securitisations could be an alternative approach, leading investment banks to be potentially reluctant to push this business.

Although stricter definition than in Switzerland and the US, it could be balanced by a ratio superior to that expected by the market (around 25x). The impact assessment will be disclosed in H110, giving banks time for discussion. While the target level is likely to be released by year-end 2010, its implementation would be by end-2012 if economic recovery allows.

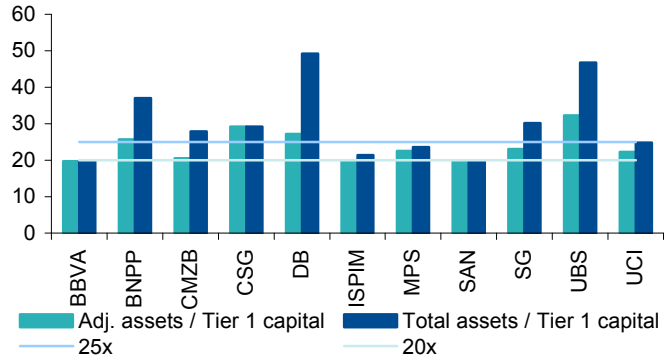
Overview of existing leverage ratio frameworks

	US	Canada	Switzerland	Basel II: BIS proposal	Additional options considered in BIS proposal
Definition	Tier 1 capital divided by total adjusted assets	Total assets divided by Tier 1 and Tier 2 capital	Tier 1 capital divided by total assets	Tier 1 capital or the predominant form of Tier 1 capital divided by total assets net of provisions and valuation adjustments	Total regulatory capital divided by total assets net of provisions and valuation adjustments
Scope	Applies to the bank holding company, excludes off-balance-sheet items	Includes specified off-balance sheet items	Excludes domestic loan book, adjusts for derivative replacement values	Includes both on and off balance sheet items. Off-balance sheet items included with a 100% credit conversion factor. Netting is not allowed. Includes accounting on-balance sheet securitisation exposures. On derivatives, 2 options: (1) to ignore potential exposure or (2) to use the current exposure method. Physical or financial collateral, guarantees or credit risk mitigation purchased should not be allowed to reduce on-balance sheet exposures. Items that are deducted from capital measure must also be deducted from the exposure's measure.	Apply a lower credit conversion factor for off-balance sheet items. Thinking about creating a common set of regulatory netting rules for derivatives and repo style transactions (Basel II netting). Might include underlying loan portfolio of securitisations. Might exclude certain high quality liquid assets in the exposure's measure
Required ratio	Min 3% for banks rated strong, 4% for all other banks	Max 20x (i.e mi 5%); up to 23x (4%) on a case-by-case basis with regulatory approval	3% consolidated level, 4% at individual level	N/A	N/A

Source: BIS, World Bank, CA Cheuvreux, Calyon

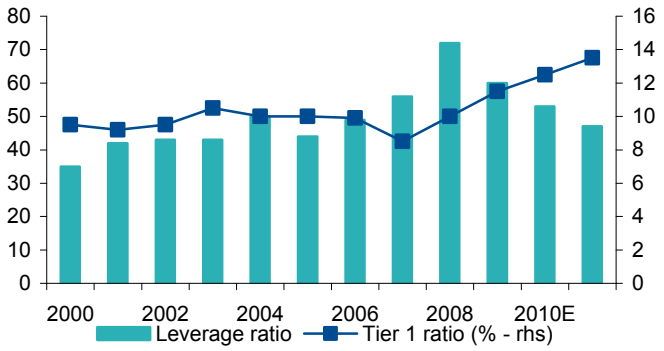
Although curbing the leverage of banks is viewed as positive, any calculation of leverage has to be first adjusted for these differences to discourage regulatory arbitrage. Applying the leverage ratio to European banks may appear easy in theory, but it is more challenging in reality.

Leverage ratio and adjusted leverage ratio



Source: Company data, CA Cheuvreux

Leverage ratio vs Tier 1 ratio

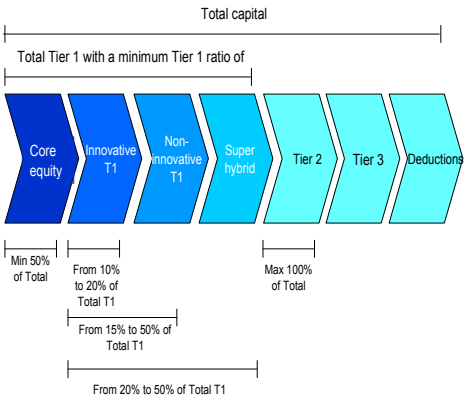


Note: leverage ratio: total assets / Tier 1 capital

Source: CA Cheuvreux

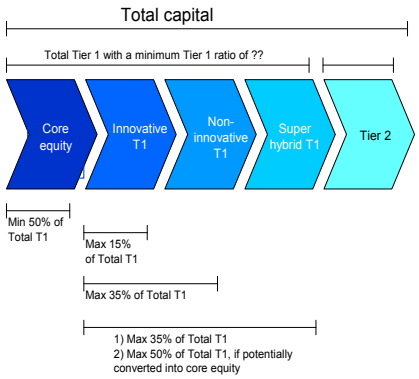
Tier 1 capital: predominantly common shares and retained earnings

Total regulatory capital ratios : today



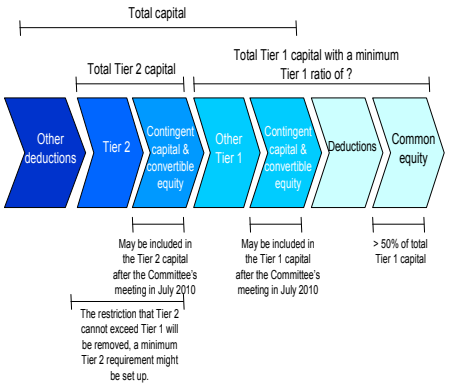
Source: BIS, G20, CEBS, CRD, Calyon

Total regulatory capital ratios : CEBS proposal



Source: BIS, G20, CEBS, CRD, Calyon

Total regulatory capital ratios : BIS proposal



Source: BIS, G20, CEBS, CRD, Calyon

The crisis has highlighted how loss absorption on a going concern basis on hybrid debts is difficult to implement, even for troubled banks that have received massive state support (eg, KBC). The quality of the Tier 1 capital base will be raised since the form will be **predominantly** common shares and retained earnings. Although the 'philosophy' of the BIS proposals is in line with expectations and follows the G20 requirements, the definition of the new regulatory framework is tougher than expected. For further details, please refer to our Credit Focus - Tougher BIS capital framework than expected, 18/12/09.

Will core equity account for at least two-thirds of Tier 1 capital?

- The BIS new capital definition is stricter than the CRD and CEBS guidelines.
- The BIS fully calibrated standards will be developed by the end of 2010, with the aim of implementation by end-2012 – if the economic recovery is assured – including a transition period and grandfathering arrangements. While these BIS proposals are still under discussion, this transition period should help to curb any increased pressure on banks and as such mitigate any tougher definition.

Distinction between going-concern capital, the Tier 1 capital, and the gone-concern capital, the Tier 2 capital.

- BIS capital proposals are based on the distinction between **going-concern capital**, the Tier 1 capital, and the **gone-concern capital**, the Tier 2 capital.
- Although no quantitative targets have been disclosed yet, the notion of **Core Tier 1 ratio has been introduced**.
- **Regulatory adjustments** (minority interest, goodwill and other intangibles, deferred tax assets, investments in own shares) should be **deducted** from the **common equity (versus Tier 1 capital in the current definition).**
- This will also lead to better harmonisation of the definition of Tier 1 capital. To illustrate, the revaluation reserve on debt instruments is still included in Tier 1 disclosed by Italian banks, but not for German (amended in June 2009), Belgian, Dutch or French banks.

Contingent capital securities: divergence of interest between regulators and debt investors.

- According to CEBS guidelines, hybrid instruments eligible beyond the 35% limit and up to 50% of total Tier 1 capital "are most similar to ordinary shares in their capital qualities". Including this 15% bucket of hybrid instruments convertible into core equity would consequently have core equity accounting for at least two-thirds of Tier 1 capital. For further details, please see our Credit Focus: Contingent capital note: answer to new capital scheme, 04/11/09.

New BIS capital definition: distinction between on-going concern and gone concern

	Capital components	Deductions
	COMMON EQUITY	
	+ Common shares	- Minority interests
	+ Retained earnings	- Goodwill and other intangibles
	+ Other comprehensive income	- Deferred tax assets
		- Treasury stock
		- Cash flow hedge reserve
		- Gains & losses due to change in credit risk
Going-concern	+ ADDITIONAL TIER 1 CAPITAL	
	= TIER 1 CAPITAL	
Gone-concern	+ TIER 2 CAPITAL	
	- OTHER AND REMAINING DEDUCTIONS	
		50-50 deductions (50% Tier 1 and 50% Tier 2) - Certain securitisation exposures - Certain equity exposures under the PL/LGD approach - Non-payment/delivery on non-DvP and non-PvP transactions - Significant investments in commercial entities Other conditional deductions - Stock surplus - Investments in capital of financial entities outside the scope of consolidation
	= TOTAL REGULATORY CAPITAL	

Source: BIS, Calyon

Standardisation of Tier 1 issues: more equity-like features

In addition to the requirement from the European Commission for a common EU definition of Tier 1 hybrids, the definitive capital framework will also include more equity-like features in hybrid capital.

Two years of transition before the new hybrid generation?

- The **CEBS** proposals released in mid-June 2009 will be effective from 31 December 2010.
- To be eligible as Tier 1 capital, hybrid instruments have to fulfil the key criteria of permanence, flexibility of payments and loss absorption. Although the key criteria are coherent with the current framework, CEBS clarified them by pointing out the equity-like features of hybrid capital. CEBS is also encouraging curbing the current divergence among European members in terms of the definition of both hybrid debts and limits to be included in Tier 1 capital.

Exclusion of innovative Tier 1 in the new BIS capital definition

- While the market was expecting that the next hybrid generation will be more equity-like in their features, the BIS proposals are tighter than the CEBS and CRD. Still included in the CEBS guidelines (innovative Tier 1: 15% of total Tier 1), **innovative Tier 1, ie, step-up Tier 1, will be excluded from the new Tier 1 capital** under Basel.
- **Grandfathering for smooth transition:** a transition period and grandfathering arrangements starting from end-2012 (lasting possibly 10 years?) will nevertheless be considered. Although we do not know the new minimum capital requirements, the cost of capital will be definitively higher.
- Such a context is encouraging banks **to be opportunistic during the transition period by issuing innovative Tier 1 issues, by** as much as they can before the stricter regulatory framework is in place. While the largest European banks, considered a 'safe haven' (good core equity base, capacity to reinforce Core equity, sound credit metrics, no state support) and as such still enjoying a rating for Tier 1 issues at investment grade, would get access to the primary market, where as it will be more problematic for other banks (banks under restructuring, Tier 2 names). As such, the first category of banks are likely to exercise **callable options in the coming two years** (and even above depending on the conditions during the transition period) in order to avoid any reluctance from investors. For the second category, the option would be an **exchange tender offer**.

Grandfathering for smooth transition

Will new hybrid debt be rated on speculative range or not rated?

- **After 2012,** and depending on the modality of the transitional period as well as grandfathering arrangements, the exercise of the callable option will be less interesting for banks, whatever their quality. As such, and waiting for further information, existing Tier 1 issues with callable option after 2012 (and to a lesser extent for the most recent ones) are likely to be larger than the ones between 2010 and 2012. In order to avoid the closing of their access to the primary market, European banks **may** however **choose the exchange tender offer solution.** Plus, the stricter capital framework will be implemented after 2012, only if the economic recovery is assured.
- Since the crisis, the **rating agencies** have reviewed their rating approach, based on the intrinsic value of a specific bank. During this reappraisal, rating agencies did not explicitly make a differentiation between innovative and non innovative Tier 1 issues. Having said that, the next hybrid generation will nevertheless be included in a different basket than existing ones, reflecting more equity-like features (potentially basket D in Moody's versus basket C for innovative Tier 1 issues). Whatever the final framework, sound credit metrics (the intrinsic value, no uplift from government support) will definitively be a strong competitive advantage. As an illustration, banks at least rated A2 on baseline credit assessment (the individual rating) can hope for a rated-hybrid Tier 1 within the investment grade category. To reiterate, the non exercise of the callable option is not considered as a trigger for downgrades by rating agencies.
- While we can understand why regulators are pushing more equity-like instruments – hybrid and other contingent capital securities – to encompass banks' capital structures, mainly as a replacement for existing hybrid debts, their success will depend on investors' appetite:

Success of this instrument correlated to a bull market

  - While the future of hybrid debts is not in doubt in the future, its form is nevertheless doubtful.
  - The natural buyers of hybrid debts may not have the agreement to hold these new debts, especially those potentially convertible into shares in stressful periods.
  - Some investors may change the terms of their funds and/or set up new funds to be able to buy this new type of asset.

In order to avoid too much pressure on banks, the new type of hybrids may not be too far from bondholders' interests

  - Depending on the quality of the issuer and the outstanding amount of hybrids with substantial equity-like features, this type of instrument may lead fixed income investors to be more nervous towards banks.
  - Although the next generation of hybrid will have more equity-like features, do not be too pessimistic. Excluding contingent capital securities, supervisors may ensure that this new type of hybrid is still coherent with bondholders' interests and rating approaches.

New hybrid Tier 1 definition: innovative Tier 1 will be phased out

	Tier 1 (going concern)		
	1998 Basel Accord	**2009 CEBS**	**2009 BIS**
Deferral Trigger	Optional, in the event of non-payment of dividends	Yes	Yes
Cumulative coupons	No	No	No
Condition on coupons		the competent authority may require the cancellation of payment, based on the solvency data	(1) coupon discretion (i.e. payment never forced) (2) cancellation of payment must not be an event of default (3) cancellation of payments must not impose any restrictions on the bank (4) coupons must be paid out of distributable items
Early repayment of principal is subject to supervisory authorization	Yes	Yes, but no contractual or statutory obligation to redeem are authorized	Yes (through both repurchase or redemption), and no incentives to redeem are authorized at any time
Loss absorption	Yes	Yes, principal loss absorption through (1) principal write down, (2) conversion of hybrids into ordinary shares at an appropriate trigger point	Yes, principal loss absorption through (1) conversion to common shares at an objective pre-specified trigger point, or (2) a write-down mechanism which allocates losses to the instrument at a pre-specified trigger point
Minimum period before step up	10 years	10 years	Step up gradually eliminated
Max step up	• 100bp, less the swap spread between the initial index basis and the stepped-up index basis • 50% of the initial credit spread, less the swap spread between the initial index basis and the stepped-up index basis	• 100bp, less the swap spread between the initial index basis and the stepped-up index basis • 50% of the initial credit spread, less the swap spread between the initial index basis and the stepped-up index basis	Step up gradually eliminated
First call date	after a minimum of 5 years subject to regulatory capital	after a minimum of 5 years	after a minimum of 5 years, at the initiative of the issuer
Conditions for exercise of a call option		(1) instruments may be called with the prior consent of the competent authorities (2) may be done if it does not affect the financial or solvency conditions of the bank	(1) prior supervisory approval (2) the issuing bank is not expected to exercise a call on a capital instrument unless it is in its own economic interest to do so (3) the bank must not do anything which creates an expectation that the call will be exercised (4)banks must not exercise the call unless: a. They replace the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the bank, or b. The bank demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised
Subordination in the event of default	Junior to depositors, general creditors, and subordinated debt of the bank	Junior to depositors, general creditors, and subordinated debt of the bank	Subordinated to depositors, general creditors and subordinated debt of the bank
Maturity	Permanent	Undated or have an original maturity of at least 30 years	Perpetual
amortization of capital	No		
Limit, max amount	15% of total Tier 1 (innovative Tier 1) Max 50% of total Tier 1 (innovative + non - innovative + super hybrid)	Max 15% of Total Tier 1 (innovative Tier 1) Max 35% of Total Tier 1 (innovative + non-innovative) + up to 50% with super hybrid	< 50% of total Tier 1 (common equity must be predominant in total Tier 1)
Comments			- Innovative Tier 1 (i.e. with step up) gradually eliminated - Contingent capital and convertible instruments might be included later in Tier 1 capital

Source: CEBS, BIS, Calyon

Is it the end of dated subordinated debts?

Tier 2 capital will be harmonised and simplified with the removal of sub-categories of Tier 2

- While the crisis highlighted how crucial the quality of the loss absorption of capital is, and as such raised the question of the inclusion of Tier 2 capital – more especially LT2 issues, the BIS still includes Tier 2 capital. We note that CEBS did not mention in its guidelines the Tier 2 capital. In Switzerland, lower Tier 2 will no longer qualify for regulatory capital after 2020 but can be issued through 2010.
- The target of Tier 2 capital is to provide loss absorption on a gone-concern basis.
- The Tier 2 capital definition will be simplified and harmonised, with the removal of sub-categories of Tier 2 (LT2 and UT2). Based on the information available, Tier 2 capital does change dramatically versus the current version. Like hybrid Tier 1 debts, a callable option may be possible after five years, but without incentives to redeem. Recognition in regulatory capital will be amortised on a straight line basis during the final five years to maturity (versus two years for Germany in the current legislation).
- While Tier 2 capital may not have sensitivity to dividend features, no discretionary criteria related to the coupon payment have been mentioned in the proposals. However, additional safeguards, such as a lock-in mechanism, are not ruled out by the BIS committee to ensure that Tier 2 capital does not need to be repaid during a period of stress.
- Although further information is necessary to assess the new Tier 2 capital, the dated subordinated debts with no deferral coupons (the LT2 issues) could still be included – based on the proposals – in the next capital framework. Also, the restriction that Tier 2 cannot exceed Tier 1 will be removed and replaced with explicit minimum Tier 1 and total capital requirements. In line with 2009 the largest European banks are likely to remain opportunistic, potentially in H110 in the LT2 segment, before potential stricter definition in Tier 2 capital is announced. Medium banks will continue to have recourse to Tier 2 capital to strengthen their total capital ratios. And finally, this will also be very interesting for banks with insurance business.
- No real changes are expected in the rating approaches, at least for the first part of 2010. As such, the LT2 segment will continue to be correlated to the senior unsecured ratings and to uplift sovereign support. Since the crisis the gap notches between UT2 and LT2 have dramatically widened, to a lesser extent for banks, and of course for Italian UT2 issues. But, the harmonisation of the Tier 2 capital may potentially lead rating agencies to review their approach on the Tier 2 segment.

Harmonisation of Tier 2 definition

		Tier 2 (gone concern)	
	1998 Basel Accord (Lower Tier 2)	1998 Basel Accord (Upper Tier 2)	2009 BIS (Total Tier 2)
Deferral Trigger	None	Yes	
Cumulative coupons	No	Yes	
Condition on coupons			No rights to accelerate the repayment of future scheduled payments, except in bankruptcy and liquidation
Early repayment of principal is subject to supervisory authorization			No incentives to redeem
Loss absorption	No	Yes	No, potentially reviewed
First call date			after a minimum of 5 years, at the initiative of the issuer
Conditions for exercise of a call option			(1) prior supervisory approval (2) the bank must not do anything which creates an expectation that the call will be exercised (3) banks must not exercise the call unless: a. They replace the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the bank, or b. The bank demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised
Subordination in the event of default	Subordinated to senior, senior or pari passu to Upper Tier 2 and senior to Tier 1	Subordinated to senior, senior to Tier 1	Subordinated to depositors and general creditors of the bank
Maturity	fixed-term maturity, minimum 5 years		Minimum 5 years
amortization of capital	20% annual over last 5 years		20% annual over last 5 years
Limit, max amount	50% of Tier 1	100% of Tier 1	The restriction that Tier 2 cannot exceed Tier 1 will be removed, a minimum Tier 2 requirement might be set up.
Comments			- Removal of UT2 and LT2 categories - Contingent capital and convertible instruments might be included later in Tier 2 capital

Source: CEBS, BIS, Calyon

Contingent capital securities: introduction of flexible capital ratios

Contingent capital securities: host security, potentially Tier 1 and Tier 2 capital

- The Basel committee is still reviewing the role that contingent capital, convertible capital and instruments with write-down features should play in a regulatory capital framework. The committee will discuss concrete proposals in this area at its July 2010 meeting.
- Still under review, both Tier 1 and Tier 2 capital could be the host security of a contingent capital security in the new Basel capital accord.
- With little information it is still difficult to assess the real impact. However, we do not expect massive primary issuance, except potentially a new Lloyds case (exchange tender offer, bad bank programme).

Contingent capital security could be viewed as an instrument to build up a capital buffer. Even more than hybrid debts, those security are primarily bullish paper. Rating agencies will notably base their approach on the probability of the conversion into equity. As such, banks may use contingent capital with better market conditions and a robust economic context. While we can understand the interest of supervisors in pushing such instruments, the question of potential investors is pending. Since plain vanilla products are still offering a decent premium and confidence towards banks has not yet recovered, no real interest from investors is expected. Additionally, stronger powers of supervisors and State toward banks could also be a reason for investor reluctance to buy such papers.

Introduction of capital buffer above minimum capital regulatory ratios

A capital buffer above the minimum capital regulatory ratios

In addition to more forward-looking provisions, a framework for **counter-cyclical capital buffers** (constraints on capital distributions…), above the minimum requirement, will be introduced.

- Rather than creating explicit buffers in the account (as with the Spanish dynamic provisioning system) BIS proposes to monitor banks through their ability to distribute earnings. This could include reducing dividend payments, share-buybacks and staff bonus payments.
- A complete freedom to decide on pay-out will be left for banks with capital well above the requirements. A 40% pay-out will require a 50%/75% excess on requirements in the illustration provided…
- Switzerland has introduced a flexible increase in capital ratio targets for UBS and Credit Suisse.

While the BIS insists that the total capital – including buffer – should not be considered as the new minimum requirement, we all know that the market is the driver in the relative value, both for equity and fixed income market. As such, the strongest capital will be more than welcome for fixed income – to a lesser extent for hybrid and equity correlated to ROE.

Higher level of minimum Core Tier 1 and Tier 1 ratios

A new minimum regulatory Tier 1 ratio: from 8% to 10% or 12%?

While the minimum level for Tier 1 ratios – currently at 4% – will be shored up, a question mark nevertheless remains over their magnitude.

- The new capital regime is expected to be implemented by 2012 if the economic recovery is assured. New BIS standards are scheduled to be disclosed by year-end 2010, giving time for discussion to the banks.
- European banks have successfully passed the European stress tests with no bank seeing its Tier 1 ratio falling below 6%.
- In parallel, the IMF financial stability report has made assumptions based on Tier 1 ratios from 6%, 8% and 10%.

Will a minimum core Tier 1 ratio be introduced?

- It is likely that investors, analysts and rating agencies will require capital ratios above the minimum level requested by regulators. Based on Q309 results and recent announcements of capital increase from large European banks, it seems that an 8% core Tier 1 ratio is becoming the new standard, leading to a Tier 1 ratio of around 10% for retail banks and 12% for investment banking businesses.

Will regulators differentiate between banks: retail & investment banks?

European banks are consequently under pressure primarily to shore up their core equity. Although this would potentially lead to a dilution for shareholders, such a trend is definitively positive for bondholders. As well as leading to an improvement in credit metrics, this would also increase room for banks to launch new hybrid debts.

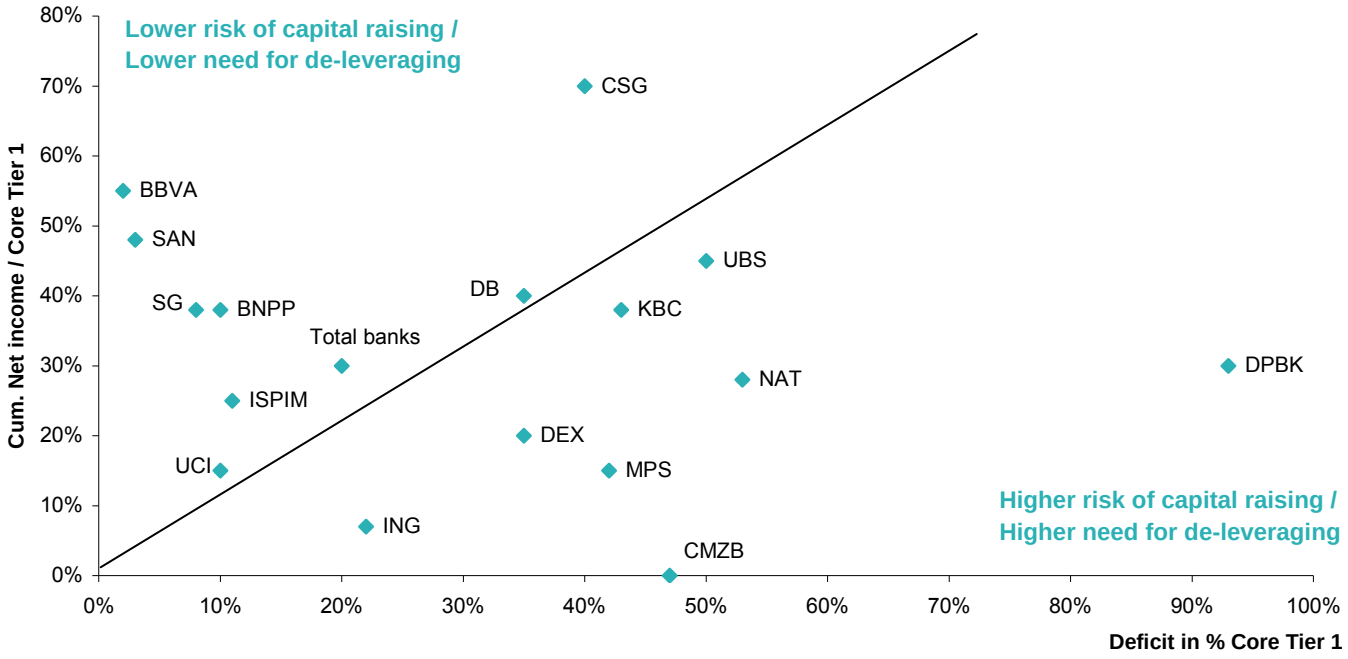
Impact of an 8% Core Tier 1 and 10% Tier 1 ratio and potential of issuance

EURm	CMZB	DB	DB	SAN	BBVA	BNPP	SG	UBS	CSG	UCI	ISPIM	MPS
Core Tier I capital (ex gov't capital)	10,769	23,197	23,197	46,501	23,355	48,500	27,700	16,151	16,137	34,666	26,482	6,198
Core Tier 1 ratio (ex gov't capital)	**3.7%**	**8.1%**	**8.1%**	**8.5%**	**8.0%**	**7.8%**	**8.6%**	**11.5%**	**10.9%**	**7.5%**	**7.2%**	**5.1%**
Hybrids	4,061	10,520	10,520	8,181	3,871	13,400	7,400	4,905	8,168	3,885	2,999	1,182
Hybrids as a % of Tier 1 capital	**27%**	**31%**	**31%**	**15%**	**14%**	**22%**	**21%**	**23%**	**34%**	**10%**	**10%**	**16%**
o/w innovative	3,450	1,300	1,300	3,020	3,908	9,897	1,455	3,703	8,074	2,721	2,750	650
Innovative hybrids as a % of Tier 1 capital	23%	4%	4%	6%	14%	16%	4%	18%	33%	7%	9%	9%
o/w non-innovative	611	9,220	9,220	5,161	0	3,503	5,945	1,202	94	1,164	249	532
Tier 1 capital	14,830	33,717	33,717	54,682	27,226	61,900	35,100	21,056	24,305	38,551	29,481	7,380
Tier 1 capital ratio	**5.1%**	**11.7%**	**11.7%**	**9.9%**	**9.4%**	**10.0%**	**10.9%**	**15.0%**	**16.4%**	**8.4%**	**8.0%**	**6.0%**
Q309 RWA	292,712	287,504	287,504	549,647	290,521	619,000	323,500	140,509	147,989	459,287	367,372	122,591
New 2010 RWA after market risk and resecuritisation impact	**316,712**	**366,574**	**366,574**	**566,528**	**296,039**	**661,000**	**346,900**	**167,606**	**183,581**	**474,432**	**374,912**	**130,377**
New Core Tier 1 ratio	**3.40%**	**6.33%**	**6.33%**	**8.21%**	**7.89%**	**7.34%**	**7.99%**	**9.64%**	**8.79%**	**7.31%**	**7.06%**	**4.75%**
New Tier 1 ratio	**4.68%**	**9.20%**	**9.20%**	**9.65%**	**9.20%**	**9.36%**	**10.12%**	**12.56%**	**13.24%**	**8.13%**	**7.86%**	**5.66%**
New Core Tier 1 ratio target	**8%**	**8%**	**8%**	**8%**	**8%**	**8%**	**8%**	**8%**	**8%**	**8%**	**8%**	**8%**
Estimated Core Tier 1 needed to reach target	**14,568**	**6,129**	**6,129**	**0**	**328**	**4,380**	**52**	**0**	**0**	**3,289**	**3,511**	**4,232**
As a % of Core Tier 1 capital	135%	26%	26%	0%	1%	9%	0%	0%	0%	9%	13%	68%
New Tier 1 capital after additional core capital	29,398	39,846	39,846	54,682	27,554	66,280	35,152	21,056	24,305	41,840	32,992	11,612
New Tier 1 ratio after additional core capital	**9.3%**	**10.9%**	**10.9%**	**9.7%**	**9.3%**	**10.0%**	**10.1%**	**12.6%**	**13.2%**	**8.8%**	**8.8%**	**8.9%**
Max % innovative / Tier 1 capital	15%	15%	15%	15%	15%	15%	15%	15%	15%	15%	15%	15%
New potential for innovative instruments issuance	**960**	**4,677**	**4,677**	**5,182**	**225**	**45**	**3,818**	**0**	**0**	**3,555**	**2,199**	**1,092**
Max % non-innovative/ Tier 1 capital	35%	35%	35%	35%	35%	35%	35%	35%	35%	35%	35%	35%
New potential for non-innovative instruments issuance	9,678	4,726	4,726	13,978	9,644	19,695	6,358	6,168	8,412	13,480	11,298	3,532
Max % hybrid / Tier 1 capital	50%	50%	50%	30%	30%	50%	50%	50%	50%	20%	20%	20%
New potential for hybrid issuance	10,638	9,403	9,403	19,160	9,869	19,740	10,176	6,168	8,412	17,035	13,497	4,624
New Tier 1 ratio target	**10%**	**10%**	**12%**	**10%**	**10%**	**10%**	**10%**	**12%**	**12%**	**10%**	**10%**	**10%**
Estimated hybrid instruments needed to reach target after additional core capital	2,273	0	4,143	1,971	2,050	0	0	0	0	5,604	4,499	1,426
Potential coverage of shortage by innovative hybrids	960	-	4,143	1,971	225	-	-	-	-	3,555	2,199	1,092

Note: Core Tier 1 ratio ex government capital (ie, ex Soffin silent participation in CZBK amounting to EUR17,178m as at Q309); Credit Suisse: estimates for the amount of innovative hybrids

Source: company data, Bloomberg, CA Cheuvreux, Calyon

Capital formation vs capital deficit for banks with potential capital need



Source: CA Cheuvreux

The banking landscape is facing with market and rating agencies pressure, rather than regulators

Although the new BIS proposals are on the tough side, the three step implementation timeframe (1/ impact assessment by H110; 2/ definition of quantitative targets by end-2010; and, 3/ implementation of new standards by end-2012 if economic recovery allows) could balance the real impact on the banking landscape. While waiting for disclosure of the new regulatory standards for capital, banks have no real choice but to pursue their conservative approach, combining deleveraging and boosting capital. European banks are now rushing in to shore up their Core Tier 1 ratios to 8%, viewed as the new standard required by the markets. Whatever the eventual minimum regulatory ratios, a comfortable ratio will undoubtedly be a key competitive advantage to gain market share in all business areas in a new banking world.

Sector fundamentals for 2010: a transitional year

New business model and emergence of national champions

2010: a transitional year

Investment banks to be favoured versus retail banks, at least in H110

With the economy on the road to recovery, will 2010 be better than 2009 for European banks? Although in better shape, banks remain vulnerable. Banks remain reluctant to adopt a more aggressive strategy in H110 given the deterioration in asset quality and that they are facing rising unemployment, uncertainties related to the financial pillars and the timing of exit from the extensive support from central banks (liquidity) and governments. After a strong recovery in 2009, will investment banks be the losers over the coming year? In our view a stricter capital regulatory framework will not be applied before a recovery is confirmed. Small and medium-sized banks are likely to remain the main losers as long as the crisis lasts (H110). While business models need to be rebuilt, 2010 is likely to be a transitional year with increasing discrimination among European banks and the emergence of national champions. Retail banks will continue to suffer thanks to the deterioration in credit and expected low interest rates. All in all, investment banks will continue to be preferred to pure retail banks. Consolidation, slow since the beginning of the crisis, is likely to accelerate, particularly in H210. With pressure to exit from state support, European banks have no real choice but to keep boosting capital while pursuing their de-leveraging. Banks able to raise the quality of their credit profile in the coming transitional year are likely to be the best prepared for a more challenging year post-crisis in 2011.

Higher discrimination between banks and debt issues

Revenues: out of the riskiest assets and a focus on core businesses

- Constrained lending production in domestic retail market (unemployment and saving approach).
- Margins will remain under pressure with less ample and cheap liquidity as well as low interest rate.
- Exposure to Central and Eastern European countries.
- De-leveraging process with a refocus on a more traditional business model, key clients and domestic markets (required by national authorities). Post crisis, revenues will be structurally lower with a stricter regulation scheme (trading book, re-securitisation).
- Restructuring plans for troubled banks rescued by the state (EU pressure).
- Although declining thanks to the normalisation of market conditions, trading fixed income and to a lesser extent equities should continue to perform well. CIB may also benefit from a recovery in forex business (DB) as well as the continued reduction of write-downs on toxic assets.
- Still suffering, asset and wealth management should improve gradually.
- Recovery in Latam with a refocus on less volatile businesses (corporate & mortgages versus consumer & card activities).

Operating income: room to optimise cost-efficiency further is shrinking

- More rigid cost base in Eurozone – notably in France and Germany – versus US and UK.
- Increase in severance pay.
- Following strong efforts in cost-cutting since the beginning of the crisis, leeway is shrinking.
- Potential litigation charges (CIB business and asset management/private banking).
- Less pressure on variable remuneration compared with before the crisis (CIB business).

- Potential revenues and cost synergies from recent acquisitions.

Asset quality: peak in non-performing loans not yet hit

- Gross operating income, crucial buffer to offset loan loss provisions.
- NPL ratios have not reached their peak yet (H110) due to the lag between the improvement in the economy and impact on balance sheets, and unemployment still rising.
- Coverage ratio to be raised: additional cash in strengthening balance sheets (disposals of non-core assets) plus potential pressure from the financial markets to have a stricter provisioning policy (dynamic provisions) before its official implementation.
- Corporate (cyclical sectors and SMEs), consumer & credit cards as well as emerging markets (CEE) are the highest-risk exposure.
- Sovereign counterparty risk, notably on emerging countries
- In mortgages, the deterioration in asset quality should remain under control
- The most toxic assets should remain in the hands of the state while the crisis is ongoing.

Financial flexibility: key competitive advantage with a gradual exit from extensive support

- Increasing cost of funding & liquidity pressure reflecting less state & central bank support plus expected stricter regulatory scheme (liquidity ratio).
- How and when will central banks be less generous towards banks? While timing is key, central banks are likely to be measured by the removal of liquidity as long as the economy remains fragile.
- A&L mismatch with significant redemptions to be refinanced in the next two years.
- Higher level and quality of capital: core capital under scrutiny.
- Pressure on RWA with the implementation of Basel II and additional charge on trading book (incremental risk charge).
- More limited leeway for troubled banks – and to a lesser extent small & medium-sized banks – thanks to EC pressure.
- Stricter regulation framework only once the recovery is confirmed.
- Intervention of state and central banks towards banks to make sure they have the capacity to finance the real economy.

Rating trends in 2010: slower pace for senior but unknown period for hybrids

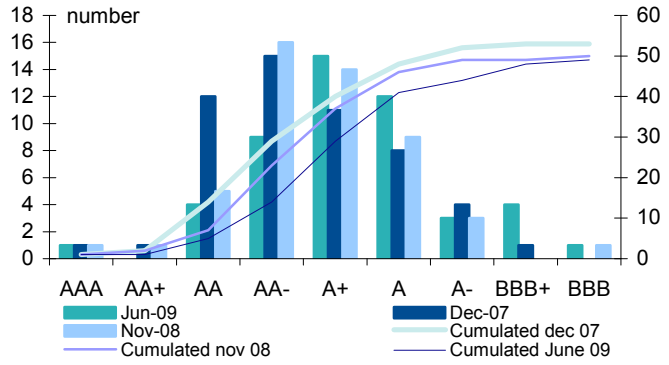
- With Moody's currently reviewing its ratings on hybrids and subordinated debts, European banks are still under pressure, notably banks which benefit from great systemic support (banks in a restructuring process are still under pressure (state support >2% RWA).
- Potential review of the rating approach leading to further differentiation among hybrid debts. As well as uncertainties related to Moody's on hybrids, the reappraisal of its approach could be accelerated with the new definition of Tier 1 debt – more equity-like feature, which would be translated into higher number of notches between senior & Tier 1 issues for all banks, even those considered safe havens.
- Rating agencies supervised at the EU level by the European System of Financial Supervisors (ESFS). This should be positive in the medium term, but could lead to uncertainty related to the reappraisal of rating methodologies.
- Toward a stabilisation trend: senior unsecured debt reflects sovereign support rather than fundamentals: the rating floor. With about half of senior unsecured debt having a negative outlook at S&P, new rating downgrades are expected, but at a slower pace than in 2009 and limited on average to one notch. We do not expect massive change in terms of methodology (except for the UK), at least in H110.

Rating assigned to LT2 should remain correlated to the senior unsecured debt (excluding Denmark and the UK). We do not expect strong notch widening of the gap between LT2 & senior.

Lower risk, higher capital but less profitability: a new business model

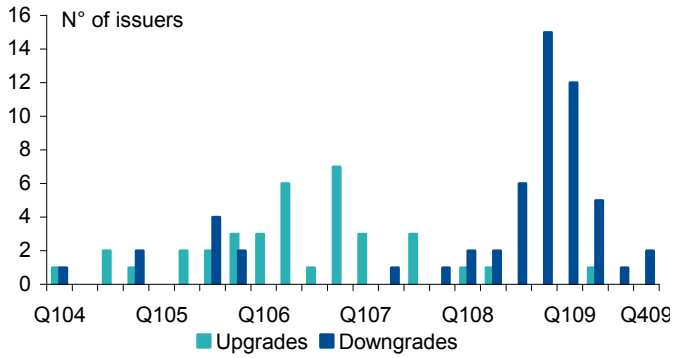
- The reappraisal of the business model is primarily explained by the crisis rather than the strengthening of financial pillars. Stricter regulation will only avoid pre-crisis abuses.
- Redefining a business model: Investment banking businesses will be the main losers, and to a lesser extent the universal banking business. The impact on retail banking will be more moderate.
- A new Steagall act splitting investment banking activities into commercial businesses is ruled out in our view.
- Despite efforts to harmonise co-ordination among countries, in reality a divergence in the soundness of and issues relating to the banking system leads to implementation difficulties.
- Post crisis, earnings will be lower with more capital required to be allocated to the riskiest businesses. This is likely to encourage banks to focus their strategy on retail banking businesses in emerging markets.
- Increasing discrimination among European banks, which can be divided into three categories: (1) banks viewed as 'safe havens'; (2) fundamentally sound banks that have received manageable state support; and (3) banks being restructured
- Pressure from governments and the EU to force troubled banks – Commerzbank, ING, RBS, KBC, etc – to review their business model, combined with the asset-disposal process, is creating opportunities for banks (eg, CSG, Deutsche Bank) that have withstood better than peers and enjoy comfortable capital ratios and/or the leeway to raise them if required.
- End of the bancassurance model? The requirement for Fortis and ING to dispose of their insurance businesses represents a key turnaround in their business model. On the other hand, KBC will retain its integrated banking and insurance model.
- A new wave of consolidation will be encouraged by increasing discrimination, business model reviews with a refocus on core businesses (size, market share, higher capital requirements) plus structurally lower profitability post the crisis. Disposals of parts of businesses – private banking, investment banking, insurance (ING, Fortis) and subsidiaries abroad (KBC) – are helping the reshuffling of the European banking landscape. So far, this has been rather limited in Europe, but an acceleration in consolidation is forecast in 2010 notably in Spain (Cajas) and Germany (Landesbanken?) with the emergence of national champions.
- While banks have focused on their domestic markets during the crisis, a potential trend reversal with acquisitions in emerging areas is not ruled out due to the need to find new growth engines.

Large European banks: long-term rating distribution



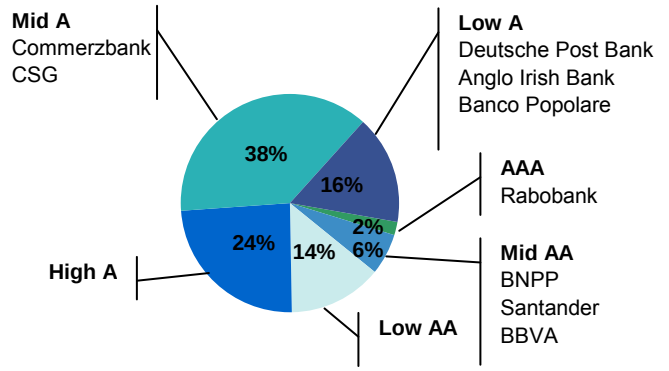
Source: S&P, Calyon

No. of senior downgrades to major European banks



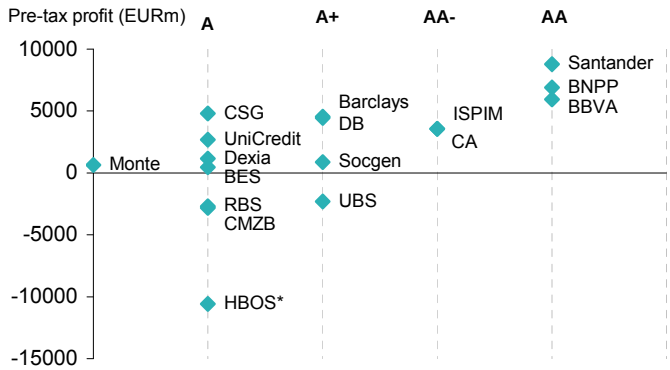
Source: S&P, Calyon (as at 25/11/09)

Rating split on selected names



Source: S&P, Calyon

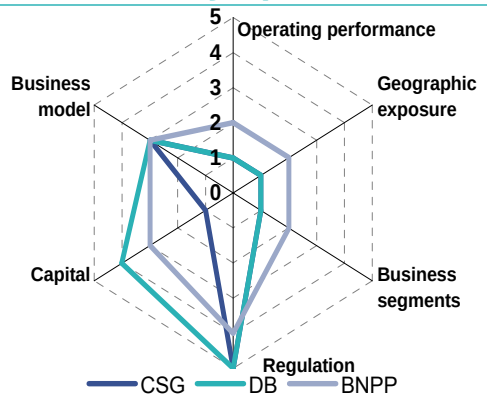
Pre-tax profit (H109) vs LT ratings



** As of H109*

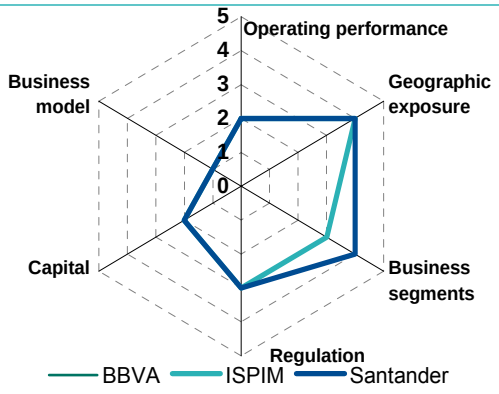
Source: S&P, Calyon (as at 30/10/09)

CSG, DB and BNPP: key exposures for 2010



Source: banks, rating agencies, Calyon

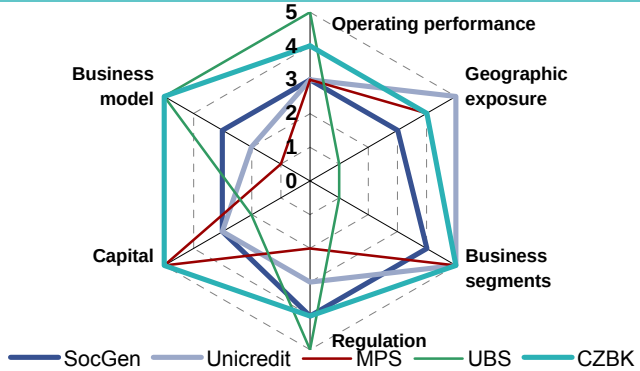
BBVA, ISPIM and Santander: key exposures for 2010



Note: BBVA and ISPIM at same levels

Source: banks, rating agencies, Calyon

Socgen, Unicredit, MPS, UBS and CZBK: key exposures for 2010



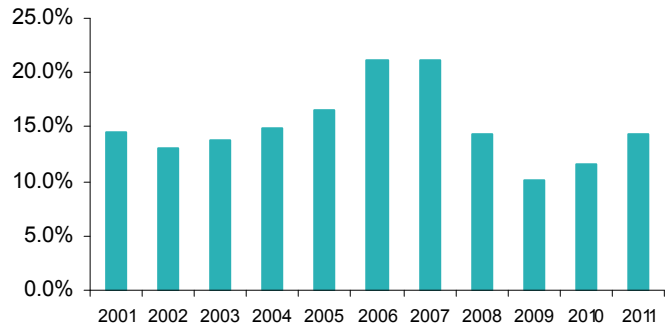
Source: banks, rating agencies, Calyon

Euromarket bonds league table

	2009		2007		2009 vs 2007	
	Rank	Market share (%)	Rank	Market share (%)	Rank	Market share
BNP Paribas Group	1	6.6	7	4	6	65.0%
HSBC	2	6.5	3	5.2	1	25.0%
Barclays Capital	3	6.2	2	6.6	-1	-6.1%
Deutsche Bank AG	4	6	1	7.6	-3	-21.1%
RBS	5	5.7	10	3.9	5	46.2%
JP Morgan	6	4.8	9	4	3	20.0%
Société Générale	7	4.2	11	3.6	4	16.7%
Calyon	8	3.5	18	2.1	10	66.7%
Credit Suisse	9	3.2	14	2.9	5	10.3%
UniCredit Group	10	3.1	15	2.8	5	10.7%
Landesbank Baden-Wuerttemberg	11	2.8	22	1.6	11	75.0%
Citi	12	2.8	4	5	-8	-44.0%
UBS	13	2.8	6	4.2	-7	-33.3%
Norddeutsche Landesbank GZ	14	2.6	26	0.9	12	188.9%
DZ Bank AG	15	2.5	23	1.5	8	66.7%
Morgan Stanley	16	2.2	13	3	-3	-26.7%
BayernLB	17	2.2	30	0.8	13	175.0%
Commerzbank AG	18	2.1	5	4.5	-13	-53.3%
Goldman Sachs & Co	19	2	19	2	0	0.0%
Intesa Sanpaolo SpA	20	1.8	27	0.8	7	125.0%

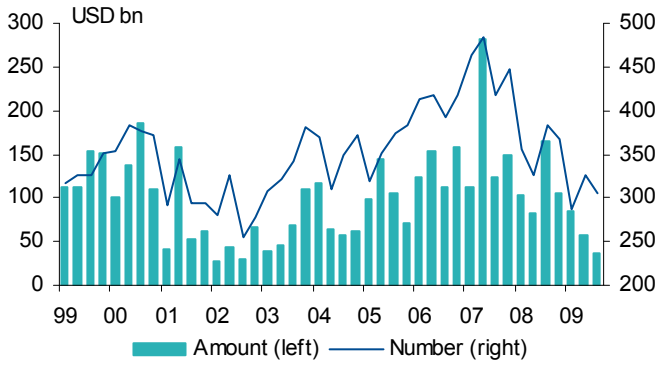
Source: Bloomberg, Calyon

European banks' core ROE, FY01-11E (%)



Source: CA Cheuvreux

Quarterly announced M&A operations for financials



Source: Thomson, Calyon

EC Restructuring plans

Bank	EC Release	Status	Restructuring plan	Comments
Bradford & Bingley	01-Oct-08	Temporary approved	Rescue aid (condition : restructuring plan within 6 months)	Nationalisation
West LB	01-Oct-08	Decision under assessment	Restructuring aid	-
Hypo Real estate	02-Oct-08	Approved	Rescue aid (funds for refinancing needs - due April 09)	-
Fortis	03-Dec-08	Approved	Restructuring aid - capital injection	-
Erste	10-Dec-08	Approved	Capital injection	Dividend restriction
SNS REAAL	11-Dec-08	Approved	Emergency recapitalisation	-
KBC	18-Dec-08	Approved	Emergency recapitalisation	-
Bayern LB	18-Dec-08	Temporary approved	Recapitalisation (condition : restructuring plan within 6 months)	-
Anglo Irish Bank	14-Jan-09	Approved	Recapitalisation	Nationalisation - No dividends on ordinary shares are allowed when no dividend on the shares to be issued is paid to the Irish State
Ethias Group	12-Feb-09	Approved	Capital injection	State has priority in receiving dividends up to 10% of its investment
Dexia	13-Mar-09	Decision under assessment	Restructuring aid	Dexia has announced that it would call a UT2 issue on its first call date (2 Oct 2009) even if it has received state aid. It will skip the interest payment on its Tier 1 and Tier 2 bonds dated 2 Nov 2009 in accordance with EC rules.
Bank of Ireland	26-Mar-09	Approved	Recapitalisation	No dividends on ordinary shares are allowed when no dividend on the shares to be issued is paid to the Irish State
ING	31-Mar-09	Temporary approved	Rescue aid (condition : review Aug/Sept 09)	-
LBBW	30-Apr-09	In depth investigation	Recapitalisation	Restructuring plan has been proposed (2 Oct 2009)
Northern Rock	07-May-09	In depth investigation	Rescue aid	-
Commerzbank	07-May-09	Approved	Capital injection	Suspension of dividend and interest payments to holders of hybrid capital with reserves: as losses are expected for FY09, no coupon payment can be expected on hybrids for the year 2009
Hypo Real estate	07-May-09	In depth investigation	Restructuring aid	-
CE & Banque Populaire	08-May-09	Approved	Capital injection	No condition attached in terms of restructuring plan, exercise of call options or payment of coupons on deeply subordinated Tier 1 notes issued by BPCE
Hypo Alpe Adria	12-May-09	In depth investigation	Rescue aid	Dividend restriction
Fortis	12-May-09	Approved	Restructuring aid	Assets transfer to BNPP required by EC might not be executed because of BNPP capital increase
Allied Irish Bank	12-May-09	Approved	Capital injection	No dividends on ordinary shares are allowed when no dividend on the shares to be issued is paid to the Irish State
West LB	12-May-09	Approved	Restructuring aid	-
HSH Nordbank	29-May-09	Temporary approved	Recapitalisation & risk shield (condition : restructuring plan within 3 months)	-
KBC	19-Jun-09	In depth investigation	Second recapitalisation	-
Anglo Irish Bank	26-Jun-09	Temporary approved	Recapitalisation (condition : restructuring plan end Nov 09)	-
IKB	17-Aug-09	Approved	Restructuring aid	IKB is prohibited from any proprietary trading as a means to inflate profits with the taxpayer's money
ING Groep NV	15-Sep-09	In depth investigation	Rescue aid	The decision of ING to repay USD800bn of LT2 notes due Oct 2014 will be taken into account in the investigation in to state aid to the bank.

Source: European Commission, Banks, Calyon

EC Restructuring plans *(cont'd)*

Bank	EC Release	Status	Restructuring plan	Comments
WestLB	07-Oct-09	Temporary approved	Additional restructuring aid (condition : new restructuring plan)	Prepares the "bad-bank" scheme to be implemented by 30 November 2009.
ABN Amro - HBU / Fortis Bank Nederland	21-Oct-09	Waiting for approval by the EC	Rescue aid	Condition: disposal of commercial banking operations in the Netherlands to Deutsche Bank
HSH Nordbank	23-Oct-09	In depth investigation	Recapitalisation & risk shield	The amount of state aid provided by the German state does not seem to meet the guidelines of the EC in terms of impaired assets.
Northern Rock	28-Oct-09	Approved	Restructuring aid package	Split of the bank into : (1) a 'good bank' which will continue the economic activities of NR (about 20% of the balance sheet) and (2) a 'bad' bank, an asset management company which will run down the remaining assets.
Dexia	30-Oct-09	Temporary approved	Extension of the guarantee scheme until end February 2010 (In depth investigation for final approval)	3 conditions: under that period , the bank (1) will not pay any dividend; (2) wwill not make any acquisitions; (3) will not pay any coupon or anticipated repayment on hybrid debt
RBS	03-Nov-09	Waiting for approval by the EC	Rescue aid	Conditions: (1) Divestments: RBS branch network (England and Wales), Natwest branches in Scotland and direct SME across the UK, RBS insurance, Global Merchant Services, RBS's interest in RBS Sempra Commodities. (2) Reduction of RWA by a further GBP60bn (through further disposals of assets or businesses) if the RBS Core Tier 1 ratio declines to below 5% at any time before 30 November 2014 and the Contingent Capital of up to GBP8bn is triggered, or if RBS falls short of its existing funded balance sheet reduction targets for 31 December 2013 by 10% or more. (3) RBS will not rank higher than number 5 in the combined all debt league tables globally for 3 years. (4) Prohibition on payments/calls on existing hybrids for 2 years unless there is a legal obligation to do so.
Hypo Real Estate	13-Nov-09	In depth investigation	Extended restructuring aid - capital injection	Conditions: (1) Additional EUR3bn capital contribution (of which a EUR1bn silent partnership contribution, EUR0.7bn contribution to HRE's reserves, and EUR1.3bn contribution to Deutsche Pfandbriefbank's reserves) as a second tranche of the rescue plan. It increases the State's ownership, previously amounting to 90%, that will reach 100% after the full takeover by SoFFin. (2) Possible participation in the German "bad bank" scheme. (3) Additional EUR52bn liquidity guarantee facility.
KBC	18-Nov-09	Approved	Asset relief and restructuring package	Conditions: (1) Businesses kept and refined: bancassurance in Belgium and CEE, CIB for home market customers. (2) Businesses kept and reviewed: Banking in Ireland. (3) Divestments: banking and insurance via complimentary channels in Belgium (Centea: total assets EUR 8.9bn and Fidea: total assets EUR 2.4bn), Banking in Russia (total assets: EUR4.2bn) and Serbia (total assets: EUR0.2bn), International corporate banking for international customers, structured derivatives and other IB, private banking outside home markets (total assets: EUR16bn). (4) IPO of CSOB in Czech Republic in 2010 (sale of 30 to 40% of KBC's shares). (5) Reimbursement of the state capital injection: 2 options achievable from 2011 to 2013: cash repurchase at 150% or conversion option that could trigger repurchase at 115%-150%. (6) No acquisitions for the next 3 years. (7) Intention to resume cash dividend payment in 2011 (based on 2010 earnings). (8) Commitment to pay coupon on all hybrid instruments based on mandatory legal nature. (9) RWA to be reduced by 25%. (10) Tier 1 target ratio: 10%, core Tier 1: 8%.

Source: European Commission, Banks, Calyon

EC restructuring plans (cont'd)

Bank	EC Release	Status	Restructuring plan	Comments
Lloyds banking group	18-Nov-09	Approved	Rescue aid	Conditions: (1) GBP180bn asset reduction (divestment of at least 600 branches of retail banking businesses: C&G savings accounts and branch-based mortgages but not the brand, Lloyds TSB Scotland but not the brand, TSB Brand, some Lloyds TSB branches in England and Wales, Intelligent Finance). (2) Two year prohibition on discretionary coupon payments/calls on existing hybrids. (3) Prohibition on acquisitions (for approximately three to four years).
ING	18-Nov-09	Approved	Rescue aid	Conditions: (1) Divestment of all insurance and investment management activities. (2) Divestment of ING Direct USA. (3) ING can not be a price leader in any EU country for certain retail and SME banking products for 3 years. (4) ING can not acquire financial institutions that would slow down the repayment of the core Tier 1 securities during the first 3 years. (5) Fee for guarantee on Alt-A RMBS raised by EUR1.3bn (pre-tax). Creation of a new company in the Dutch retail market out of part of its current operations.
Hypo Real Estate	21-Dec-09	Temporary approved	State guarantees	
BAWAG	22-Dec-09	Temporary approved	Rescue aid (capital injection + guarantee)	Condition: restructuring plan within 3 months
West LB	23-Dec-09	Temporary approved In depth investigation	Urgent rescue aid Bad bank	Bad bank takes over a portfolio of toxic and non strategic assets of EUR 85.1bn. To this end, capital injection of EUR 3bn by SoFFin. In depth investigation will determined if the amount of state aid is not too high.
Hypo Alpe Adria	23-Dec-09	Temporary approved + extension of in depth investigation	Rescue aid	Nationalisation Condition: in-depth restructuring plan by end march 2010

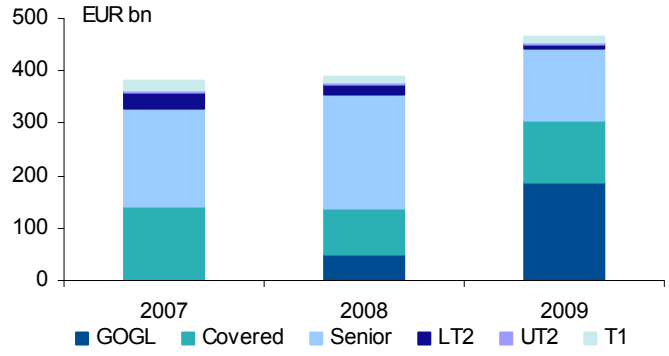
Source: European Commission, banks, Calyon

Primary activity

2010 refinancing needs: in decline

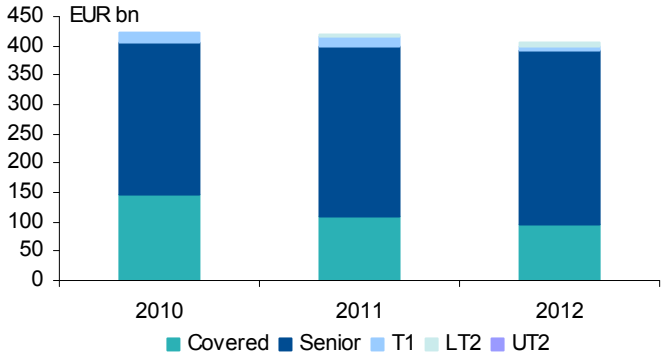
The banking sector accounts for about half of the iBoxx sector. Despite a record primary market from corporates (>EUR250bn in 2009 vs EUR125bn in 2008), the banking sector has accounted for two-thirds of the total EUR-denominated primary market year-to-date (including covered bonds and senior debt guaranteed debts). After a paralysed primary market in H208, primary issuance has been dynamic on the whole with a growth rate 20% higher than the 2008 and 2009 amounts. Senior guaranteed debt (75% of total primary market) made up the bulk of Financials primary issuance since October 2008, but from May this has been gradually replaced by covered bonds (around 50% of total primary issuance in H209) and to a lesser extent senior unsecured debt. Compared with senior unsecured primary issuance in the full years 2008 and 2007, the latter has fallen by 35% and more than 25%, respectively. The summer was marked by the reopening of the hybrid segment, but primarily from well-rated European names.

European banks' new issues (all currencies)



Source: ESBC, Bloomberg, Bondware, Calyon

European banks' total redemptions (all currencies)



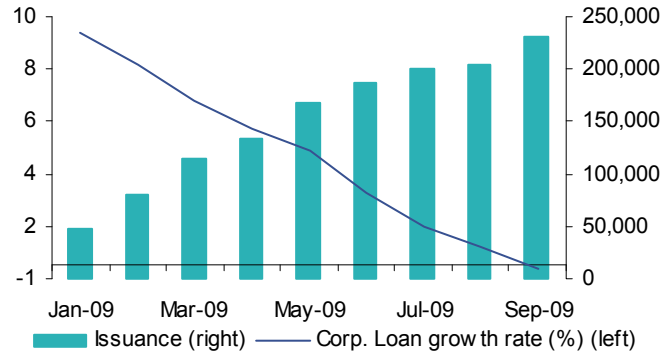
Source: Dealogic, Calyon hybrid team, Calyon

What to expect in 2010?

2010 refinancing needs for the European banking sector are likely to be lower than 2009:

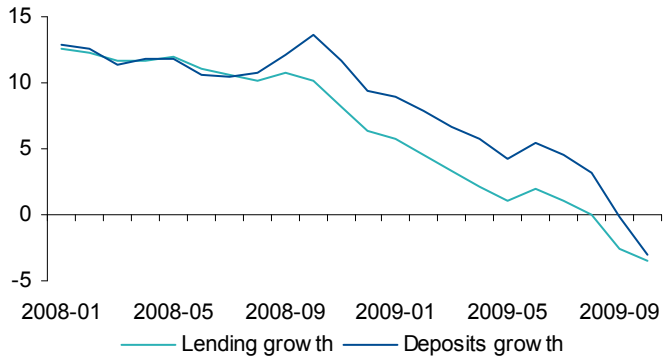
- Most European banks, except for some Tier 2 banks, completed their 2009 refinancing needs by September 2009. As a consequence, and benefiting from more favourable market conditions, European banks have started to refinance their 2010 needs.
- European banks enjoy ample liquidity owing to the extensive measures undertaken by central banks. Although exit strategies have not been ruled out, they will be gradual in order to avoid potential panic.
- Illustrating banks' willingness combined with a sluggish economy, growth in deposits has been outpacing growth in loans and total assets. At least for the first part of 2010 no trend reversal is forecast as long as unemployment continues to rise.
- 2009 has been marked by strong appetite from retail investors, a trend which is forecast to continue although at a slower pace.
- Considering total redemptions of around EUR425bn for 2010, 2010 public primary fixed income market is expected to decline 10-15% versus 2009, depending on fixed income market conditions and the economic climate. Note that after a record level reached in 2009, corporates are not expected to be so active during 2010. A total of around EUR450bn in issuance is expected to be launched by European banks during full-year 2010, with the division among financials segment available shown in the two tables below.

New issues in non-financials (EURm) market vs corporate loan growth



Source: ESBC, Bloomberg, Bondware, Calyon

Lending growth vs growth in deposits (%, MoM)



Source: Central banks, ECB, Bundesbank, Calyon

- In line with 2009, currencies other than EUR are likely to be used by European banks (around 10% of total issuance in 2009, predominantly in subordinated debts).

Total primary issuance to be expected for selected European banks in 2010

Type of debt	Primary issuance in 2010 (Calyon forecast)	Comments
GOGL	around EUR50bn	Extension of the guaranteed senior program pending the European Commission approval
		Small and medium-sized banks no access or diffult access to the fixed income market
Covered bonds	around EUR150bn-EUR190bn	EUR60bn purchase programme for Euro-denominated covered bonds planned to be completed by the end of June 2010
		Distinction between the UCITs covered bonds and structured covered bonds by the ECB?
		S&P's methodology less stringent than initially viewed, a massive wave of downgrades is not expected
		Eligible for central banks included within the new liquidity buffers (BIS proposal, CEBS)
Senior	around EUR180bn-EUR220bn	Adding to 2010 redemption on senior, depending on the market conditions and appetite for starting 2011 refinancing
		Quantitative easing expected to be reduced gradually
		Choices between covered bond and senior
LTII	<EUR10bn	Tier 2 banks for which hybrid debt is too expensive
		Banks with insurance business
		Opportunistic before the harmonisation of the Tier 2 capital (BIS)
		Depending on the BIS new definition (potential information after June-2010) primary issuance may be stronger than our forecasts
UT2	between 0 to EUR3bn	No real interest, except potentially for countries with dated UT2
		Depending on the BIS new definition, primary issuance may be more dynamic from H210.
Tier 1	between EUR15 and EUR20bn	Opportunistic before stricter capital regulatory rules with new hybrid generation, more equity like-features and progressive exclusion of innovative Tier 1 issues (BIS)
		Capital to be a crucial factor in 2010: increase in core Tier 1 offers new room for issuance hybrids (H210)
		Volume issuance correlated to a bullish market
Total	**Around EUR450bn**	Like 2009, interest in issuing in other currencies (around 10% of the total issuance)

Source: Bloomberg, Bondware, Dealogic, Calyon

- In line with 2009, European banks may consider starting to refinance their 2011-12 needs in order to improve their A&L duration (redemption of senior guarantee debts) and/or increase their refinancing programme in June 2010 depending on 'open windows' and the recovery of the credit cycle.

Total primary issuance to be expected for selected European banks in 2010 (EUR bn)

	Funding MLT programme for 2009	Funding completed in 2009	Public debt issues in 2009	Bonds maturing in 2010	Funding needs for 2010	Public debt issues in 2010 (Calyon estimates)
BBVA	N/A	Yes	EUR5bn	EUR15bn	EUR10bn	between EUR6bn and EUR8bn
BNPP	EUR30bn, reviewed to EUR38bn after Fortis acquisition	EUR40bn	EUR22bn (including EUR11bn from SFEF)	EUR13.8bn (subordinated and senior)	EUR28bn	EUR15bn
CMZB	EUR20bn	EUR29bn	EUR14bn	EUR48bn	below EUR20bn (30/40% of unsecured, 60/70% covered)	around EUR10bn
CSG (CHFbn)	N/A	Yes	around CHF19bn	CHF12bn	N/A	around CHF20bn in the best case, but potentially less given de-risking process
DB	EUR33bn	EUR36bn	EUR4.8bn	between EUR15bn and EUR20bn	modest	between EUR4bn and EUR7bn
ISPIM	EUR29bn	EUR32bn	EUR4.5bn	EUR38.9bn	EUR40bn	EUR15bn
MPS	N/A	No, one issue of covered bonds after T-bonds issue completed	EUR1bn	EUR7.3bn	no such pressure with growth in deposits > lending growth	between EUR2bn and EUR3bn mostly in covered and senior at first, and potentially more to start reimbursing 2011 and 2012
Santander	EUR30bn	Yes	EUR8bn	EUR29.8bn	EUR18bn	EUR5-6bn (maybe EUR7-8bn if opportunities) mostly covered and senior
Soc Gen	EUR25bn, reviewed to EUR30bn in June 2009	between EUR30bn and EUR35bn	EUR15.7bn (including EUR11.2bn from SFEF)	EUR15.2bn	minimum EUR20bn (o/w around 50% in private placements)	around EUR10bn
UBS	N/A	Yes	CHF17bn	CHF11bn	N/A	around CHF15bn
Unicredit	N/A	above EUR30bn	EUR7.6bn	EUR43.4bn	potentially slightly below bonds maturing in 2010, given funding needs already started to be covered in H209, deleveraging process	around EUR5/7bn

Source: Banks, Bloomberg, Bondware, Calyon estimates

Sector allocation

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Setting the scene

Despite a plethora of shapes to describe the emergence from the 'Great Recession' we remain firmly entrenched in the view of a shape we cannot draw, although the closest description is one of an inverse 'square root'. After a large dip in GDP, we have seen a slight rebound but the path back from here remains a long and difficult one, and potentially fragile. Given the issues facing the global economy, we attach a very low probability of a 'V'-shaped recovery and, although we give some credence to a double dip, this does not feature as our central scenario. Unemployment has yet to peak, and there remain some concerns that we might see a 'jobless recovery'. Our economists forecast the European unemployment rate is unlikely to begin falling until Q111.

Calyon economic forecasts

Eurozone	2007	2008	2009	2010	2011
GDP	2.7	0.6	-3.9	1.2	1.6
private consumption	1.6	0.3	-1.0	0.4	1.3
public consumption	2.2	2.1	2.5	1.2	0.9
investment	4.8	-0.6	-10.3	-0.6	2.0
*change in inventories **	0.0	0.1	-0.5	0.6	0.1
*net exports **	0.4	0.0	-1.1	0.3	0.2
Unemployment rate	7.4	7.5	9.4	10.1	9.9
Inflation (YoY %)	2.1	3.3	0.3	1.2	1.9

** Contribution to GDP. Others are annual growth rates*

Source: Calyon. As at 01/12/09

For the love of credit

The investment case

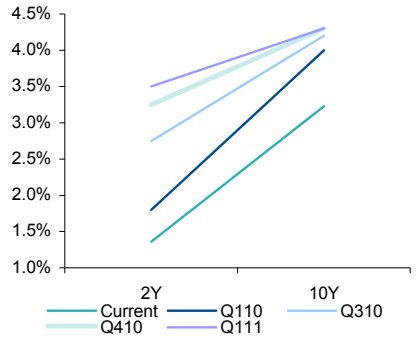
The investment case for IG credit in 2010 is not as strong as it was in 2009 simply because valuations have 'normalised'. We believe there are strong arguments for a general tightening in spreads over the course of 2010 (see fundamental, valuations, technical arguments on next page). However, the tightening in spreads will be more moderate than in 2009 and is likely to be capped, given the concerns that remain on the macroeconomic environment. Our central scenario, however, does not include a sell-off in credit to participate in an equity market rally. Whilst equity market valuations would look cheap in a 'V'-shaped recovery, in a slow-growth economy the upside to equities from here is probably limited. This may be enough to entice investors at some point in 2010, but we doubt the economic uncertainty regarding a double dip would be supportive of this technical. Better visibility after Q110 may feed investor appetite for equities, and this remains a real risk – something we will reassess throughout the year.

Government bonds: a spanner in the works…

Markets are expecting a steepening in the yield curve through 2010 (non-parallel shift), although Calyon forecasts for the evolution of 10Y government bond yields are more aggressive than the consensus, in terms of timing. The rise in 2Y rates will be greater as rates at the short end have been kept artificially low by the ECB's expansionary monetary policy. The longer end of the curve will feel pressure from significant net government supply in Q110, expectations of a rate hike and a gradual reversal of the ECB's version of quantitative easing – the reversal of the 12-month unlimited liquidity auctions. This could suppress bank appetite for government bonds (a significant buyer in 2009) as banks have in the past year used the bonds as repo collateral in the auctions as part of a carry trade. The steepening of the yield curve could have the following implications:

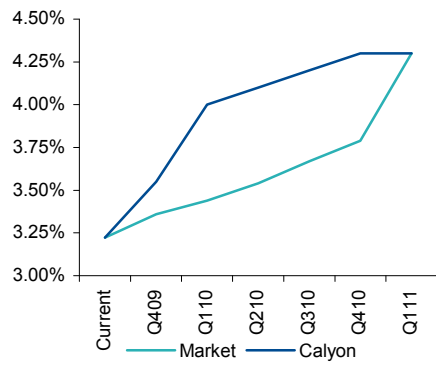
- Investors that cannot or do not hedge interest rate risk will experience mark-to-market losses, at the very least. Some of these losses could be offset in the credit markets by spread tightening and by the absolute level of spreads. As a result, duration considerations may play a greater part in sector allocation decisions.
- The 10Y bund yield is likely to peak at 4.5% during this cycle so interest rate risk could be concentrated in 2010.
- A 10Y bund yield of 4.5% is still relatively low, as a number of investors usually target a 5% yield. We expect demand for credit to remain unchanged, particularly if corporate bonds continue to yield 100bp+ over bunds.
- As initial market forecasts are not as aggressive as Calyon's, a steepening yield curve, because it was not anticipated, may not have that large an impact on sector allocations at the start of the year.

Bund yield curve steepening



Source: Bloomberg, Calyon

Calyon vs market 10Y bund yield forecast



Source: , Bloomberg Calyon

Fundamentals

- Credit spreads tend to tighten with improvements in the macroeconomic environment. GDP is a backward-looking indicator but PMI data is more forward-looking; even a slow recovery is a recovery and we should see a tightening bias to spreads next year.
- Unemployment could be drag but it is a lagging variable. Consumer confidence is picking up, albeit from decade lows.
- Inflation outlook remains subdued and base rate increases in Europe are unlikely in 2010.
- Emerging markets may help stabilise performance but the delinking between developed and developing countries is just a myth. Asia's performance has been driven by China, where government stimulus spending and an explosion in credit have been behind the growth. As these ease next year, China will return to its export-driven model, but this is not sustainable given exports are a zero sum game. Consumers in the West are in no position to continue taking the same level of supply of goods as they have done in the past. Growth in developed and developing countries must go hand in hand.
- Credit metrics should continue to stabilise in 2010 as a result of the improvements to the macroeconomic environment.
- Corporates will be conservative about leverage in the year ahead but the ability to reduce leverage is likely to be constrained by the depth of the recession.
- Reduced risk of M&A in 2010. A low-growth environment may encourage M&A activity but we expect to see limited appetite from the equity and credit markets, which is likely to act as a buffer to activity.
- The pace of downgrades will continue to slow in 2010 and the ratings drift – the difference between upgrades and downgrades – will improve even with the limited scope for upgrades at present.

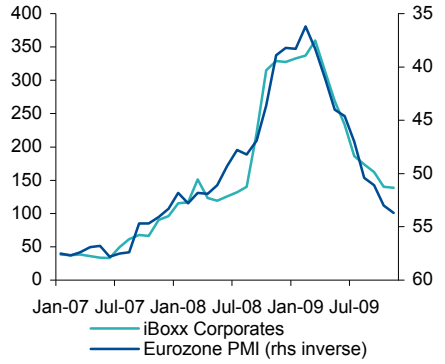
Valuations

- **Credit:** Even allowing for the deterioration in credit quality, ie, downgrades, credit spreads still look favourable compared with the past. For example, the spread on the iBoxx Financials index is 202bp vs 34bp at the start of 2007. The spread on the iBoxx Non-Financials is 94bp vs 50bp. The lack of a leveraged bid means we are unlikely to reach those levels but some 'juice' still remains, particularly in Financials. Spreads also imply a 1Y default rate of 1.365%, which is large compared with the historical average of 0.15% for IG credit.
- **Government bonds:** Credit spreads over the risk-free rate (bunds) are still healthy at over 100bp for most sectors, bar Healthcare and Utilities. Historically, the spread over the 10Y bund was around 60bp (H107). The fall in credit quality does warrant the extra spread but it is possibly only a little generous; however in a low-interest environment, the extra spread is likely to appeal
- **Equities:** As in credit, valuations have been 'normalising' in equity markets too. Using 1Y ahead earnings and historic PER ratios, there looks to be some upside available. Other sectors, particularly non-cyclicals such as Telecoms, Healthcare and Utilities look interesting given their dividend yields, which are higher than yields on the iBoxx bonds. From the bottom-up approach to valuations, we estimate there could be potential returns of up to 10% if analyst target prices for each individual equity are approached (fundamentals view).
- However, our concern here is not valuations per se. In 2009 we saw private banks and retail investors emerge as marginal investors – both of whom are potentially less committed to credit than traditional investors.
- The question is whether these marginal buyers will become marginal sellers if they begin to see value in equities. We believe not. So far these buyers have shown little inclination to sell their credit positions, instead sitting on IG bonds paying a decent coupon (from the start of the year). At present, despite the potential upside, the equity market outlook is sufficiently clouded to prevent a re-allocation of existing investments.

Technical

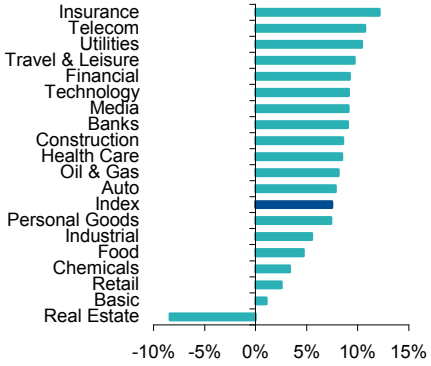
- Spreads in cash credit have at certain periods of time been more a function of supply and demand than fundamentals – before the crisis the leveraged buyer helped to drive down spreads, and last year the 'wall of cash' helped to 'normalise' spreads despite the record issuance. Although technicals should be less of a driver of performance in 2010, the impact will not be negligible.
- **Supply**: Primary market issuance was at a record EUR295bn (YTD) this year in the Eurobond market (non-financials). With redemptions of EUR113bn this year, net supply was a huge EUR182bn. For 2010, we expect issuance will struggle to breach the EUR200bn mark and could potentially be as low as EUR150bn. Redemptions are in the region of EUR105bn, but we estimate EUR50bn of these have already been refinanced.
- **Demand**: Very difficult to quantify and dependent upon the macroeconomic environment. However, we believe the cash dynamics within the credit markets in 2010 make it less reliant on cash inflows to drive performance, for the following reasons:
  - Net supply is more manageable this year.
  - Analysis of Bloomberg data on the holdings of fixed income funds suggests there could be EUR15-34bn of cash on the sidelines waiting to be invested in credit.
  - Coupon income that needs to be reinvested. We estimate the iBoxx Corporate index will throw off EUR62bn of cash in 2010. Once management charges have been accounted for and those requiring income have been paid, there could be EUR15-20bn of surplus funds.
  - We are expecting negative supply of EUR50bn for Financials in 2010, partly due to de-leveraging and partly due to a shifting preference towards covered bonds.

iBoxx corporate spread and PMI



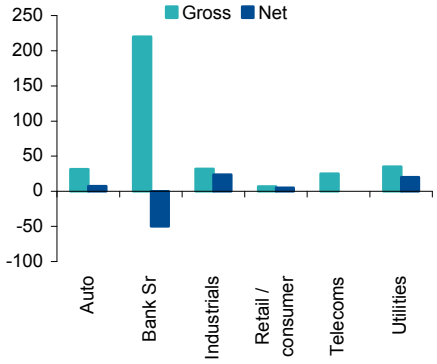
Source: Bloomberg, Markit, Calyon

Potential upside to median analyst equity target price



Source: Bloomberg, Calyon

Calyon 2010 gross and net supply for sectors covered



Source: Calyon

Sector allocation

This year, we take a top-down approach to our sector allocations. We begin by dividing the iBoxx Corporate index into three categories, Financials, Cyclicals and Non-Cyclicals. The Financials index already exists within the iBoxx Corporate index but we created the other two from the iBoxx Non-financials index by mapping the 15 non-financial sectors to our cyclical categorisation. The exercise is not perfect but it does allow us to tailor our decision-making process to map the economic cycle more closely. Our iBoxx universe is split as follows.

Composition of the iBoxx Corporates index

Financials			Cyclicals			Non-Cyclicals		
Index	EURbn outstanding	Weight in iBoxx Corporate index	Index	EURbn outstanding	Weight in iBoxx Corporate index	Index	EURbn outstanding	Weight in iBoxx Corporate index
Bank Senior	313.5	26.2%	Automobiles & Parts	61.9	5.2%	Food & Beverage	19.0	1.59%
Bank Lower Tier II	98.8	8.3%	Basic Resources	12.8	1.1%	Health Care	36.8	3.07%
Bank Upper Tier II	11.4	1.0%	Chemicals	29.9	2.5%	Personal & Household Goods	30.8	2.57%
Bank Tier I	42.7	3.6%	Construction & Materials	21.5	1.8%	Retail	25.0	2.08%
Insurance	63.5	5.3%	Industrial Goods & Services	66.1	5.5%	Technology	4.8	0.40%
Financial Services	44.4	3.7%	Media	10.2	0.9%	Telecommunications	104.8	8.76%
			Oil & Gas	46.9	3.9%	Utilities	148.3	12.39%
			Travel & Leisure	4.1	0.3%			
Total	**574.3**	**48.0%**		**253.3**	**21.2%**		**369.4**	**30.9%**

Source: Markit, Calyon

Our target is to beat the return on the iBoxx Corporate index over the course of 2010 and so we are less focused on short-term tilts towards certain sectors at differing times. This will save on execution costs but also, given the lack of visibility at present, keep us reasonably defensive. We have also assumed interest rates have been hedged, so we concern ourselves only with spread movements.

As noted above, our central scenario is of an environment of moderately tightening spreads in 2010. Our first decision is how to weight the portfolio (underweight/marketweight/ overweight) between financials and non-financials. Once this has been done, we look to weight the portfolio between our synthetic cyclical and non-cyclical indices. After the allocations to the three categories above have been decided, we look at the sectors where we have significant analyst coverage, eg, Autos, Utilities and Telecoms, to decide a sector weighting within the category weighting. The decision will be based on expected performance against the iBoxx Financials/Non-Financials or other sectors within the category. For sectors where we do not have analyst coverage, eg, Insurance and Technology, we take a market neutral view.

Our investment process for this year is simply to recommend relative weightings of the sectors against the iBoxx Corporates index, and the process can be seen below.

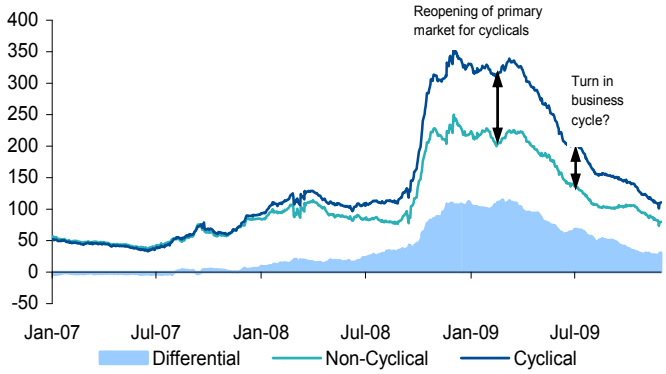
Cyclicals vs non-cyclicals

Cyclicals: Overweight

Non-cyclicals: Underweight

- The outlook for cyclicals was at its weakest in Q109 as the markets contemplated a 'Great Depression' scenario, leading to a real concern cyclical names would not be able to refinance.
- The compression between the two occurred in two legs. Firstly, the alleviation in refinancing risk as cyclical names began tapping the primary market in March. Secondly, as the economy began to show signs of stabilisation in Q209, the turn in the economic cycle began to favour cyclicals.
- A recovery will be slow. But consumer confidence is increasing from decade lows and despite rising unemployment. Private consumption is expected to grow next year. Commodity and raw-material prices are also improving or recovering from cyclical lows.
- Credit metrics in non-cyclicals will stabilise in 2010 but show slight improvements for cyclicals, with Autos the exception. We expect continued compression between the two indices, from the current 36bp differential. Both indices have a rating of (A-) but the cyclicals index has a lower duration of 3.9Y vs 4.48Y in non-cyclicals.
- Risks: A double dip, not just in GDP but also in supply. The fortunes of the Autos sector and some cyclical sectors such as Steel are correlated

Cyclicals vs non-cyclicals index



Source: Markit, Calyon

Cyclicals

- Our core coverage is in Autos and Industrials

Industrials: Overweight

Auto: Underweight

- Auto index is trading tighter than the non-financial index.
- We expect compression between the two – Autos currently at 91bp and Industrials at 114bp.
- This implies an increase in duration from 2.8Y in Autos and 4.8Y in Industrials but also a pick-up in yield from 2.8% to 4.1%.
- Both indices have the same average rating of A-, but we expect a stabilisation in ratings for Industrials versus Autos, where credit quality will remain under pressure given demand was artificially supported by government incentives in 2009.

Non-cyclicals

- Our core coverage is in Utilities, Telecoms, Consumer and Retail

Telecoms: Overweight

Utilities: Underweight

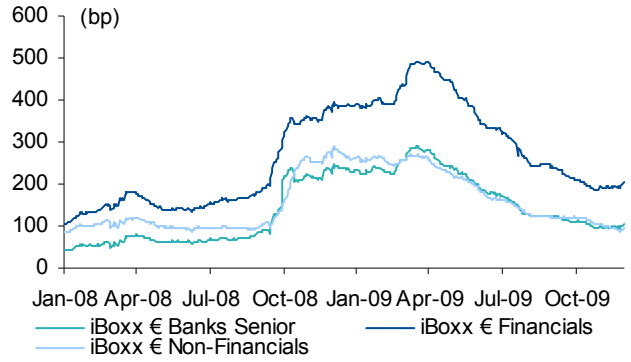
Retail: Marketweight

- We see limited scope for a sell-off in Utilities in 2010 given the rating stabilisation and 'normalisation' of issuance.
- However, Utilities spreads have compressed so much since Q309 the sector is beginning to look expensive.
- Telecom bonds offer an average 20bp pick-up and an equivalent yield to maturity, despite the lower duration (4.2Y vs 5.3Y).
- Fundamentals of both Telecoms and Utilities should remain fairly stable in 2010, leading to rating consolidation. Current one-notch rating differential – BBB+ Telecoms and A- Utilities – should therefore remain unchanged.

Relative value

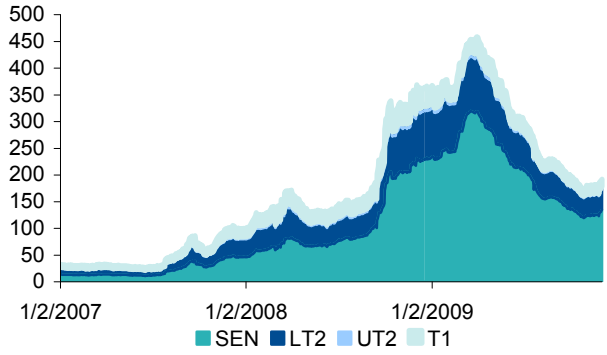
Financials have not yet fully recovered

iBoxx: financials versus non-financials



Source: iBoxx, Bloomberg, Calyon

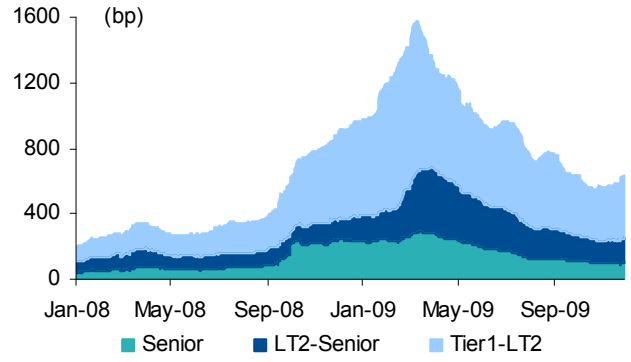
iBoxx € banks: composition of index (bp)



Source: iBoxx, Bloomberg, Calyon

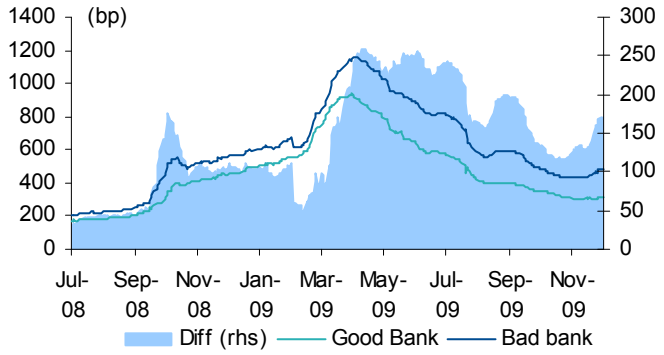
While Financials have recovered over the year, the sector still appears very large compared with non-financials. We recommend overweighting Financials – rated two notches higher and offering much lower duration – versus non-financials and limiting exposure to curve steepening.

Tier 1, LT2 and senior



Source: iBoxx, Bloomberg, Calyon

Callable LT2 euro-denominated currencies



Source: iTraxx, Bloomberg, Calyon

Cash: room for tightening

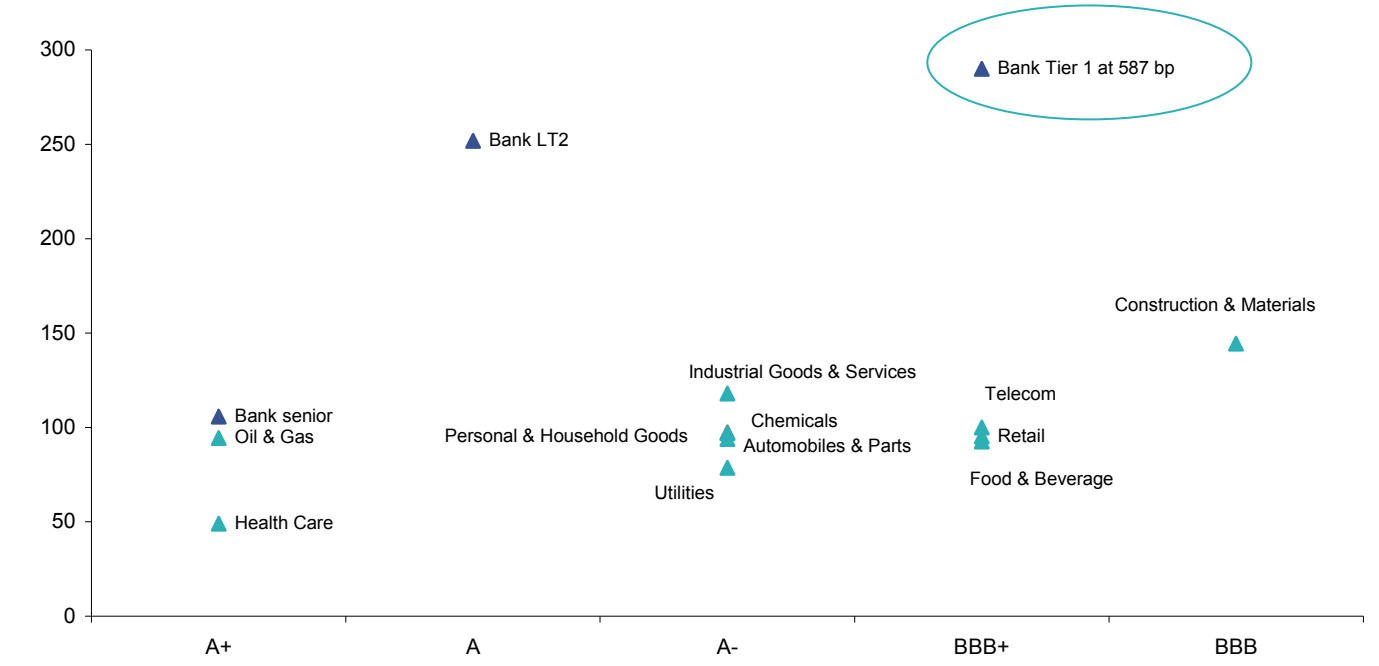
Senior unsecured debt: Outperform – government support offers strong security

- Given the slow economic recovery with rising unemployment, credit metrics will continue to deteriorate.
- The exit from government support and quantitative easing is expected to be gradual.
- Senior unsecured ratings primarily reflect strong government support (three notches of support) rather than fundamentals, leading downgrades to be limited to one notch to Single A on average.
- Even after considering some additional downgrades, senior unsecured debt still appears large compared with corporates (financial senior index: 77% of iBoxx corporates). In parallel, CDS senior unsecured debt has converged with non-financials CDS.
- Despite being more dynamic than in previous years, the primary market is expected to be lower than the redemptions on senior unsecured debt, therefore not exposed to overhang risk. In H110, most new issues are likely to carry a

decent new premium, and with the cash floating around in the sector we expect these to be eroded fairly quickly.

Post-crisis, the new banking environment will encompass lower risk, higher capital, lower pro-cyclicality. Given that the prospects for fixed income are not significantly constrained by expected lower profitability, senior unsecured debt is unlikely to be a 'paradise lost'.

iBoxx: spread versus ratings per sector



Source: iBoxx, Bloomberg, Calyon

LT2: Overweight – correlated to senior unsecured debt

Risk of non-exercise of the callable option, especially on banks under restructuring. Among them, banks where a restructuring plan has not yet been approved by the European Commission. We still rule out the likelihood of banks with relatively good access to the fixed income market (subordinated and hybrids) deciding to follow Deutsche Bank's decision. Exchange tender offers should remain a good alternative to avoid too much of an impact on investors while launching any new debt issue.

Fewer investors are able to invest in this segment than in senior unsecured debt, putting some constraints on switching from senior unsecured debt to LT2 paper (even dated ones).

While the Tier 2 capital will be included into the new BIS capital definition, the Tier 2 capital will be however be harmonised, simplified with the removal of sub-categories of Tier 2 (LT2 and UT2). Such uncertainties related to the future of the LT2 could put pressure on relative value.

Barring UK names, ratings on LT2 issues are correlated to the senior unsecured debt. No change in rating approach is expected in 2010. Since the crisis, the gap notches between UT2 and LT2 have dramatically widened, to a lesser extent for banks, and of course for Italian UT2 issues. But, the harmonisation of the Tier 2 capital may potentially lead rating agencies to review their approach on Tier 2 segment.

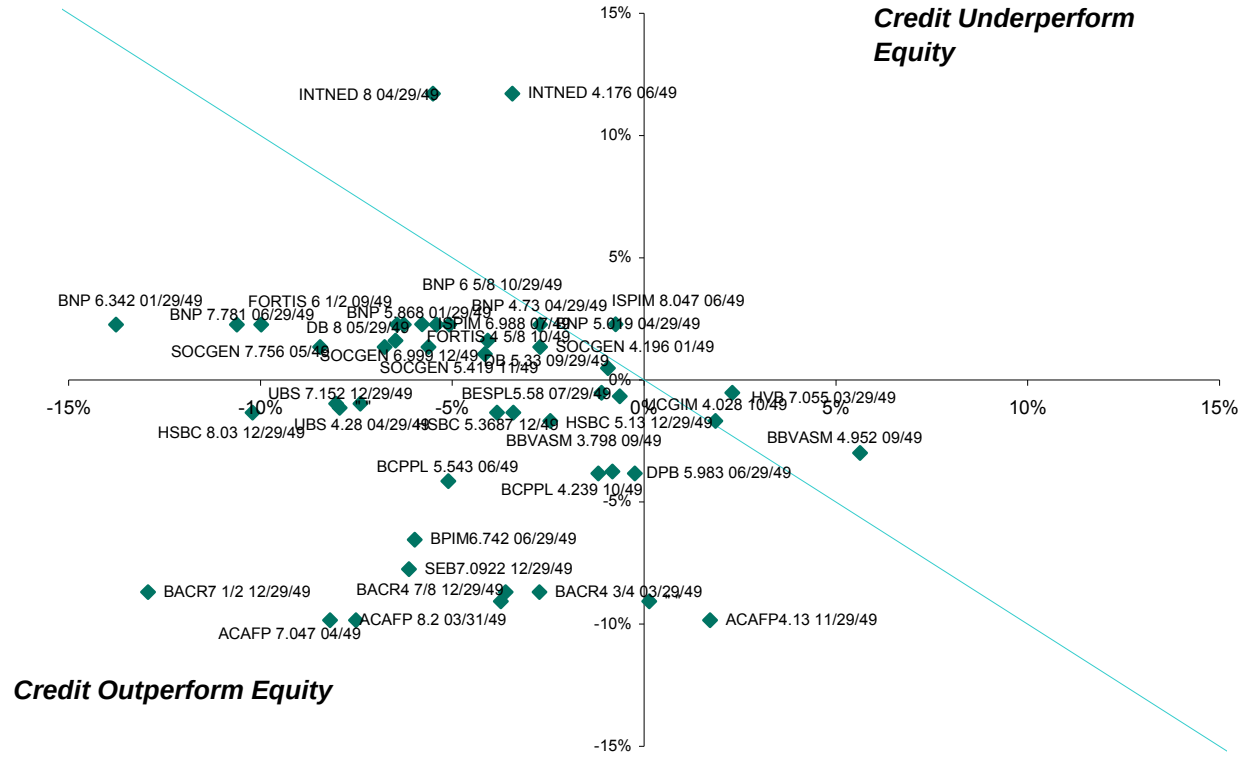
After taking into account potential supply below EUR10bn for 2010 (mostly Tier 2 names and banks with insurance business), the existing LT2 outstanding amount is expected to decrease with the implementation of the new regulation framework. Depending on the new definition (potential information after June-2010), primary issuance in LT2 segment could be stronger than our EUR10bn forecasts. Italian banks could also be present in the UT2 segment (dated, cumulative coupon).

- Although the dated LT2 segment (no risk of callable option) has recovered, we still see room for tightening.
- Callable paper still appears cheap on the whole, with differentiation necessary among (1) troubled banks (support from the government >2% RWA) and (2) banks that have succeeded in coping with the crisis without massive state support.

Tier 1: Sectorperform – too early to bet on a major recovery given the unknown period we are facing

- Given the slow economic recovery with rising unemployment, credit metrics will continue to deteriorate.
- The banking system has entered into an unknown period with the market waiting for a stricter regulatory framework, notably on capital with new hybrid generation. This will continue to lead to volatility among hybrids.
- The implementation of the new capital scheme by 2012 will put pressure on existing hybrid issues with a callable option after 2012, since banks may choose not to exercise the callable option from 2012 facing higher capital after 2012. In order to avoid any closure of their access to the primary market, European banks may however choose the exchange tender offer solution.
- Ratings are correlated to intrinsic value, excluding systemic support. Following the massive wave of downgrades during 2009 (even Moody's), a slower pace of downgrade is now expected. However, total outstanding hybrids on investment grade are limited.
- Pressure to boost capital, notably by retaining higher earnings, leads to potential concerns over dividend and as a consequence over coupons.
- Payments on coupons for issues launched by banks under restructuring plans or still under investigation are still unclear. Furthermore, it can be difficult to assess for which issues coupons can be considered mandatory.
- Stronger supply on hybrids is expected, especially after H210, which will put pressure on existing hybrid debt. As banks will have to issue hybrid, banks may be reluctant not to exercise the callable option during 2010 and 2011.
- After a period of banks being rescued by governments, now it is time for the restructuring and clean-up process.
- Despite recovering since March, hybrid debts remain very large while offering an interesting potential risk/return. We would be selective by name and favour primary issues.
- Although the next generation of hybrids is likely to have more equity-like features, a transition period and grandfathering arrangements will be implemented to avoid potential panic in the market. Indeed, even Tier 1 capital will be predominantly common equity – hybrids have to be included in order to avoid too much pressure on banks – especially given the capital shortfall with the implementation of the revised regulation. Based on this argument – which may lead banks to be more reluctant not to exercise the callable option (without offering an exchange tend-offer alternative) – some existing hybrid issues with callable after 2012 appear cheap.

Tier 1 vs equity



Source: Bloomberg, Calyon

Dividend payout ratios and yields for selected European names

(%)	2007		2008		2009E		2010E		2011E		2009-11E average	
	Payout	Yield	Payout	Yield	Payout	Yield	Payout	Yield	Payout	Yield	Payout	Yield
BBVA	42.9%	4.4%	45.5%	7.0%	29.8%	3.4%	50.6%	5.7%	50.8%	6.4%	43.7%	5.2%
BNPP	38.8%	4.5%	20.4%	3.3%	26.4%	2.2%	27.1%	2.7%	26.1%	3.6%	26.5%	2.8%
Commerzbank	34.3%	3.8%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
CSG	32.9%	3.7%	-1.4%	0.4%	30.0%	3.5%	30.0%	3.3%	30.0%	3.8%	30.0%	3.5%
Deutsche Bank	34.5%	5.0%	-6.6%	1.8%	17.1%	2.1%	16.7%	2.1%	27.6%	4.2%	20.5%	2.8%
ISPIM	67.0%	7.0%	0.0%	0.0%	41.6%	3.1%	50.4%	3.5%	50.8%	5.2%	47.6%	3.9%
MPS	96.9%	7.0%	7.0%	0.7%	21.5%	0.8%	39.3%	2.3%	40.4%	3.9%	33.7%	2.3%
Santander	44.9%	4.4%	50.5%	9.6%	56.2%	5.1%	52.3%	5.1%	50.2%	5.7%	52.9%	5.3%
SocGen	44.3%	0.9%	34.7%	3.3%	33.1%	1.7%	36.9%	4.1%	36.6%	5.8%	35.5%	3.9%
UBS	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	40.8%	3.9%	39.9%	4.5%	26.9%	2.8%
Unicredit	52.7%	4.6%	0.0%	0.0%	18.5%	0.9%	54.2%	2.2%	53.6%	5.7%	42.1%	2.9%
Average banks panel	**44.5%**	**4.1%**	**13.6%**	**2.4%**	**24.9%**	**2.1%**	**36.2%**	**3.2%**	**36.9%**	**4.4%**	32.7%	3.2%

Source: Calyon

Financials: coupon deferral and non-exercise of callable option for subordinated debts, 2009-10

		Type of securities			Reason				
	Bank	LT2	UT2	T1	Bank decision	EC	National authorities	Net loss trigger	Comments
Coupon deferral	Dresdner Bank			x				x	
	IKB			x				x	Coupons on T1 and UT2 securities will not be paid for several years in a row
	Depfa Bank			x	x				Will not be paying coupons on any other T1 and UT2 in 2009
	HSH Nordbank			x			x		Coupon has been deferred on silent participations
	Hypo real estate			x				x	
	Banca Italease			x					
	Bradford & Bingley	x		x			x		
	Dexia		x	x		x			Will not be paying coupons on any other T1 until end February 2010
Not called	Dexia		x	x		x			
	RBS	x	x				x		
	Deutsche bank	x		x		x			
	Banco Sabadell	x				x			
	BPE Financiaciones	x				x			
	Anglo Irish	x				x			
	AIB		x			x			
	KBC			x		x			
	Fortis			x		x			
	Crédit Logement			x			x		
	Erste			x		x			
	Bank of Ireland			x		x			
	ING			x		x			
	Anglo Irish		x	x		x			
	Fortis			x		x			
	Commerzbank			x		x			

Note: green: announced; blue: banks under restructuring plans that might suffer from some pressure from the EC on their callable options on subordinated debts in 2010

Source: EC, banks, Bloomberg, Calyon's hybrid team, Calyon

Tier 1 calls in 2010

Issuer	Year	Pricing date	Cur	Tranche Value (EUR equiv m)	Coupon	First call date	Maturity	ISIN
Deutsche Postbank Funding Trust II	2004	10-Dec-04	EUR	500	6.0000	23-Dec-09	Perpetual	DE000A0DHUM0
Royal Bank of Scotland plc	2004	19-Nov-04	EUR	1250	5.5000	31-Dec-09	Perpetual	XS0205935470
Deutsche Bank Capital Funding Trust VI	2005	04-Jan-05	EUR	900	6.0000	25-Jan-10	Perpetual	DE000A0DTY34
Credit Agricole SA	2003	10-Dec-03	EUR	550	6.0000	28-Jan-10	Perpetual	NL0000113868
SG Capital Trust I	2000	08-Feb-00	EUR	500	6.0000	4-Feb-10	Perpetual	XS0107805607
Fortis Capital Funding Trust	2000	23-Feb-00	USD	400	7.8750	22-Feb-10	Perpetual	CUSIP: 349916403
BOI Capital Funding LP	2005	22-Feb-05	EUR	600	7.68	1-Mar-10	Perpetual	XS0213178295
Banca Lombarda Preferred Securities Trust	2000	28-Feb-00	EUR	155	6.2500	3-Mar-10	Perpetual	
EFG Hellas Funding Ltd	2005	03-Mar-05	EUR	200	8.1700	10-Mar-10	Perpetual	DE000A0DZVJ6
Standard Chartered Capital Trust 1	2000	09-Mar-00	EUR	500	6.7500	18-Mar-10	Perpetual	XS0109213172
OKOBANK	2005	18-Feb-05	EUR	50	6.6250	30-Mar-10	Perpetual	XS0213603177
EFG Fiduciary Certificates	2004	27-Oct-04	EUR	325	6.5000	11-Apr-10	Perpetual	XS0204324890
EFG Fiduciary Certificates	2004	16-Dec-04	EUR	75	6.5000	30-Apr-10	Perpetual	XS0204324890
Credit Suisse Group Capital II Ltd	2000	07-Jun-00	EUR	250	8.8750	3-Jun-10	Perpetual	USG0732RAB45
NBP Capital Trust 1	2000	21-Jun-00	EUR	200	6.2500	27-Jun-10	Perpetual	XS0113462609
Kaupthing Bank hf	2005	16-Jun-05	EUR	175	7.0000	27-Jun-10	Perpetual	DE000A0E6B87
Credit Suisse Group Capital IV Ltd	2000	07-Jun-00	SFR	150	8.3200	28-Jun-10	Perpetual	CH0010916325
Erste Finance 2 Ltd	2000	27-Jun-00	EUR	125	6.5000	30-Jun-10	Perpetual	GB0040442534
Nova Ljubljanska Banka dd	2005	15-Jul-05	EUR	130	5.2500	30-Jun-10	Perpetual	XS0224488543
Royal Bank of Scotland Group plc	2005	15-Jun-05	EUR	1,250	6.3500	30-Jun-10	Perpetual	DE000A0E6C37
Royal Bank of Scotland Group plc	2005	12-May-05	USD	1,000	3-mth Euribor+2.40%	30-Jun-10	Perpetual	US7800977701
Anglo Irish Capital Funding Ltd	2004	21-Sep-04	EUR	600	6	30-Sep-10	Perpetual	XS0201790317
UniCredito Italiano Capital Trust 1	2000	28-Sep-00	EUR	540	9.2000	5-Oct-10	Perpetual	USU90400AA73
UBS Preferred Funding Trust I	2000	29-Sep-00	USD	1,500	8.0480	5-Oct-10	Perpetual	
BNP Paribas Capital Trust	2000	24-Oct-00	USD	500	8.6220	10-Oct-10	Perpetual	CUSIP: 055960AA6
BAWAG Capital Finance Ltd	2000	18-Oct-00	EUR	150	9.0030	27-Oct-10	Perpetual	XS0119643897
San Paolo IMI Capital Trust I	2000	03-Nov-00	EUR	1,000	8.7650	31-Oct-10	Perpetual	XS0120282610
Skandinaviska Enskilda Banken AB	2005	19-Jan-05	INR	2,500	8.25	6-Dec-10	Perpetual	US3135867527
HSBC Holdings plc	2005	15-Sep-05	USD	1,305	6.5000	15-Dec-10	Perpetual	US4042806046
Sampo Bank plc	2005	25-Nov-05	EUR	125	6.2	16-Dec-10	Perpetual	US4042806046
Royal Bank of Scotland Group plc	2000	07-Dec-00	GBP	200	8.7000	20-Dec-10	Perpetual	XS0121856859
EFG Hellas Funding Ltd	2005	03-Nov-05	EUR	150	8.4390	31-Dec-10	Perpetual	XS0234821345
ING Capital Funding Trust III	2000	12-Dec-00	USD	1,500	7.3870	31-Dec-10	Perpetual	US44978NAA37

Source: Bloomberg, Bondware, Bondrumours, Reuters, Calyon's hybrid team, Calyon

LT2 calls in 2010

Issuer	Year	Tranche Value (USDm)	Coupon	First call date	Maturity	ISIN
Banca CR Firenze SpA	2004	226	3-mth Euribor +40bp	15-Dec-09	15-Dec-14	XS0208011154
Banca Sella SpA (Old)	2004	75	3-mth Euribor +55bp	15-Dec-09	15-Dec-14	XS0207577528
Société Générale	2002	980	4.875	18-Dec-09	18-Dec-14	XS0159565349
Banif Finance Ltd	2004	75	3-mth Euribor +80bp	29-Dec-09	29-Dec-14	XS0208463306
Northern Rock	2002	384.9	5.625	13-Jan-10	13-Jan-15	XS0157198937
Standard Chartered Bank	2005	500.0	3-mth Libor +30bp	4-Feb-10	3-Feb-15	XS0211497135
Sberbank	2005	1000.0	6.23	11-Feb-10	11-Feb-15	XS0212423221
Deutsche Bank	2004	349.3	3-mth Libor +30bp	17-Feb-10	17-Feb-15	XS0198456054
ABN AMRO	2005	1497.9	3-mth Libor +20bp	9-Mar-10	9-Mar-15	XS0213858243
Cajasur	2005	99.1	3-mth Euribor +44bp	11-Mar-10	11-Mar-15	ES0264730054
Cajamar	2005	399.3	3-mth Euribor +30bp	16-Mar-10	16-Mar-15	ES0214601017
HSBC Holdings	2005	749.1	3-mth Libor +17.5bp	16-Mar-10	16-Mar-15	XS0214365263
Svenska Handelsbanken	2005	656.7	3-mth Euribor +18bp	16-Mar-10	16-Mar-15	XS0214448473
Allied Irish Banks	2004	529.3	3-mth Euribor +30bp	23-Mar-10	23-Mar-15	XS0208845924
RBS plc	2005	579.9	4.25	30-Mar-10	30-Mar-15	CA78010XAA96
Abbey National	2005	645.6	3-mth Euribor +25bp	21-Apr-10	21-Apr-15	XS0217621050
Abbey National	2005	377.7	5.25	21-Apr-10	21-Apr-15	XS0217626521
Swedbank	2005	299.6	3-mth Libor +25bp	30-Apr-10	30-Apr-15	XS0216216845
Nordea Bank	2005	963.1	3-mth Euribor +20bp	20-May-10	20-May-15	XS0219610275
Barclays Bank plc	2005	1497.1	3-mth Libor +20bp	25-May-10	25-May-15	XS0213053910
SEB	2003	585.1	4.125	28-May-10	28-May-15	XS0169360657
Den norske Bank	2003	318.2	5.125	3-Jun-10	3-Jun-15	XS0163772790
ABN AMRO	2005	1886.3	3-mth Euribor +25bp	8-Jun-10	8-Jun-15	XS0221082125
Sanpaolo IMI	2003	411.3	3.75	9-Jun-10	9-Jun-15	XS0169765988
Cassa dei Risparmi di Forli	2005	87.8	3-mth Euribor +40bp	10-Jun-10	10-Jun-15	IT0003859672
UniCredito Italiano	2005	628.4	3-mth Euribor +25bp	15-Jun-10	15-Jun-15	XS0220921117
BCP Finance	2005	378.7	3-mth Euribor +35bp	15-Jun-10	15-Jun-15	XS0220057581
Capitalia	2005	362.1	3-mth Euribor +45bp	23-Jun-10	23-Jun-15	XS0222426958
Credit Logement	2005	1818.2	3-mth Euribor +29bp	23-Jun-10	23-Jun-15	FR0010206326
Banca Popolare di Milano	2005	724.6	3-mth Euribor +45bp	29-Jun-10	29-Jun-15	XS0222841933
Caja Duero	2005	181.6	3-mth Euribor +40bp	30-Jun-10	30-Jun-15	ES0214854012
MPS	2005	422.5	3-mth Euribor +40bp	30-Jun-10	30-Jun-15	XS0222761230
Rabobank Nederland	2005	1280.1	3-mth Euribor +12.5bp	28-Jul-10	28-Jul-15	XS0217360824
Nordea Bank	2005	327.9	3.95	5-Aug-10	5-Aug-15	CAW58018AP20
Nationwide Building Society	2005	956.9	3.375	17-Aug-10	17-Aug-15	XS0212573462
Hypo Tirol Bank	2000	13.5	6.5	13-Sep-10	13-Sep-20	AT0000332226
Nordea Bank	2005	640.5	4.625	21-Sep-10	21-Sep-15	XS0229729362
Deutsche Bank	2005	928.3	3-mth Euribor +20bp	22-Sep-10	22-Sep-15	XS0229840474
MPS	2003	237.9	4.5	24-Sep-10	24-Sep-15	XS0176510641
MPS	2003	439.5	4.5	24-Sep-10	24-Sep-15	XS0176510641
RZB	2005	245.5	3-mth Euribor +30bp	28-Sep-10	28-Sep-15	AT0000285457
DnB NOR Bank	2005	250.4	3-mth Euribor +20bp	28-Sep-10	28-Sep-15	XS0229349021
RBS plc	2005	750.0	3-mth Libor +24bp	29-Sep-10	29-Sep-15	XS0223318501
BNP Paribas	2005	719.9	3-mth Libor +17.5bp	5-Oct-10	5-Oct-15	XS0230888439
Standard Bank plc	2005	250.0	3-mth Libor +115bp	8-Oct-10	8-Oct-15	XS0231826024
D Carnegie & Co AB	2005	62.3	3-mth Euribor +160bp	12-Oct-10	12-Oct-15	XS0231686428
BBVA	2005	528.8	3-mth Libor +20bp	21-Oct-10	21-Oct-15	XS0231518043
Caja de Ahorros de Canarias	2005	181.0	3-mth Euribor +34bp	4-Nov-10	4-Nov-15	ES0214981070
Deutsche Postbank	2005	596.0	3-mth Euribor +30bp	4-Nov-10	4-Nov-15	DE0001397081
BBVA	2003	868.5	4.5	12-Nov-10	12-Nov-15	ES0213211081
UBS	2005	1506.6	3-mth Euribor +15bp	17-Nov-10	17-Nov-15	XS0234775483

Source: Bloomberg, Bondware, Bondrumours, Reuters, Calyon's hybrid team, Calyon

LT2 calls in 2010 (cont'd)

Issuer	Year	Tranche Value (USDm)	Coupon	First call date	Maturity	ISIN
Rural caja	2005	117.6	3-mth Euribor +40bp	22-Nov-10	22-Nov-15	ES0215316029
BNP Paribas	2005	249.6	3-mth Libor +20bp	23-Nov-10	23-Nov-15	XS0220065501
BNP Paribas	2005	748.9	3-mth Libor +20bp	23-Nov-10	23-Nov-15	XS0220065501
Scarborough Building Society	2005	34.3	5.875	1-Dec-10	1-Dec-15	XS0236960885
BNP Paribas	2005	368.6	3.125	6-Dec-10	6-Dec-15	XS0220648603
BNP Paribas	2005	625.0	3.125	6-Dec-10	6-Dec-15	XS0220648603
UBI Banca	2005	589.5	3-mth Euribor +40bp	7-Dec-10	7-Dec-15	XS0237670319
Caja Espana	2005	117.1	3-mth Euribor +35bp	7-Dec-10	7-Dec-15	ES0215474190
Irish Life & Permanent plc	2005	235.7	3-mth Euribor +25bp	7-Dec-10	7-Dec-15	XS0236617055
BNP Paribas	2005	269.8	4.75	8-Dec-10	8-Dec-15	XS0221178584
BNP Paribas	2005	364.6	4.75	8-Dec-10	8-Dec-15	XS0221178584
Banco Santander Totta	2005	450.0	3-mth Euribor +28bp	9-Dec-10	9-Dec-15	XS0237609168
KBC	2005	353.2	3-mth Euribor +20bp	14-Dec-10	14-Dec-15	XS0238065170
DePfa Bank	2005	619.1	3-mth Euribor +20bp	15-Dec-10	15-Dec-15	XS0229524128
Deutsche Bank	2004	403.5	5.25	15-Dec-10	15-Dec-15	XS0189609745
Kensington Group plc	2006	94.0	9	21-Dec-10	21-Dec-15	XS0233803153
Kensington Group plc	2005	132.7	9	21-Dec-10	21-Dec-15	XS0233803153
Banco Itau Europa	2005	119.8	3-mth Euribor +55bp	22-Dec-10	22-Dec-15	XS0239063414
BPE Financiaciones SA	2005	238.3	3-mth Euribor +15bp	23-Dec-10	23-Dec-15	ES0257080012

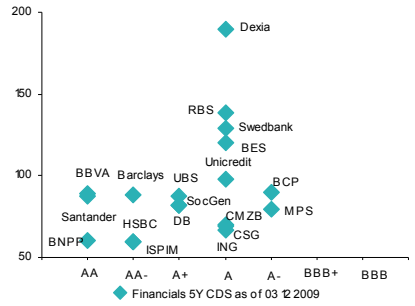
Source: Bloomberg, Bondware, Bondrumours, Reuters, Calyon's hybrid team, Calyon

Exchange tender offers in 2009

Announce-ment date	Transaction expiry date	Bank	Initial instrument	New securities	Type	Success rate
30-Nov-09	10-Dec-09	Banco Popular	T1	LT2	Tender	TBD
12-Nov-09	19-Nov-09	SNS Bank	T1	T1	Exchange	87%
3-Nov-09	20-Nov-09	Lloyds TSB	UT2 T1 Prefs	Cash	Exchange	100%
29-Oct-09	4-Nov-09	Banco Popolare	LT2	2016 LT2	Exchange	-
16-Oct-09	30-Oct-09	BNP Paribas	ABS/MBS	Cash	Tender	5%
5-Oct-09	14-Oct-09	BBVA	T1	T1	Exchange	81%
14-Sep-09	29-Sep-09	Banco Pastor	T1	Cash	Tender	19%
14-Sep-09	25-Sep-09	KBC	T1	Cash	Tender	EUR 56% GBP 88%
14-Sep-09	25-Sep-09 (Early) 13-Oct-09 (Expiry)	KBC	T1	Cash	Tender	71%
18-Sep-09	1-Oct-09 (Early) 19-Oct-09 (Expiry)	SEB	T1	T1	Tender	28% (Early)
9-Sep-09	17-Sep-09	SNS Bank	RMBS -'Hermes'	Cash	Tender	43%
25-Aug-09	1-Sep-09	Banco Santander	LT2	Cash	Tender	2%
24-Aug-09	7-Sep-09	Banco Santander	Securitised	Cash	Tender	3.83%
30-Jul-09	7-Aug-09	Irish Nationwide	Senior LT2	2010 Senior Fixed LT2	Exchange	EUR 34% (Senior) GBP 88% (Senior) GBP 92% (LT2)
22-Jul-09	30-Jul-09	Anglo Irish	T1 UT2 LT2	Cash	Tender	EUR 69% GBP 91%
20-Jul-09	24-Jul-09	Credit Agricole	T1	Cash	Tender	53%
9-Jul-09	22-Jul-09 (EUR, GBP & JPY) 6-Aug-09 (USD Private exchange)	Banco Santander	T1 UT2	T1 LT2	Exchange	EUR 32% GBP 65% USD 48%
7-Jul-09	15-Jul-09	Britannia	LT2	Cash	Tender	EUR 39% GBP 0%
6-Jul-09	31-Jul-09	BPCE	T1	EUR series and USD series	Exchange	52%
6-Jul-09	9-Jul-09	Caja Madrid	LT2	2015 LT2	Exchange	65%
30-Jun-09	Early 7-Jul-09 Expiration 9-Jul-09	Lloyds TSB	LT2 UT2	Senior	Exchange	GBP: 73.85% EUR: 47.16%
22-Jun-09	3-Jul-09	NBG	T1	Cash	Tender	30%
22-Jun-09	Early 6-Jul-09 Expiration on 20-Jul-09	Barclays	UT2	LT2	Exchange	>75% (Early) 78% (Expiry)
18-Jun-09	18-Jul-09	Caixa Galicia	T1	Cash	Tender	73%
11-Jun-09	16-Jun-09	Allied Irish Banks	UT2 T1	LT2	Exchange	78%
10-Jun-09	18-Jun-09	UBI Banca	Pref LT2	Senior	Exchange	30%
4-Jun-09	17-Jun-09	Caixanova	UT2	Cash	Tender	20%
18-Jun-09	26-Jun-09	RZB	T1	2016 T1	Exchange	TBD
19-May-09	16-Jun-09	Bank of Ireland	Pref	Cash	Tender	58%
15-May-09	12-Jun-09	Rabobank	Pref	2019 T1	Exchange	48%
13-May-09	26-May-09	Caja Duero	Pref	Cash	Tender	30%
30-Apr-09	13-May-09	Barclays	UT2	2021 LT2	Exchange	74%
29-Apr-09	12-May-09	Caixa Galicia	UT2	Cash	Tender	26%
6-Apr-09	21-Apr-09	Standard Chartered	UT2 LT2	• Exchange: senior • Tender: Cash	Exchange & tender	Exchange: 42% Tender: 24%
2-Apr-09	20-Apr-09	Banco Pastor	UT2	Cash	Tender	78%
1-Apr-09	7-Apr-09	Credit Agricole	UT2	Cash	Tender	52%
26-Mar-09	22-Apr-09	RBS	UT2 T1	• Tender: Cash • Exchange: Senior	Tender & exchange	Tender: 64% Exchange: 61%
26-Mar-09	3-Apr-09	Sampo Bank	LT2	Senior	Exchange	94%
25-Mar-09	By Sep-09	Banca Popolare di Milano	T1	Cash	Tender	TBD
25-Mar-09	7-Apr-09 (phase 1); 15-Apr-09 (phase 2)	HBOS/ Lloyds	UT2	Senior	Exchange	54.50%
24-Mar-09	21-Apr-09	Banco Sabadell	T1	Cash	Tender	30%

Source: Calyon's hybrid team

CDS Senior 5Y



Source: Bloomberg, Calyon

Issuer recommendations

After a convergence trend between CDS senior and CDS subordinated, the last part of the year is facing a widening of CDS subordinated, due to the negative newsflow and all the uncertainty surrounding the future of the banking world. Note, however, that CDS senior has remained more stable. Given all the elements mentioned already, we consider that CDS senior, which is now more in line with corporates, has room for further tightening. While we maintain our Outperform on senior, we prefer Cash on senior unsecured debt, which offers further tightening in our view.

Changes to issuer recommendations

Intesa Sanpaolo: Although credit metrics should remain solid in our view, the Italian bank is the tightest among the large European banks. It appears too expensive in our view, leading us to change our recommendation from Sectorperform to **Underperform**.

Deutsche Bank: Despite a strong recovery, results have been below CSG, which delivered a great performance during 2009. Although Deutsche Bank will be penalised because of its higher RWA market risk, the latter will not be implemented before year-end. After taking into account the integration of Sal Oppenheim, in our view Deutsche Bank has room to deliver a relatively good performance in 2010, notably with leading positioning in FX. As such, we change our recommendation from Sectorperform to **Outperform**.

Credit Suisse Group: While the Swiss bank has delivered a fantastic performance during 2009, performance is likely to decelerate in 2010. As a result, and given the tight level of the CSG CDS senior compared with other investment banks and the index bank senior as a whole, we change our recommendation from Sectorperform to **Underperform**.

BBVA: Although the bank will continue to face a credit deterioration, it should benefit from economic recovery in the US and Mexico. As such, we review our recommendation from Sectorperform to **Outperform**.

Unicredit: has been penalised by rising concerns on sovereign emerging exposure, following the Dubai World event. Sensitive to CEE, Unicredit CDS senior 5Y appears very large compared with the rest of the European banks and the senior CDS 5Y Banks. As such, we review our recommendation from Sectorperform to **Outperform**.

When to switch between investment banks and retail

The market is looking for signals as to when to switch from investment banks to retail banks. For the first part of 2010, investment banks are likely to remain tighter than the bank senior index:

- While central banks are expected to be less generous, the end of quantitative easing may represent a key turnaround for the banking system depending on the timing and speed.
- Non-performing loans are not likely to peak until June 2010. As long as unemployment continues to rise, asset quality deterioration is not expected to improve before 2011. A deceleration in the cost of risk combined with confirmation of economic recovery, however, could be a sign of hope for retail (H210?).
- Investment banks will the main losers of the new regulation, with pressure on their capital needs. A stricter regulation scheme than anticipated by the market (not forecast in the short run, however) would represent a sign to favour retail. As such, the size of investment banks as well as leading franchises in some key businesses would be a competitive advantage. While we are forecasting a fall in revenues of not more than 15% after the record levels in 2009, sustainable revenues will be key for those banks.
- With such uncertainty and limited precise guidance, management guidance – potentially disclosed during Q409 results – and efforts to be transparent in their progress related to the new financial pillars scheme will be also important.

Summary of our recommendation on CDS

	Rating		Spot	Variation			Expected	Spot vs Index			CDS Recommendation		
Issuer	S&P/Moody's	Calyon	CDS	1 Week	1 Month	YTD	Trend	Ratio	Fair Value	Spot - FV	Previous	Since	New
Santander	AA neg/AA	Low-AA	**80**	-2	-10	-24	→	94%	**78**	**1**	Underperform	17/09/09	Sectorperform
HBOS	A/AA-	NR	**131**	-1	-4	18	↘	156%	**125**	**6**	NR	18/12/08	NR
Intesa Sanpaolo	AA- neg/AA-	High-A	**59**	-2	-2	-51	→	69%	**55**	**4**	Sectorperform	07/12/09	Underperform
Commerzbank	A neg/A+	Low-A	**60**	-1	-10	-26	↗	72%	**70**	**-10**	Underperform	17/09/09	Sectorperform
BNP Paribas	AA neg/AA neg	Low-AA	**60**	0	-1	-10	→	71%	**56**	**4**	Suspended	07/12/09	Sectorperform
RBS	A /AA-	NR	**139**	0	-2	3	↘	165%	**120**	**19**	NR	18/12/08	NR
Deutsche Bank	A+/AA- neg	High-A	**79**	1	-4	-50	→	93%	**80**	**-1**	Sectorperform	07/12/09	Outperform
Bco Espirito Sant	A neg/A+	NR	**115**	-2	-8	18	→	137%	**110**	**5**	NR	18/12/08	NR
Credit Suisse Gr	A/AA- neg	High-A	**59**	-1	-11	-122	→	70%	**75**	**-15**	Sectorperform	07/12/09	Underperform
Societe Generale	A+/A+	High-A	**76**	-4	-9	-30	↗	90%	**78**	**-3**	Suspended	07/12/09	Sectorperform
Montepaschi di S	A- /A	Low-A	**74**	-2	-8	-36	→	88%	**69**	**6**	Underperform	18/12/08	Underperform
UBS	A+/A+	Mid-A	**79**	-1	-9	-133	→	94%	**98**	**-19**	Underperform	15/04/09	Underperform
Barclays	A+ neg/AA-	NR	**84**	-1	-5	-78	→	100%	**87**	**-3**	NR	18/12/08	NR
BBVA S A	AA neg/AA- pos	Low-AA	**82**	-2	-9	-16	→	98%	**80**	**2**	Sectorperform	07/12/09	Outperform
Unicredit	A/A neg	Mid-A	**93**	-2	-5	-31	→	111%	**88**	**5**	Underperform	07/12/09	Outperform
Index Banks Se			**84**	-1	-6	-36	↘						

Key: ↘ Outperformance expected; → No trend reversal is expected; ↗ Underperformance expected

Source: Bloomberg, Calyon (as at 07/12/09)

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Financials – Issuer profiles

Contents

BBVA 68
BNP Paribas 70
Commerzbank 72
Credit Suisse Group 74
Deutsche Bank 76
Intesa Sanpaolo 78
Montepaschi 80
Santander 82
Société Générale 84
UBS 86
Unicredit 88
Appendix 90

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BBVA

Ratings

S&P/Moody's/Fitch
AA neg/Aa2 neg/AA- pos

Calyon Rating
Low-AA

Rating agencies' opinion

UP

S&P: Outlook back to stable if BBVA is able to maintain its resilient asset quality and strong earnings.

Moody's: BFSR upgrade if stronger risk absorption capacity and/or a significantly lower risk profile with recurring earnings power maintained in the 2.5-3.7% range and net recurrent income in the 1.8-2.1% range.

Fitch: Positive outlook reflecting that the bank is well-positioned to deliver continued solid performance.

DOWN

S&P: More negative impact on the financial performance due to further deterioration of credit conditions in Spain, Latam (Mexico) and the US.

Moody's: BFSR downgrade if inadequate lower risk absorption capacity compared with the group's risk profile, lower share of recurring earnings, as well as any adverse changes to the perceived risk profile of the Latam franchise, particularly Mexico.

Background

BBVA is one of the largest European banks and the second-largest bank in Spain after Santander, with a market share of about 10% in terms of deposits. The bank enjoys a well-diversified business mix, with assets dominated by retail businesses. In addition to its leading positions in Spain and Portugal, BBVA benefits from a strong retail franchise in Latin America, particularly in Mexico via Bancomer, the largest commercial bank in the country (which accounts for 20% of RWA, of which two-thirds in Mexico). BBVA is also present in the southern US (mostly Texas via Compass Bancshares) and to a lesser extent in China.

Operating performance trend

Despite recession in Spain and a particularly tough environment in Mexico, BBVA has demonstrated its capacity to produce strong gross operating income (EUR9.3bn in 9M09, +18% YoY at constant exchange rates). Resilience in net interest revenue (70% of total revenues) due to asset repricing, plus excellent cost control, explains such a level of operating buffer, crucial for absorbing the rise in loan loss provisions (LLP: 30% of GOI). Despite signs of stabilisation observed in Q309, LLP will remain high in coming quarters due to the rise in unemployment combined with the subsequent lag between economy and impact on the bank's balance sheet.

A conservative approach will be pursued in order to preserve a sufficiently good operating performance. BBVA remains confident for 2010 with recovery expected in Mexico (cost control, growth expected in mortgage production, gradual reduction in non-performing loans and cost of risk). Latam – the growth engine – should be able to offset the lack of dynamism in Spain. Unlike other Spanish banks, BBVA believes it can preserve margin in Spain & Portugal (gaining new customers, stabilisation in mortgage repricing and less impairment) and as such keep NIR relatively stable.

Key investment themes

The deterioration in asset quality remains one of the main concerns although it is slower than peers in its key geographical areas. NPL ratios came in at 3.4% for a 68% coverage ratio. Although needing attention, exposure to Spanish properties is under control (stock: EUR1bn well covered). Any capital gains from disposals will be used to strengthen generic provisions (EUR4.7bn in 9M09). After being sharply hit in Mexico, Spain will be the main threat in 2010, somewhat offset by collateral and the gradual trend expected, which should be manageable for BBVA.

BBVA enjoys strong capital ratios, thanks to solid operating results (+110bp of core capital since January) and the EUR2bn convertible debt. With an 8% core capital ratio, BBVA wants to be prepared for the new capital standard and will wait for the definitive framework before disclosing its new capital target. With stable RWA, organic growth is expected to contribute 20bp per quarter to the Core Tier 1 ratio under normal conditions.

New financials pillars: While regulation will be stricter post-crisis, **no substantial impact is forecast in BBVA's business model**, reflecting its retail banking profile. BBVA still prefers organic growth – combined with further room for cost savings (South America, integration of Guaranty Bank in the US) – to M&A.

Relative value: Operating performance correlated to Mexican turnaround

Delivering good operating income based on its geographic diversification and cost efficiency will remain the priority. Stabilisation in Mexico and a more optimistic outlook for 2010 are more than welcome. Combined with a sound Core Tier 1 ratio, BBVA has the capacity to deliver earnings resilience in coming quarters. BBVA remains one of our favourite names in H110. No real concerns regarding the payment of coupons on hybrid debt with a 30% payout expected during 2009 – an issue to be discussed in 2010. With lending growth below the rise in deposits, funding needs for 2010 are likely to remain limited (around EUR7bn?). As such, both primary and secondary can be played depending on the premium offered.

BBVA

www.bbva.com

Key shareholders

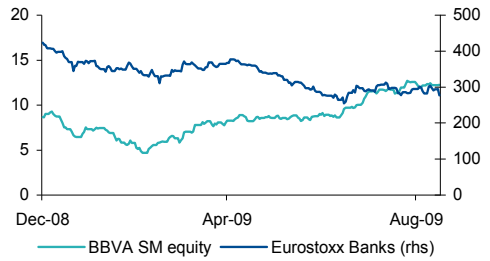
State Street Bank	5%
Iaga	5%
Float	90%

Equity & Bond metrics

Equity ticker	BBVA SM	Bonds maturing in 2010	EUR 13,244m
Bond Ticker	BBVASM		
Number of shares (m)	3,748	Last rating action	30/7/2009
Market Cap.	EUR 47,674m		

Source: Bloomberg

Stock performance



EURm	Q309	Q209	Q109	2008
Net attributable profit	**1,380**	**2,168**	**1,834**	**6,927**
Spain & Portugal	606	613	657	2565
Wholesale banking & AM	231	271	268	773
Mexico	377	361	363	1938
USA	18	43	42	212
South America	226	241	222	733
NPL ratio	**3.4%**	**3.2%**	**2.8%**	**2.3%**
Spain & Portugal	4%	3.7%	3.2%	2.6%
Wholesale banking & AM	0.8%	0.7%	0.6%	0.2%
Mexico	4%	3.9%	3.6%	3.2%
USA	3.9%	4.5%	3.9%	3.4%
South America	2.8%	2.6%	2.3%	2.1%
Coverage ratio	**68.0%**	**68%**	**76%**	**92%**
Spain & Portugal	59%	55%	61%	67%
Wholesale banking & AM	118%	133%	170%	1002%
Mexico	135%	137%	150%	161%
USA	43%	49%	53%	57%
South America	127%	129%	139%	149%

Guidance

Attract new clients benefiting from the weaknesses of other Spanish banks
Recovery in 2010, with growth in mortgage loans
Cost synergies with absorption of Guaranty Bank

Spain default rate below 5% in 2009

Declining trend

Considered as comfortable
Any capital gains from disposals for generic provisions

EURm	Q309	Q209	Q109	2008
Total assets	**537,305**	**542,634**	**543,350**	**542,650**
Total loans	345,629	327,926	332,647	335,260
Total customer deposits	249,365	249,096	243,795	255,236
Tier 1 capital	**27,226**	**23,724**	**22,493**	**22,364**
Risk weighted assets	290,521	291,575	291,834	276,475
Net interest income	3,434	3,586	3,272	11,686
Commission and fees	1,086	1,102	1,079	4,527
Trading revenues	325	435	364	1,558
Other revenues & dividends	109	369	174	1,207
Net banking income	**4,954**	**5,492**	**4,889**	**18,978**
Total operating expenses	-2,017	-2,017	-2,070	-8,455
Provision for credit losses	-1,741	-1,077	-1,020	-4,371
Income before taxes	1,947	2,168	1,834	6,927
Net attributable profit	**1,380**	**1,561**	**1,238**	**5,414**
Core Tier 1 ratio	8.0%	6.9%	6.4%	6.2%
Tier 1 ratio	**9.4%**	**8.2%**	**7.7%**	**7.9%**
Net interest margin	2.54%	2.64%	2.41%	2.18%
Cost to income ratio	**40.7%**	**39%**	**42%**	**45%**
Coverage ratio	**68.0%**	**68%**	**76%**	**92%**
NPL ratio	**3.4%**	**3.2%**	**2.8%**	**2.3%**

Guidance

Organic growth rather than M&A
stable in Spain in the coming quarters

Growth of expenses in 2009e: 0%
Stabilisation of costs of risks in 2010

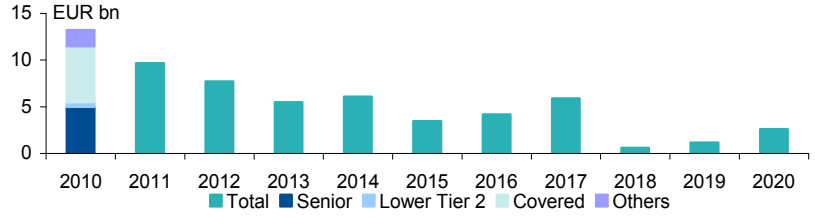
Prudent dividend payout policy: 30%
Sound Core Tier 1 ratio to be prepared to new standards

Capacity to preserve margins

Enough generic provisions until early 2011

Source: Company, Calyon
N/A: not available

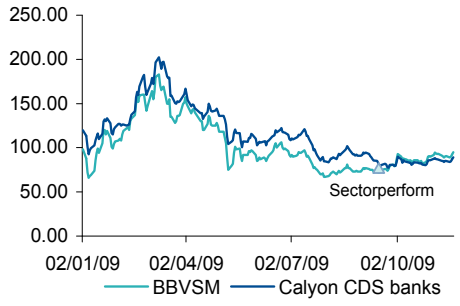
Debt redemption in 2010



Source: Bloomberg, Calyon

Others : Notes, non-rated Bonds, deposits, retail

CDS 5Y senior performance



Source: Bloomberg, Calyon

Key announcements

Aug-09: acquisition of the banking operations of Guaranty Bank
Sep-09: announcement of EUR2bn convertible bonds
Sep-09: sale and lease back of 948 branches to Deutsche Bank
Oct-09: announcement of exhange tender-offer on three perpetual securities

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BNP Paribas

Ratings

S&P/Moody's/Fitch
AA neg/Aa1 CW neg/AA neg

Calyon Rating
Low-AA

Background

BNPP is a major international French banking group with extensive business and geographical diversification, enhanced by the acquisition of a 75% stake in Fortis Bank, Belgium and Luxembourg. In France, BNPP ranks fourth in customer lending. The group has three major operating entities, namely Retail Banking (France, Italy, Fortis, international retail and financial services), Corporate and Investment Banking (mainly in Europe, includes financing, advisory and capital markets) and Private Banking and Asset Management, Securities Services and Insurance (partnership with Fortis). About 90% of credit exposure is concentrated in developed countries.

Operating performance trend

Reflecting its strong geographic and product diversification, BNPP posted **excellent 9M09 results** fuelled by revenues in CIB (50% of total pre-tax income) and FIM trading in particular (EUR6.4bn for 9M09 vs EUR1.7bn 9M08) where the bank is No.1 in EUR-denominated issues. In addition to the resilience of revenues in other segments such as French retail banking and Asset Management (9M09 net inflows: EUR15.6bn) as well as efforts made on controlling costs, the bank has a robust profit generation capacity. Cost of risk has flattened but remains very high: 141bp.

After such tremendous results, BNPP seems optimistic for 2010 and should be able to sustain a sound operating performance. Nevertheless, **next year may be challenging, with the integration of Fortis**. In the CIB businesses, the bank should post good results with only a small decrease due to stabilisation of markets in FIM but offset by good volumes and margins in financing businesses. This year might be a bit tough in France but as a recovery is expected in the US and emerging markets, resilience in revenues should be possible in 2010. Fortis integration costs (EUR0.8bn expected for 2010) are likely to increase charges but the bank should be able to keep expenses under control. BNPP expects a decrease in RWA of around EUR42bn, due to synergies following the full integration of Fortis. All in all, the bank is well prepared for 2010 with a **very good operating buffer**.

Key risk drivers

Deterioration in asset quality: Consumer lending should remain the main threat for 2010 as BNPP is highly exposed to this segment (20% of total lending, European leader), with a very high cost of risk (340bp for Q309) and a large presence in countries such as Spain and Italy. BNPP will also have to keep an eye on emerging markets (Ukraine, Mediterranean countries) and Bancwest, whose cost of risk has more than trebled in one year. Corporate lending (30% of lending portfolio) should also be scrutinised as firms are operating in a tough environment. Since Fortis' assets will be fully integrated in 2010, cost of risk might rise again.

Tier 1 ratio: BNPP has a sound Tier 1 ratio (optimisation of RWA combined with the capital increase) even if it is still one of the lowest in the market. Nevertheless, the hierarchy should be maintained among banks as BNPP's model of a universal bank and its strong operating buffer will allow it to maintain this level and therefore be able to face the stricter capital requirements and increase in market risk RWA.

BNPP's well diversified and integrated business model should enable it to deal with the new regulation framework. In 2010 BNPP will focus on integrating and developing its most recent acquisitions (Fortis and BNL) rather than M&A, which should lead to synergies, improving cost control and revenues. BNPP has revised its synergy targets following the integration of Fortis to EUR900m (vs EUR500m initially), EUR850m of which are cost synergies.

Relative value: All eyes on the Fortis integration

Its geographic and well diversified business model will help BNPP deliver a sustainable performance in 2010. The priority will be the Fortis integration. The bank remains one of our top picks. In terms of relative value, BNPP appears expensive and we have a **Sectorperform** recommendation.

Rating agencies' opinion

UP

S&P: Outlook back to stable unlikely until clear stabilisation of the economic environment and confirmation that the Fortis acquisition is positive for BNPP's earning capacity.

DOWN

S&P: Strong deterioration in the risk-adjusted earnings performance in 2009-10.

Moody's: CW negative reflecting concerns on the integration of Fortis Bank SA/NV leading to an increase in large corporate exposure as well as the long-term strategy on capital. The downgrade of senior debt will be limited to one notch.

Fitch: If BNPP increases risk appetite in CIB or if asset quality deteriorates and weakens the bank's capitalisation.

BNP Paribas

www.bnpparibas.com

Key shareholders

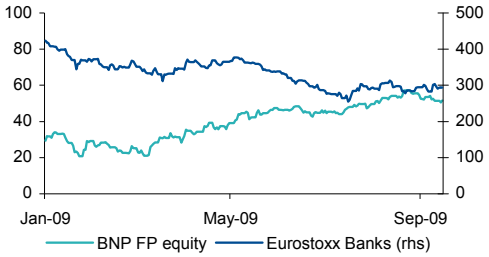
French State	14%	Axa	5%
Belgian State	11%		
Float	69%		

Equity & Bond metrics

Equity ticker	BNP FP	Bonds maturing in 2010 (sub and sen)	EUR 13,824m
Bond Ticker	BNP FP		
Number of shares (m)	1,184	Last rating action	22/10/2009
Market Cap.	EUR 66,596m		

Source: Bloomberg

Stock performance



EURm	Q309	Q209	Q109	2008
Net Banking Income	**10,663**	**9,993**	**9,477**	**27,376**
French retail banking	1,447	1,462	1,471	5,717
Other Retail (incl. BNL)	3,044	3,024	3,000	11,556
BNPP Fortis	2,233	1,441	0	0
Investment solutions	1,207	1,207	1,147	4,935
Corporate & investment bank	2,934	3,351	3,696	4,973
Cost of risk (bp)	**141**	**144**	**128**	**105**
French retail banking	43	51	35	20
BNL bc	113	97	74	73
Personal Finance	340	313	288	222
BancWest	353	286	277	167
Emerging market retail banking	342	293	243	157
CIB- Financing businesses	86	121	117	116
Income before taxes	**2,445**	**2,170**	**2,290**	**3,924**
French retail banking	326	380	440	1,647
Other Retail (incl. BNL)	135	201	302	2,341
Investment solutions	376	319	302	1,310
Corporate & investment bank	1,236	1,145	1,229	-1,189

Guidance

Total synergies expected: EUR 900m by 2012
Greater than 1pt jaws effect
BNL bc: positive jaws effect>5pts
Integration costs expected in 2010: EUR 0.8bn

Cost/income ratio: 60% medium-term target
Loan loss provisions / RWA

Positive 2pts jaws effect
Coverage ratio: 85%
60-70bp in 2009, the level of 2002

Excluding PEL/CEL effects

EURm	Q309	Q209	Q109	2008
Total assets	N/A	**2,289,322**	N/A	**2,075,551**
Total loans	N/A	704,751	N/A	494,401
Total customer deposits	N/A	606,318	N/A	413,955
Tier 1 capital	**62,500**	**60,300**	**44,500**	**41,800**
Risk weighted assets	619,000	651,000	504,000	528,000
Net interest income	N/A	N/A	N/A	13,498
Commission and fees	N/A	N/A	N/A	5,859
Trading revenues	N/A	N/A	N/A	3,157
Other revenues	N/A	N/A	N/A	4,862
Net banking income	**10,663**	**9,993**	**9,477**	**27,376**
Total operating expenses	-6,037	-5,818	-5,348	-18,400
Provision for credit losses	-2,300	-2,345	-1,826	-5,752
Income before taxes	2,445	2,170	2,290	3,924
Net attributable profit	**1,305**	**1,604**	**1,558**	**3,021**
Core Tier 1 ratio	7.9%	7.2%	6.8%	5.4%
Tier 1 ratio	**10.1%**	**9.3%**	**8.8%**	**7.8%**
Net interest margin		1.01%	N/A	0.82%
Cost to income ratio	**56.6%**	**58.2%**	**56.4%**	**67.2%**
Coverage ratio	**N/A**	**N/A**	**N/A**	**75.6%**
Gross doubtful loans / Gross loans	**N/A**	**N/A**	**N/A**	**3.7%**

Source: Company, Calyon
N/A: not available

Guidance

M&A not the priority
Lending growth in France : +4% in 09

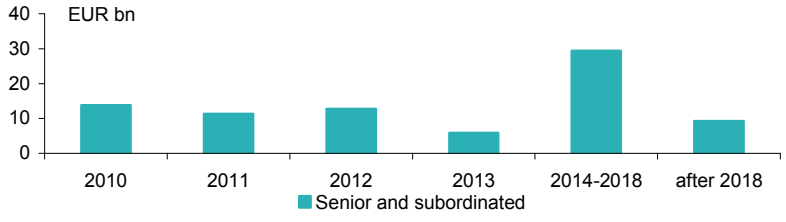
Maintaining a reponsible dividend strategy
Decrease of EUR 42bn expected by 2012
Confident on capital formation and earning in H209

Impact of toxic assets not subtantial in 2010e

Synergies expected: EUR 850m by 2012
Cost of risk: EUR7-8bn in FY09, peak in H209
Moderate decrease in LLP in 2010
Pay-out ratio: between 33% and 40%
ROE: 15% medium term
Tier 1 medium-term target: 7.5%

Negligible exposure to CIT

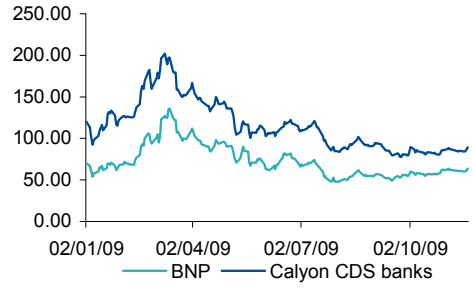
Debt redemption in 2010



Source: Bloomberg, Calyon

Covered bonds redemption in 2010: EUR 2bn

CDS 5Y senior performance



Source: Bloomberg, Calyon

Key announcements

May-09: acquisition of Fortis Bank and partnership in Insurance with Fortis
Aug-09: agreement with ISPIM on Findomestic
Sep-09: EUR4.3bn capital increase to pay back the French State

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Ratings

S&P/Moody's/Fitch
A neg/Aa3 neg/A+

Calyon Rating
Low-A

Rating agencies' opinion

UP

S&P: On the condition: (1) restructuring progress, (2) reduction in the downside risk to asset quality and earnings while the bank still benefits from state support.

DOWN

S&P: Senior rating downgrade if state support is insufficient.

Moody's: (1) Significant deterioration in asset quality leading to substantial additional risk charges, (2) an extended period of weak earnings, which may lead to substantially reduced internal capital generation, (3) a failure to quickly and substantially strengthen the efficiency of most of the combined group's business lines.

Fitch: The senior rating is at its support rating floor.

Commerzbank

Background

Second-largest bank in Germany, Commerzbank is the leading bank for private and corporate banking in Germany (No.1 in Mittelstand) with around 1,200 branches. Primarily focused on private customers and SMEs, its businesses also encompass corporate and investment banking, commercial real estate, public finance and treasury as well as CEE (BRE Bank in Poland). Following the acquisition of Dresdner, the bank has entered into a restructuring and de-leveraging phase, leading to a division of its activities into a core bank, an asset-backed lender (real estate, public finance and ship lending, 30% of total assets) and a restructuring division (4% of total assets). Eurohypo will be sold by 2014 in accordance with the restructuring plan approved by the European Commission.

Operating performance trend

A net loss of EUR2.7bn in 9M09, of which EUR1bn for Q3, was released by CMZB. In Q309, operating profit returned to the black, fuelled by a rebound in trading revenues rather than weak core revenues. Expecting another tough quarter, the bank expects a **loss for FY09** and thus is not allowed to service profit-related equity-like instruments (shares and hybrid debts).

Despite a less pessimistic economic outlook and an improvement in financial markets, Q409 will be a very difficult quarter, which will be affected by additional integration costs related to Dresdner (EUR300m in Q409). No further goodwill impairments (Eurohypo) are planned. The large gains in structured credit (divestments, write-ups) – one of the main drivers of trading revenues in Q309 – will not be repeated in Q4. While net interest revenues are likely to remain stable in Q4 (Mittelstand business), commission and trading are expected to decline. With the effect of integration on expenses, it will be hard to deliver positive operating income in Q4, which is crucial for absorbing loan loss provisions.

Key risk drivers

The deterioration in asset quality will remain Commerzbank's **Achilles' heel** in the coming quarters. The target for loan loss provisions for FY09 was revised in Q309 to EUR4.2bn from EUR3.6bn. In addition to its high sensitivity to the German economy (Mittelstand: EUR112bn), Commerzbank is facing strong exposure to: commercial real estate (EUR99bn), shipping (EUR27bn), public finance (EUR133bn), ABS portfolio (value of EUR24bn) and CEE (EUR25bn). However, Commerzbank will not have recourse to the German bad bank programme.

Tier 1 ratio: Although considered appropriate by management, in our view the 10.9% Tier 1 ratio does not offer a large enough buffer after taking into account the risk profile and limited capacity to absorb losses by operating income. After benefiting from a fall in RWA, this is likely to rise notably due to a rating migration impact (RWA: EUR300bn FY09). The implementation of Basel II is expected to lead to a doubling of RWA market risk, to EUR32bn (EUR15-20bn targeted in 2012).

Business model: The redeployment of the **business model** following the **Dresdner acquisition** is constrained primarily by the state and **European Commission** rather than the reappraisal of the financial pillars.

Relative value: A long way to the end of the line

The outlook remains rather poor in 2010, a year marked by the continuation of restructuring and the strategic re-alignment towards the Mittelstand. It will be challenging for Commerzbank to deliver a positive profit in 2010. Investing in the senior unsecured debt and to a lesser extent LT2 (potential non-exercise of the callable but coupons to be paid) is exposure to sovereign support. Enjoying a senior rating at the single-A floor and as such relatively cheap cost of funding despite its weak fundamentals, the bank has started to refinance around EUR10bn of its EUR20bn funding needs for 2010. On hybrid debts, prudence is in order given uncertainties related to the deferral of coupons (which issues and for how long?).

Commerzbank

www.commerzbank.com

Key shareholders

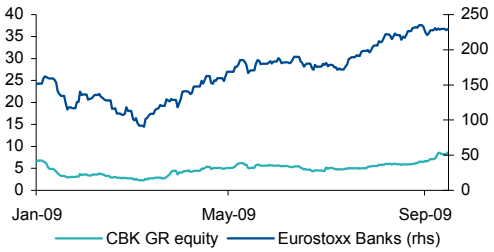
Rep. Of Germany	25%
Allianz	12%
Float	63%

Equity & Bond metrics

Equity ticker	CBK GR	Bonds maturing in 2010	EUR48,000m
Bond Ticker	CMZB		
Number of shares (m)	1,181	Last rating action	9/4/2009
Market Cap.	EUR 7,815m		

Source: Bloomberg

Stock performance



EURm	Q309	Q209	Q109	2008
Allocated equity	**34,539**	**26,738**	**23,608**	**15,074**
Private customers	*3,252*	*3,268*	*3,332*	*2,405*
Mittelstandsbank	*5,274*	*5,383*	*5,711*	*4,991*
Central and Eastern Europe	1,621	1,595	1,647	1,874
Corporate & Markets	4,409	4,814	5,066	6,206
Asset Based Finance (ABF)	6,572	6,852	7,420	7,008
Portfolio Restructuring Unit	1,786	1,934	2,070	1,999
Pre-tax profit	**-1,428**	**-509**	**-884**	**-5,511**
Private customers	-145	19	-8	850
Mittelstandsbank	13	116	301	1,171
Central and Eastern Europe	-36	-82	-59	321
Corporate & Markets	-196	-65	-19	-1,304
ABF	-768	-318	162	-873
Portfolio Restructuring Unit	498	-242	-1,419	-6,268
Exposure at default ABF (EUR bn)	**258**	**239**	**253**	**268**
Real estate**	99	82	84	86
Shipping	27	28	25	26
Public finance	133	129	144	156

** pro-forma Q209, Q109 and 2008* *** including Retail Eurohypo in Q3: EUR20bn*

Guidance

Rating migrations on Corporates early 2010e

Main concerns: Ukraine, CRE and SME in Germany
Focus on Germany-related client business

Potentially net profit in 2010e (previously 2011e)

Not promise a profit in 2010
LLP 2/3 of total charges for FY09

To be reduced to EUR100bn

EURm	Q309	Q209	Q109	2008
Total assets	**892,307**	**911,815**	**1,011,535**	**625,196**
Total loans	379,349	373,821	391,531	283,564
Total customer deposits	275,966	296,620	310,231	170,203
Tier 1 capital	**32,008**	**33,410**	**21,346**	**22,500**
Risk weighted assets	292,712	296,579	315,742	221,824
Net interest income	1,769	1,838	1,692	4,729
Commission and fees	953	947	850	2,846
Trading revenues	659	93	-523	-450
Other revenues	58	177	315	-692
Net banking income	**3,439**	**3,055**	**2,334**	**6,433**
Total operating expenses	-2,264	-2,263	-2,081	-4,956
Provision for credit losses	-1,053	-993	-844	-1,855
Income before taxes	-1,428	-487	-880	-403
Net attributable profit	**-1,053**	**-746**	**-861**	**3**
Core Tier 1 ratio	**9.6%**	**9.9%**	**5.3%**	**8.8%**
Tier 1 ratio	10.9%	11.30%	6.80%	10.10%
Net interest margin	0.78%	0.8%	0.7%	0.8%
Cost to income ratio	**65.8%**	**74.1%**	**89.2%**	**77.0%**
Coverage ratio	**39.3%**	**39.8%**	**39.4%**	**39.3%**
Gross doubtful loans / Gross loans	**5.5%**	**4.8%**	**4.37%**	**4.35%**

Source: Company, Calyon
N/A: not available

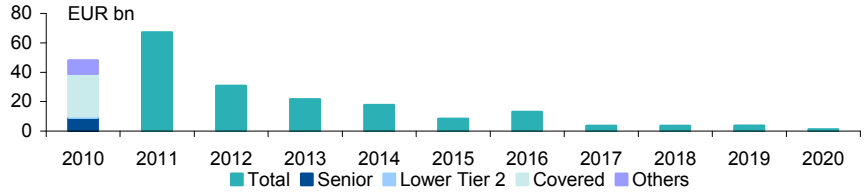
Guidance

EUR900bn by end-2012, EUR600bn w/o Eurohypo
RWA Market risk to double to EUR32bn
Funding plan < EUR20bn in 2010
Repayment of the Soffin silent pati. by 2011
RWA EUR300bn in FY09, EUR290bn by 2012
Synergies beginning in 2011

Not repeated in Q409

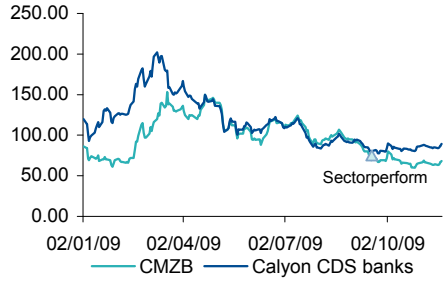
Restructuring charges: EUR300m in Q4
<EUR8bn operating expenses by end-2010
LLP of EUR4.2bn in 2009e, LLP to decline in 2010
Pre-tax profit of EUR4bn in 2012
Net loss and probably in 2010e, ROE of 12% by 2012
Potential capital increase not ruled out
Tier 1 target between 7-9%

Debt redemption in 2010



Source: Bloomberg, Calyon *Others : Notes, non-rated Bonds, deposits, retail*

CDS 5Y senior performance



Source: Bloomberg, Calyon

Key announcements

May-09: new strategic business plan 'Roadmap 2012'
May-09: Dresdner Bank merged into Commerzbank
May-09: Commerzbank finalised agreement with Soffin
May-09: capital injection under conditions approved by the European Commission

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Credit Suisse Group

Ratings

S&P/Moody's/Fitch
A/Aa2 neg/AA- neg

Calyon Rating
High-A

Background

The second-largest Swiss banking group after UBS, CSG is one of the world's largest private banks and held AuM of CHF1,175bn in H109. The bank is active in over 50 countries (Switzerland: 25%, EMEA: 28%, America: 39%, Asia Pacific: 11% of revenues at H109) and employed 41,200 staff at end-June 2009. Its priorities are to continue to invest in Private Banking, reduce risk and volatility in Investment Banking and increase collaboration between Private Banking & Asset Management.

Operating performance trend

CSG showed an excellent performance in 9M09, fuelled by fixed income trading revenues and benefits from the restructuring process. Gaining market share from weaker peers, Private Banking demonstrated good resilience with a slowdown in gross margin in Q3 (WM: 125bp) but not in net new money (CHF13.1bn). Toxic assets continued to fall with CMBS amounting to CHF3.6bn (vs CHF6.6bn in Q209).

Will this operating performance be sustainable in coming quarters? The main contributors to CIB revenues have been cash equity, rates, prime brokerage, leveraged finance and RMBS non-agency trading. CSG remains confident of maintaining a sound performance despite a normalisation of financial conditions taking more time than expected. CSG estimates that 27% of CIB revenues are at risk. Enjoying a competitive advantage with a comfortable capital buffer, CSG revenues should be driven by better momentum in FX, commodities, equity derivatives – although CSG does not enjoy leading positions – investment grade debt and prime services. Taking into account headway in derisking toxic assets (RWA: CHF18.4bn) and assets increasing by around CHF60bn under SFAS 167, CSG is prepared to take more risks in an evolving banking landscape.

Key theme

Deterioration in asset quality remains low, especially in Switzerland. Gross loans amounted to CHF243bn in 9M09 and can be split as follows: (1) CHF133bn in corporate, (2) CHF63bn in commercial and industrial loans, (3) CHF25bn real estate and (4) CHF110bn retail (CHF4bn in consumer finance). We forecast net non-performing loans to account for only 14.3% of equity in 2010e.

Capital ratios are at an excellent level, highlighting the fall in RWA – which should gradually accelerate in 2010 (+5.6% YoY forecast by Cheuvreux). With a normalisation of the payout ratio (30%), CSG's priority remains sound capital ratios with stricter minimum regulatory capital ratios expected in Switzerland (Tier 1 ratio to be 12% by 2013).

Private banking and asset management: Although it will take time, the stricter regulatory scheme will impact CSG's balance sheet leading the bank to maintain a conservative approach to capital ratios. Viewed as a key competitive advantage, CSG has stated it wants to be ready for opportunities to reinforce its franchise in private banking and asset management (some assets held by UK banks, ING?) – businesses that should benefit from the gradual recovery of the financial markets and customers' focus on savings.

Relative value: Ready for opportunities as banking outlook evolves

Despite less exceptional conditions, the trend in fixed income trading is likely to remain relatively good. In addition to restructuring benefits plus the capacity to boost its franchises through organic growth and potential acquisitions, CSG should be able to maintain a relatively good performance in H110 following its excellent 9M09 results. In Q409, CSG will benefit from a favourable comparable basis. Although it will be impacted by the new regulatory framework, 2010 will be 'only' a transitional year. With its comfortable buffer, CSG is still to be favoured given better earnings can be expected in CIB versus banks exposed to mature domestic retail markets. While CSG has performed better than Deutsche Bank, the gap is likely to be reduced given greater leeway for recovery at DB. CSG appears relatively expensive in both CDS and cash, leading us to favour any potential primary market activity.

Rating agencies' opinion

UP

S&P: Rather unlikely, but would be based on recovery to stronger profitability, with structurally lower risk-taking and strong capitalisation.

DOWN

S&P: If volatile trading results, or charges put pressure on capital or customer confidence.

Moody's: If the bank's risk reduction strategy is not successful.

Fitch: The global environment for banks is likely to remain difficult in 2010.

Credit Suisse Group

www.credit-suisse.com

Key shareholders

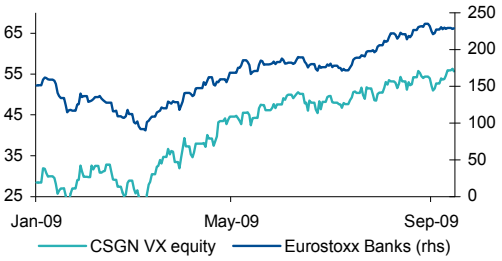
Qatar invt	8%
Crescent holding	3%
Float	89%

Equity & Bond metrics

Equity ticker	CSGN VX	Bonds maturing in 2010	CHF 12,000m
Bond Ticker	CS		
Number of shares (m)	1,185	Last rating action	28/7/2009
Market Cap.	CHF 64,108m		

Source: Bloomberg

Stock performance



CHFm	Q309	Q209	Q109	2008
Asset Under Management (bn)	**1,225**	**1,232**	**1,189**	**1,174**
Gross margin on WM (bp)	125	135	134	131
Total assets	**1,064,208**	**1,092,904**	**1,156,086**	**1,170,350**
Private banking	350,867	367,693	373,306	374,771
Investment banking	846,960	883,014	953,398	976,713
Asset Management	19,484	16,557	17,240	21,580
Net Banking Income	**8,917**	**8,610**	**9,557**	**11,862**
Wealth management	*2,429*	*2,501*	*2,369*	*10,697*
Corporate & institutional clients	*404*	*450*	*509*	*2,210*
Private banking	*2,833*	*2,951*	*2,878*	*12,907*
Investment banking	5,046	6,011	6,442	-1,835
Asset Management	765	434	6	496
Income before taxes	**2,620**	**1,564**	**3,054**	**-12,163**
Wealth management	*723*	*759*	*724*	*2,509*
Corporate & institutional clients	*144*	*176*	*268*	*1,341*
Private banking	*867*	*935*	*992*	*4,209*
Investment banking	1,746	1,655	2,414	-14,183
Asset Management	311	55	-490	-1,127

Guidance

Private banking gross margin in 125-135bp range

Net new asset growth > 6%
RWA targeted at USD135bn by end-2009

Pre-tax margin over market cycles >40%

(-) 5,300 headcount, 11% CSG headcount

CHFm	Q309	Q209	Q109	2008
Total assets	**1,064,208**	**1,092,904**	**1,156,086**	**1,170,350**
Total loans	242,186	243,191	237,510	235,797
Total customer deposits	286,073	295,349	286,703	296,986
Tier 1 capital	**36,457**	**36,389**	**36,744**	**34,208**
Risk weighted assets	221,983	234,884	260,831	257,467
Net interest income	1,688	1,187	1,998	8,409
Commission and fees	3,312	3,540	2,933	14,755
Trading revenues	6,489	3,214	4,899	-9,853
Other revenues	428	669	-273	-1,449
Net banking income	**8,917**	**8,610**	**9,557**	**11,862**
Total operating expenses	6,244	6,736	6,320	-23,212
Provision for credit losses	-53	-310	-183	-813
Income before taxes	2,620	1,564	3,054	-12,163
Net attributable profit	**2,354**	**1,571**	**2,006**	**-8,218**
Core Tier 1 ratio	11.3%	10.4%	9.1%	8.6%
Tier 1 ratio	**16.4%**	**15.5%**	**14.1%**	**13.3%**
Leverage ratio (FINMA)	4.1%	4%	3.80%	3.10%
Cost to income ratio	**70.0%**	**79.0%**	**78.0%**	**N/A**
Coverage ratio	**58.9%**	**62.7%**	**64.0%**	**61.1%**
Gross doubtful loans / Gross loans	**0.88%**	**0.98%**	**1.16%**	**1.08%**

Source: Company, Calyon
N/A: not available

Guidance

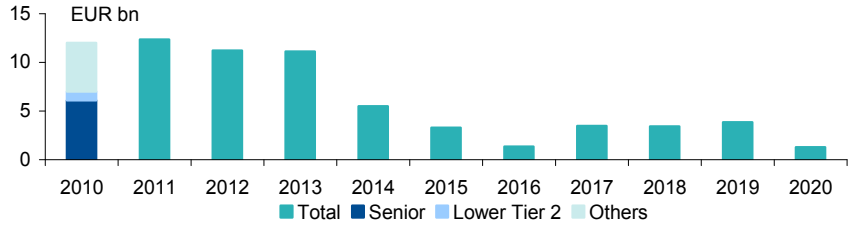
Liquid assets: CHF118bn accepted under central bank facilitie
More 'normalized' dividend in 2009
Small acquisitions are not excluded

Revenues from 'Integrated collaboration': CHF10bn by 2012
Cost reduction by CHF2bn, 9% of the 9M cost base

Target of a ROE > 18%

Tier 1 target ratio: 12.5%
Minimum leverage ratio FINMA of 3% by 2013
Target of cost/income ratio: 65%

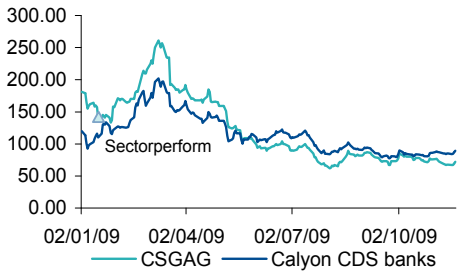
Debt redemption in 2010



Source: Bloomberg, Calyon

Others : Notes, non-rated Bonds, deposits, retail

CDS 5Y senior performance



Source: Bloomberg, Calyon

Key announcements

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Ratings

S&P/Moody's/Fitch
A+/Aa1 CW neg/AA- neg

Calyon Rating
High-A

Deutsche Bank

Background

Deutsche Bank is a major European bank and a leading global investment bank (corporate investment bank: 75% total RWA in H109). The German bank is active in 76 countries (credit exposure by geographical region at end-2008: 55% Western Europe (mostly Germany and UK), 34% North America, 2% Eastern Europe, 8% Asia/Pacific). DB is one of the world's largest asset managers with EUR854bn assets under management at end-September 2009. Its strategy focuses on enhancing retail and private banking (Postbank, parts of ABN Amro Netherlands business unit, Sal. Oppenheim) while streamlining its CIB business.

Operating performance trend

Deutsche Bank has made a strong recovery, fuelled by fixed income trading (EUR8.6bn, 40% of total revenues in 9M09). The equities business delivered a sound performance and asset management returned to profitability. After the jump in Q209, risk provisions – including EUR215m on re-classified assets – improved, leading to 46bp provisioning. One of the main concerns in June, the growth in non-performing loans (EUR8.7bn) declined.

In 9M09, the investment bank accounted for two-thirds of adjusted pre-tax profit. Will this performance be sustainable under 'normal' conditions in financial markets? Although the high margins and volumes recorded in H109 on fixed income are no longer achievable, a similar level to Q3 can be reiterated next quarter given strong appetite, weakness of some players, and higher fees than pre-crisis expected.

The bank could benefit from a recovery in FX (leader), emerging markets and the US. With better 'colour' in asset management plus recent acquisitions, the losses on toxic assets (around EUR26bn exposure, mostly commercial real estate and LBOs) should decline. Deutsche Bank is likely to deliver a decent operating performance, although at a slower pace than 9M09.

Key risk drivers

Non-performing loans will continue to be watched in coming quarters, after doubling in the past three quarters. On top of the exposure in leverage finance and commercial real estate, its substantial exposure to corporates (loans: EUR187bn end-2008) represents another threat. In 9M09, delinquency ratios continued to rise in small corporates, mortgages and consumers. Accounting for 70% of the PBC loan book, mortgage delinquencies are under control – a trend likely to continue.

Trading book: Due to its CIB exposure, the bank will be impacted by the new regulatory scheme. Deutsche Bank will be hit firstly on its **trading book** exposure with revised Basel II due to be implemented by 1 January 2011 (RWAs: EUR50bn market risk under Basel II). With rating migration and other changes on OTC derivatives, RWA are likely to rise in coming quarters after falling in 9M09. Maintaining a sound Tier 1 ratio, at least 10% targeted by end-2011, will remain the priority. Surprisingly, a Core Tier 1 ratio – at the 'magic' 8% level – is not so key. DB does not rule out a capital increase to finance acquisitions (private banking).

Re-alignment of business model: Efforts will continue to be made in de-risking (level 3 assets: EUR60bn) and re-aligning the business model towards a higher contribution to operating profit from retail & private banking. Further acquisitions are planned but will depend on opportunities that arise from the reshuffling of the banking system (disposals of assets by troubled banks required by EU).

Relative value: Re-alignment of business model through acquisitions

Although at a slower pace, operating performance is likely to remain sound, fuelled by CIB business. We welcome re-alignment efforts, but it will take time. While the bank will not be immune to the new regulatory scheme, no real impact is expected in H110. We still favour CIB banks over pure retail businesses but in the short term prefer CSG, waiting for a recovery in areas where DB enjoys competitive advantages (FX, US exposure) and a higher contribution from private banking.

Rating agencies' opinion

DOWN

S&P: Material additional charges from trading, credit or litigation risks affecting capital, or if a more persistent slowdown in operating revenues were to jeopardise medium-term earning potential.

Moody's: (1) Failure to develop and grow more stable business lines and activities, (2) increased appetite for market or credit risks in contravention of DB's announced risk reduction programme, (3) failure to provide greater transparency on risky exposures, (4) weaker levels of economic or regulatory capitalisation. The impact of the review on the ratings for senior and senior subordinated debt will not exceed 1 or 2 notches.

Fitch: Failure to maintain a reduced risk profile, to strengthen retail business, to contain risks in legacy portfolios, or to sustain core earnings and capital erosion.

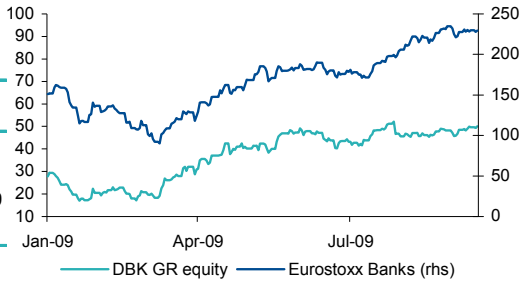
Deutsche Bank

www.db.com

Key shareholders

Allianz	7%
CSG	4%
Float	89%

Stock performance



Equity & Bond metrics

Equity ticker	DBK GR	Bonds maturing in 2010	EUR18,000m
Bond Ticker	DB		
Number of shares (m)	621	Last rating action	20/11/2009
Market Cap.	EUR 30,549m		

Source: Bloomberg

EURm	Q309	Q209	Q109	2008
Total risk weighted assets	**364,973**	**295,096**	**315,993**	**307,732**
Corporate Banking and Securities	202,316	209,762	232,940	234,344
Global transaction banking	14,679	15,119	15,606	15,400
Asset and Wealth management	12,810	13,742	15,184	16,051
Private & business clients	37,343	38,087	36,015	37,482
Corporate investments	3,246	16,067	14,222	2,677
Net Banking Income	**7,238**	**7,940**	**7,241**	**13,621**
Corporate Banking and Securities	4,440	4,646	4,258	436
Global transaction banking	658	653	666	2,774
Asset and Wealth management	772	618	515	3,264
Private & business clients	1,389	1,414	1,381	5,777
Corporate investments	242	660	153	1,290
Income before taxes	**1,315**	**1,316**	**1,815**	**-5,741**
Corporate Banking and Securities	988	828	1,323	-8,476
Global transaction banking	194	181	221	1,106
Asset and Wealth management	134	-85	-173	-525
Private & business clients	149	55	206	945
Corporate investments	117	377	65	1,194

Guidance

Focus on domestic retail and exit most riskiest units

Confident in maintaining CIB performance in Q4

Not out of the crisis

EURm	Q309	Q209	Q109	2008
Total assets	**1,659,557**	**1,732,873**	**2,103,425**	**2,202,423**
Total loans	260,155	264,485	273,263	269,281
Total customer deposits	364,973	368,532	395,670	395,553
Tier 1 capital	**37,537**	**32,509**	**32,316**	**31,094**
Risk weighted assets	287,504	295,096	315,993	307,732
Net interest income	3,133	2,764	3,843	12,453
Commission and fees	2,284	2,242	2,182	9,749
Trading revenues	1,763	2,620	1,760	-9,326
Other revenues	58	314	-544	745
Net banking income	**7,238**	**7,940**	**7,241**	**13,621**
Total operating expenses	-5,379	-5,624	-4,900	-18,286
Provision for credit losses	-544	-1,000	-526	-1,076
Income before taxes	1,315	1,316	1,815	-5,741
Net attributable profit	**1,393**	**1,092**	**1,185**	**-3,835**
Core Tier 1 ratio	8.1%	**7.8%**	**7.1%**	**7.0%**
Tier 1 ratio	11.7%	11.00%	10.20%	10.10%
Leverage ratio*	25	24	25	28
Cost to income ratio	**74.3%**	**70.8%**	**67.7%**	**134.2%**
Coverage ratio	**36.4%**	**38.0%**	**40.0%**	**42.5%**
Gross doubtful loans / Gross loans	**3.3%**	3.1%	2.1%	1.7%

Guidance

Dividend pay-out not a priority

Commitment to reduce the size of the B/S

No target, priority remains on Tier 1 ratios

Target ratio of 10%, no need for further capital

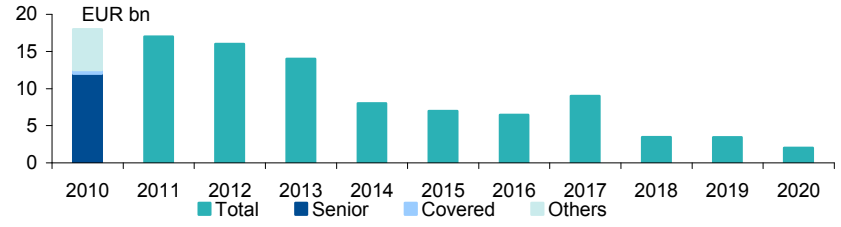
Target ratio for leverage ratio of 25

Source: Company, Calyon

N/A: not available

** total assets adjusted 'pro-forma US gaap / total equity adjusted to FV gains / losses on all own debt*

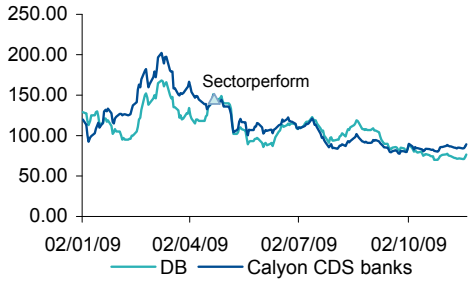
Debt redemption in 2010



Source: Bloomberg, Calyon

Others : Notes, non-rated Bonds, deposits, retail

CDS 5Y senior performance



Source: Bloomberg, Calyon

Key announcements

Feb-09: Postbank transaction has been closed
Oct-09: acquisitions of parts of ABN Amro business unit Netherlands
Oct-09: acquisitions of Sal. Oppenheim

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Ratings

S&P/Moody's/Fitch
AA- neg/Aa2/AA-

Calyon Rating
High-A

Rating agencies' opinion

UP

S&P: Outlook back to stable if ISPIM can weather the economic storm without materially hampering its financial profile.

Moody's: Senior upgrade correlated to BFSR upgrade if significant and sustainable improvement in financial fundamentals, particularly and efficiency measures.

Fitch: Strong record of high and stable profitability without increasing risk exposure and from stronger capitalisation.

DOWN

S&P: If asset quality and earnings deteriorate significantly during 2009.

Moody's: Rating downgrade due to a BFSR downgrade if failure to deliver the full benefits of integration, combined with protracted weak performance across several of the group's divisions, combined with deteriorating asset quality.

Fitch: Might occur if failure to maintain its target capitalisation or from material deterioration in asset quality.

Intesa Sanpaolo

Background

ISPIM is Italy's second-largest banking group with a national market share in customer loans and deposits of about 20%. The northern regions represent more than half of its branches. The bank enjoys leading market shares in retail, corporate banking, bancassurance and asset management (market share: around 20%, assets under management: EUR214bn at end-June 2009). Its international division – mainly in CEE where the bank owns one of the largest banks in Hungary, Croatia, Slovakia, Serbia and Albania – accounted for 10% of total net income in H109.

Operating performance trend

9M09 results demonstrated ISPIM's resilience, with 2009 set to outpace the 2008 net income (EUR2.8bn in 2008, EUR2.2bn in 9M09). Q409 will include the contribution of around EUR260m from the completion of the Findomestic sale. After the peak hit in Q209, the cost of risk is decreasing to account for 40% of gross operating income in Q309. This leads the bank to expect a cost of risk below 100bp for FY09, a level which will not be outpaced in 2010.

Maintaining a sustainable operating performance will be a competitive advantage. After the expected fall in Q209, rather flattish net interest revenue (two-thirds of NBI) is now forecast in Q4, with potentially better signs for H110 owing to (1) a reduced impact from the fall in euribor, (2) the full effect of the hedging policy, and (3) recovery in loan demand. Commissions on asset management are likely to improve. Further improvements in cost-efficiency via the optimisation and simplification of the whole group (synergy effects: already beaten the EUR1.2bn target, additional EUR180m by Q110) will help the bank to preserve its operating performance. In contrast to its largest peers, a headcount reduction programme is not planned.

The bank plans to keep a comfortable funding and liquidity positioning in 2010 based on: (1) large deposit base (70% from retail business), (2) already started its 2010 funding programme (EUR29bn planned, EUR32.5bn issued), (3) EUR72bn assets eligible for central banks, (4) EUR4.3bn net interbank position.

Key risk drivers

Asset quality: With its high sensitivity to the Italian economy, asset quality will continue to be hit, but at a slower pace than in 2009. NPL ratio was 8% for a 42.5% coverage ratio. In our view ISPIM has a more conservative approach than most of its peers with a larger operating buffer. Residential mortgages – less risky assets – account for 10% of its total lending portfolio. SMEs and small businesses represent 18% of the total lending portfolio, while exposure to consumer finance and commercial real estate reached 3% and 5% in Q309, respectively.

Core Tier 1: Ratio will not be below 7%. Proactive measures – disposals of non-core assets and a potential IPO – will help to increase the Core Tier 1 ratio by 100bp before April 2010. If required, further capital actions could be undertaken to shore up the capital base by a further 100bp. Market risk amounted to around EUR15bn, but a threefold increase is not expected following the implementation of the new regulation. The bank plans to pay dividends again from 2010.

The new regulation framework will not impact ISPIM as much, as it is a retail bank. A new business plan will be disclosed next year. After three years of mergers, focus will be on optimisation, leading to a potential rationalisation of the branch network. CEE exposure (7% of total lending) is considered core.

Relative value: Comfortable room to cope with credit deterioration

With solid core businesses, ISPIM benefits from comfortable room to cope with the challenging economic context. While we generally favour banks with investment banking businesses, ISPIM is among our favourite names. In terms of relative value, ISPIM appears rather expensive in both CDS and cash. As such, we would favour playing subordinated debt in secondary (hybrid debt until 2012), and wait for the primary market. ISPIM is likely to use covered bond issues for its refinancing needs.

Intesa Sanpaolo

www.group.intesasanpaolo.com

Key shareholders

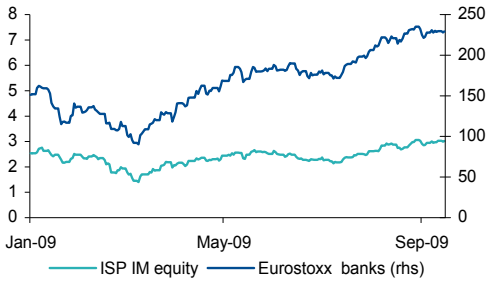
Compagnia di San P	8%
Credit Agricole	6%
Fond CR PR LOMBA	5%
Float	86%

Equity & Bond metrics

Equity ticker	ISP IM	Bonds maturing in 2010	EUR 38,917m
Bond Ticker	ISPIM		
Number of shares (m)	11,849	Last rating action	13/4/2007
Market Cap.	EUR 36,722m		

Source: Bloomberg

Stock performance



EURm	Q309	Q209	Q109	2008
Risk weighted assets EURbn	**367.4**	**369.7**	**378.7**	**383.1**
Banca Dei Territori	151.5	156.6	154.8	174.2
Corporate & Investment banking	138.4	129.1	134.6	118.0
Public finance	16.4	17.1	15.6	16.7
International subsidiary banks	32.2	32.5	32.5	32.8
Eurizon Capital & Banca Fideuram	5.7	5.9	6.0	5.5
Net banking income	**4,549**	**4,731**	**4,136**	**17,609**
Banca Dei Territori	2,516	2,748	2,584	12,536
Corporate & Investment banking	1,059	1,064	838	2,209
Public finance	93	126	115	348
International subsidiary banks	553	549	541	2,285
Eurizon Capital & Banca Fideuram	208	204	221	988
Net income	**674**	**513**	**1,075**	**2,553**
Banca Dei Territori	259	380	399	1,682
Corporate & Investment banking	445	362	289	320
Public finance	44	13	54	55
International subsidiary banks	92	81	81	186
Eurizon Capital & Banca Fideuram	113	32	45	-918

Guidance

RWA cut by EUR15bn between 2009/11
After three years of merger, optimisation and simplification of the group

Loan demand to come back in H110

Additional cost synergies: EUR180m by Q110

Low cost of risks being sustainable

EURm	Q309	Q209	Q109	2008
Total assets	**631,608**	**638,442**	**639,304**	**636,133**
Total loans	377,896	386,324	387,486	395,189
Net interest income	2,605	2,779	2,687	12,454
Commission and fees	1,363	1,340	1,255	5,491
Trading revenues	447	439	107	-1,420
Other revenues	134	173	87	1,084
Net banking income	**4,549**	**4,731**	**4,136**	**17,609**
Total operating expenses	-2,327	-2,341	-2,314	-12,231
Provision for credit losses	-885	-1,216	-809	-3,635
Income before taxes	1,350	1,189	1,013	3,589
Net income	**674**	**513**	**1,075**	**2,553**
Core Tier 1 ratio	7.20%	6.90%	6.40%	6.3%
Tier 1 ratio	**8.00%**	**7.70%**	**7.2%**	**7.1%**
Net interest margin	1.64%	1.74%	**1.7%**	**1.8%**
Cost to income ratio	**51.2%**	**49.5%**	**55.9%**	**69.5%**
Coverage ratio	42.5%	43.1%	48.5%	49.0%
Gross impaired loans / Gross loans	8.0%	7.3%	6.0%	5.5%

Source: Company, Calyon
N/A: not available

Guidance

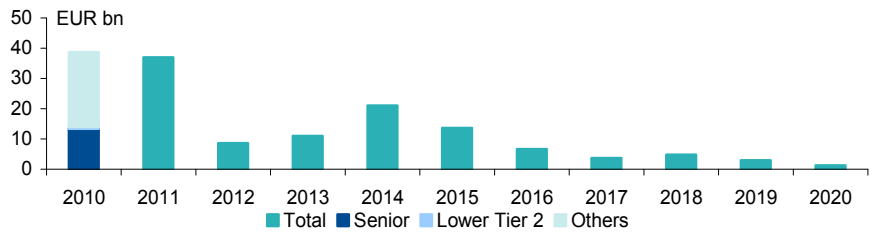
Announcement before year-end to disposals / possible listings of non-core assets
Impact of net interest spread compression to stabilise

Level to be rather sustainable

Staff cut plan: - 2,000 people in 2009
2009-2011 costs below 2008 level
LLP: peak hit in Q209, cost of risk < 100bp FY09
Q409: EUR260m capital gains on Findomestic sale
Net profit ≥ 2008
Core Tier 1 ratio target > 7%
Tier 1 ratio target > 8%

Cost to income ratio < 50%

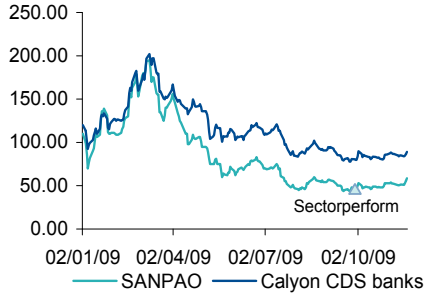
Debt redemption in 2010



Source: Bloomberg, Calyon

Others : Notes, non-rated Bonds, deposits, retail

CDS 5Y senior performance



Source: Bloomberg, Calyon

Key announcements

Jul-09: programme of covered bonds backed by loans to public sector
Aug-09: agreement with BNPP on Findomestic
Sep-09: launched EUR1.5bn LTII bullet

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Montepaschi

Ratings

S&P/Moody's/Fitch
A-/A1/A

Calyon Rating
Low-A

Background

MPS is the third-largest bank in Italy with a market share of around 10% in terms of assets. The acquisition of Antonveneta boosted its franchise in north-eastern Italy (42% of branches in Northern Italy). The retail banking network is now nationwide, with a leading position in the region of Tuscany (44% of total lending from central Italy). 98% of its loan portfolio is domestic. Its businesses encompass commercial banking, private banking and wealth management, and corporate banking. Held 45% by the Fondazione MPS, the bank is focused on streamlining its network and exploiting the full cost and revenue synergies from the integration of Antonveneta.

Operating performance trend

The Italian bank showed good resilience in Q309, fuelled by commercial dynamism. In contrast to other large Italian names, NIR remains stable, thanks to both volume effects and asset repricing. A fall of 8% in operating expenses has helped to deliver resilience in gross operating income. Asset quality has deteriorated at a slower pace following the peak in Q209. Interbanking positions have been reduced.

Despite a better-than-expected Q309, all the previous guidance for FY09 has been reiterated – 5% decrease in NIR, 4-5% cost-cutting and 105-110bp cost of risk (95bp in 9M09). Does this confirmation highlight management's prudence or a deceleration in Q409? While the bank will continue to feel benefits from the optimisation of its network and further progress in the Antonveneta realignment, rising unemployment will have an impact. Revenue, particularly NIR (interest rate sensitivity, less leeway on asset repricing), will remain under pressure. Cost control will remain the priority (negative growth in 2010). The bank may face a tough H110, notably on asset quality, before starting to benefit from a potential recovery in H210.

Key risk drivers

Deterioration in asset quality remains the Achilles' heel for Montepaschi – despite an improvement on Q209 – which faces a substantial amount of doubtful loans. Coverage ratio is just below 50%. Despite efforts to diversify its geographic network throughout Italy in the northern region, MPS still has material exposure to the south and islands (one-third of doubtful flows, 20% of total loans). While the mortgage portfolio is likely to remain under control, small business (26% of doubtful flows, 15% of total loans) and SME exposure (corporate: 58% of doubtful flows, one-third of loan portfolio) will continue to hit the bank. Consumer goods represent around one-third of the total diversified loan book.

Capital ratios are weak, a position which differs from other large European banks. The Tier 1 ratio will be at least 7% after including the EUR1.9bn T-bonds (to be completed in Q409), the completion of expected disposals (branches, real estate) and around a 15-20% dividend payout ratio. Positively, the bank will become eligible for the covered bond programme. The capital base, however, remain just-adequate given its risk profile and new market standards. Given all these elements plus the redemption of T-bonds before 2015, a capital increase is not ruled out.

The business model is not likely to dramatically change due to the new regulatory framework since it is a retail bank,. Further pressure may be put on capital as well as asset quality (counter-cyclical treatment).

Relative value: Substantial doubtful loans and weak capital

Despite network optimisation and the Antonveneta integration in line with the 2008-11 business plan, credit metrics are penalised by substantial doubtful loans, only adequate coverage ratio and capital base. While the CDS appears expensive, we would favour cash (senior and dated subordinated), firstly in the primary market. The bank is likely to launch covered bonds, potentially up to EUR2bn, before year-end, assuming a total EUR3-4bn primary issuance in 2010 (after including EUR3.5bn and EUR3.3bn bond maturities in 2011 and 2012). Considering its shareholding structure, its domestic market share and improvements to capital, we view Low-A as a rating floor. Positive rating actions are not expected in H110.

Rating agencies' opinion

UP

S&P: Positive rating actions currently unlikely and would be dependent on fundamentally stronger risk-adjusted profitability and capitalisation metrics.

DOWN

S&P: Worsening economic conditions that have negative implications for MPS credit metrics. The impact of the ratings, however, will be mitigated by potential further extraordinary government support.

Moody's: BFSR downgrade due to lack of improvement in efficiency (three-year average below 65%), profitability and Tier 1 (above 6.5%), coupled with a difficult integration of Antonveneta. A senior downgrade to A2 is unlikely.

Fitch: Failure to reach its target capitalisation at end-2009 or faster-than-expected asset quality deterioration.

Montepaschi

www.mps.it

Key shareholders

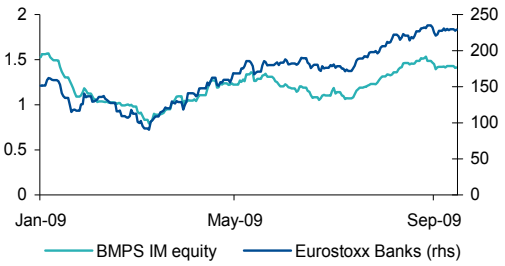
Fondazione MPS	45%
JP Morgan	3%
Float	52%

Equity & Bond metrics

Equity ticker	BMPS IM	Bonds maturing in 2010	EUR 7,283m
Bond Ticker	MONTE		
Number of shares (m)	5,569	Last rating action	1/10/2009
Market Cap.	EUR 8,602m		

Source: Bloomberg

Stock performance



EURm	9M09	H109	Q109	2008
Revenues	**4,341**	**2,933**	**1,483**	**5,953**
Retail and Private banking	2,436	1,670	853	3,882
Corporate banking	1,475	1,006	497	1,782
Corporate Center	430	258	134	288
Non-performing loans (gross)	**15,051**	**14,628**	**13,072**	**N/A**
Non performing loans - sofferenze	10,078	9,395	9,017	8,372
Watchlist	4,271	4,530	3,414	3,289
Restructured	702	703	641	N/A
Risk exposure				
South and Sicilia	17%	17%	17%	16%
Tuscany and Umbria	19%	19%	20%	18%
Center and Sardinia	21%	20%	19%	22%
North	39%	39%	40%	39%
Foreign	5%	5%	5%	5%
Provisions / commercial loans (bp)	**95**	**95**	**79**	**73**
Retail	71	81	N/A	N/A
small business	145	165	N/A	N/A
Corporate	135	135	N/A	N/A

Guidance

EURm	Q309	Q209	Q109	2008
Total assets	**219,061**	**212,062**	**207,621**	**213,796**
Total loans	146,208	145,111	144,708	145,353
Total customer deposits	N/A	81,803	N/A	81,596
Net interest income	913	988	1,013	4,269
Commission and fees	476	391	395	1,787
Trading revenues	8	26	54	-118
Other revenues	19.6	45	21	14.9
Net banking income	**1,407**	**1,450**	**1,483**	**5,953**
Total operating expenses	-884	-861	-890	-3,932
Cost of risks	-360	-429	-315	-1,247
Income before taxes	179	127	276	114
Net attributable profit	**69**	**32**	**301**	**953**
Core Tier 1 ratio	N/A	N/A	N/A	4.2%
Tier 1 ratio	**6.0%**	**5.8%**	**5.6%**	**5.1%**
Net interest margin	1.69%	1.88%	1.92%	2.01%
Cost to income ratio	**62.8%**	**59.4%**	**60.0%**	**66.0%**
Coverage ratio	**43.2%**	**41.8%**	**47.1%**	**56.8%**
Gross impaired loans / Gross loans	**9.9%**	**9.7%**	**8.3%**	**7.7%**

Source: Company, Bankscope, Calyon *N/A: not available*

Guidance

NII guidance better than -5% FY09

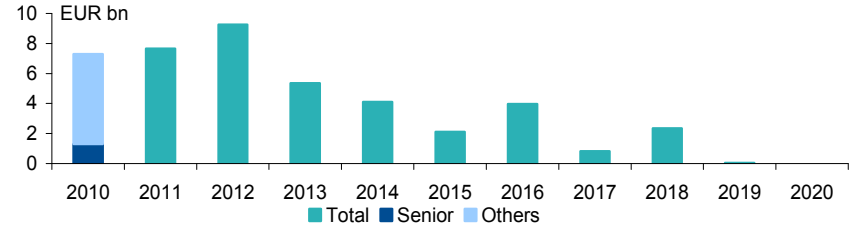
Cost cutting to 4/5% in 2009e
LLP target 105-110bp

Net profit target: EUR2.2bn by 2011

2009 target Tier 1: 7.1%, Tier 1>7% by 2011

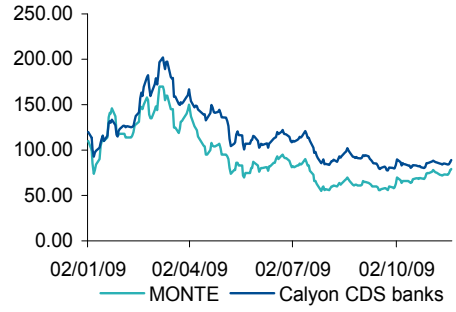
Cost to income: 47% by 2011

Debt redemption in 2009



Source: Bloomberg, Calyon *Others : Notes, non-rated Bonds, deposits, retail*

CDS 5Y senior performance



Source: Bloomberg, Calyon

Key announcements

Q409: EUR1.9bn T-bonds

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Ratings

S&P/Moody's/Fitch
AA neg/Aa2 neg/AA

Calyon Rating
Low-AA

Santander

Background

Santander is one of the largest European banks and enjoys c.13% market share in terms of deposits in Spain. The Abbey National franchise has been boosted by the acquisition of Alliance & Leicester as well as the purchase of the retail deposits and branch network of Bradford & Bingley. As a result of its active acquisitions strategy, Santander enjoys strong retail franchises outside Spain, especially in the UK, Brazil, Mexico and Chile. Its businesses encompass retail and corporate banking, insurance and asset management.

Operating performance trend

Santander delivered sound 9M09 results, reflecting geographic diversification combined with cost efficiency. The bank reiterated that it would match last year's profit in 2009. Although more optimistic, Santander appears quite cautious in 2010.

The main threat is Spain (46% of total RWA), which faces slow lending volumes and pressure on margins. While the bad loans ratio in Spain should be 3.3% in FY09, the peak is not expected to be hit before H110. Thus, the strengthening of allowances (generic provisions: EUR7.5bn proforma) – through capital gains on disposals – will be maintained as a priority. The decline in NIR should be offset by an improvement in fees leading to stable net banking income in Spain. Santander appears less confident than BBVA in the domestic markets.

Net profit will be fuelled by a sustainable performance in Latam (Latam + Brazil: 80% of pre-tax profit), which should enjoy a better economic environment (Mexico). While the bank will see fruit from synergy effects and deceleration in cost of risk and non-performing loans, the comparison basis is likely to be less favourable than for BBVA, affected in 2009 by the tough recession in Mexico. In the UK, as well as no surge in the cost of risk, Santander will continue to attract new customers and improve its margins, benefiting from the weaknesses of the large UK banks.

Key risk drivers

Asset quality will continue to deteriorate, but at a slower pace particularly in Latam. With a weak recovery, rising unemployment plus Spanish customers' focus on saving, no trend reversal is forecast in the domestic market. Consumer lending (NPL ratios: 5.46% in 9M09), credit cards as well as Spanish properties (stock: around EUR4bn) are the main concerns. However, Santander has the capacity to continue outperforming its peers in all geographic areas.

Santander enjoys solid capital ratios, with Core Tier 1 ratio at 8.4% (pro-forma). This comfortable buffer highlights the proactive strategy pursued in 2009 (capital gains: EUR2.25bn). No further IPO nor major M&A is planned. A conservative approach together with the generation of organic earnings (10-15bp per quarter) will help to preserve sound core capital ratios.

Santander does not expect a material impact from the new regulatory framework, whose effects are expected to be felt in 2011, due to its retail profile,. As a consequence, Santander will keep the same strategy in 2010 – based on organic growth and integration of its previous acquisitions – and business model.

Relative value: Tough 2010 in Spain offset by Latam

Santander will be one of the main winners in 2009. Its geographic diversification and proactive strategy will continue to help the bank to withstand the challenging economic environment. However, it could be difficult to maintain this operating momentum, correlated to the turnaround in Latam as well as no surge in cost of risk in the UK. Asset quality will be under scrutiny, especially consumer lending and Spanish properties. BBVA is likely to benefit from a more favourable comparison basis in 2010. With a 50% dividend payout in 2009, confidence remains on the payment on coupons for hybrid debts. Expecting limited primary issuance in 2010 (around EUR5bn?), the secondary market will therefore be looked at, notably senior subordinated debts (versus senior issues).

Rating agencies' opinion

UP

S&P: Outlook back to stable if Santander is able to maintain its resilient asset quality and strong earnings.

DOWN

S&P: Deteriorating credit conditions in its main markets that will result in a significant impact on the bank's financial performance.

Moody's: (1) Inadequate risk absorption capacity, (2) lower degree of recurrent earnings.

Fitch: Should asset quality deteriorate more sharply and should profitability be affected by this and lower volumes.

Santander

www.santander.com

Key shareholders

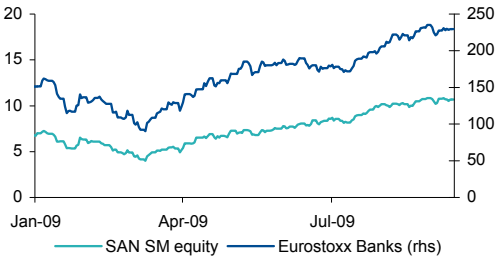
State Street	4%
Barclays Global	3%
Float	93%

Equity & Bond metrics

Equity ticker	SAN SM	Bonds maturing in 2010	EUR 29,783m
Bond Ticker	SANTAN		
Number of shares (m)	8,229	Last rating action	30/07/2009
Market Cap.	EUR 94,055m		

Source: Bloomberg

Stock performance



EURm	Q309	Q209	Q109	2008
Total Risk weighted assets	**549,647**	**559,421**	**546,088**	**514,013**
Continental Europe	252,500	254,915	257,416	261,325
United Kingdom	81,501	86,654	82,668	86,168
Latin America	131,701	143,817	139,260	129,629
Brazil	*78,694*	*79,226*	*73,736*	*70,033*
Net Banking Income	**10,004**	**10,147**	**9,219**	**33,488**
Continental Europe	*4,071*	*4,240*	*4,071*	*14,560*
United Kingdom	*1,408*	*1,004*	*908*	*2,412*
Latin America	4,599	4,309	4,083	16,171
Pre-tax profit	**2,883**	**3,171**	**2,742**	**11,422**
Continental Europe	*1,840*	*1,873*	*1,805*	*6,484*
United Kingdom	*594*	*647*	*548*	*1,673*
Latin America	1,403	1,264	1,238	4,708
Brazil	*863*	*694*	*701*	*2,625*
NPL ratios	**3.03%**	**2.80%**	**2.50%**	**2.00%**
Continental Europe	*3.41%*	*3.10%*	*2.73%*	*2.31%*
United Kingdom	*1.65%*	*1.54%*	*1.25%*	*1.04%*
Latin America	4.20%	3.97%	3.27%	2.95%

Guidance

Gaining market shares
Total asset in Spain: flat versus 2009
RWA of GBP70bn in FY09
Recovery in Latam in Spain
15-20% growth in assets in 2010

The main threat in 2010
Alco hedge & fast repricing of mortgage book

On track to deliver double digit growth in UK

Peak in H110 in Spain
3.5% for Spain & consumer finance <6% for FY09
2% for UK for FY09

EURm	Q309	Q209	Q109	2008
Total assets	**1,082,370**	**1,148,460**	**1,115,365**	**1,049,632**
Total loans	670,059	694,068	685,497	626,888
Total customer deposits	471,263	483,774	477,015	420,229
Tier 1 capital	**50,568**	**52,586**	**48,602**	**46,775**
Risk weighted assets	549,647	559,421	546,088	514,013
Net interest income	6,822	6,617	6,039	20,945
Commission and fees	2,291	2,374	2,164	9,020
Trading revenues	777	977	862	2,596
Other revenues	114	179	154	927
Net banking income	**10,004**	**10,147**	**9,219**	**33,488**
Total operating expenses	-4,086	-4,087	-3,967	-14,949
Provision for credit losses	-2,616	-2,658	-2,234	-6,693
Income before taxes	2,883	3,171	2,742	11,422
Net attributable profit	**2,221**	**2,423**	**2,096**	**8,876**
Core Tier 1 ratio	7.7%	7.5%	7.3%	7.5%
Tier 1 ratio	**9.2%**	**9.4%**	**8.9%**	**9.1%**
Net interest margin	2.45%	2.34%	2.17%	2.00%
Cost to income ratio	**40.8%**	**41.6%**	**43.2%**	**44.6%**
Coverage ratio	**73.3%**	**72.3%**	**80.0%**	**90.6%**
NPL ratios	**3.0%**	**2.8%**	**2.5%**	**2.0%**

Source: Company, Calyon
N/A: not available

Guidance

Any material increase is expected

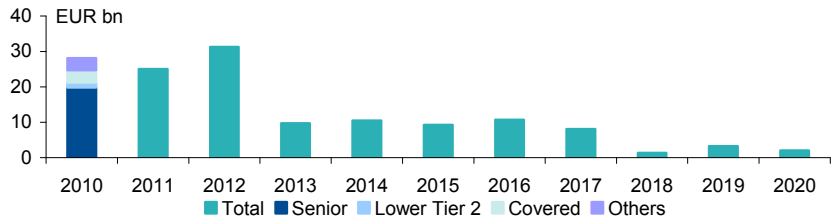
Dividend to be at least in line with 2008
Any plans for major M&A are ruled out
Reduction in 2010 is expected
Should improve in 2010

Synergies > EUR2bn of extra profits in 2008-11e

Full-year net profit target of EUR10bn
Core Tier 1 ratio targeted to reach 8.5% in 2010
Generate 15/20bp of capital each quarter
Be under pressure in 2010

Generic provisions≥ EUR6.3bn in 09e
Release of generic provisions to last till 2011

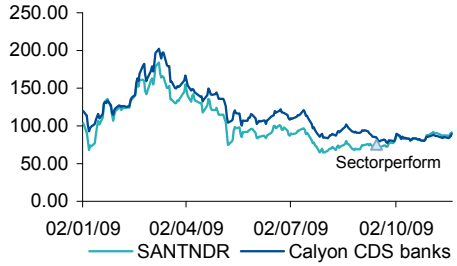
Debt redemption in 2010



Source: Bloomberg, Calyon

Others : Notes, non-rated Bonds, deposits, retail

CDS 5Y senior performance



Source: Bloomberg, Calyon

Key announcements

May-09: sale of Banco de Venezuela
Jul-09: announcement of exchange offers on come Tier 1 and UT2 bonds
Aug-09: announcement of EUR16.5bn buy-back own securitisation bonds
Sep-09: announcement of the IPO Brasil unit

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Ratings

S&P/Moody's/Fitch
A+/Aa2 neg/A+

Calyon Rating
High-A

Société Générale

Background

Soc Gen is the third-largest bank in France by total assets. Its activities encompass a domestic & foreign retail network, specialised services, CIB, private banking and asset management. The merger of asset management with CAAM will create the fourth-largest asset manager in Europe. Through organic growth and selective acquisitions, Soc Gen has diversified abroad (30% of total assets in 2008), notably in the Mediterranean and CEE (10% of the group's commitments in June 2009). Soc Gen owns the Czech Republic's third-largest retail bank, Komercni Banka.

Operating performance trend

Soc Gen continued to be hit in 9M09, due to EUR4.4bn "de-risking" operation charges. The net attributable income stood at only EUR457m in 9M09, after benefiting from favourable taxes. Excluding non-recurring items, revenues would have been EUR7bn in Q309 (+11% YoY), fuelled by trading revenues (35% of total NBI) with strong performance in fixed income and equities businesses (strong recovery in Q2 and Q309). The French retail network improved this quarter with a better interest margin (+6.9% vs Q308 excluding PEL/CEL). Guidance for 2% growth in interest income for FY09 has been affirmed. Notably highlighting the de-risking process, emerging businesses faced a slowdown in revenues. In contrast to the trend recorded by BNPP, a EUR3.8bn net outflow has been released in asset management. However, operating income succeeded in absorbing the surge in cost of risk (150bp, 117bp excluding CDO for US RMBS reclassified assets).

Coming quarters are likely to continue to be tough with reclassified assets (Soc Gen: EUR28.6bn, BNPP: EUR11bn) weighing on the cost of risk. After reaching a peak, cost of risk will nevertheless remain high. Cost control will remain a priority while revenues are likely to be driven by CIB, at least in H110. The bank could benefit from commodities business, recovery in structured credit and better performance in equities derivatives as well as fixed income business. Domestic retail should remain flattish while CEE and financial services are likely to face a challenging H110, before a potential recovery (Russia).

Key risk drivers

Deterioration in asset quality is likely to continue to hurt Soc Gen in coming quarters although at a slower pace. Despite de-risking efforts, assets at risk amounted to EUR30bn at end-September 2009. While domestic mortgage exposure should remain manageable, exposure to consumer lending (EUR22bn loans, EUR19bn in equipment finance, Germany and Italy: one-third of NBI) – notably in CEE (Russia, Poland, Romania, Bulgaria) – will continue to be closely monitored. CEE will remain a concern – with around EUR43bn total outstanding – Komercni Banka to a lesser extent (EUR15bn loans). Diversified corporate exposure (EAD exposure: around EUR300bn) could be affected by rating migrations.

Including the **capital increase** (EUR4.8bn, 2 November 2009), the pro-forma Core Tier 1 ratio should be 8.6%, offering a more comfortable buffer for organic business and potential targeted acquisitions. Reducing RWA will now be more limited, while market risk (EUR10bn at end-Sept) is expected to treble from the end of 2010.

Rating agencies' opinion

DOWN

S&P: Further material deterioration in earnings.

Moody's: A BFSR downgrade – due to material reduction of SG's operating efficiency, persistent volatility of its profitability and strong asset quality deterioration; will lead to a downgrade of senior rating.

Fitch: Already at its support rating floor.

Business profile: Hit by the crisis, Soc Gen has undertaken a realignment of its businesses reducing some of the riskiest businesses. While its universal banking business model will help to limit the impact of the new regulatory scheme, the bank will still be impacted (market risk). Considering the domestic retail business mature, the bank is likely to consider targeted acquisitions in CEE, notably Poland.

Relative value: Not as bad as 2009, but no light at the end of the tunnel

Despite an improvement, the impact of the crisis will continue to hit results (H110). This explains a CDS larger than the senior bank index. Senior unsecured debt is already at a rating floor. Given the level of secondary cash issues, we favour the primary market, with a funding programme of at least EUR20bn in 2010 (EUR33bn YTD). Following the capital increase, hybrid debts could be launched before stricter rules come into force. We have a **Sectorperform** recommendation on 5Y CDS.

Société Générale

www.societegenerale.com

Key shareholders

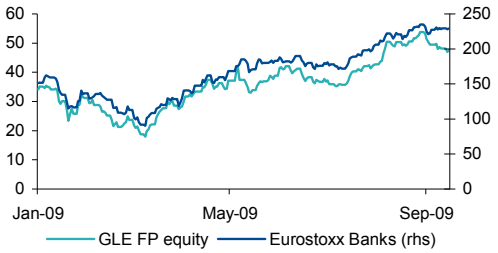
Socgen	12%
Groupama	4%
Float	85%

Equity & Bond metrics

Equity ticker	GLE FP	Bonds maturing in 2010	EUR 15,250m
Bond Ticker	SOCGEN		
Number of shares (m)	740	Last rating action	11/5/2009
Market Cap.	EUR 35,085m		

Source: Bloomberg

Stock performance



EURm	Q309	Q209	Q109	2008
Risk weighted assets (bn)	**324**	**340**	**344**	**343**
French networks	81	79	79	79
International retail banking	69	70	70	70
Financial services	39	38	38	38
Global investment mgnt and services	20	21	22	23
Corporate & investment banking	107	122	128	124
Cost of risk (bp)	**117**	**112**	**120**	**97**
French networks	66	65	68	56
International retail banking	200	185	173	122
Financial services	278	242	197	160
Global investment mgnt and services	N/A	N/A	N/A	N/A
Corporate & investment banking	78	93	139	116
Net income	**426**	**309**	**-278**	**2,010**
French networks	287	280	216	1,251
International retail banking	108	122	118	618
Financial services	9	17	31	459
Global investment mgnt and services	68	80	18	110
Corporate & investment banking	133	-12	-414	-214

Guidance

The CEO sees opportunity to buy assets
NBI: 2% growth for FY09 (w/o effects PEL/CEL)
Potential acquisitions in Poland

LLP/RWA

Slow growth in domestic retail
Cost of risk in mid-cycle: range of 30-40bp
Cost of risk of mid-cycle: range of 60-80bp

Target acquisitions in private banking
ROE target: 15% by 2012

EURm	Q309	Q209	Q109	2008
Total assets	**N/A**	**1,058,859**	**N/A**	**1,130,003**
Total loans	N/A	346,499	N/A	354,613
Total customer deposits	N/A	291,480	N/A	282,514
Tier 1 capital	**33,700**	**32,000**	**29,858**	**30,300**
Risk weighted assets	323,500	335,700	343,200	402,400
Net interest income	N/A	N/A	N/A	7,948
Commission and fees	N/A	N/A	N/A	7,415
Trading revenues	N/A	N/A	N/A	4,770
Other revenues	N/A	N/A	N/A	1,733
Net banking income	**5,970**	**5,716**	**4,913**	**21,866**
Total operating expenses	-3,898	-4,107	-3,777	-15,528
Provision for credit losses	-1,513	-1,075	-1,354	-2,655
Income before taxes & minority interests	571	537	-111	4,008
Net attributable profit	**426**	**309**	**-278**	**2,010**
Core Tier 1 ratio	7.9%	7.3%	6.5%	6.7%
Tier 1 ratio	**10.4%**	**9.5%**	**8.7%**	**8.8%**
Net interest margin	N/A	1.24%	N/A	0.70%
Cost to income ratio	**65.3%**	**71.9%**	**76.9%**	**71.0%**
Coverage ratio	**52.0%**	**53.0%**	**54.0%**	**56.0%**
Doubtful loans/customer loans	**4.7%**	**4.2%**	**3.8%**	**3.5%**

Guidance

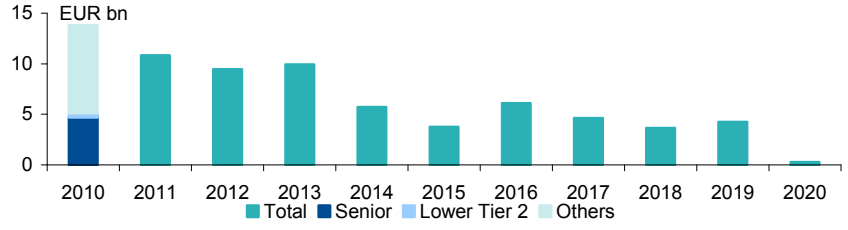
French lending network: +4% in 2009 in govt plan
Funding programme: EUR30bn FY09
Paid back State capital injection

Stable in H209 versus H109

The dividend payout close to 2008 (36%)
Core Tier 1 ratio and Tier 1 viewed as sound

Source: Company, Calyon
N/A: not available

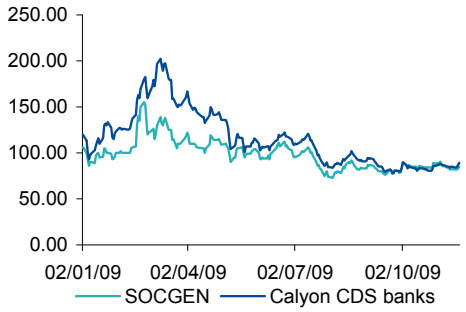
Debt redemption in 2010



Source: Bloomberg, Calyon

Others : Notes, non-rated Bonds, deposits, retail

CDS 5Y senior performance



Source: Bloomberg, Calyon

Key announcements

May-09: acquisition of an additional 7% stake in Rosbank
Jul-09: finalisation of the agreement to create a combined AM group with CASA
Oct-09: EUR4.8bn capital increase to pay back state capital injection
Oct-09: acquisition of the remaining 20% minority interests of Credit du Nord

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Ratings

S&P/Moody's/Fitch
A+/Aa3 neg /A+

Calyon Rating
Mid-A

UBS

Background

UBS is the world's largest wealth manager (CHF2,250bn invested assets at end-June 2009), a leading institutional asset manager and the largest commercial bank in Switzerland. Accounting for more than two-thirds of total RWA, investment banking has entered a de-leveraging phase. UBS operates in over 50 countries (total assets in 2008: 32% US, 23% UK, 24% rest of Europe/Middle East/Africa, 11% Switzerland, and 10% Asia Pacific). Exposure to emerging markets was CHF33bn at end-2008, with about half in Asia.

Operating performance trend

Another loss will be posted in FY09. Despite de-risking, UBS is facing difficulties in recovering client confidence and retaining its key employees, crucial for halting net new outflows in wealth and asset management (CHF91bn outflows year-to-date). Recovery in CIB revenues – fuelled by fixed income trading (no leading market share in fixed income primary market) – is lagging behind other investment banks.

After a sharp de-leveraging, UBS is now making an effort to rebuild its franchise in both CIB and wealth management. In a three- to five-year horizon, UBS considers it should be able to deliver CHF15bn pre-tax profit. After two years of losses, this performance – in line with the level reached in 2006 – appears rather ambitious.

Similar to its FX strategy, the client-centric business model (previously proprietary trading, structured credit and securitisation) will be the base for rebuilding the fixed income activities – central for the recovery of the CIB. The bank has started re-hiring in fixed income. The FICC business (increased contributions from foreign exchange, money markets, rates and emerging) aims to generate medium-term quarterly revenues of more than CHF2bn on a normalised basis, leading to CHF8bn per year, which would account for 40% of CIB business.

In asset and wealth management, UBS forecasts net new money being positive starting in 2010, with an increase in third parties. In the medium term, a pre-tax profit of at least CHF10bn is expected in wealth management and Swiss Banking, while around CHF1.3bn pre-tax profit should be generated by global asset management. With volume growth, this performance is correlated to better gross margin, planned to be at least 100bp (international clients: 83bp in Q309). At a time when UBS has to recover client confidence, faces fierce competition and potential litigation and a review of tax evasion, we have doubts over UBS's ability to raise its gross margin.

Key risk drivers

Although UBS sold a substantial **portion** (USD39bn) of its **toxic assets** to the Swiss National Bank (SNB), the bank could continue to be hurt by additional losses, notably on monolines (USD14.4bn notional amount). As well as exposure to new litigation and the impact of rating migrations (total loans: CHF315bn, CHF20bn reclassified assets included with investment bank), more of a risk-taking strategy is not ruled out in our view in order to prevent negative income.

UBS has one of the highest **core Tier 1 ratios** in Europe, but how can we make sure such a high level is **sufficient** given the lack of visibility on its upcoming performance and uncertainty regarding the regulatory framework? As well as market risk three times higher (CHF16bn in 9M09, CHF28bn end-2008), a minimum Tier 1 ratio will be 12% by 2013. The leverage ratio, which does not include Swiss lending (CHF160bn), could be reviewed. No target on Tier 1 has been provided.

Relative value: Rocky road to making a promise a reality

Despite efforts to reshuffle its business model, it will take time to break the vicious circle. As long as UBS posts losses, it will be hard to recover client confidence. Although the bank may enjoy a potential recovery in FX, it will not benefit fully from the normalisation of the markets. The senior unsecured debt and senior subordinated are at a rating floor, helping to reduce uncertainties for debt investors.

Rating agencies' opinion

UP

S&P: If a resilient and consistent performance over a sustained period is observed.

DOWN

S&P: Unable to restore underlying profitability and progressively rebuild its reputation with clients and investors.

Moody's: If additional systemic support were required, it could potentially result in a transforming event such as a break-up or sale, which could threaten the bank's franchise value.

Fitch: At its support rating floor.

UBS

www.ubs.com

Key shareholders

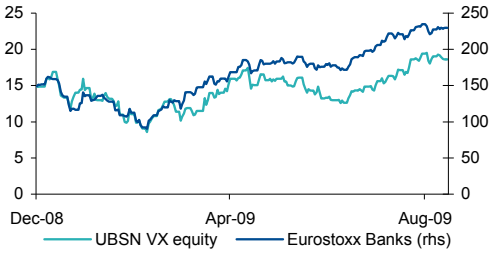
Govt Of Singapore	7%
Deutsche Bank	2%
Float	91%

Equity & Bond metrics

Equity ticker	UBSN VX	Bonds maturing in 2010	CHF 36,264m
Bond Ticker	UBS		
Number of shares (m)	3,558	Last rating action	18/11/2009
Market Cap.	CHF 57,214m		

Source: Bloomberg

Stock performance



CHFm	Q309	Q209	Q109	2008
Risk weighted assets	**210,763**	**247,976**	**277,665**	**302,273**
WM & Swiss bank	50,400	51,800	54,800	62,300
WM Americas	*21,900*	*23,200*	*24,600*	*26,900*
Global asset management	4,400	5,600	6,400	8,500
Investment bank	125,900	160,600	184,500	195,800
Corporate Centre	8,100	6,900	7,400	8,800
Net Banking Income	**5,992**	**6,157**	**6,104**	**3,793**
WM & Swiss bank	2,799	2,934	3,011	*15,413*
WM Americas	*1,378*	*1,367*	*1,408*	*6,278*
Global asset management	567	530	502	*2,904*
Investment bank	1,409	901	356	-21,800
Corporate Centre	-160	425	827	998
Income before taxes	**-593**	**-1,316**	**-1,548**	**-27,560**
WM & Swiss bank	792	932	1,077	6,013
WM Americas	*110*	-221	-35	-823
Global asset management	130	82	-59	1,333
Investment bank	-1,370	-1,846	-3,162	-34,300
Corporate Centre	-255	-263	631	217

Guidance

Basel II: market risk expected to increase to CHF60bn
Invested assets WM > CHF1tn target

Assets (excluding PRVs): CHF550bn medium-term

Gross margin > 100bps in medium term

Operating income > CHF3bn medium-term targets
Guidance for IB: CHF20bn in revenues

Profit before tax: CHF6.5bn medium-term target
Profit before tax > CHF1bn medium-term target
Profit before tax: CHF1.3bn medium-term target
Profit before tax: CHF6bn medium-term target

CHFm	Q309	Q209	Q109	2008
Total assets	**1,476,053**	**1,599,873**	**1,861,326**	**2,014,815**
Total loans	311,890	315,837	344,134	340,308
Total customer deposits	420,532	446,116	446,484	474,774
Tier 1 capital	**31,583**	**32,640**	**29,240**	**33,154**
Risk weighted assets	210,763	247,976	277,665	302,273
Net interest income	1,654	1,143	1,899	5,992
Commission and fees	4,530	4,502	4,241	22,929
Trading revenues	148	220	-630	-25,820
Other revenues	-340	292	595	692
Net banking income	**5,992**	**6,158**	**6,105**	**3,792**
Total operating expenses	-6,359	-7,093	-6,528	-28,555
Provision for credit losses	-226	-388	-1,135	-2,996
Income before taxes	-593	-1,316	1,569	-27,560
Net attributable profit	**-564**	**-1,402**	**-1,975**	**-21,292**
Core Tier 1 ratio	11%	10%	7.7%	8.5%
Tier 1 ratio	**15.0%**	**13.2%**	**10.5%**	**11.0%**
FINMA ratio	3.51%	3.50%	2.56%	2.46%
Cost to income ratio	**106.1%**	**115.2%**	**106.9%**	**N/A**
Coverage ratio	**45.0%**	**45.7%**	**30.5%**	**31.8%**
Gross doubtful loans/Gross loans	**1.9%**	**2.3%**	**3.3%**	**2.0%**

Source: Company, Calyon
N/A: not available

Guidance

Total balance sheet CHF1.5 trillion in 3-5 years

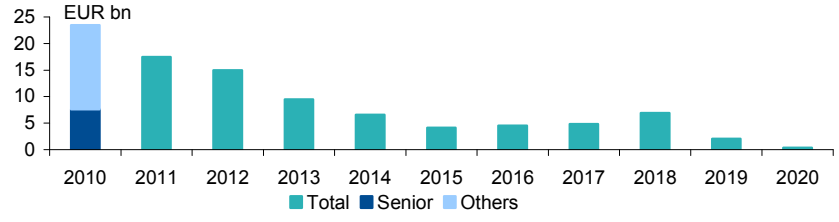
Total RWA medium term outlook CHF290bn

cost reduction target: CHF3.5bn in 2010

Pre-tax profit: CHF15bn in medium term
No target on Tier 1 ratio during investor day
Tier 1 ratio above 10%

Cost to income ratio: 65-70% medium term target

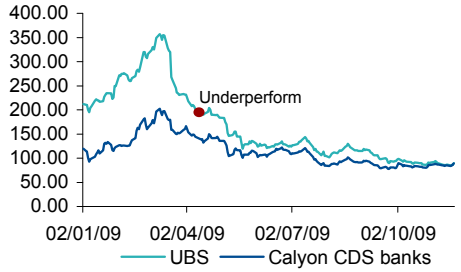
Debt redemption in 2010



Source: Bloomberg, Calyon

Others : Notes, non-rated Bonds, deposits, retail

CDS 5Y senior performance



Source: Bloomberg, Calyon

Key announcements

Jun-09: CHF3.8bn capital raised
Aug-09: the agreement with US did not call for a penalty from UBS
Aug-09: Swiss Federation placed its 322m shares, 10% of outstanding
Nov-09: announcement of new 3-5 targets
Nov-09: senior debt downgraded by Moody's

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Ratings

S&P/Moody's/Fitch
A/Aa3/A neg

Calyon Rating
Mid-A

Rating agencies' opinion

DOWN

S&P: Further material deterioration in profitability and/or asset quality.

Moody's: Downgrade of BFSR of more than two notches, due to significant erosion in profitability, material asset quality deterioration and inadequate capital, would potentially lead to downgrade in senior.

Fitch: If asset quality deteriorates substantially, if capitalisation proved inadequate or if the bank failed to stabilise its operating performance and balance its weakening revenues with cost efficiencies.

Unicredit

Background

Unicredit is one of the largest European banks and the second-largest bank in Italy with market share in loans and deposits of around 15%. Following an aggressive acquisition strategy over recent years, Unicredit enjoys leading market share not only in Italy (acquisition of Capitalia, Italy: about 50% of total risk-weighted assets) but also in CEE (15% of total RWA in H109, with the bulk in Poland) and to a lesser extent in Germany/Austria. In addition to its CEE division, its business mix is well diversified encompassing retail (34% of total revenues in 9M09), private banking and asset management as well as market & investment banking (55% of RWA). The latter encompasses markets and investment banking (MIB, 15% of RWA in H109) and corporate units (45% of RWA in H109) from Q309.

Operating performance trend

In a challenging economic environment in all geographic areas, Unicredit reported a net attributable profit of EUR1.3bn (-52% adjusted YoY) for 9M09. The third quarter was driven by the new CIB division and Poland (4% of total RWA, but around 25% of total pre-tax profit). Despite a slowdown in the cost of risk, retail suffered from the fall in NIR in Italy (elimination of overdraft charges, drop in euribor rates). The CEE business was hit by a clean-up of the Kazakhstan portfolio.

After the de-leveraging process, 2010 is likely to be another tough year for Unicredit. In revenues, Italy will continue to face a bleak economy and margin pressure, highlighting its high interest rate sensitivity. Asset repricing in Germany will be more limited. A ceiling in profitability seems to have been reached in Western countries, while the CEE division – highly correlated to the recovery in Western countries (notably Germany) – is not likely to post strong revenue growth in coming quarters. In line with Q309, the investment banking business and Poland (with the end of the deposit war) should continue to represent the main growth engines. The bank may also benefit from an improvement in AM. Maintaining sufficient operating income will be crucial for Unicredit in order to absorb the cost of risk (80% of operating income). Thus, reining in costs will remain one of the main priorities.

Key risk drivers

Asset quality will be the main concern. Despite hitting a peak at 136bp in H109, the **cost of risk** will remain at a **high level** with a 10% rise in net impaired loans in Q309. Will 2010 be the end of the one-offs (CIB with a EUR8.3bn ABS portfolio, Germany, clean-up in Kazakhstan)? Corporate exposure will still be under pressure in Germany (total loans: EUR72bn) and Italy (EUR116bn). Private consumption primarily will be under scrutiny in CEE, and especially in Hungary (EUR4bn), Ukraine (EUR3bn), Russia (EUR8bn) and Turkey (EUR8bn); we are less concerned about Poland. While its strong franchise and long-standing presence in the region will help to limit losses, Unicredit does not provide NPL and coverage ratios by country, which might have helped the market to assess better their real exposure. A total 49% coverage ratio is not considered comfortable.

After including the capital increase (EUR4bn, by Q110), the **Core Tier 1** ratio should be 8.39% – a level **more coherent** with Unicredit's risk profile and the new standard required. Unicredit has declined to provide information on its market risk exposure.

Unicredit's **business model** is highly sensitive to macroeconomic deterioration. After the merger of the corporate and MIB units, we do not rule out new changes in **perimeter**. In such a complex group, more visibility as required by the new regulatory framework will be warmly welcomed.

Relative value: Unicredit, the name to play the CEE recovery

While the bank enjoys a strong business and geographic diversification, it will continue to be hit by macroeconomic deterioration. Visibility remains rather poor on such a complex group. We would wait until at least end-Q110 to play the German and CEE recovery.

Unicredit

www.unicreditgroup.eu

Key shareholders

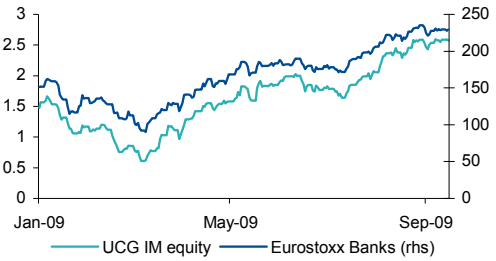
Mediobanca	7%
Fondazione CR Verona	5%
Float	80%

Equity & Bond metrics

Equity ticker	UGC IM	Bonds maturing in 2010	EUR 43,418m
Bond Ticker	UCGIM		
Number of shares (m)	16,755	Last rating action	16/4/2009
Market Cap.	EUR 39,445m		

Source: Bloomberg

Stock performance



EURm	Q309	Q209	Q109	2008
RWA (end of period, Basell)	**459,287**	**485,816**	**503,665**	**576,980**
Retail	69,933	73,170	72,044	80,410
Market & investment banking	254,626	270,581	282,043	278,371
Private banking	4,926	5,012	4,759	5,172
Asset Management	2,038	1,971	1,942	1,831
Poland	22,457	22,479	23,217	24,957
CEE	68,391	72,030	75,118	76,073
Net banking income	**6,731**	**7,764**	**6,562**	**26,866**
Retail	2,276	2,616	2,673	11,466
of which Italy	*1,637*	*1,974*	*1,982*	*8,497*
Market & investment banking	2,651	2,898	2,241	6,474
Private banking	167	215	206	916
Asset Management	184	159	181	1,088
Poland	427	405	374	2,183
CEE	1,103	1,205	1,196	4,736
Cost of risk (bp)	150	164	109	86
Retail	91	117	108	85
CEE	344	252	216	133

Guidance

De-risking non-strategic positions

Starting to reinvest in CEE
CEE and lower extent Germany: engine growth in 2010

Do not expect a sharp increase of the VAR in Q409

LLP annualized on average loans

EURm	Q309	Q209	Q109	2008
Total assets	**957,709**	**982,712**	**1,028,294**	**1,045,612**
Total loans	565,457	585,087	600,672	612,480
Customer deposits & debt securities	590,103	590,684	577,062	591,290
Tier 1 capital	**38,551**	**37,208**	**37,782**	**34,921**
Risk weighted assets	459,287	485,816	503,665	512,532
Net interest income	3,927	4,710	4,650	18,373
Commission and fees	1,930	1,889	1,846	9,093
Trading revenues	716	957	-93	-1,980
Other revenues	158	208	159	1,380
Net banking income	**6,731**	**7,764**	**6,562**	**26,866**
Total operating expenses	-3,831	-3,868	-3,822	-16,692
Provision for credit losses	-2,318	-2,586	-1,853	-4,044
Income before taxes	751	1,007	922	5,458
Net attributable profit	**394**	**490**	**447**	**4,012**
Core Tier 1 ratio	7.55%	6.85%	6.69%	6.0%
Tier 1 ratio	**8.39%**	**7.66%**	**7.5%**	**6.8%**
Net interest margin	1.62%	1.87%	1.79%	1.76%
Cost to income ratio	**56.9%**	**49.8%**	**58.2%**	**62.1%**
Coverage ratio	**49.1%**	**50.10%**	**51.6%**	**52.5%**
Gross impaired loans/Gross loans	8.99%	8.1%	7.2%	6.6%

Source: Company, Calyon
N/A: not available

Guidance

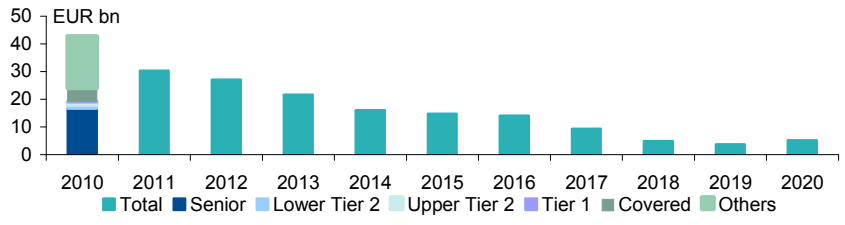
(+) 100bp rate curve parallel shift: around EUR500m positive impact
Regaining colour in mutual funds

Staff cut: 3,800 more exits by 2010 (already charged)
cost base to be reduced by EUR190m per year
Peak of cost of risk in Q209

Pro-forma capital increase: Core Tier 1 8.39%
Pro-forma leverage: 23x

Cost to income ratio: 51% in 2010e

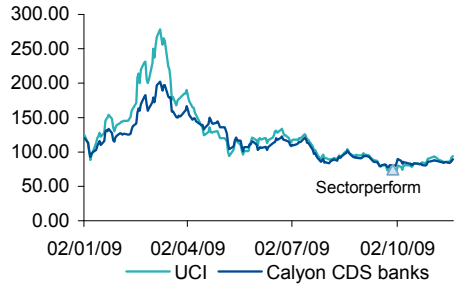
Debt redemption in 2010



Source: Bloomberg, Calyon

Others : Notes, non-rated Bonds, deposits, retail

CDS 5Y senior performance



Source: Bloomberg, Calyon

Key announcements

Feb-09: EUR3bn convertible bond issue fully subscribed
Sep-09: announcement of EUR4bn capital increase to avoid T-bonds

Appendix

Geographical exposure

Company	Grade	Comment in regard to geographic exposure
Unicredit	5	Highly sensitive to the fragile Italian economy, Poland drives CEE results
BBVA	4	NII breakdown Rise in Latam contribution (+31.7% YoY for operating income)
Santander	4	In terms of lending: UK= 32%, Latam=14%
ISPIM	4	Breakdown as of Q209
CZBK	3	CEE primary exposure: Poland (2010E DP: +2.2%) High exposure to Mittelstand and CRE (30% of Q309 NII), highly correlated to German economy (look out for evolution of unemployment)
MPS	3	As of Q408. No exposure to emerging markets. High sensitivity to domestic economy. Italy 2010E GDP: +0.2%
SocGen	3	Concentration of credit risk in Czech Republic, Romania and Russia (Rosbank)
DB	1	Breakdown of loan portfolio as of Q408
BNPP	2	As of Q408
CSG	1	
UBS	1	Gross credit exposure as of Q408

Sources: banks, rating agencies, Calyon

Consumer lending exposure

Company	Grade	Comments in regard to consumer lending
CZBK	2	No significant risky exposure to domestic market, limited exposure to CEE
MPS	3	Exposure mostly to Central and Southern Italy which are more fragile than the industrialised North + rising unemployment to hit. Still, consumer = only 4% of total loans.
Unicredit	3	Exposure contained but likely to deteriorate in CEE
Santander	5	Integration of specialised consumer credit companies in 2008 + NPL 5.46% in Q3-09 (+159bp in 12 months)+ 6.4% of total assets + negative trend in consumer Latam + peak in bad loans in H1-10 + rising unemployment (close to 20%)
BBVA	2	Lowered exposure to consumer loans and credit cards, still 11% of total loans at end 2008 + danger of rising unemployment
SocGen	4	Recently reinforced consumer activities in Europe and mostly in CEE (revenues to double between 2006 and 2010), with Brazil, Poland and Russia accounting for 37% of portfolio + exposure to equipment financing in Germany and Italy
ISPIM	2	Rising unemployment , but conservative approach in consumer lending to help mitigate credit deterioration (reduced lending). CEE= 7.3% of all loans, not too worrying
BNPP	4	High provisioning (340bp) in consumer finance, 20% of total lending, European leader + large presence in Spain and Italy
DB	1	Consumer credit exposure in Germany, Spain, Italy and Poland. Still, manageable in total loan portfolio since not so significant
CSG	1	1.6% of loans. No exposure
UBS	1	1.53% of assets in 2008, no significant exposure

Sources: banks, rating agencies, Calyon

Residential mortgage exposure

Company	Grade	Comments in regard to residential mortgage
CZBK	2	Resilience in domestic retail lending portfolio portfolio, with the exception of CEE
MPS	3	NPL stabilisation. Most of exposure in Central and Southern Italy, to watch closely due to deteriorating economic environment and rising unemployment.
Unicredit	3	No significant concern
Santander	4	Spain & UK residential mortgages = 33.5% of group's total lending + adjustment of real estate markets in Spain, US, UK hence shift to these countries to hit provisions
BBVA	4	36% of total lending (mostly Spain, Mexico and US), good quality although deteriorating due to economic conditions + adjustment of real estate market in Spain and US
SocGen	3	Good quality of French res. mortgage portfolio and improving, but worrying in CEE, overall exposure limited
ISPIM	3	Italian real estate market relatively sound for retail: lowest level of indebtedness of households in Europe, of consumer credit outstanding and LTV among lowest. 26% of total loans and deterioration to happen in CEE
BNPP	2	Relatively stable, no major concern. Domestic retail is sound, but exposure remains in CEE (although limited)
DB	2	74% of German retail loans (majority of retail) are mortgages, nothing to be really worried about, only for international loans but there amounts are limited
CSG	2	CHF88bn exposure, but no issue there as there is no real estate bubble in Switzerland. Exposure would come from exposure to US
UBS	2	No peak in losses on residential mortgages in Switzerland, since no price bubble hence no adjustment expected

Sources: banks, rating agencies, Calyon

Corporate exposure

Company	Grade	Comments in regard to corporate exposure
CZBK	3	Singe name concentration + shipping main concerns
MPS	4	42% of loans to Northern region, and better geographic diversification thanks to Antonveneta but exposure to deteriorating domestic market
Unicredit	4	Negative economic outlook and margin pressure, and exposures in Germany, Austria, Italy and CEE, i.e. all bleakest economic environments in Europe
Santander	2	Corporate business = 34% of group's assets
BBVA	3	Pay attention to concentration of risk: 20 largest risk exposures = 9.5% of total risk + single name concentration (large Spanish and European companies)
SocGen	3	Large corporate portfolio (47% of loans) remains an issue, with sizeable operations in emerging markets, notably Russia. Good quality in domestic market, exposure to rating migrations
ISPIM	4	Weak economic environment in Italy and CEE: decline in corporate lending and asset quality deterioration. Moratorium for corporate and SME loans signed with government this year may have mitigated provisions
BNPP	3	Stabilisation of provisions, but operating in tougher environment and corporate delinquencies expected to rise in 2009 and 2010
DB	3	Material single-names exposures in leverage loan book and strong franchise in corporate loans to be affected by weak economic environment
CSG	2	Exposure to Germany corporates, but good quality of portfolio. Exposure to rating migrations
UBS	2	Good hedging of corporate exposure, although greatest exposure. Risk of rating migrations still present

Sources: banks, rating agencies, Calyon

Cyclical corporate exposure

Company	Grade	Comments in regard to cyclical corporate exposure
CZBK	5	Very significant shipping and CRE exposures
MPS	4	Top 20 real estate clients = EUR15bn exposure. Cyclicals = 53% of corporate lending, still reasonable, but not given the current state of Italian economy. Consumer goods=1/3 of corporate loan book
Unicredit	4	Important exposure to cyclical sectors: real estate, auto, textile
Santander	3	Good diversification of loan book by sector, still, remaining exposure to real estate developers
BBVA	3	Despite good diversification, significant risk towards utility corporate, and Spanish construction companies. Lending to real estate and construction sector in Spain = 18% of lending
SocGen	3	Cyclicals = nearly 3/4 of corporate EaD, BUT remind that most of the exposure is to domestic market + very good diversification of commitments
ISPIM	2	Exposure to real-estate sector of corpo loans (NPL >4% for producer households and building & construction, 6% of total loans). Cyclicals (construction, distribution, fashion, metals & services) only represent 23% of the group's loans in Q3-09
BNPP	2	Loan book well diversified by name, sector and geography. Dominated by Investment grade corporate exposures. Approximately 25% of credit risk from cyclicals in 2008, but well diversified + CRE exposure (21.6% of net credit exposure)
DB	2	Great exposure to cyclicals somewhat balanced by importance of loans to households.
CSG	3	Significant exposure to CRE, but being reduced significantly (-90% since beginning of crisis). Main exposure in Germany (27%) and US (23%). Cyclicals = 2/3 of corporate loan portfolio, mainly in real estate companies services and manufacturing
UBS	2	Exposure in markets such as Germany and UK for CRE in particular

Sources: banks, rating agencies, Calyon

SME exposure

Company	Grade	Comments in regard to SME exposure
CZBK	5	EUR112bn exposure to Mittelstand, very sensitive to economic downturn + bleak prospects for Germany
MPS	5	46% of loans, significant exposure due to industrial framework of Italy. Similar to ISPIM: high correlation to economy, and expected deterioration in portfolio.
Unicredit	4	Exposure concentrated in Italy and Germany, with bleak prospects and SMEs very sensitive to local environment.
Santander	3	Greatest increase in loans for SME sector in Q3-09 (+7%) + group's strategy is to increase market share in SME business but no major deterioration so far
BBVA	3	Exposure to SMEs moderate but deterioration of economic environment should have some impact
SocGen	3	Segment most affected in credit risk of French networks
ISPIM	4	Same as for corporate: will greatly suffer from deteriorating economic environment, and is very fragile. 18% of total lending portfolio (of which exposure in CEE). In particular, ISPIM wants to expand business in midcap sector.
BNPP	2	Exposure increased due to integration of Fortis, with high cost of risk (especially for Fortis). 38% of lending (among which 5% in CEE)
DB	2	No mention of significant exposure to SMEs, still, moderate impact due to economic environment may hit provisions
CSG	1	No significant exposure, albeit in activities in Germany, but rather limited impact
UBS	1	No significant exposure

Sources: banks, rating agencies, Calyon

Sovereign exposure

Company	Grade	Comments in regard to sovereign exposure
CZBK	4	Great government support from capital injections + significant exposure to CEE
MPS	1	No sovereign exposure
Unicredit	3	4.34% shares held by Central bank of Lybia + significant exposure to CEE countries: 28% of loans, in particular Poland
Santander	2	99.73% of shares held by European and US residents, credit exposure 17% Latam + Rest of World
BBVA	2	No exposure in shareholding structure, credit exposure: 8% loans in Mexico (also 29% of earnings), EUR16.6bn of Latam public-sector debt of which 92% is Mexico
SocGen	2	No sovereign risk in shareholding structure, 10.6% of shares held by employees, emerging markets exposure held in credit risk
ISPIM	2	No sovereign risk in shareholding structure, exposure to CEE (12% of loans)
BNPP	2	Repayment of government share aid, credit exposure to Eastern Europe, not so significant
DB	2	No sovereign risk out of credit exposure: due to vast network, DB has exposure in many countries. Of which Asia in particular and CEE
CSG	3	Great majority of shareholders in Switzerland but 8% shares held by Qatar
UBS	2	No sovereign risk in shareholding position, however risk due to exposure to Asia, remains very limited, and is mainly due to large international network

Sources: banks, rating agencies, Calyon

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Gwenaëlle Lereste

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BNP Paribas	E
Commerzbank	None
Credit Suisse Group	F
Deutsche Bank	None
Intesa Sanpaolo	E
Montepaschi	None
Santander	None
Société Générale	E
UBS	None
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