BARCLAYS CAPITAL

EQUITY RESEARCH

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HAPPY NOW?

Four questions on the European banks' stress test

Question 1: Will the sector bounce strongly? The US bank sector surged 70% around the time of its stress test, but we do not think Europe will follow suit. The US stress test proved the catalyst for massive equity recapitalisations, coincided with an economic recovery, and was performed on a sector trading one-third below its long-run valuation. We believe the July 2010 European stress test is unlikely to lead to any meaningful capital raising, was released at a time of growing economic uncertainty, and has been conducted on a sector trading within 10% of its long-run valuation.

Question 2: Is the test credible? We give a qualified "yes". Two year loan losses of 3.6% represent 30-year highs for the sector but are dwarfed by the US's 9% stressed level. Whilst such comparisons can be misleading, there does appear to be more individual bank "wiggle room" for European banks, which we see as disappointing. In addition, pre-provision profit assumptions feel optimistic. There are substantial differences by country; in Spain, for example, the assumption is for a cumulative decline in commercial property prices of 55%, yet for just 7% in Greece. This may reflect an element of delayed recognition in Spain. The absence of testing for full sovereign default is understandable, but new disclosure allows investors to conduct their own stress test.

Question 3: Who was the stress test done for? Our view is not for us in equities, but for the debt markets. Whilst the US test last year was conducted in the shadow of nationalisation risk, this test was prompted by a renewed funding crisis. Indeed shareholders' equity has not even been tested. So what is the debt market likely to make of it? We see a "cautious welcome" as the likely view.

Question 4: Will funding costs come down? This is perhaps the key question. To the extent that the market feared what it did not know, the full sovereign risk disclosure is likely to be a positive. However, much of the sector's funding pressure is, in our view, structural: too many balance sheets (banks and sovereigns) chasing too few funds. With or without a stress test, Europe's banks still have €1.5trn of debt maturing by 2012, as well as the need to repay over €500bn to central banks. Well-capitalised banks with limited exposure to SGIIP (Spain, Greece, Ireland, Italy, Portugal) sovereigns, such as HSBC and BNP Paribas, should continue to be best placed to benefit. Of the big caps in Europe, BBVA appears to us the weakest positioned. We suspect structurally higher overall funding costs – and the differential in costs among banks – are set to remain.

INDUSTRY UPDATE

European Banks
2-NEUTRAL
Unchanged

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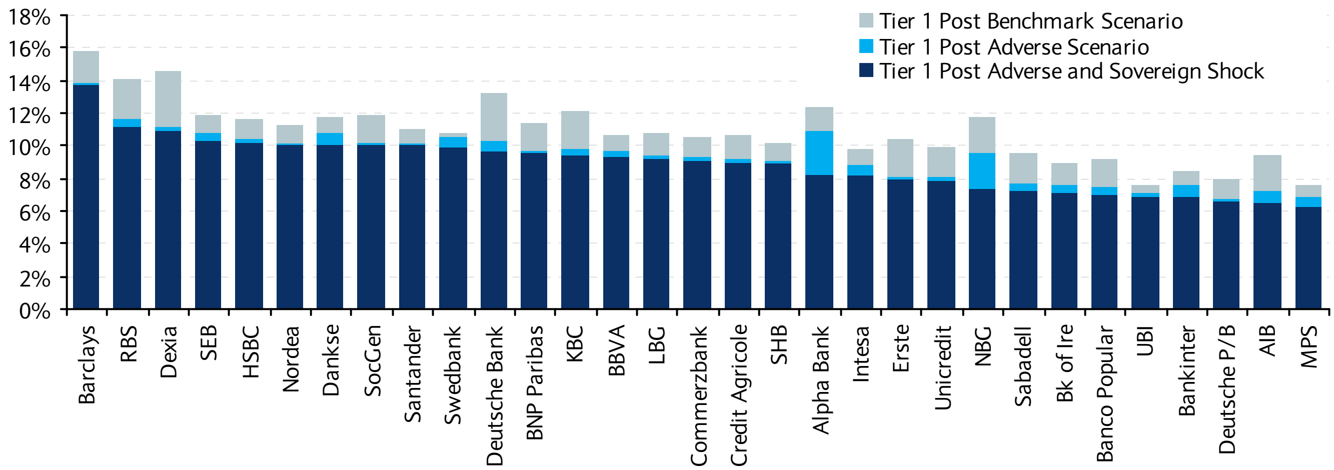
Question 1: Will the sector bounce strongly?

Our view is probably not. At the headline level the results are "better" than expected, with a 92% pass rate (ie, 7 failures) against expectations of a 75%-85% pass rate (ie, 15-20 failures). As Figure 1 shows, our entire quoted universe passed, with MPS closest to the 6% failure level.

Figure 1: Stress test –results

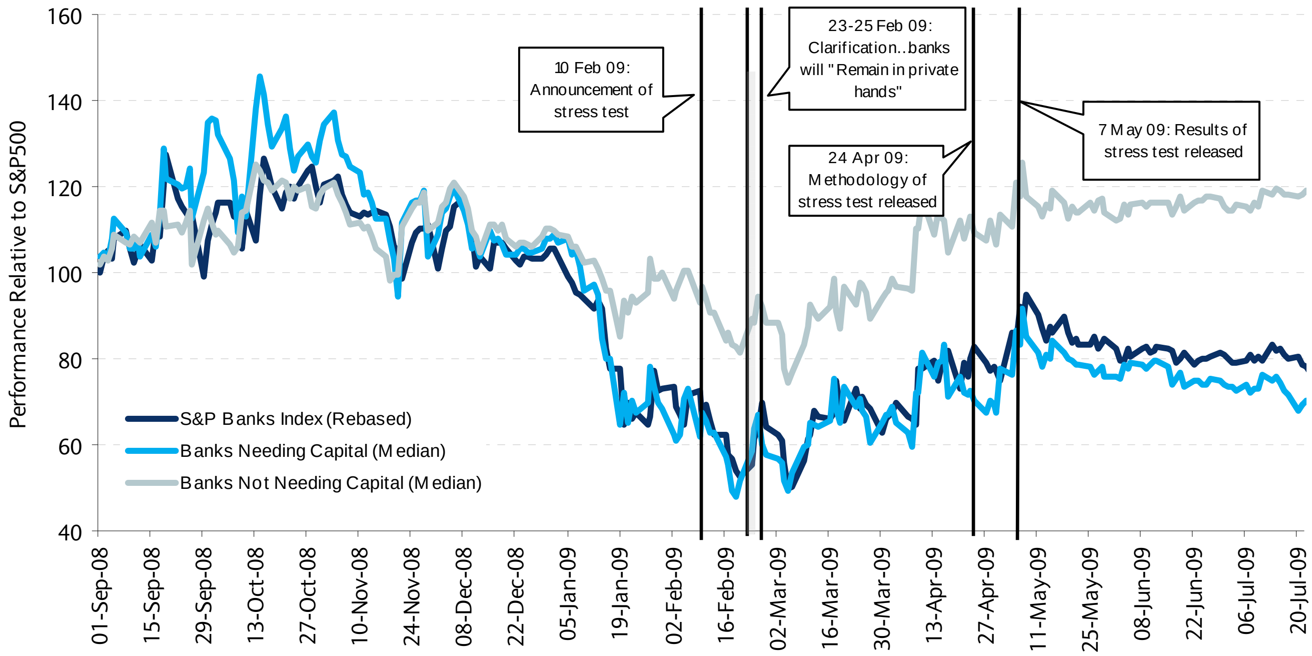


Source: CEBS

But as any parent bemoaning the grade inflation that appears to have made their children's exams easier knows, the result of any test is entirely a function of the difficulty level set. We discuss below *(Question 2)* just how credible we view this test to be.

However, one view might be that perhaps it does not matter that we can poke around and find faults. It is easy to criticize, but the high-level message of the stress test should not be completely ignored: European banks only need €3.5bn to cope with a return of recession conditions and a degree of "sovereign shock". Given this benign outcome, could not the European bank sector rally sharply, as indeed the US sector did around the time of its stress test (Figure 2)?

Figure 2: Performance of US banks before, during and after US stress test

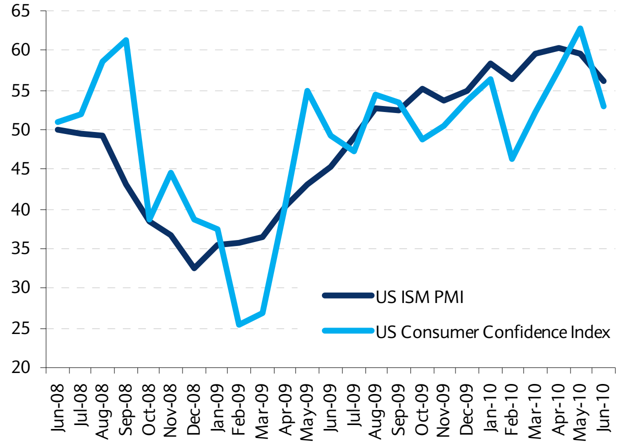


Source: Datastream, Federal Reserve Bank of New York, Barclays Capital

Despite only a 47% pass rate, the US stress test in May 2009 was initially viewed by many commentators as also not very credible. Yet the test proved crucial to the rehabilitation of the sector, representing a key catalyst for significant equity capital raising ($130bn over the remainder of 2009). Arguably that is the first, most obvious difference with the US then and Europe now: the US sector actually did raise capital on the back of the stress test. Europe , in our view, does not need to.

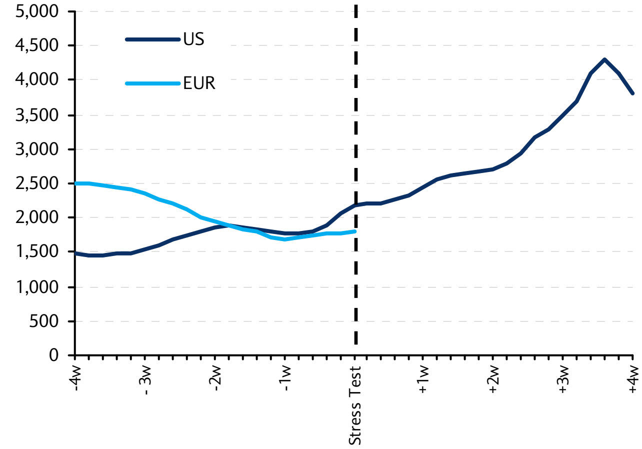
But perhaps the more important difference with the May 2009 test is that it coincided with signs of economic recovery; as Figure 3 shows, US consumer and manufacturing sentiment had already turned decisively by spring 2009. By contrast, the economic outlook in July 2010 is clouded by renewed concerns of slowing economic growth. As a sentiment gauge, the Baltic Dry Index of worldwide shipping prices shows this divergence clearly; in the month leading up to the US stress test it jumped by one-third (and carried on rising), whereas over the month leading to the European stress test results the same index has fallen by one-third (Figure 4).

Figure 3: US economic indications, 2008-present



Source: Datastream

Figure 4: Baltic Dry Index – Before and after stress tests



Source: Bloomberg, Barclays Capital

Perhaps as important for bank share prices at the time was the statement by the US government on 23 February 2009 that the presumption underpinning the stress tests would be for banks to "remain in private hands": a statement which, given the continued concerns over the fate of (especially) Citigroup, sparked a sector recovery. Indeed, as shown in Figure 2, that February 23rd date is far closer to the sector's trough than the 7 May stress test results day.

However, perhaps the bigger constraint on a European sector rally from here is valuation. Currently the European banking sector is trading on 1.25x tangible book. That represents only a modest discount to the 30-year average (1.4x). By contrast, back in May 2009 the US banks were trading on almost a 30% discount to their 30-year average.

Figure 5: Valuation comparison, US vs. European banks around stress test

	Price to tangible book		Divergence from 30-year averages		Standard deviations	
	US banks	European banks	US banks	European banks	US banks	European banks
3 months prior to stress test	1.02x	1.37x	-46%	-2%	-1.04	-0.04
2 months prior to stress test	1.24x	1.15x	-35%	-18%	-0.79	-0.37
1 month prior to stress test	1.35x	1.22x	-29%	-13%	-0.67	-0.26
At stress test date	1.34x	1.25x	-29%	-11%	-0.68	-0.22
30-year average PTBV	1.94x	1.40x				

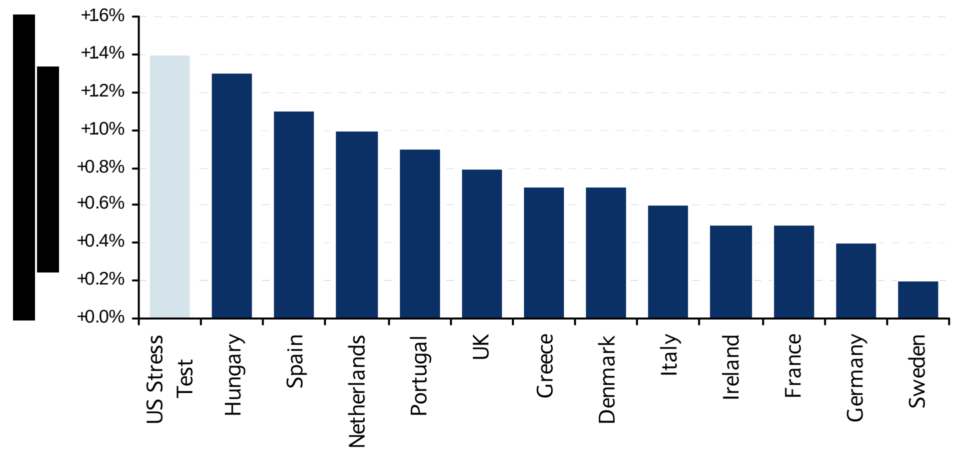
Source: Barclays Capital

Question 2: Is the test credible?

Given the almost 100% pass rate, the next key question is whether this test is viewed as credible. Given that the European stress test was conducted *after* a deep recession, the severity of the stressed downturn was always going to be much more modest than that used in the US stress test.

So what do we think of the assumptions used? The main economic assumption – a 3% GDP divergence from current forecast over a two-year period – had already been disclosed and compared to a 2.9% deviation in the US stress test. At the individual country level, that GDP divergence would mean renewed recession for 18 (out of 27) countries for 2010 and for 13 in 2011. The impact on unemployment from moving from benchmark to adverse scenario is shown below (Figure 6). For comparison, in the US stress test the increase in unemployment in the adverse scenario was 1.4%. In this context, the GDP assumptions for the EU stress test appear broadly sensible; the unemployment shock perhaps a little benign.

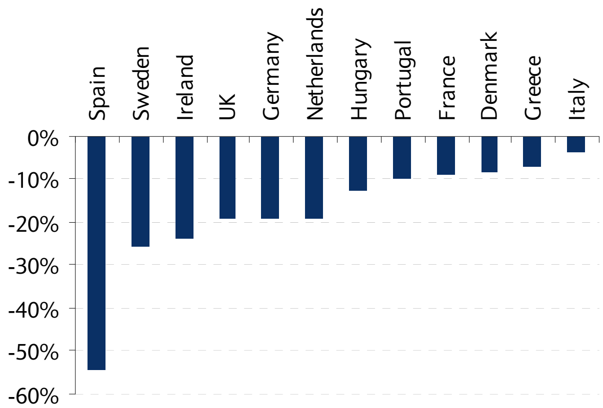
Figure 6: Change in unemployment rate in adverse scenario



Source: CEBS, Federal Reserve

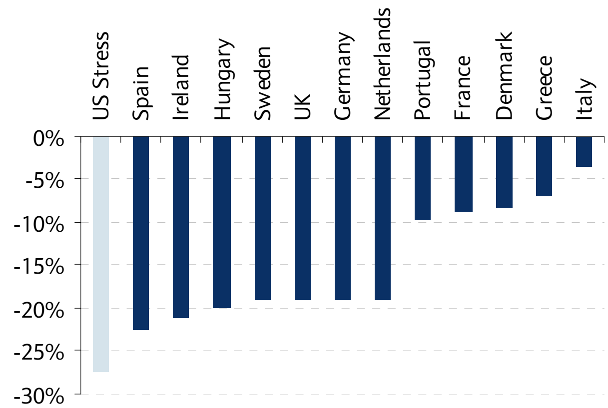
However, perhaps the more interesting assumptions to analyse are property prices. Figures 7 and 8 show the two-year (2010 and 2011) cumulative decline in commercial and residential property prices. The massive decline in Spain is striking, both in absolute terms and also relative to other major countries in Europe. Clearly asset prices have risen more in Spain, which will explain much of the difference, but there will also be inevitably a suspicion that there is a component of delayed loss recognition in the cumulative asset price decline projections. The US stress test did not include an explicit commercial property assumption but it did include a 27% two-year decline in residential property prices.

Figure 7: Cumulative decline in commercial property prices 2010-2011 incorporated in stress test



Source: CEBS

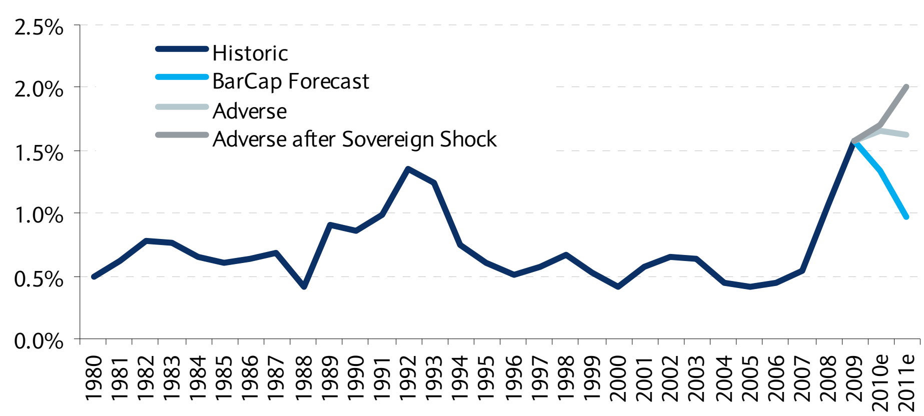
Figure 8: Cumulative decline in residential property prices 2010-2011 incorporated in stress test



Source: CEBS, Federal Reserve

The GDP variation, increase in unemployment, and forecast decline in property prices together result in a Europe-wide loan book loss rate of 1.6% before the impact of a "sovereign shock", rising to 2% with sovereign shock included. To be clear, this increase post-sovereign shock is unrelated to any banking book losses on sovereign exposures themselves, but rather is the forecast impact of higher borrowing costs arising from higher sovereign spreads. At the 2% level, impairments would be around 20% higher than the 2009 level, itself a 30-year high.

Figure 9: European credit impairment charge – Historic, forecast & stress test

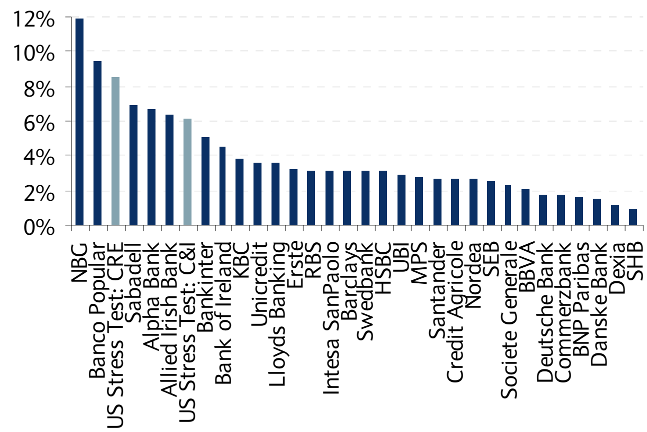


Source: Worldscope, Company Reports, CEBS, Barclays Capital

Whilst the impairment losses in the adverse scenario would represent 30-year peaks, the level is much lower than that applied in the US stress test (9.1%). We believe the two numbers are essentially incomparable, given that 1) the July 2010 stress test comes *after* a deep recession; and 2) the loan books of the two banking sectors are very different, due largely to the distorting impact of Freddie Mac and Fannie Mae. Specifically, for the 19 banks included in the US stress test, only 9% of their portfolio was first lien mortgagees, compared to nearer one third for the European bank sector.

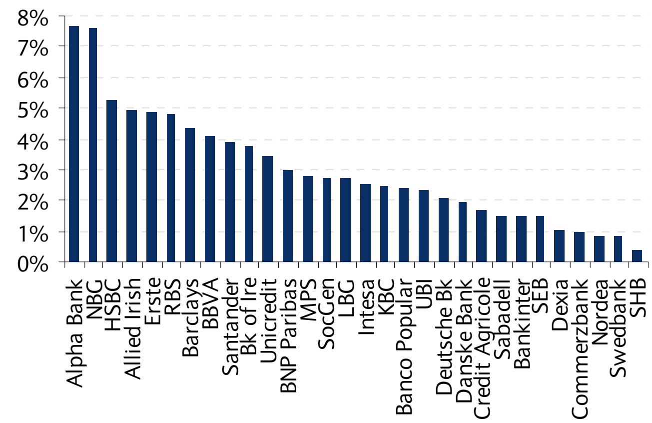
Figures 10 and 11 compare two-year impairment losses split between corporate loans and retail loans. Banks in the most stressed economies (Spain, Greece, Ireland) and with the highest proportion of higher risk unsecured credit (HSBC in the US, UK banks) incorporate the highest forecast loss rates.

Figure 10: 2yr corporate loan losses (adverse & sovereign shock)



Source: CEBS, Federal Reserve,

Figure 11: 2yr retail loan losses (adverse & sovereign shock)



Source: CEBS

Nevertheless, we feel it is still fair to say that this European stress test appears to have more "wiggle room". The estimates used in the US stress test also incorporated loan-specific details on past performance, origination year, borrower characteristics and geographic distribution, as well as disclosure of estimated losses across eight separate loan book elements (vs two in Europe). Additionally, the Committee of European Banking Supervisors (CEBS) has adopted only a "top down approach for smaller and less complex banks". This, we believe, reduces the credibility of the European stress test compared to the US equivalent.

Sovereign shock is not sovereign default

Moreover, the "sovereign shock" modeled by the CEBS focuses only on government bond exposures in trading books and the associated impairment losses on commercial loans (with higher government yields leading to more defaults in the real economy). AFS and hold-to-maturity portfolios are not explicitly tested for sovereign losses. Whilst this is perhaps understandable from both an accounting point of view and in view of the presence of EU/IMF bailout funds, it should be noted that the US stress test took a more conservative approach, focusing *"on whether…it is more-likely-than-not that firms will be required to sell the security before recovery of its cost base"*. Furthermore, given that the catalyst for a European stress test was fears over bank sovereign exposures, concentrating only on trading book assets may provide limited reassurance.

Pre-provision profits – How conservative?

Impairment losses in the adverse scenario are forecast to total €473bn (or €522bn with sovereign shock). This is almost fully offset by forecast pre-provision profits of €507bn. To give some context, pre-provision profits for the 91 banks included in the stress test totaled €270bn in 2009, implying that the adverse scenario with sovereign shock would experience pre-provision profits running just 6% below 2009 levels.

Instinctively this feels generous. The experience of 2007-2009 was that pre-provision earnings fell sharply across the sector (by around one-third), clearly impacted by structured credit write-downs and other capital market losses which we would not expect to be repeated. Nevertheless, just a 6% fall still looks optimistic. Indeed, we suspect the CEBS was itself somewhat suspicious of this outcome, describing it as a "somewhat positive outlook". Specifically, the CEBS suggests that the "zero growth" assumption built into the exercise may actually prove too optimistic for those banks that are deliberately shrinking.

Figure 12 shows how the pre-provision profit forecasts included in the adverse scenario compare to our own forecasts for pre-provision profits. Comparisons are difficult – not least because the stress test assumes a static balance sheet. Moreover, our forecasts are of course effectively based on the benchmark scenario whilst the stress test numbers are based on the adverse scenario. Hence we would expect our forecasts to be higher than the benchmark scenario, and in most cases they are. (Unfortunately the stress test does not disclose estimated pre-provision profits in the benchmark scenario). Indeed, for only two banks – Deutsche Bank and Credit Agricole – is the CEBS number higher than our forecast. For Credit Agricole this reflects the different scope of the business being stressed (our forecast is for Credit Agricole S.A whereas the stress test applied to the entire group). For Deutsche Bank, we understand this difference largely reflects financial asset impairments being added back to pre-impairment income and then subsequently deducted. At the other extreme, we understand that the very weak estimate of pre-provision profits for both Deutsche Postbank and KBC reflects the impact of a simultaneous rise in short-term and long-term interest rates which – due to the additional assumption that their investment portfolio is unchanged (the "zero growth assumption) – damages their margins.

Figure 12: Analysis of pre-provision profits included in stress test

	2005	2006	2007	2008	2009	2010E	2011E	Cumulative 2010/11	BarCap forecast cumulative 2010/11	Per stress test cumulative 2010/11	Stress test PPP vs Barcap
	€m	€m	€m	€m	€m	€m	€m	€m	Local Currency	Local Currency	
AIB	1,643	2,006	2,335	2,605	1,989	1,569	1,606	3,175	3,175	901	**-72%**
Deutsche Postbank	945	1,305	1,307	-658	224	1,177	1,323	2,500	2,500	1,023	**-59%**
KBC	3,471	4,775	4,640	-771	-5	4,432	3,212	7,644	7,644	3,279	**-57%**
UBI	1,692	1,755	2,051	1,637	1,556	1,296	1,855	3,151	3,151	2,411	**-23%**
Unicredit	7,988	11,976	13,346	10,190	12,248	11,606	13,346	24,951	24,951	20,374	**-18%**
MPS	1,747	1,865	1,787	2,020	2,043	2,290	2,830	5,120	5,120	4,350	**-15%**
Commerzbank	1,765	2,910	2,830	2,329	1,713	4,028	4,214	8,242	8,242	7,009	**-15%**
SocGen	7,010	8,714	7,618	6,338	5,964	9,441	9,646	19,087	19,087	16,774	**-12%**
Santander	8,910	11,218	14,840	18,540	22,960	24,848	26,473	51,320	51,320	45,737	**-11%**
HSBC	22,630	25,383	27,114	23,932	26,939	25,962	26,896	52,858	68,646	61,442	**-10%**
SEB	1,346	1,752	1,864	1,630	1,489	1,353	1,627	2,980	2,980	2,668	**-10%**
BBVA	6,813	8,340	9,641	10,523	12,308	11,721	12,045	23,766	23,766	21,768	**-8%**
Swedbank	1,649	1,519	1,752	1,911	1,593	1,339	1,508	2,847	2,847	2,720	**-4%**
BNP Paribas	8,485	10,878	12,273	8,976	16,851	16,080	16,498	32,578	32,578	32,001	**-2%**
LBG (pro forma with HBOS)	15,997	18,590	18,860	11,439	12,215	14,078	14,854	28,932	24,519	24,444	**0%**
RBS	14,562	16,563	14,663	-1,197	8,816	12,222	15,223	27,445	23,258	24,219	**4%**
Intesa Sanpaolo	4,383	8,287	9,250	7,990	8,161	7,856	8,879	16,735	16,735	17,782	**6%**
Bk of Ireland	1,419	1,759	2,004	1,871	1,409	1,131	1,094	2,225	2,225	2,482	**12%**
Deutsche Bank	6,197	8,337	8,876	-4,998	8,644	7,885	8,142	16,027	16,027	21,775	**36%**
Credit Agricole	4,527	5,832	4,050	3,321	5,760	6,802	7,538	14,340	14,340	22,611	**58%**

Source: CEBS and Barclays Capital

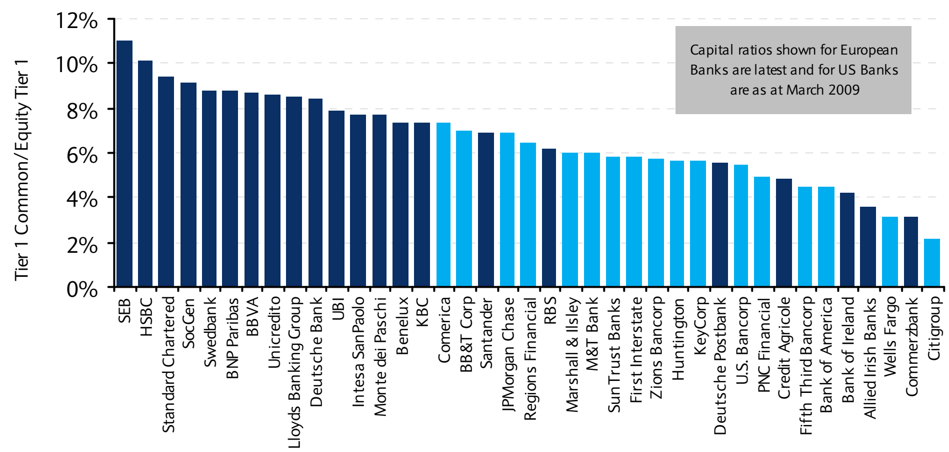
Question 3: Who was the stress test done for?

The US stress test was clearly done for the equity market, in our view. In the period leading up to it there were growing concerns that the US banking industry was on the verge of being nationalised, especially in light of the rescues of both Citigroup and Bank of America in the period leading up to the test. The government preference shares that were injected via the TARP process boosted reported Tier 1 ratios yet did nothing for equity Tier 1 ratios. It was clear that shareholders' equity was vulnerable and hence the test was focused on stressing both Tier 1 and Tier 1 common. And it was the Tier 1 common test that proved the harsher of the two to satisfy.[1]

The European stress test is very different. We do not see it as primarily being done as an exercise for the equity market. The pressure for a European-wide stress test emerged in direct response to the severe pressures in the funding market that developed during April and May 2010. Indeed, equity capital itself is not even being tested, but instead Tier 1 capital. That reflects several things, not least the fact that the European bank sector today has much higher equity Tier 1 (or Tier 1 common) ratios than the US banks had in May 2009. Figure 13 illustrates this.

[1] Indeed, the vast majority of the €185bn capital shortfall in the US stress test came from a shortfall in Tier 1 common – with virtually no shortfall in overall Tier 1 capital.

Figure 13: Equity Tier 1 ratios at time of stress test – Europe & US

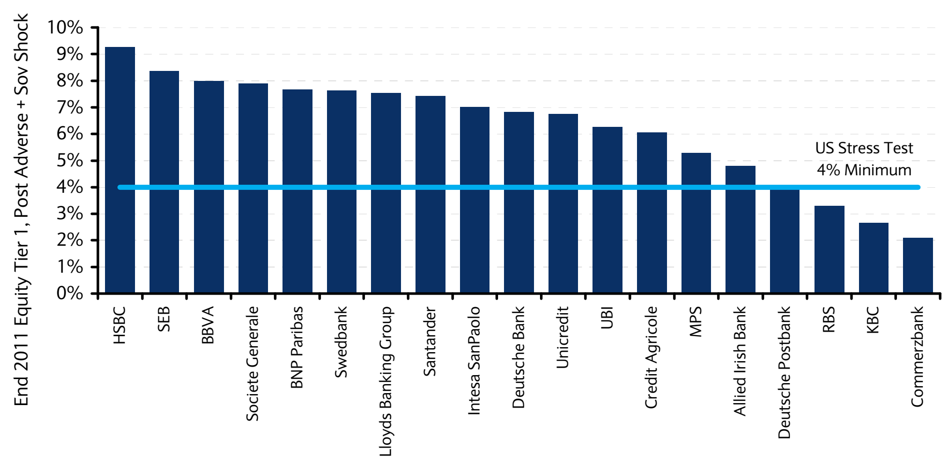


Source: Barclays Capital

Of course we can do our own US-style equity Tier 1 stress. Figure 14 takes the results of the adverse scenario plus sovereign shock and shows our estimate of what that would do to equity Tier 1 ratios. It suggests that four banks of our covered universe that were subject to a stress test – RBS, KBC, Commerzbank and Deutsche Postbank – would fail the 4% equity Tier 1 ratio threshold that was applied in the US stress test. But as noted, we do not see this as especially important since the test is not for equity holders but debt counterparties.

Indeed, as we discuss below, perhaps the single most important thing to emerge from the stress test is not the result itself but the new disclosure on sovereign risk, which we expect will help remove some of the uncertainly in funding markets for some of the more stressed names.

Figure 14: 2011 Equity Tier 1 ratios post-adverse scenario & sovereign shock



Source: CEBS, Barclays Capital

Question 4: Will funding costs come down?

Given our view that the real audience of this stress test is the debt market, the final but most important question is, what will the debt market think of the stress test? Will it lower funding costs? Will it "work"?

We have discussed this in some detail with our colleagues in both the rates and credit space and we believe the comments below are consistent with their views.

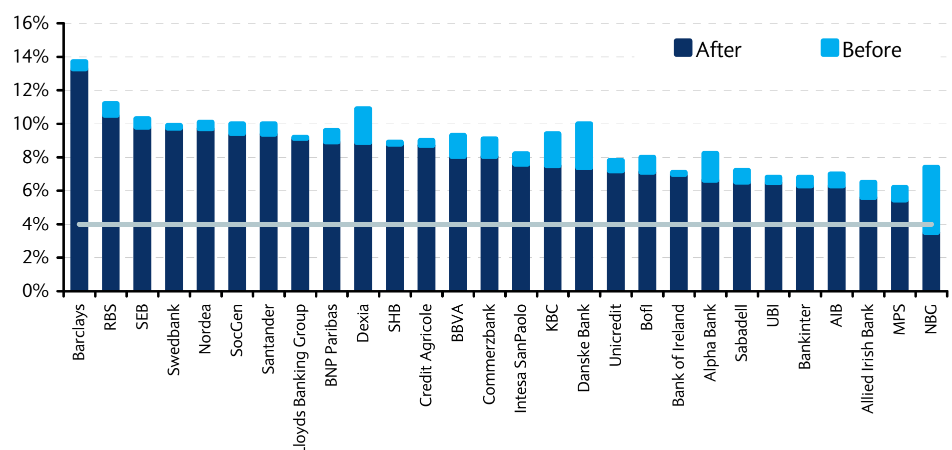
Funding costs for all banks are elevated at the moment – but importantly, vary substantially among banks. Higher bank funding costs can be explained by a combination of cyclical and structural factors. Cyclical because bond spreads typically rise in periods of economic distress or uncertainty; and structural because there are too many balance sheets (banks, sovereigns, private equity etc) chasing too few funds.

Whilst just €3.5bn of recapitalisation is being required under the stress test, far less than most commentators had predicted, we still think that overall the stress test helps funding conditions for banks insofar as uncertainty is reduced. As an example, there have been widespread concerns about Spanish banks (of all sizes) encountering funding problems in the past 2-3 months. Given that all the listed Spanish banks are shown to be comfortably solvent even after (amongst other things) testing for a 55% decline in commercial real estate prices, we anticipate that their access to funding markets is likely to improve following the stress test.

Is the funding situation helped by the additional sovereign disclosure? Again, probably yes. The publication of exposures shifts risk from the systemic to the idiosyncratic; banks passing the stress test by particularly wide margins could benefit most. Indeed, one result of having a stress test which "everyone" passes is that the market itself reinforces the funding winners/losers distinction.

To look at this, we use the additional sovereign disclosure to extend the stress test and take two approaches. First, in Figure 15 we apply the same haircuts on sovereign exposures in the trading book to the banking book to gauge the impact on Tier 1[2] .

Figure 15: Tier 1 Ratios before and after banking book sovereign stress

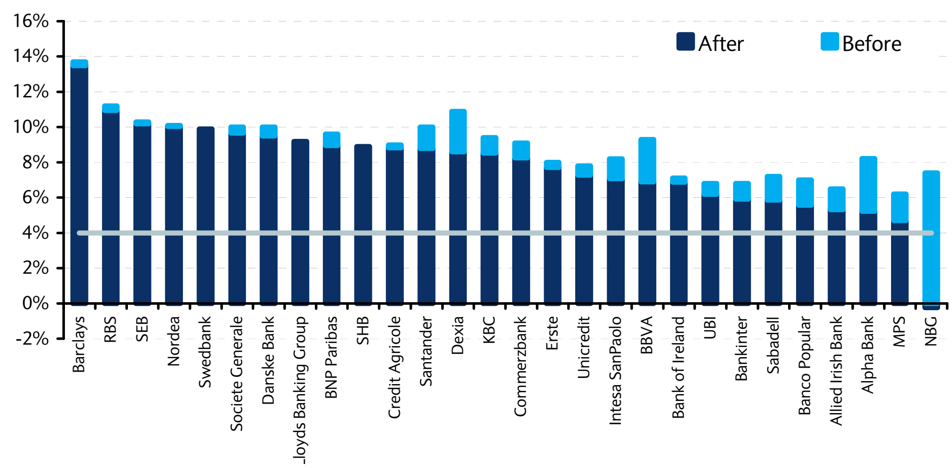


Source: CEBS, Barclays Capital

[2] We take Tier 1 because, in general, funding markets only care about how big a buffer they have, not the composition of that buffer. We make the simplifying assumption that Tier 1 counts more as "capital" than as "funding".

Second, as a more draconian test of peripheral European exposures, in Figure 16 we double the banking book haircuts for Greece (to 46%), Spain (to 24%), Portugal (to 28%), Ireland (to 26%) and Italy (to 15%), but leave the other sovereign exposures untouched. Under both scenarios, most banks see their Tier 1 ratios remain above 6% and virtually all are above the 4% regulatory minimum. In aggregate then, the incremental disclosure should help ease funding pressures. In terms of individual stocks, it is perhaps worth pointing out that SocGen appears better placed than either BNP Paribas or Credit Agricole[3]; Santander better than BBVA; the larger cap Italians (Unicredit and Intesa SanPaolo) better than their mid-cap counterparts; and Bank of Ireland better than Allied Irish. Probably unsurprisingly, all of the UK and Nordic banks have relatively small exposures.

Figure 16: Tier 1 Ratios before and after doubling the SGIIP haircuts



Source: CEBS, Barclays Capital

However, it should be noted that passing an extended stress test based on sovereign exposures only provides a partial answer. A scenario whereby Spanish sovereign debt trades with a 28% haircut would almost certainly also mean an even more severe credit quality environment than stress-tested for by the CEBS.

As an aside, one thing that surprised us was how small Lloyds Banking Group's exposure to European sovereign risk is, both to SGIIP countries and others. Overall Lloyds reports just £8bn of European exposure in the stress test, whereas at the end of 2009 it reported "primary liquidity"[4] of £88bn – far more in line with banks of similar size – with another £62bn of "secondary liquidity". This repositioning of the balance sheet is clearly a benefit in terms of getting through the stress test, but might this potentially signify a less liquid balance sheet?

Of course, any stress test that we perform here is, essentially, arbitrary. As such, in Figure 17, we include a more conservative measure of SGIIP exposure, the total "unstressed" SGIIP sovereign exposure as a proportion of Tier 1. If the situation for SGIIP economies deteriorates (further), then the realised pain that each bank experiences may be rather different to that shown in the stress test in Figure 16. Hence, this approach helps to tease

[3] However, of the 3 French banks, BNP Paribas is the only one that doesn't have a commercial banking business in Greece, which is excluded from our analysis in Figure 16

[4] UK Gilts, US Treasuries, Euro AAA government debt; unencumbered cash balances held at Central banks

out additional differences we see among banks – which essentially magnifies the differences identified in Figure 16.

Figure 17: Analysis of SGIIP exposures

	----------SGIIP exposures-----------		% other sovereigns	Not tested
	% tested (trading book)	% not tested (banking book)	Not tested (banking book)	SGIIP as % Tier 1
NBG	8%	92%	92%	**344%**
MPS	32%	68%	59%	**252%**
BBVA	17%	83%	62%	**171%**
Dexia	5%	95%	93%	**150%**
Intesa SanPaolo	35%	65%	68%	**137%**
Banco Popular	0%	100%	None	**130%**
Alpha Bank	3%	97%	99%	**121%**
Sabadell	0%	100%	Negligible	**119%**
Allied Irish Bank	0%	100%	100%	**115%**
UBI	14%	86%	92%	**93%**
Bankinter	4%	96%	Negligible	**83%**
Santander	23%	77%	23%	**76%**
KBC	13%	87%	91%	**73%**
Unicredit	40%	60%	84%	**66%**
Commerzbank	1%	99%	89%	**63%**
BNP Paribas	6%	94%	96%	**49%**
Danske Bank	56%	44%	36%	**30%**
Erste	1%	99%	84%	**22%**
Bank of Ireland	0%	100%	0%	**20%**
Societe Generale	40%	60%	86%	**19%**
Credit Agricole	58%	42%	83%	**14%**
RBS	46%	54%	77%	**12%**
Barclays	16%	84%	82%	**10%**
SEB	0%	100%	79%	**6%**
Nordea	32%	68%	84%	**3%**
HSBC	87%	13%	59%	**1%**
Lloyds Banking Group	0%	100%	96%	**0%**
Swedbank	None	None	34%	**0%**
SHB	None	None	35%	**0%**
DnB NOR	100%	0%	0%	**0%**

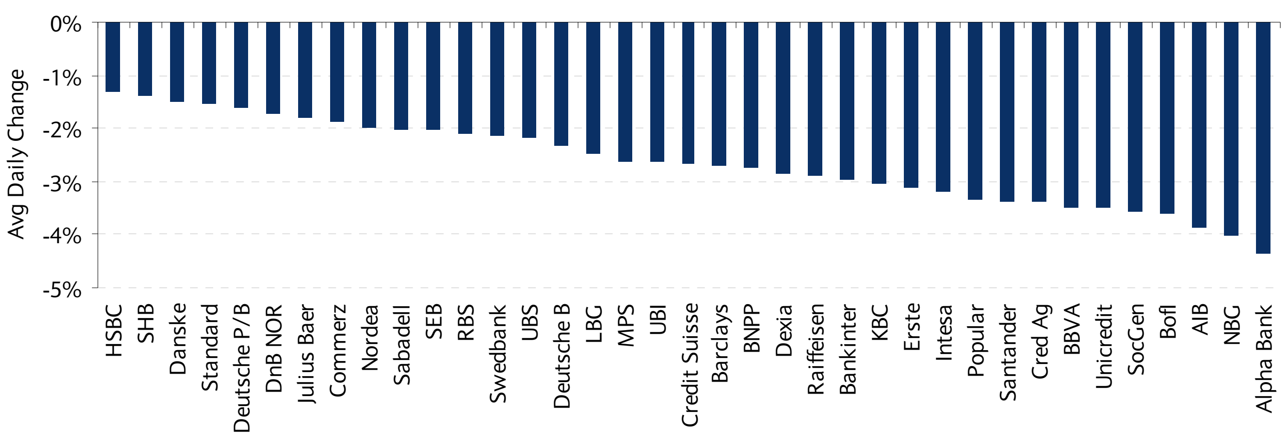
Source: CEBS

Of course, the materiality of this analysis is dependent on how sensitive each bank is to a change in the market perception of its SGIIP-related risk. After all, if the market is not worried about a particular bank's sovereign exposure, then additional disclosure that confirms this view will have limited price impact.

To this end, Figure 18 measures the average year-to-date price change of each European bank when the CDS spread of one of the SGIIP sovereigns increases by more than 20bps. In other words, which banks have sold off most when SGIIP sovereign risk has increased? Some of the results are hardly surprising: for instance, NBG and Alpha Bank show strong sensitivity, whilst HSBC, Standard Chartered and several Nordic banks are more or less indifferent to "bad days" for SGIIPs. However, this analysis does yield some interesting comparisons when set against the findings from the additional stress test information.

For instance, Santander and BBVA behave pretty similarly on "bad days" – yet the previous analysis suggests that Santander is less at risk. Similarly, SocGen and Credit Agricole are far more sensitive than is BNP Paribas. Whilst this is understandable given SocGen and Credit Agricole's greater commercial exposure to Greece, the magnitude of the difference is perhaps too big, since the sovereign exposures for both appear manageable. Finally, both Unicredit and Intesa appear to have very similar resilience to a sovereign stress of the banking book – and yet this year, Unicredit has exhibited greater sensitivity to SGIIP distress.

Figure 18: YTD average daily price change when SGIIP CDS spread increases by 20bps or more



Source: DataStream, Barclays Capital

So we can perhaps glimpse a basis for differentiating among banks on funding, as a result of the stress test. But the stress test does little to improve the structural funding challenges facing European banks. We estimate that the industry has maturing term debt totaling €1.5trn by the end of 2012, which – when adding in the c €500bn of central bank liquidity that will need, at some stage, to be refinanced independently – suggests funding challenges remain.

ANALYST(S) CERTIFICATION(S)

We, Simon Samuels, Mike Harrison, Jeremy Sigee, Tom Rayner, Kiri Vijayarajah, Rohith Chandra-Rajan and Antonio Rizzo, hereby certify (1) that the views expressed in this research report accurately reflect our personal views about any or all of the subject securities or issuers referred to in this research report and (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this research report.

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Materially Mentioned Stocks (Ticker, Date, Price)

Allied Irish Banks PLC (ALBK.I, 23-Jul-2010, EUR 0.90), 3-Underweight/2-Neutral

Banca Monte dei Paschi di Siena (BMPS.MI, 23-Jul-2010, EUR 0.96), 1-Overweight/2-Neutral

Banco Bilbao Vizcaya Argentaria S.A. (BBVA.MC, 23-Jul-2010, EUR 9.84), 3-Underweight/2-Neutral

Banco Santander SA (SAN.MC, 23-Jul-2010, EUR 10.12), 3-Underweight/2-Neutral

Bank of Ireland (BKIR.I, 23-Jul-2010, EUR 0.74), 3-Underweight/2-Neutral

BNP Paribas (BNPP.PA, 23-Jul-2010, EUR 49.82), 1-Overweight/2-Neutral

Commerzbank AG (CBKG.DE, 23-Jul-2010, EUR 6.44), 3-Underweight/2-Neutral

Credit Agricole SA (CAGR.PA, 23-Jul-2010, EUR 9.36), 3-Underweight/2-Neutral

Credit Suisse Group AG (CSGN.VX, 23-Jul-2010, CHF 44.33), 2-Equal Weight/2-Neutral

Deutsche Bank AG (DBKGn.DE, 23-Jul-2010, EUR 49.75), 1-Overweight/2-Neutral

Deutsche Postbank AG (DPBGn.DE, 23-Jul-2010, EUR 23.30), 2-Equal Weight/2-Neutral

HSBC Holdings PLC (HSBA.L, 23-Jul-2010, GBP 6.46), 1-Overweight/2-Neutral

Intesa Sanpaolo (ISP.MI, 23-Jul-2010, EUR 2.40), 2-Equal Weight/2-Neutral

Julius Baer (BAER.VX, 23-Jul-2010, CHF 36.08), 2-Equal Weight/2-Neutral

KBC Groep NV (KBC.BR, 23-Jul-2010, EUR 33.59), 1-Overweight/2-Neutral

Lloyds Banking Group PLC (LLOY.L, 23-Jul-2010, GBP 0.64), 3-Underweight/2-Neutral

Royal Bank of Scotland Group PLC (RBS.L, 23-Jul-2010, GBP 0.45), 1-Overweight/2-Neutral

Skandinaviska Enskilda Banken AB (SEBa.ST, 23-Jul-2010, SEK 47.89), 2-Equal Weight/2-Neutral

Société Générale (SOGN.PA, 23-Jul-2010, EUR 38.00), 2-Equal Weight/2-Neutral

Standard Chartered PLC (STAN.L, 23-Jul-2010, GBP 18.24), 2-Equal Weight/2-Neutral

Swedbank AB (SWEDa.ST, 23-Jul-2010, SEK 79.00), 1-Overweight/2-Neutral

UBI Banca (UBI.MI, 23-Jul-2010, EUR 8.00), 2-Equal Weight/2-Neutral

UBS AG (UBSN.VX, 23-Jul-2010, CHF 15.47), 3-Underweight/2-Neutral

UniCredit (CRDI.MI, 23-Jul-2010, EUR 2.04), 1-Overweight/2-Neutral

Other Material Conflicts

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European Banks

Allied Irish Banks PLC (ALBK.I)	Banca Monte dei Paschi di Siena (BMPS.MI)	Banco Bilbao Vizcaya Argentaria S.A. (BBVA.MC)
Banco Santander SA (SAN.MC)	Bank of Ireland (BKIR.I)	BNP Paribas (BNPP.PA)
Commerzbank AG (CBKG.DE)	Credit Agricole SA (CAGR.PA)	Credit Suisse Group AG (CSGN.VX)
Deutsche Bank AG (DBKGn.DE)	Deutsche Postbank AG (DPBGn.DE)	HSBC Holdings PLC (HSBA.L)
Intesa Sanpaolo (ISP.MI)	Julius Baer (BAER.VX)	KBC Groep NV (KBC.BR)
Lloyds Banking Group PLC (LLOY.L)	Royal Bank of Scotland Group PLC (RBS.L)	Skandinaviska Enskilda Banken AB (SEBa.ST)
Société Générale (SOGN.PA)	Standard Chartered PLC (STAN.L)	Swedbank AB (SWEDa.ST)
UBI Banca (UBI.MI)	UBS AG (UBSN.VX)	UniCredit (CRDI.MI)

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