

Banking on Europe

The 3R's of European Banking*

- **Return of Capital Back on the Table** — The capital return story is growing with 4 out of 6 Nordic banks beating on 2013 dividends, including a higher-than-consensus first dividend at Danske Bank (Buy, Focus list, DKr150) since 2007. UBS provided clear guidance of its intention to payout over 50% while BNP Paribas also looks well-placed. Regulatory 'creep' may delay 'specials' but not necessarily dividend payout 'normalisation'.
- **Regulation No Longer One-Directional** — On the back of LCR (liquidity) forbearance, we have also seen Leverage and NSFR (stable funding) 'softening' while ring-fencing requirements have been 'kicked into the long grass'. Overall, the broad contours of regulation have largely been defined, although banks need to do more around resolution mechanisms.
- **Banking Union Should Reduce Sector Risk Premium** — We expect the AQR & stress-test to introduce greater transparency on 'problem' assets and speed-up the 'healing' process – including via 4Q13 'front-loading' of impairments. An illustrative 'stress-test' – based on AQR, macro shock, RWA harmonisation & sovereign stress – could drive c€12bn additional capital needs at a minimum 5.5% level, rising to €27bn at a more conservative 6.5% fully-loaded ratio.
- **Restructuring & Provisioning Normalisation To Drive Upgrades** — Banks have targeted cost programmes of c10% of expense base, of which two-thirds has yet to be delivered. We expect market focus to increasingly shift from balance sheet metrics towards provision 'normalisation' – we see a 'normalised' sector RoTE of c13% in the current low-rate environment. The major Swiss banks and UK international banks remain most geared to the rising US rates cycle.
- **Overweight Banks, Further Rerating Potential** — We estimate European banks trade at 5.3x P/GOP (+1 year) vs pre-Eurozone crisis average of 6.2x (c85%), or 0.7x US banks vs. a historical average of 0.8x. Our Focus list comprises of: Barclays (TP £3.45), BNP Paribas (TP €71), ING (TP €11.60) & Danske (TP DKr150).

***CORRECTION:** The previous version of this report contained incorrect stress test output data for Banco Popolare di Milano, as stated in Figure 24. This also led to incorrect sector-level capital shortfall data on pages 1, 4 and 25. This version is correct.

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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1) 3Rs of European Banking

Retain sector Overweight – supported by Restructuring, Recovery & Return of Capital potential

■ **Return of Capital:** 'Snowball' effect in payout ratios in the context of limited balance sheet growth

- **Dividend Vikings:** In FY13 season, positive dividend surprises from 4 out of 6 Nordic banks: Danske restarted dividends for the first time since 2007; SHB and Swedbank announced 70%+ payout ratios while DnB beat
- **2013E:** Following Natixis 'special', BNP Paribas could announce higher dividend payout / share buybacks
- **2014E:** Barclays, CS, Danske, Lloyds, SocGen, UBS (>50% payout ratio)
- **2015E:** Bankinter, Erste, ING, ISP, KBC
- Regulatory 'creep' may delay 'specials' but not necessarily dividend payout 'normalisation'

■ **Restructuring** and provisioning normalisation should drive earnings upgrades, over time

- Banks have targeted cost programmes of c10% of expense base, of which one-third has been achieved
- Market focus should gradually shift from balance sheet metrics towards normalised' provisioning and returns.

■ **Regulation:** Banking Union should serve to reduce sector risk premium

- ECB-supervised AQR/stress-test to speed-up the 'healing' process, especially via increased transparency
- Regulation is no longer one-directional e.g. LCR (liquidity), Liikanen (ring-fencing), NSFR (stable retail deposits, operational deposits, 6-12m wholesale funding), DTA forbearance
- Basel leverage forbearance broader than expected going beyond repo netting, derivatives variation margin netting and calibrated approach on off-balance sheet credit lines. Also covers written credit derivatives and importantly, double-counting of centrally cleared derivatives.

■ **Valuation:** Citi European Banks universe trades at:

- 5.3x P/GOP (+1 year) vs pre-Eurozone crisis average of 6.2x (c85%); 0.7x US average vs 15 year average of 0.8x
- On our estimates, Barclays, BES and DBK (all Buy-rated) trade at more than 20% discount to EU sector average & own history

■ **Focus List::** Barclays (TP £3.45), BNP Paribas (TP €71), ING (TP €11.60) & Danske (TP DKr150)

2014 – What to Watch Out For?

Focus on Rates cycle and Resolution & Recovery planning

■ **Capital Issuance:** Selective equity capital raising from AQR/stress-test process

- Banks with relatively high levels of problem loans relative to capital remain most at risk: Greek, Italian and Spanish banks albeit with risks partly offset by DTA forbearance (eg Spain)
- Recent examples of strengthening capital include: Raiffeisen (RBI, €2.78bn to redeem €2.5bn of participation capital), Banco Popolare (BP, €1.5bn partly to reimburse €1.0bn convertible bond), Banco Popular (€450m), Banco de Sabadell (€1.4bn), Bank of Ireland (€580m to redeem €1.8bn state aid), Erste Bank (€660m) and Barclays Bank (£5.8bn). Pending capital increase at Banco Popolare di Milano (BPM, €0.5bn) and Monte dei Paschi (MPS, €2.5bn). Disposals include: Santander Consumer Finance IPO (US\$1.8bn) and BBVA CITIC stake sale (US\$1.3bn).
- Greater risks from unquoted sector given limited market access
- Mock stress-test: B3 capital sector-level capital ratio declines from 9.8% to 7.6% with shortfall of c€12bn at 5.5% min, c€27bn at 6.5% and c€58bn at 7.5%
- Market focus to increasingly shift to additional 'bail-in' buffer: AT1 and T2 capital.

■ **Regulation:** Shift to Recovery & Resolution planning

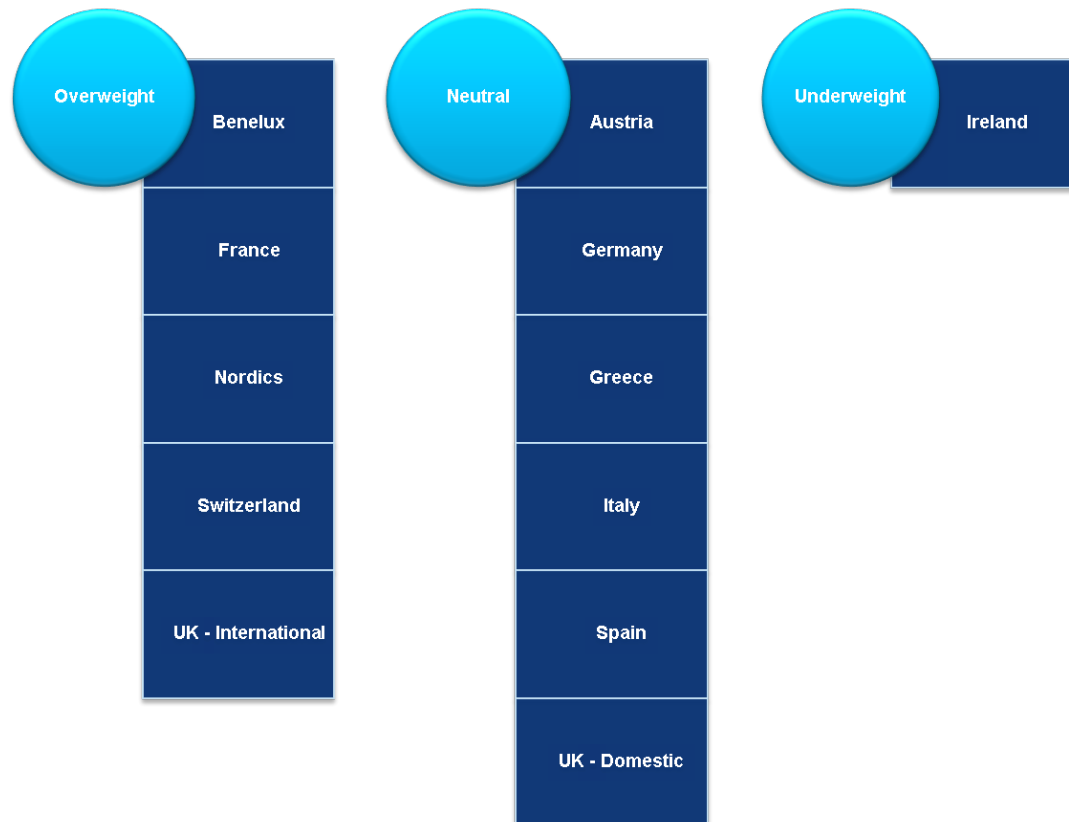
- Loss absorbency and bail-in regime blurring lines between equity and debt
- Move to substantial & deeper tranches of loss-absorbing capacity to stand behind B3 capital
- SPE vs MPE approach: SPE simpler for regulators; much depends on banks' existing structure

■ **Rates Cycle:** Higher USD rates offer opportunity for "under-earning" US\$ balance sheets

- On a 12m view, 4-5 year duration has moved by: SFr 30-50bps; € curve up 40-50bps; USD 60-90bps; GBP 90-110bps
- Swiss Banks & UK International best-positioned given surplus USD balance sheets

Country Weighting

Figure 1. Recommendations by Country Weighting



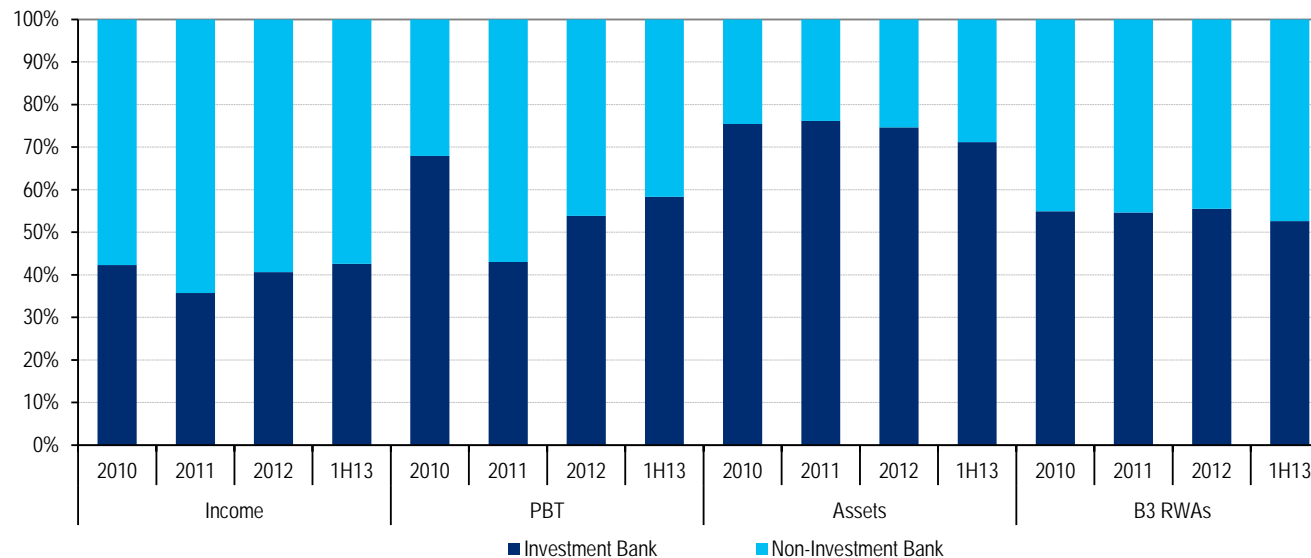
Source: Citi Research

Barclays (Focus) – (BARC.L; Buy; TP £3.45)

Risk premium decline from balance sheet deleveraging; improving returns from cost plans

- **Regulation** – Rights issue should materially reduce future uncertainty on capital
- **Retail Banking** – Respectable growth and returns in UK Retail and BarclayCard
- **Capital Markets** – Opportunity to be a winner in the consolidating world of capital markets
- **Catalysts** – Evidence of cost take-out over 2014e.

Figure 2. Focus on Shrinking IB Assets



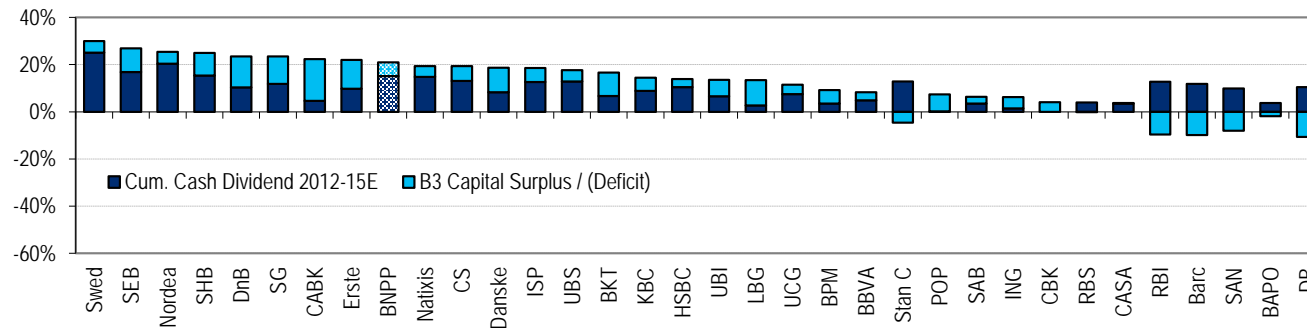
Source: Citi Research

BNP Paribas (Focus) – (BNPP.PA; Buy; TP €71)

Capital return and restructuring should drive re-rating

- **Restructuring** – €2bn cost reduction (c8% of cost base)
- **Return of Capital** – Payout ratio of 40-50% as well as potential share and minority interest buybacks
- **Regulation** – Risk premium reduction from greater regulatory clarity (e.g. leverage, ring-fencing)
- **Recovery** – In domestic markets in France, Italy and Belgium
- **Catalyst** – Early-2014 strategic plan

Figure 3. Capital Surplus Position (Post- Dividends) % Market Cap, By Bank, 2015E



Source: Citi Research

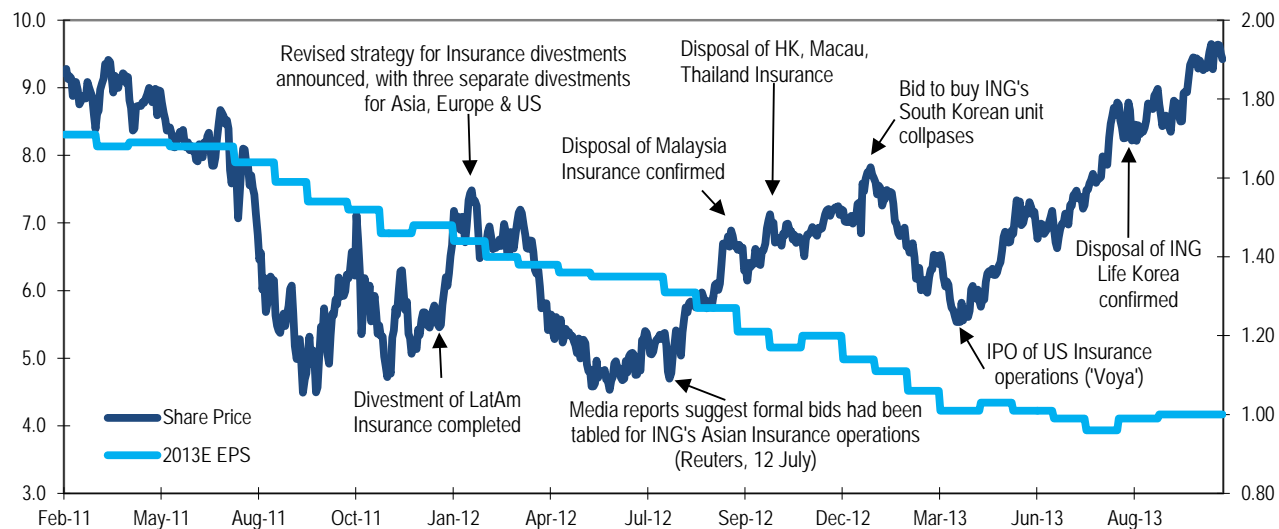
Note: 1) Barclays, BPM, MPS & SAB are adjusted for capital raise 2) Swiss banks are adjusted for special dividend as well 3) BAPO excludes potential positive effect from conversion of outstanding convertibles 4) DNB equity T1 capital is on B1 transitional rules basis

ING Groep (Focus) – (ING.AS; Buy; TP €11.60)

Restructuring story with improving fundamentals at ING Bank

- Progress on Divestments – Asia and US divestments are now almost complete and Insurance Europe appears to be on track “for a base case IPO in 2014”
- Capital Return – 40% payout ratio in 2015E rising to 50% in 2016E, equivalent to 5.5% dividend yield
- EPS Momentum – After two years of negative earnings momentum at ING Bank there are signs that this has now reversed
- Catalysts – Further progress on insurance divestments, improving net interest margins, slowing impairments as well as upcoming Bank investor day

Figure 4. Progress on Divestments & EPS Momentum



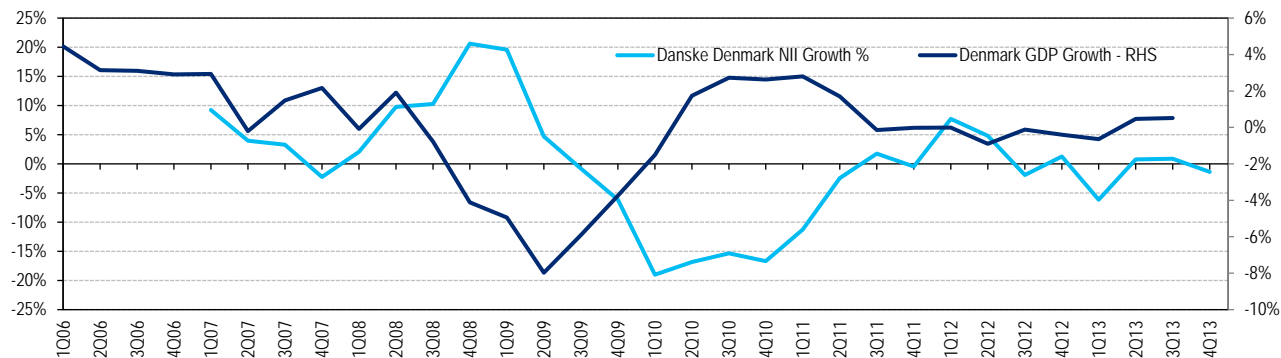
Source: Datastream and Citi Research

Danske (Focus) – (DANSKE.CO; Buy; TP Dkr150)

Recovery story backed by restructuring plan and capital return potential

- **Valuation** – Lowest rated Nordic bank trading at 1.0x P/TB 2014E
- **Recovery** – Emerging Danish economic recovery set to improve revenue trends
- **Restructuring** – New CEO's income and cost initiatives aim to improve the RoE from 4.9% (9M13) to 9% by 2015 and to 12% in the long term
- **Return of Capital** – Fully loaded B3 CT1 ratio increased to 12.8% at 4Q13, with first dividend since 2007 of Dkr2.0/share vs. consensus of Dkr1.29
- **Catalyst** – New CEO's cost reduction plan, lower impairments and normalisation of trading & insurance income

Figure 5. GDP Recovery Encouraging for NII Growth



Source: Company Reports, IMF, Citi Research

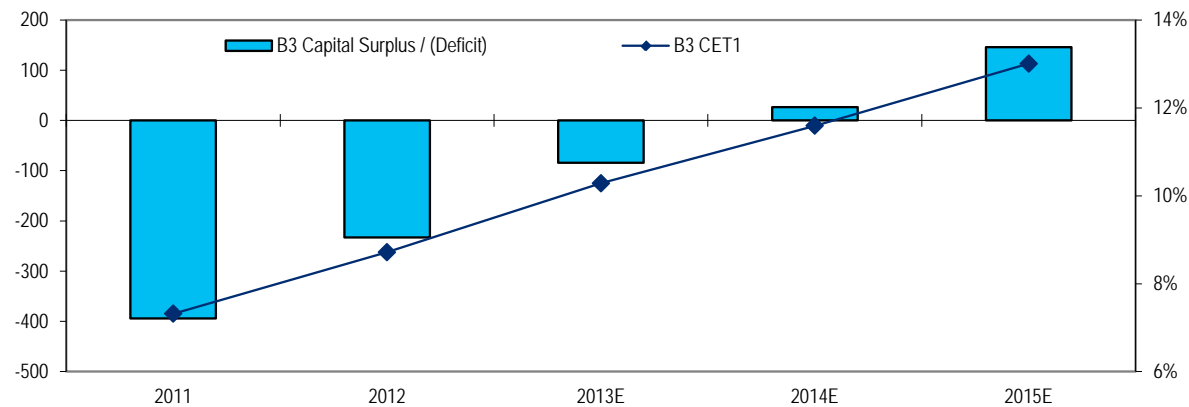
2) Return of Capital

Inflection Point in Sector Capital

Sector capital surplus grows to over c€150bn by 2015E, from deficit of over c€400bn at end-2011

- We assume that banks meet a minimum B3 'fully-loaded' ratio of 10%
- Risk-weight assets adjusted for mortgages and trading book

Figure 6. Sector Capital Deficit Turning to Surplus, 2011-2015E (€bn)



Source: Company Reports and Citi Research Estimates

Note: 1) Europe ex Greece and Portugal; 2) We assume minimum mortgage risk-weights of 15% and apply a +50% surcharge on internal model-based market risk RWAs

Figure 7. Citi B3 CET1 Ratio (Fully Loaded) Target Estimate, 2015E

| Stock | Citi B3 CET1 Ratio Tgt | Stock | Citi B3 CET1 Ratio Tgt | Stock | Citi B3 CET1 Ratio Tgt | Stock | Citi B3 CET1 Ratio Tgt |
|------------------|------------------------|--------------------|------------------------|-----------------|------------------------|----------------------|------------------------|
| BNP Paribas | 10.0% | UBI Banca | 10.5% | Credit Suisse | 11.5% | Raiffeisen Bank Intl | 12.0% |
| Commerzbank | 10.0% | Credit Agricole | 11.0% | Banco Popular | 12.0% | RBS | 12.0% |
| ING | 10.0% | Erste Bank | 11.0% | Banco Santander | 12.0% | Nordea | 13.0% |
| KBC | 10.0% | HSBC | 11.0% | Bankinter | 12.0% | SE Banken AB | 13.0% |
| Natixis | 10.0% | Intesa Sanpaolo | 11.0% | BBVA | 12.0% | SHB | 13.0% |
| Societe Generale | 10.0% | Lloyds Banking Grp | 11.0% | Bco de Sabadell | 12.0% | Swedbank | 13.0% |
| Banco Popolare | 10.5% | Standard Chartered | 11.0% | CaixaBank | 12.0% | UBS | 13.0% |
| BP Milano | 10.5% | UniCredit | 11.0% | Danske Bank | 12.0% | DnB | 13.5% |
| Monte dei Paschi | 10.5% | Barclays | 11.5% | Deutsche Bank | 12.0% | | |

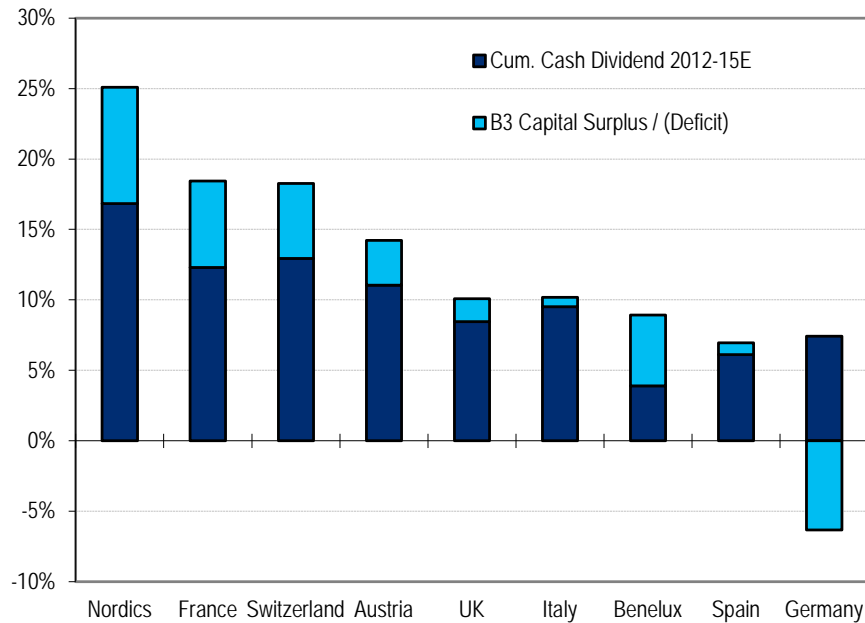
Source: Citi Estimates

Which Countries Are Best-placed?

Nordic, French and Swiss banks remain amongst best-placed for capital return, in our view

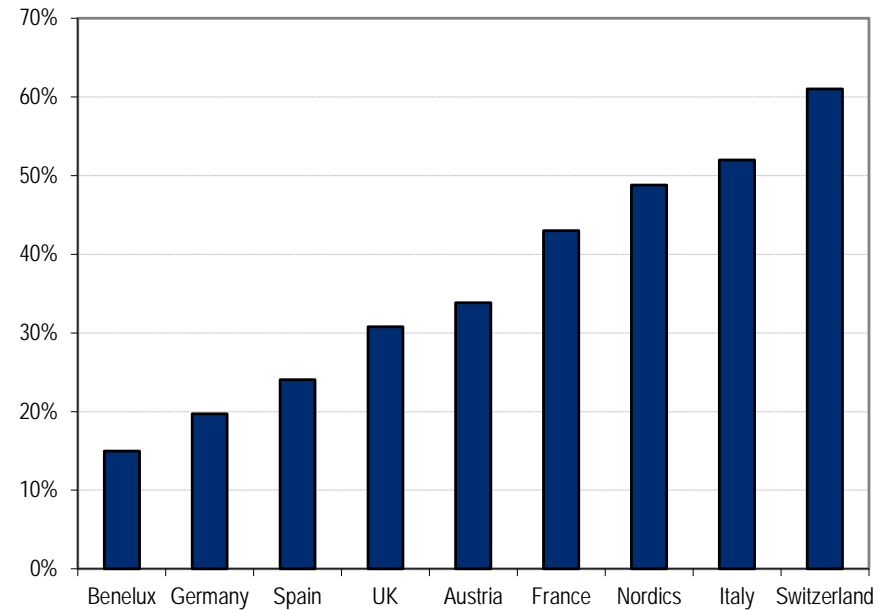
- The Nordic, French and Swiss banks remain amongst the best-placed banks for capital return
- By contrast, Italy, Spain and Germany continue to lag; Erste & RBI capital raise has helped address Austria's gap
- Subject to AQR risk (e.g. higher coverage for Italian banks)
- Regulatory 'creep' may delay 'specials' but not necessarily dividend payout 'normalisation'

Figure 8. Capital Surplus Position: By Country, 2015E, % of Market Cap



Source: Citi Research Estimates

Figure 9. Average Payout Ratios 2014-2015E: By Count



Source: Citi Research

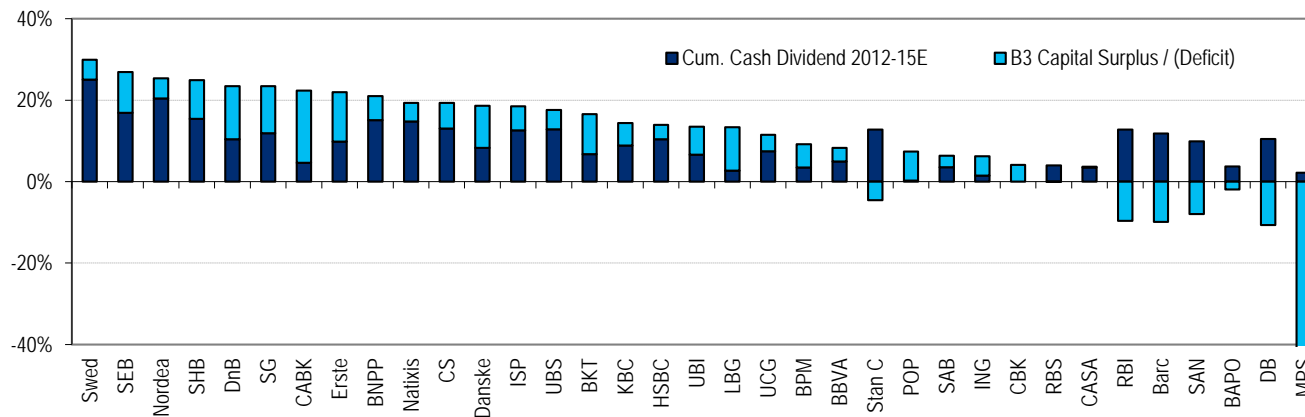
Note: Including our assumptions of special dividends, notably for Swiss banks over 2014-15E

Which Banks Are Best-placed?

2013 confirmed that markets reward increase in payout ratios

- **Dividend Vikings:** In FY13 season, positive dividend surprises from 4 out of 6 Nordic banks: Danske restarted dividends for the first time since 2007; SHB and Swedbank announced 70%+ payout ratios while DnB beat
- **2013E:** Following Natixis 'special', BNP Paribas could announce higher dividend payout / share buybacks
- **2014E:** Barclays, CS, Danske, Lloyds, SocGen, UBS (>50% payout ratio)
- **2015E:** Bankinter, Erste, ING, ISP, KBC
- Regulatory 'creep' may delay 'specials' but not necessarily dividend payout 'normalisation'

Figure 10. Capital Surplus Position: By Bank, 2015E, % of Market Cap



Source: Citi Research;

Notes: 1) Barclays, MPS & SAB are adjusted for Capital raise; 2) Swiss banks are adjusted for special dividends 3)BAPO excludes potential positive effect from conversion of outstanding convertibles

Is Capital Return An Illusion? Nordics Case Study

Swedish banks remain well-capitalised and were leading performer in 2013, despite tougher standards

- **Dividend Vikings:** In FY13 season, positive dividend surprises from 4 out of 6 Nordic banks: Danske restarted dividends for the first time since 2007; SHB and Swedbank announced 70%+ payout ratios while DnB beat
- The Swedish regulator increased the mortgage risk weight floor to 25%. Fully loaded B3 CET1 ratios remain strong after adjustment
- YoY capital ratios increased more than triple-digit basis points
- Nordic banks have the highest capital surplus in Europe as measured relative to equity market value
- We estimate that average cash dividend payout ratio for Nordic banks will exceed 50% by 2015

Figure 11. Gross T1 Capital, as a % of B3 RWAs (vs. 1.5% B3 Requirement)

| Capital Position of Nordic Banks | | | | | | | | | |
|----------------------------------|-------|-------|-------|-------|-------|-------|---------|------|-----|
| B3 FL CET1 | 3Q12 | 4Q12 | 1Q13 | 2Q13 | 3Q13 | 4Q13 | 25% RWA | QoQ | YoY |
| Danske Bank | 10.7% | 12.5% | 13.1% | 13.6% | 12.2% | 12.8% | | +60 | +2 |
| DnB* | 10.0% | 10.7% | 10.6% | 10.8% | 11.0% | 11.8% | | +80 | +11 |
| Nordea | 11.2% | 11.7% | 12.1% | 13.1% | 13.4% | 14.6% | 14.0% | +120 | +29 |
| SEB | 13.2% | 13.1% | 13.3% | 14.2% | 15.0% | 15.0% | 13.7% | +0 | +19 |
| SHB | 15.9% | 16.4% | 17.5% | 17.8% | 18.8% | 18.9% | 14.4% | +10 | +24 |
| Swedbank | 15.4% | 15.4% | 16.4% | 17.2% | 18.0% | 18.3% | 14.3% | +30 | +29 |

Source: Company Reports and Citi Research Estimates;

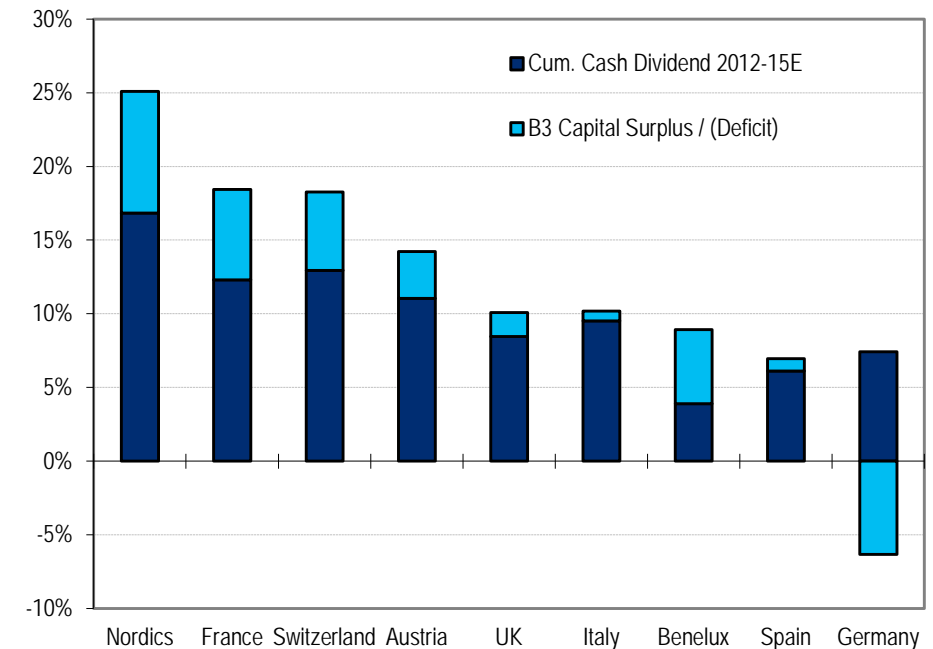
Note: *DNB numbers show Equity T1 capital on B1 transitional rules basis

Nordics Banks Cash Payout Ratio Exceeds 50% by 2015

| | 2012 | 2013E | 2014E | 2015E |
|--------------|------|-------|-------|-------|
| Nordics | 46% | 49% | 48% | 50% |
| Danske Bank | 0% | 29% | 35% | 39% |
| DnB | 25% | 23% | 22% | 25% |
| Nordea | 43% | 58% | 63% | 74% |
| SE Banken AB | 52% | 50% | 52% | 55% |
| SHB | 47% | 51% | 51% | 52% |
| Swedbank | 75% | 82% | 75% | 75% |

Source: Company Reports, Citi Research Estimates

Figure 12. Capital Surplus Position: By Country, 2015E, % of Market Cap



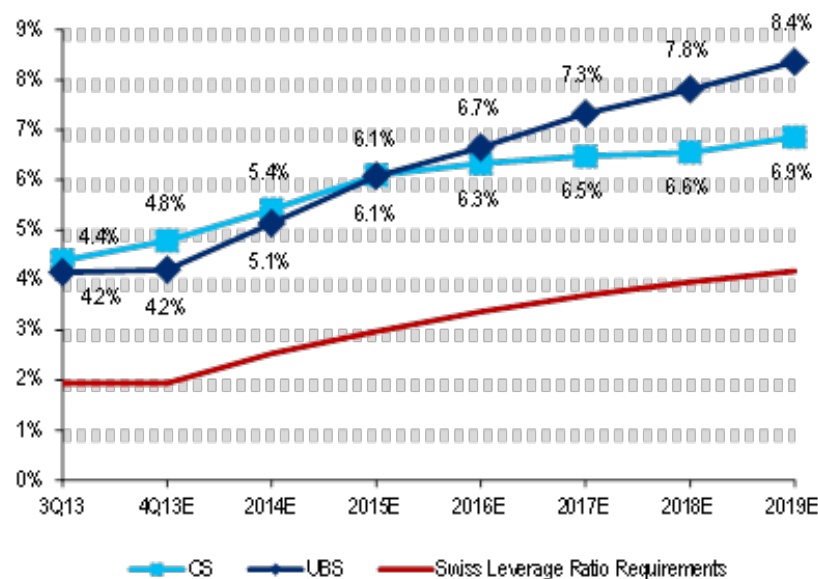
Source: Company Reports, Citi Research Estimates Note: 1) Last Updated for end-2Q13

Is Capital Return An Illusion? Swiss Case Study

Swiss banks' leverage concerns are overdone, in our view

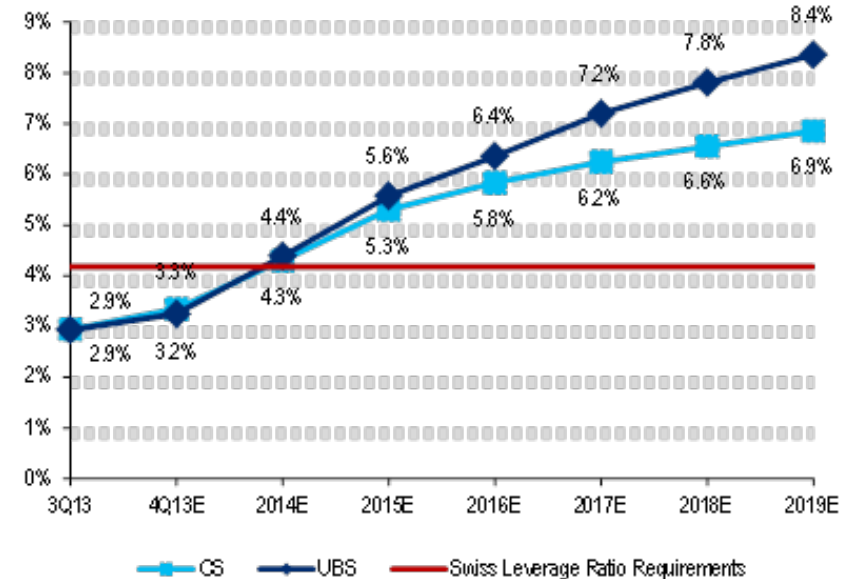
- Significant regulatory uncertainty caused by:
 - UBS operational RWA add-on (SFr28bn), and
 - The Swiss Finance Minister quoted as stating that a 6-10% leverage ratio is “being discussed”
- 'Gold-plating' to 6% leverage ratio cannot be ruled-out but potential mitigating factors include:
 - Rebates from becoming more 'resolvable'
 - Exclusion of liquidity buffers
- TBTF process being driven by Expert Commission and likely to be phased in over several years from 2015
- Both CS & UBS forecast to achieve 6% 'phase-in' FINMA leverage ratio by end-2015E

Figure 13. Phase-in FINMA Leverage Ratio



Source: Company Reports and Citi Research Estimates

Figure 14. Fully Loaded FINMA Leverage Ratio



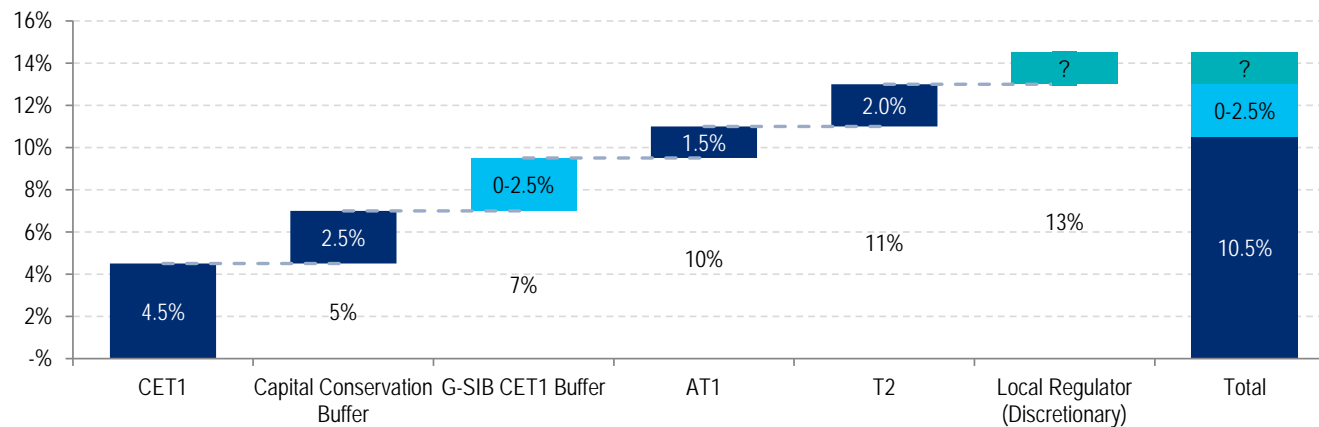
Source: Company Reports and Citi Research Estimates

From Equity To Additional “Bail-In” Capital

Focus to shift from Equity to AT1/T2 issuance

- Much of the market's focus to date has been on banks building up equity capital ratios
- However the Basel III capital stack also includes 1.5% AT1 and 2.0% T2 requirements
 - AT1 also forms part of the Capital Measure to meet leverage ratio requirements
- National regulators could potentially also raise these minimum requirements to higher levels to deepen loss-absorbing capacity

Figure 15. Fully-Loaded Basel III Minimum Capital Requirements Plus G-SIB and Discretionary Regulatory Buffers



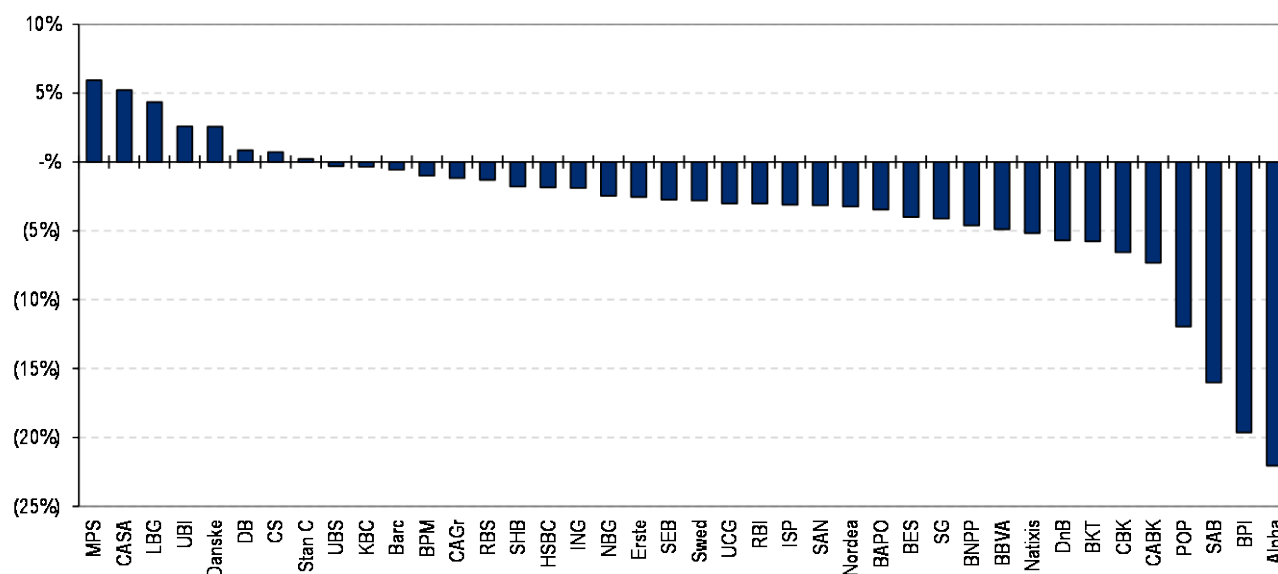
Source: <http://www.bis.org>; Citi Research

Additional “Bail-In” Capital – Winners & Losers

Greek, Portuguese and Spanish banks most impacted by cost of new capital structure

- Vast majority of European banks likely to be negatively impacted transitioning to new capital structure. Greek, Portuguese, and Spanish banks likely to be among most heavily impacted, as well as BNPP & SG.
- Banks with relatively high levels of ‘legacy’ hybrids are likely to see a more limited negative earnings impact from substitution to ‘new generation’ AT1/T2 instruments
- We find that a higher proportion of banks meet the 2.0% T2 requirement than the 1.5% AT1 requirement

Figure 16. Illustrative P&L Impact, as a % of Normalised Pre-Provision Operating Income



Source: Citi Research Estimates;

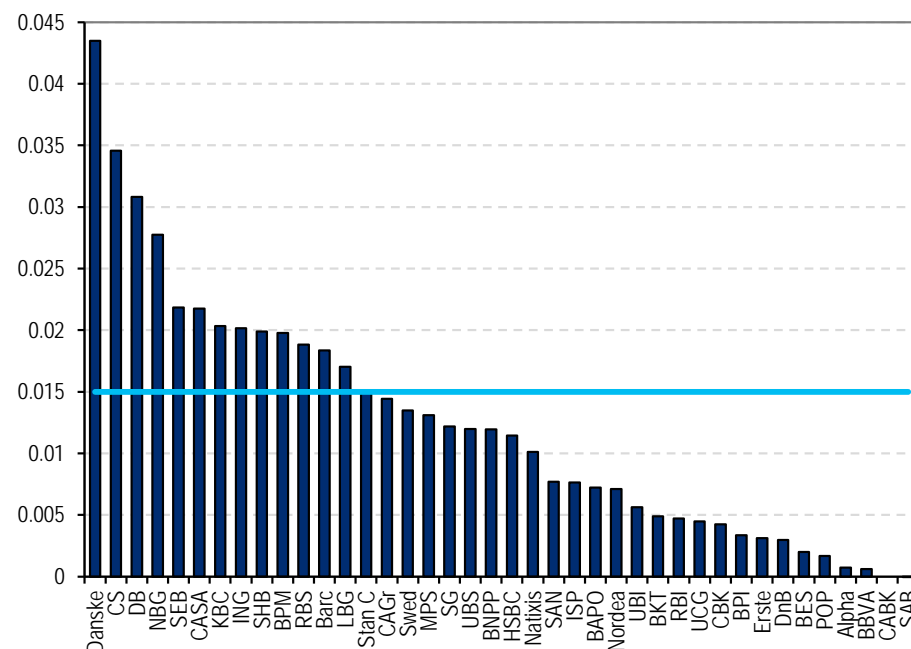
Note: Illustrative P&L impact of replacing legacy positions with new AT1/T2 capital to meet minimum B3 requirements

Additional “Bail-In” Capital – AT1 & T2 Capital

Spanish banks relatively weaker on both existing T1 & T2 instruments

- AT1 – Danske, CS and Deutsche Bank have strongest legacy T1 capital positions (c.3-4.5% of B3 RWAs).
 - UK domestic banks seem relatively well-positioned; Spanish banks amongst the weakest
- T2 – Most banks already have enough T2 capital to meet 2.0% requirement
 - Italian and UK banks on average have the greatest surplus to threshold level; Greek, Portuguese, Nordic and Spanish fare the worst
 - BNPP has the least T2 capital of all major European wholesale banks

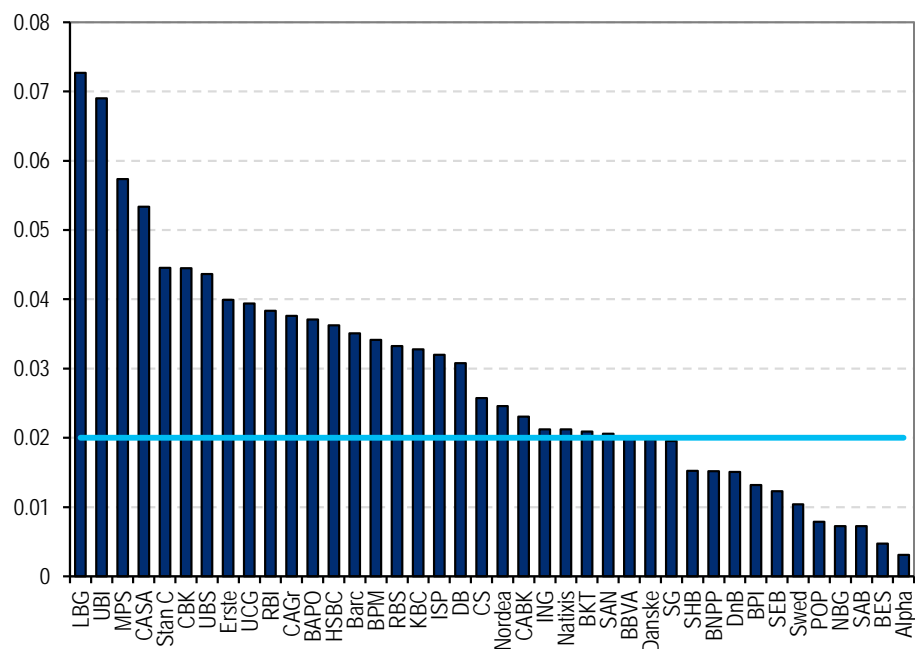
Figure 17. Gross T1 Capital, as a % of B3 RWAs (vs. 1.5% B3 Requirement)



Source: Company Reports, Citi Research

Note: 1) 10% grandfathering of AT1 securities p.a. assumed; 2) Last updated for end-2Q13

Figure 18. Gross T2 Capital, as a % of B3 RWAs (vs. 2.0% B3 Requirement)



Source: Company Reports, Citi Research

Note: 1) Last Updated for end-2Q13

Snowball Effect on Sector Dividend Yield (2012-2015E)

Figure 19. European Banks Dividend Cheat Sheet

| | | DPS (€) | | | | Dividend Yield (%) | | | | | | DPS (€) | | | | Dividend Yield (%) | | | |
|-------------------------|----------|---------|-------|-------|-------|--------------------|-------------|-------------|-------------|----------------------|-----------|------------|------------|------------|------------|--------------------|-------------|-------------|-------------|
| | | 2012 | 2013E | 2014E | 2015E | 2012 | 2013E | 2014E | 2015E | | | 2012 | 2013E | 2014E | 2015E | 2012 | 2013E | 2014E | 2015E |
| Benelux | | | | | | 3.8% | 0.0% | 2.4% | 4.9% | Italy | | | | | | 1.3% | 0.9% | 1.6% | 4.2% |
| KBC | KBC.BR | 1.00 | 0.00 | 1.00 | 2.00 | 3.8% | 0.0% | 2.4% | 4.9% | Banco Popolare | BAPO.MI | 0.00 | 0.00 | 0.03 | 0.05 | 0.0% | 0.0% | 1.9% | 3.8% |
| ING | ING.AS | 0.00 | 0.00 | 0.00 | 0.40 | 0.0% | 0.0% | 0.0% | 4.0% | BP Milano | PMII.MI | 0.00 | 0.00 | 0.00 | 0.02 | 0.0% | 0.0% | 0.0% | 4.6% |
| Austria | | | | | | 2.8% | 2.9% | 3.5% | 4.2% | Intesa Sanpaolo | ISP.MI | 0.05 | 0.05 | 0.07 | 0.09 | 3.8% | 2.8% | 3.7% | 5.1% |
| Erste Bank | ERST.VI | 0.40 | 0.60 | 0.80 | 1.00 | 1.7% | 2.3% | 3.1% | 3.9% | Monte dei Paschi | BMP.SI | 0.00 | 0.00 | 0.00 | 0.01 | 0.0% | 0.0% | 0.0% | 5.7% |
| Raiffeisen Bank Intl | RBIV.VI | 1.17 | 0.85 | 0.95 | 1.10 | 3.9% | 3.5% | 3.9% | 4.5% | UBI Banca | UBI.MI | 0.05 | 0.05 | 0.11 | 0.18 | 1.4% | 1.1% | 2.3% | 3.6% |
| France | | | | | | 2.5% | 3.4% | 4.3% | 5.3% | UniCredit | CRDI.MI | 0.09 | 0.09 | 0.10 | 0.14 | 2.4% | 1.7% | 1.9% | 2.6% |
| BNP Paribas | BNPP.PA | 1.50 | 2.00 | 2.46 | 2.97 | 3.5% | 3.6% | 4.4% | 5.3% | Nordics | | | | | | 4.1% | 3.7% | 4.2% | 5.2% |
| Credit Agricole | CAGR.PA | 0.00 | 0.35 | 0.38 | 0.44 | 0.0% | 3.9% | 4.1% | 4.8% | Danske Bank | DANSKE.CO | 0.00 | 0.27 | 0.54 | 0.74 | 0.0% | 1.6% | 2.3% | 4.4% |
| Natixis | CNAT.PA | 0.10 | 0.14 | 0.19 | 0.25 | 4.7% | 3.2% | 4.5% | 5.8% | DnB | DNB.OL | 0.28 | 0.29 | 0.30 | 0.36 | 2.9% | 2.2% | 2.3% | 2.8% |
| Societe Generale | SOGN.PA | 0.45 | 1.15 | 1.75 | 2.25 | 1.6% | 2.8% | 4.2% | 5.4% | Nordea | NDA.ST | 0.34 | 0.45 | 0.55 | 0.70 | 4.7% | 4.7% | 5.8% | 7.4% |
| Germany | | | | | | 1.1% | 1.1% | 1.1% | 2.2% | SE Banken AB | SEBa.ST | 0.32 | 0.38 | 0.43 | 0.49 | 4.9% | 4.0% | 4.6% | 5.2% |
| Commerzbank | CBKG.DE | 0.00 | 0.00 | 0.00 | 0.00 | 0.0% | 0.0% | 0.0% | 0.0% | SHB | SHBa.ST | 1.24 | 1.33 | 1.39 | 1.51 | 4.6% | 3.8% | 4.0% | 4.3% |
| Deutsche Bank | DBKGn.DE | 0.75 | 0.75 | 0.75 | 1.50 | 2.3% | 2.2% | 2.2% | 4.4% | Swedbank | SWEDa.ST | 1.14 | 1.16 | 1.30 | 1.37 | 7.7% | 5.8% | 6.5% | 6.9% |
| Greece | | | | | | 0.0% | 0.0% | 0.0% | 0.0% | Switzerland | | | | | | 2.4% | 2.0% | 2.7% | 4.3% |
| Alpha Bank | ACBr.AT | 0.00 | 0.00 | 0.00 | 0.00 | 0.0% | 0.0% | 0.0% | 0.0% | Credit Suisse | CSGN.VX | 0.62 | 0.61 | 0.61 | 1.63 | 3.5% | 2.8% | 2.8% | 7.4% |
| National Bank of Greece | NBGr.AT | 0 | 0 | 0 | 0 | 0.0% | 0.0% | 0.0% | 0.0% | EFG Internatnl | EFGN.S | 0.08 | 0.12 | 0.20 | 0.33 | 1.1% | 1.2% | 2.0% | 3.2% |
| Portugal | | | | | | 0.0% | 0.0% | 0.0% | 0.0% | Julius Baer | BAER.VX | 0.50 | 0.49 | 0.57 | 0.73 | 1.9% | 1.4% | 1.7% | 2.1% |
| Banco BPI | BBPI.LS | 0.00 | 0.00 | 0.00 | 0.00 | 0.0% | 0.0% | 0.0% | 0.0% | UBS | UBSN.VX | 0.12 | 0.16 | 0.41 | 0.61 | 1.1% | 1.2% | 3.0% | 4.5% |
| Banco Espirito | BES.LS | 0.00 | 0.00 | 0.00 | 0.00 | 0.0% | 0.0% | 0.0% | 0.0% | Vontobel | VONN.S | 1.00 | 1.06 | 1.14 | 1.22 | 4.3% | 3.6% | 3.9% | 4.2% |
| Spain | | | | | | 4.8% | 3.5% | 3.4% | 4.8% | UK | | | | | | 2.0% | 2.2% | 3.2% | 5.1% |
| Banco Popular | POP.MC | 0.00 | 0.04 | 0.07 | 0.11 | 0.0% | 0.9% | 1.6% | 2.4% | Barclays | BARC.L | 7.40 | 7.66 | 15.08 | 22.92 | 2.5% | 2.4% | 4.7% | 7.2% |
| Banco Santander | SAN.MC | 0.60 | 0.60 | 0.50 | 0.60 | 9.8% | 9.3% | 7.8% | 9.3% | HSBC | HSBA.L | 31.90 | 36.15 | 38.87 | 42.53 | 4.0% | 4.6% | 4.9% | 5.4% |
| Bankinter | BKT.MC | 0.05 | 0.08 | 0.08 | 0.20 | 2.5% | 1.5% | 1.6% | 4.0% | Lloyds Banking Group | LLOY.L | 0.00 | 0.00 | 1.81 | 4.82 | 0.0% | 0.0% | 1.9% | 5.2% |
| BBVA | BBVA.MC | 0.42 | 0.37 | 0.37 | 0.37 | 6.0% | 4.2% | 4.2% | 4.2% | RBS | RBS.L | 0.00 | 0.00 | 0.00 | 12.06 | 0.0% | 0.0% | 0.0% | 3.0% |
| Bco de Sabadell | SABE.MC | 0.03 | 0.00 | 0.02 | 0.04 | 1.6% | 0.0% | 1.1% | 1.9% | Standard Chartered | STAN.L | 65.36 | 67.68 | 70.48 | 76.57 | 3.4% | 4.2% | 4.4% | 4.7% |
| CaixaBank | CABK.MC | 0.23 | 0.20 | 0.15 | 0.25 | 8.8% | 5.3% | 4.0% | 6.7% | Sector | | 117 | 125 | 143 | 182 | 2.4% | 2.1% | 2.6% | 4.0% |

Source: Company Reports, Citi Research Estimates

European banks: Key features of recent hybrid issuance

| Issuer | Tier | Issuer Date | Maturity | Ccy | Cpn | Reset | Amount (mn) | Coupon language | Basis of Trigger | Loss Absorption Mechanism | Trigger | Reg Call / Cap. event |
|---------------------------|------------------|-------------|----------|--------|--------|-----------------|-------------|---------------------------|---|--------------------------------------|---|--------------------------------|
| Alternative Tier 1 | | | | | | | | | | | | |
| ACAAP | AT1 | 15-Jan-14 | Perp-24 | \$ | 7.88% | 5y\$ m/s+489.8 | 2 | Fully opt. | B3 (Transitional) CET1 / RWAs | Temporary principal write-down | Transitional CET1<5.125% (S.A.) or CET1<7% (Group) | Current Principal Amount=100 |
| SocGen | AT1 | 11-Dec-13 | Perp-23 | \$ | 7.88% | 5y\$ m/s+503.6 | 1,750 | Fully opt. | B3 (Transitional) CET1 / RWAs | Temporary principal write-down | B3 CET1 <5.125% | Current Principal Amount (CPA) |
| Credit Suisse | AT1 | 04-Dec-13 | Perp-23 | \$ | 7.50% | 5y\$ m/s+459.8 | 2,250 | Opt. - incl. div. stopper | B3 (Transitional) CET1 / RWAs | Full Permanent Writedown | CET1 + high trigger instruments <5.125% or non-viability | 103 |
| Barclays | AT1 | 13-Nov-13 | Perp-18 | \$ | 8.25% | 5y\$ m/s+670.5 | 2,000 | Fully opt. | B3 (fully loaded) CET1 / RWAs | Full Conv. Into Equity &/or cash | B3 fully loaded CET1 <7.00% | Par |
| Banco Popular | AT1 | 03-Oct-13 | Perp-18 | € | 11.50% | 5y€ m/s+1,023.7 | 500 | Fully opt. | B3 (Transitional) CET1 / RWAs | Full Conv. into Equity | B3 CET1 <5.125%, T1<6% ANDBank/(| Par |
| SocGen | AT1 | 29-Aug-13 | Perp-18 | \$ | 8.25% | 5y\$ m/s+639.4 | 1,250 | Fully opt. | B3 (Transitional) CET1 / RWAs | Temporary principal write-down | B3 fully loaded CET1 <5.125% | CPA |
| BBVA | AT1 | 26-Apr-13 | Perp-18 | \$ | 9.00% | 5y\$ m/s+826.2 | 1,500 | Fully opt. | CET1 / Capital Principal / EBA CT1 / T1 Ratio | Full Equity Conv. | 1) CET1 < 5.125%; 2) EBA CT1 < 7.0% 3) Cap. Principal < 7.0% | Par |
| Rabobank | AT1 | 09-Nov-11 | Perp-17 | \$ | 8.40% | 5yUST m/s+749 | 2,000 | Fully opt. | Equity Capital Ratio (Equity / RWAs) | Pro-rata Permanent Write-down | Equity Capital Ratio < 8.0% | Par |
| Rabobank | AT1 | 19-Jan-11 | Perp-16 | \$ | 8.38% | 5yUST m/s+642.5 | 2,000 | Fully opt. | Equity Capital Ratio (Equity / RWAs) | Pro-rata Permanent Write-down | Equity Capital Ratio < 8.0% | Par |
| Tier 2 / Senior | | | | | | | | | | | | |
| Credit Agricole | T2 | 12-Sep-13 | 33-18 | \$ | 8.13% | 5y\$ m/s+628.3 | 1,000 | Must pay | B3 (Transitional) CET1 / RWAs | Full Permanent Writedown | B3 CET1 <7.0% | Par |
| Credit Suisse | T2 (Low Trigger) | 11-Sep-13 | 25-20 | € | 5.75% | 5y\$ m/s+400 | 1,250 | Must pay | B3 (Transitional) CET1 / RWAs | Full Permanent Writedown | 1) B3 CET1 <5.0% or 2) non-viability declaration by FINMA | Par / 103 on Cap. Event |
| Credit Suisse | T2 (Low Trigger) | 08-Aug-13 | Aug-23 | \$ | 6.50% | - | 2,500 | Must pay | B3 (Transitional) CET1 / RWAs | Full Permanent Writedown | 1) B3 CET1 <5.0% or 2) non-viability declaration by FINMA | Par / 103 on Cap. Event |
| UBS | T2 (PBC) | 22-May-13 | 23-18 | \$ | 4.75% | 5y\$ m/s+376.5 | 1,500 | Must pay | B3 (Transitional) CET1 / RWAs | Full Permanent Writedown | 1) B3 CET1 <5.0% or 2) non-viability declaration by FINMA | Par / 101 on Cap. Event |
| Barclays | T2 | 04-Apr-13 | 23-18 | \$ | 7.75% | 5y\$ m/s+683.3 | 1,000 | Must pay | B3 (Transitional) CET1 / RWAs | Full Permanent Writedown | B3 CET1 <7.0% | Par |
| KBC | T2 | 17-Jan-13 | 23-18 | \$ | 8.00% | 5y\$ m/s+709.7 | 1,000 | Must pay | B3 (Transitional) CET1 / RWAs | Full Permanent Writedown | B3 CET1 <7.0% | Par |
| Barclays | T2 | 21-Nov-12 | Nov-22 | \$ | 7.63% | - | 3,000 | Must pay | B3 (Transitional) CET1 / RWAs | Full Permanent Writedown | B3 CET1 <7.0% | Par |
| UBS | T2 (PBC) | 10-Aug-12 | Aug-22 | \$ | 7.63% | - | 2,000 | Must pay | B3 (Transitional) CET1 / RWAs | Full Permanent Writedown | 1) B3 CET1 <5.0% or 2) non-viability declaration by FINMA | Par / 101 on Cap. Event |
| Credit Suisse | T2 (BCN) | 03-Mar-12 | 22-17 | CHF | 7.13% | 5y m/s+668.5 | 750 | Must pay | B3 (Transitional) CET1 / RWAs | Full Equity Conv. | 1) B3 CET1 <7.0% or 2) non-viability declaration by FINMA | 102 |
| UBS | T2 (PBC) | 22-Feb-12 | 22-17 | \$ | 7.25% | 5y\$ m/s+606.1 | 2,000 | Must pay | B3 (Transitional) CET1 / RWAs | Full Permanent Writedown | 1) B3 CET1 <5.0% or 2) non-viability declaration by FINMA | Par / 101 on Cap. Event |
| Bank of Ireland | T2 | 29-Jul-11 | Jul-16 | € | 10.00% | - | 1,000 | Must pay | B3 (Transitional) CET1 / RWAs | Full Conv. into Equity | 1) B3 CET1 <8.25% or 2) non-viability declaration by CBI | - |
| Credit Suisse | T2 (BCN) | 24-Feb-11 | 41-16 | \$ | 7.88% | 5y\$ m/s+522 | 2,000 | Must pay | B3 (Transitional) CET1 / RWAs | Full Equity Conv. (Variable) | 1) B3 CET1 <7.0% or 2) non-viability declaration by FINMA | 102 |
| Yorkshire B/S | T2 | 01-Apr-10 | Apr-15 | £ | 13.50% | - | 100 | Must pay | B2 CT1 (static) / RWAs | Conversion to PPDS | B2 CT1 <5% | Par |
| Rabobank | Senior | 12-Mar-10 | 43891 | € | 6.88% | - | 1,250 | Must pay | Equity Capital Ratio (Equity / RWAs) | Permanent principal writedown to 25% | Equity Capital Ratio <7.0% | - |
| Lloyds | LT2/UT2 | 01-Dec-09 | 10Y Perp | \$/£/€ | Var. | - | - | Must pay | B2 CT1 (static) / RWAs | Full Equity Conv. (Fixed) | B2 CT1 <5% | Var. |

Source: Bond Prospectuses, Citi

3) Regulation – No Longer One Directional

Regulation – No longer one-directional

Banking Union & regulatory forbearance to reduce the sector risk premium

- ECB-supervised AQR/stress-test to speed-up the 'healing' process, especially via increased transparency
- Regulation is no longer one-directional e.g. FTT (Financial Transaction Tax), LCR (liquidity), Liikanen (ring-fencing), NSFR (stable funding), DTA (Spain) forbearance
- Basel leverage forbearance was broader than expected going beyond repo netting, derivatives variation margin netting and calibrated approach on off-balance sheet credit lines. Also covers written credit derivatives and importantly, double-counting of centrally cleared derivatives.

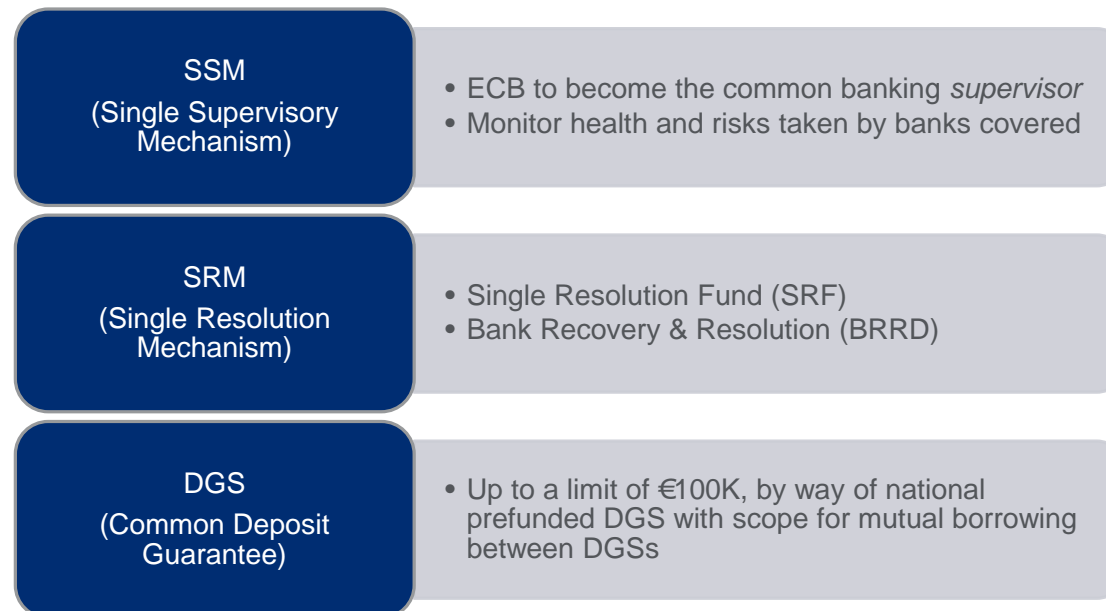
Focus on:

- **3 Pillars of Banking Union** – Single Supervisory Mechanism (SSM), Single Resolution Mechanism (SRM) and Deposit Guarantee Scheme (DGS)
- **AQR** – 'front-loading' of provision reserves
- **Bank Recovery and Resolution Directive (BRRD)** – recovery & resolution planning
- **Stress Test methodology** – asset quality, macro shock & risk-weights, notably sovereign-related

Three Pillars of Banking Union (BU)

Over-complicated and under-funded but wheels in motion – Banking Union to reduce sector risk premium

Figure 20. Three Pillars of Banking Union (BU)



Source: Company Reports and Citi Research Estimates

ECB Comprehensive Assessment

Key Issues:

■ Supervisory Risk Assessment

- Addressing key risks in banks' balance sheets
- Capital benchmark based on 8% 'phased' B3 CET1 comprising of: 4.5% minimum + 2.5% capital conservation buffer + 1% systemic add-on
- For the AQR, the relevant deduction will be that as of 1 Jan 2014; for the stress test that of 'end of the horizon' – which we interpret as the end of the stress test horizon, possibly 2015-16
- Will also cover liquidity, leverage and funding

■ Asset Quality Review

- Focus on asset-side of banks' balance sheets
- All asset classes including NPLs, restructured loans and sovereign exposures will be covered
- Both credit and market exposures with "special consideration on level 3" assets
- Based on balance sheet data as of 31 Dec 2013
- Run by the ECB with the support of NCBs and Oliver Wyman

■ Stress-Test

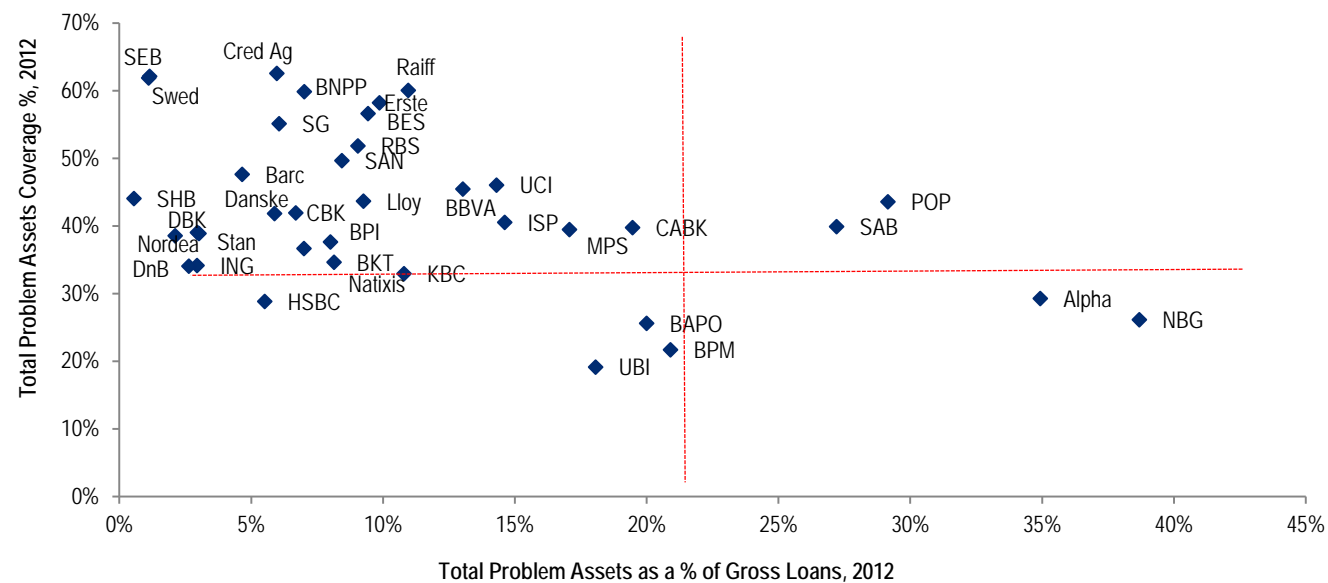
- Building-on and complementing AQR; in coordination & cooperation with EBA
- Forward-looking view of banks' shock-absorption capacity under stress over 2014-16 with minimum 5.5% transitional CET1 ratio
- Common stressed market parameters for trading, available for sale and fair value books
- ECB to publish further details in early-Feb 2014; further update in March/April on methodology & scenarios; one final result published at the end of the exercise
- Key unknowns: GDP or stress projections; treatment of sovereign exposure; and extent to which systemic risk taken into account

AQR – Assessing ‘Problem’ Assets & Coverage

AQR will create much greater consistency on ‘problem’ loans, for the first time

- Focus on restructured loans & problem categories like shipping, CRE and mortgages in some markets
- Expect front-loading, notably in 4Q13 (eg KBC guidance on Irish book, Banco Popolare, Deutsche Bank, Sabadell)

Figure 21. ‘Total Problem Assets % Gross Loans’ vs ‘Total Problem Assets Coverage’



Source: Company Reports, Citi Research

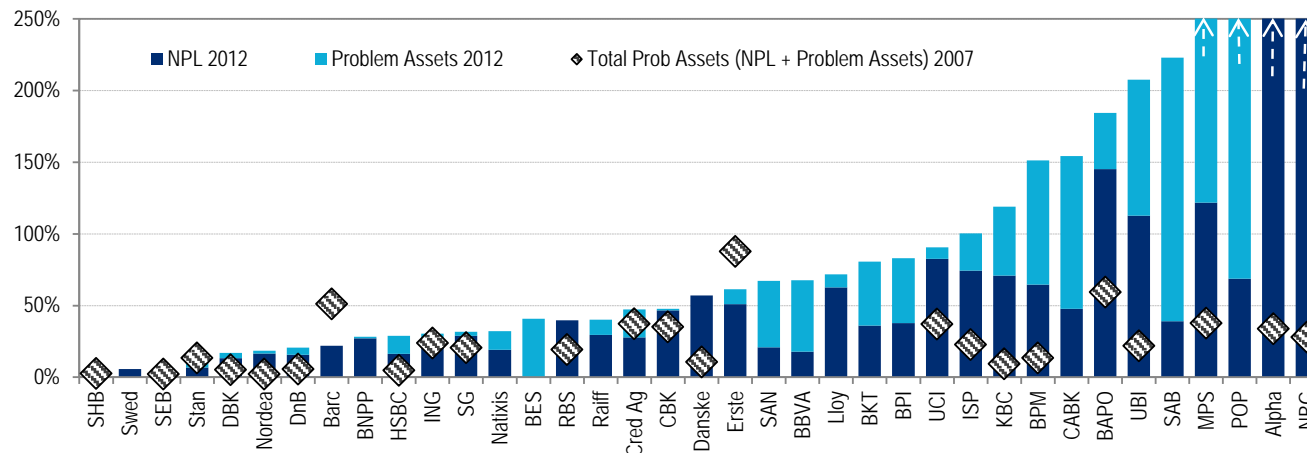
Note: 1) Problem asset add-ons (where available) include 90 day past due loans but unimpaired, foreclosed assets and performing / substandard restructured loans; Total Problem Assets = NPLs + Problem assets add-ons. 2) The ratio ‘Uncovered Total Problem Assets % TBV’ excludes collateral

AQR – Kicking the Tyres

AQR will help to speed-up the healing process

- Although most listed banks should get away with reserve strengthening, some may have to raise capital, undertake disposals to maintain adequate capital etc.
- Banks with relatively high levels of ‘unreserved’ problem loans relative to capital remain most at risk – Greek and Spanish (forborne loans) and Italian (provision coverage levels)

Figure 22. Uncovered Total Problem Assets % Tangible Equity



Source: Company Reports, Citi Research

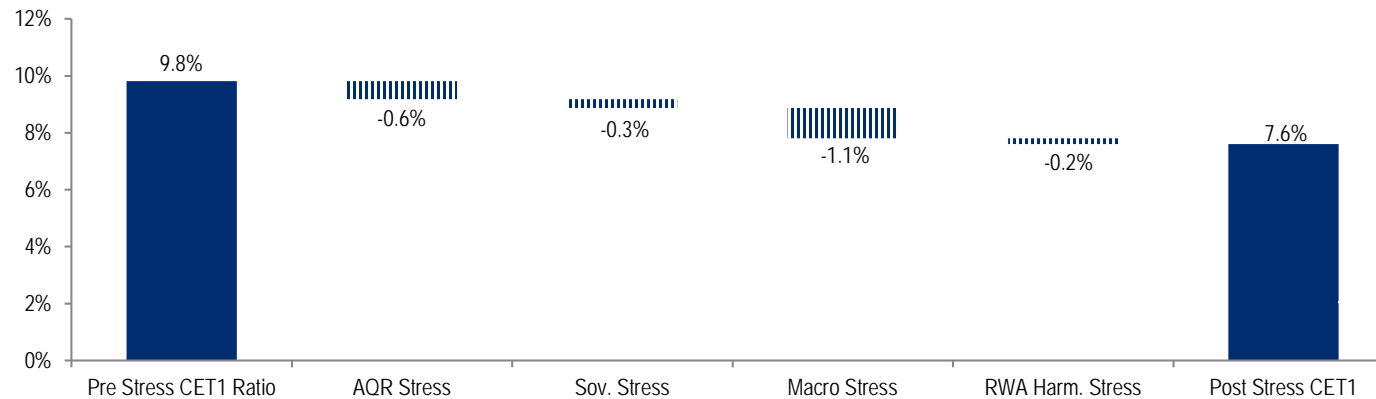
Note: 1) Problem asset add-ons (where available) include 90 day past due loans but unimpaired, foreclosed assets and performing / substandard restructured loans; Total Problem Assets = NPLs + Problem assets add-ons. 2) The ratio 'Uncovered Total Problem Assets % TBV' excludes collateral; 3) 2012 TBV adjusted for capital raises for Barclays, BAPO, BPM, Commerzbank, DB, Erste, MPS, POP, RBI & SAB; 4) Greek banks data based on 2Q13, defined as all impaired loans; 5) Adjusting BES definition on problem asset add-ons would inflate the total problem assets moderately

The UK banks provide mixed disclosure on forbearance and restructured loans. Four banks provide the outstanding stock of total restructured loans (RBS is the one exception), but only Lloyds, HSBC and Standard Chartered split out how these loans are then classified between ‘performing’ and ‘non-performing’ (RBS provides similar disclosure, but only on loans that were renegotiated during the year, rather than the stock). For this reason we have not included an add-on for performing restructured loans for the three UK domestic banks, which we have done for select European peers (but not for the Austrian banks, Nordic banks, BNPP, Commerzbank or KBC where disclosure is also lacking). If we were to include this add-on then uncovered total problem assets as a proportion of tangible book would be higher for the UK domestic banks e.g. for Lloyds we estimate this add-on would increase the percentage from 72% to 108%. Barclays, which has a smaller stock of restructured loans, is likely to be less impacted.

Illustration of Stress Tests – Sector Level

Sector-level capital shortfall of €12bn at 5.5% min, €27bn at 6.5% and €58bn at 7.5%

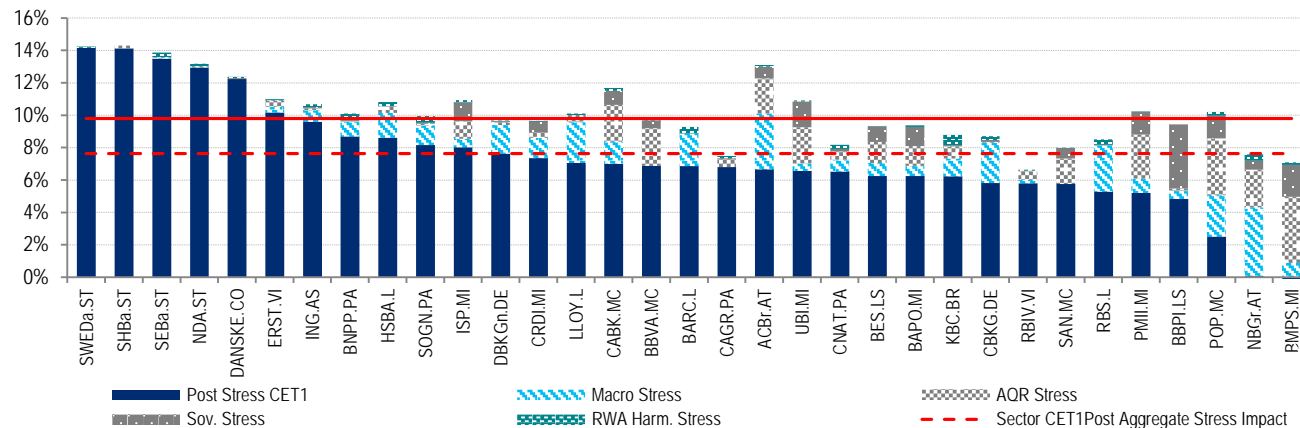
Figure 23. Stress Test – Citi European Banks Universe



Source: Citi Research, Citi Estimates, EBA 2011 Stress Test, Company Reports

Note: See next page "Illustration of Stress-Test – Methodology & Assumptions" for details and stocks covered in analysis

Figure 24. Stress Test – Detailed Impact on Citi European Banks Universe



Source: Company Reports and Citi Research Estimates

Illustration of Stress-Test – Methodology & Assumptions

How do we do it?

■ Methodology – 4 Layers of Stress:

- Macro shock, based on revised impact from 2011 EBA stress test.
- Asset Quality Review (AQR) on expanded 'problem assets'
- Sovereign exposure shock on Trading + FVO and AFS exposures, based on 2011 EBA stress test
- RWA harmonisation across mortgage, trading and sovereign HTM exposures
- Impact could be markedly different this time around.

■ Assumptions:

- Based on end-2013 fully-loaded B3 CET1 ratios (more conservative)
- Macro shock based on 2011 EBA stress test albeit assuming 75% reduction in RWA inflation from securitisation positions, both banking & trading book. Worth noting that 2011 EBA stress-test may have extrapolated notably large trading losses, based on 2008 experience.
- AQR impact assumes coverage ratios remain unchanged on expanded 'problem assets' vs. existing NPL coverage ratio (may underestimate impact where issue is declining NPL coverage levels e.g. Italy)
- Asset quality data is based on end-2012 except Spanish banks that are based on end 1H13
- Stressed NPLs = Gross NPLs + Problem Assets (Restructured Loan, Foreclosed Loans, Past due > 90 days but not impaired)
- RWA harmonisation assumes minimum risk-weight of 15% on mortgages, +50% surcharge on market risk-weight and +10% on EEA sovereign exposure

■ Stocks Covered in Analysis:

| | | | | |
|-----------------|-----------------|--------------------|-------------------------|------------------|
| Alpha Bank | BBVA | Deutsche Bank | Monte dei Paschi | SHB |
| Banco BPI | BNP Paribas | Erste Bank | National Bank of Greece | Societe Generale |
| Banco Espirito | BP Milano | HSBC | Natixis | Swedbank |
| Banco Popolare | CaixaBank | ING | Nordea | UBI Banca |
| Banco Popular | Commerzbank | Intesa Sanpaolo | Raiffeisen Bank Intl | UniCredit |
| Banco Santander | Credit Agricole | KBC | RBS | |
| Barclays | Danske Bank | Lloyds Banking Grp | SE Banken AB | |

Who Pays? Towards Greater Burden Sharing

Key Issues:

■ De Facto Bail-in

- Revised EC State Aid rules: “*all capital generating measures including the conversion of junior debt should be exhausted, provided that fundamental rights are respected and financial stability is not put at risk*”. Banks are also required to have sound plans for restructuring or orderly wind-down before they can receive recapitalisations or asset protection measures

■ In Transition State (To 2015):

- Retained earnings, raise capital, asset sales, LME
- Bail-in according to EU State Aid rules (see above)
- National framework including resolution mechanisms and public backstops; credibility, effectiveness and consistency across national frameworks, reviewed regularly by the Commission State
- Use of €-area/EU level instruments: (i) ESM loan to Member State (ii) €60bn ESM direct recapitalisation instrument although in practice we believe mutualisation of past problems/legacy assets is very unlikely

■ In ‘Steady’ BRRD State (From 2016):

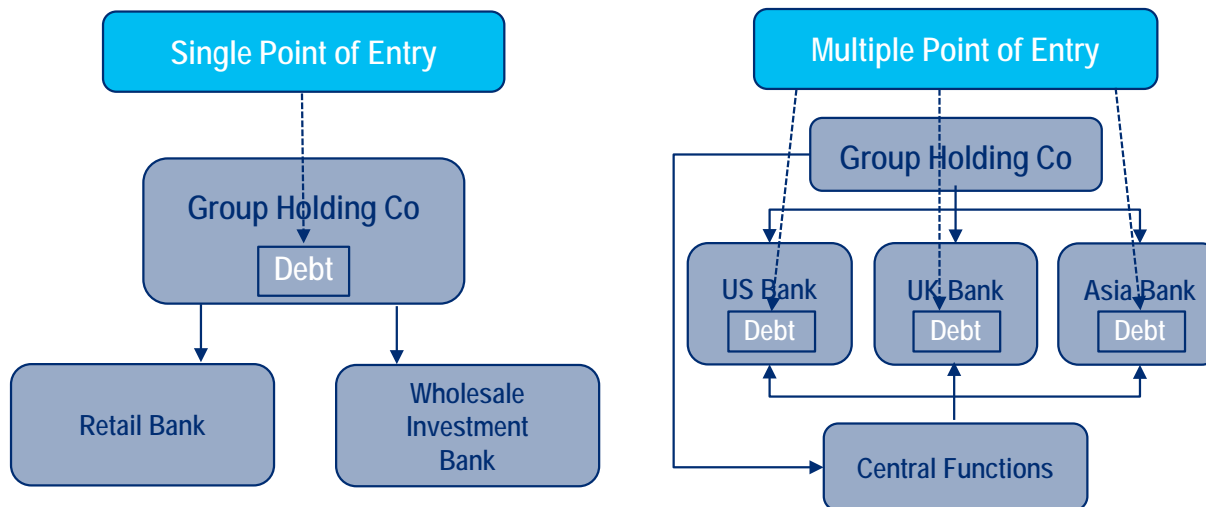
- Retained earnings, raise capital, asset sales, LME
- Bail-in of investor capital, which is mandatory up to 8% of bank’s non-risk-weighted assets before using any public sector money
- National resolution fund
- Single Resolution Fund
- ESM with maximum exposure of €60bn

Resolution – Single & Multiple Points of Entry

SPE vs. MPE approach: SPE simpler for regulators; much depends on banks' existing structure

- CS has proposed a SPE structure and plans to issue bail-in eligible debt out of the group holding company
- Multi-local banks (e.g. HSBC, SAN) likely to follow the MPE route

Figure 25. Single & Multiple Points of Entry

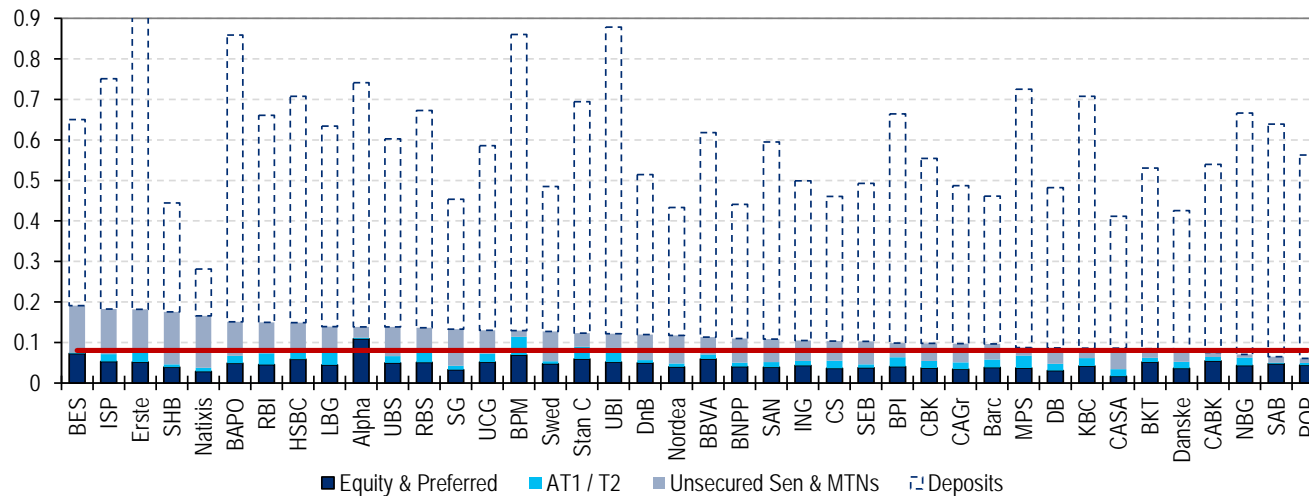


Source: RBS

European Banks – Loss-Absorbing Capital

- 'Open Bank' Resolution – Bank continues as a 'going concern' post bail-in
- 'Closed Bank' Resolution – Bank is split into two – a 'good' or 'bridge' bank and a 'bad' bank

Figure 26. Loss-Absorbing Capital vs. 8% Threshold, 2013



Source: Company Reports, Citi Research, Dealogic

Notes:

1. Senior unsecured debt and MTN data has been sourced from publicly-available information from Dealogic, except for Spanish banks for which total senior unsecured is per company disclosure
2. Senior unsecured debt and MTNs includes facilities at end-2Q13, except for SAN and CABK, which are at end-2012;
3. Senior unsecured debt and MTNs includes facilities with maturities and/or call dates after 30-Jun-14, except for POP, SAN, BKT, BBVA, and CABK, which include facilities for all maturities;
4. Erste Bank total assets reduced by 25% to remove effects due to consolidation of savings banks not fully owned;
5. Monte dei Paschi is proforma for expected €2.5bn equity issuance, per company announcement;
6. Banco de Sabadell is proforma for c.€1.4bn equity issuance in Sep-13; and
7. Barclays is proforma for c.€5.8bn equity issuance in Sep-13.

Looking Ahead

Figure 27. Key Upcoming Events

| | |
|--|--|
| ECB to communicate more details about AQR & Stress Test Methodology | 1Q 14 |
| Final adoption of Recovery and Resolution Directive ("RRD") (Scheduled date for vote in European Parliament Plenary session) | UPDATED (from 11/11/13) to February 2014 |
| Final adoption of Recovery and Resolution Directive ("RRD") (Scheduled date for vote in European Parliament Plenary session) | 3 to 6 February 2014 |
| ECB to finalise selection of portfolios for AQR | Mid-Feb 2014 |
| European Parliament election | 22-25 May 2014 |
| ECB Asset Quality Review | Q2-14 |
| Irish Bank PCAR | 1H-14 |
| EBA Stress Tests | 3Q-14 |

Source: Citi Research

Dialling Back on Leverage Ratio

First proposal usually toughest – expect further significant forbearance

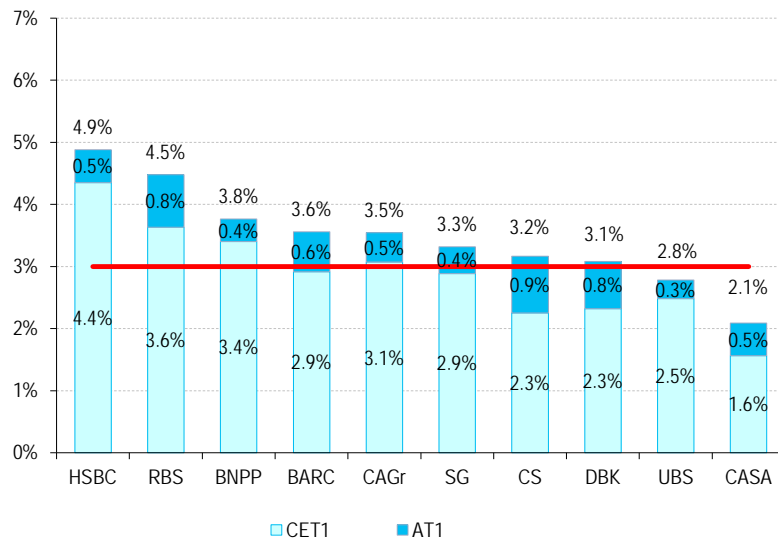
- Basel has significantly dialled back on June 2013 leverage proposal.
 - Use of variation margin netting against derivatives
 - Allowing netting of Securities Financing Transactions (repo) under certain conditions
 - Calibrated approach towards off-balance commitments (Standardised approach with floor of 10%)
 - Avoiding double counting of client centrally-cleared transactions
 - More favourable treatment of written credit derivatives
 - Highlighted per our notes '[Dialling-Back on Leverage Ratio?](#) (6 Dec 2013) and [Dialling-Back on Leverage Ratio? Part II](#) (3 Jan 2014)
- Together with continued progress on leverage exposure reduction, should *partly* alleviate leverage concerns

CRD4 Leverage Ratios at 3Q13 and 2014E

Basel leverage forbearance *partly* alleviates concerns around 'June 2013 Basel leverage proposal' that raised the stakes

- Most banks have met minimum 3% requirement at 3Q13 (giving credit for existing AT1) and should certainly be well above this threshold ahead of public disclosure starting in 2015
- Concerns are focused around:
 - June 2013 Basel leverage proposal which had much more stringent definitions, especially on netting, but forbearance on leverage rules should alleviate concerns
 - Potential deleveraging needs & impact on business model (e.g. Deutsche Bank)
 - Repo shrinkage & impact on market liquidity

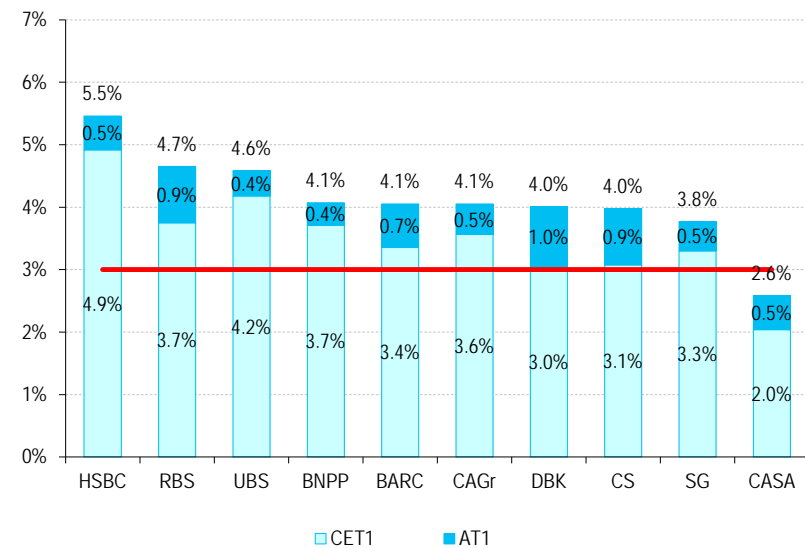
Figure 28. CRD IV Leverage Ratios – 3Q13



Source: Company Reports and Citi Research Estimates

Note: Regulators when looking at CASA look at the parent company level (CA Group)

Figure 29. CRD IV Leverage Ratios – 4Q14E



Source: Company Reports and Citi Research Estimates

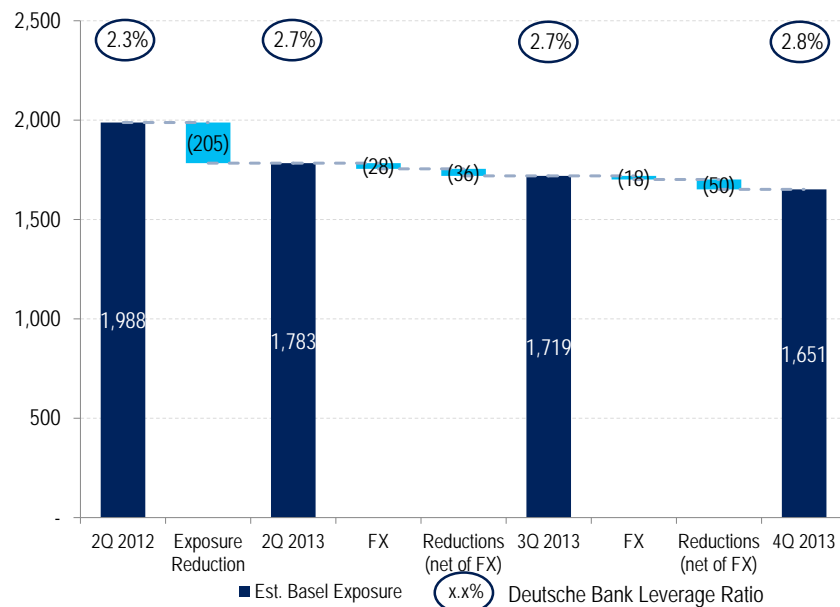
Note: Regulators when looking at CASA look at the parent company level (CA Group)

Deutsche Provides Roadmap To Leverage Reduction

€250bn leverage toolbox, in addition to €200bn reduction achieved in 12m to mid-2013

- Total CRD4 exposure reduction of c.€250bn, of which €86bn (excl. FX) already achieved in 2H13
- Within the total €250bn leverage toolbox:
 - 42% from reductions in SFTs, of which >75% will be due to trade compression, tear-up, re-striking and process enhancements
 - 24% from cash and collateral management
 - **Rest:** 16% Non-Core run-off/de-risking; 12% trading inventory reduction; and 6% off-balance sheet

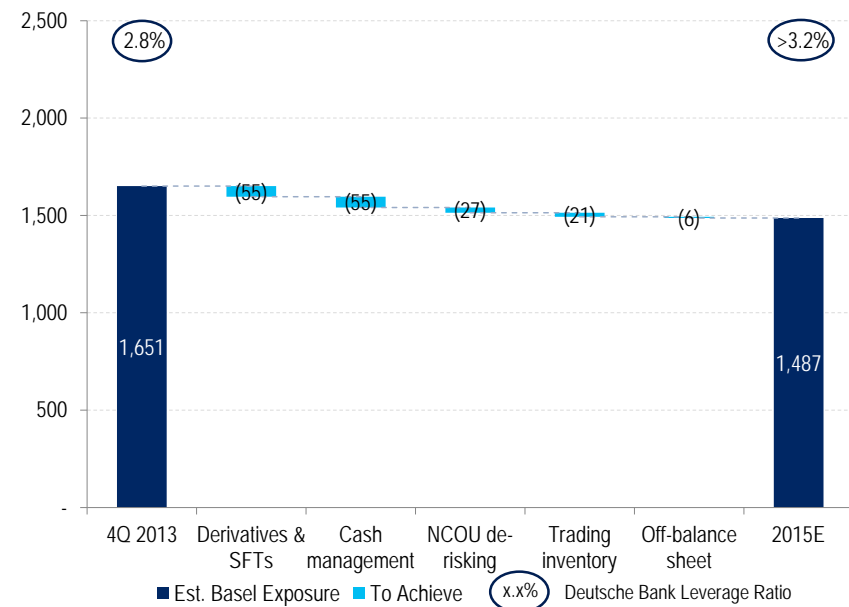
Figure 30. Estimated DBK Basel Exposure Progress – 2Q12 - 4Q13



Source: Company Reports, Citi Research Estimates

Note: Basel Exposure Measures in prior periods estimated by increasing disclosed CRD4 Exposure Measures by €200m, per the guidance for 4Q13 Basel Exposure

Figure 31. DBK Basel Leverage Exposure Guidance – 4Q13 - 2015E



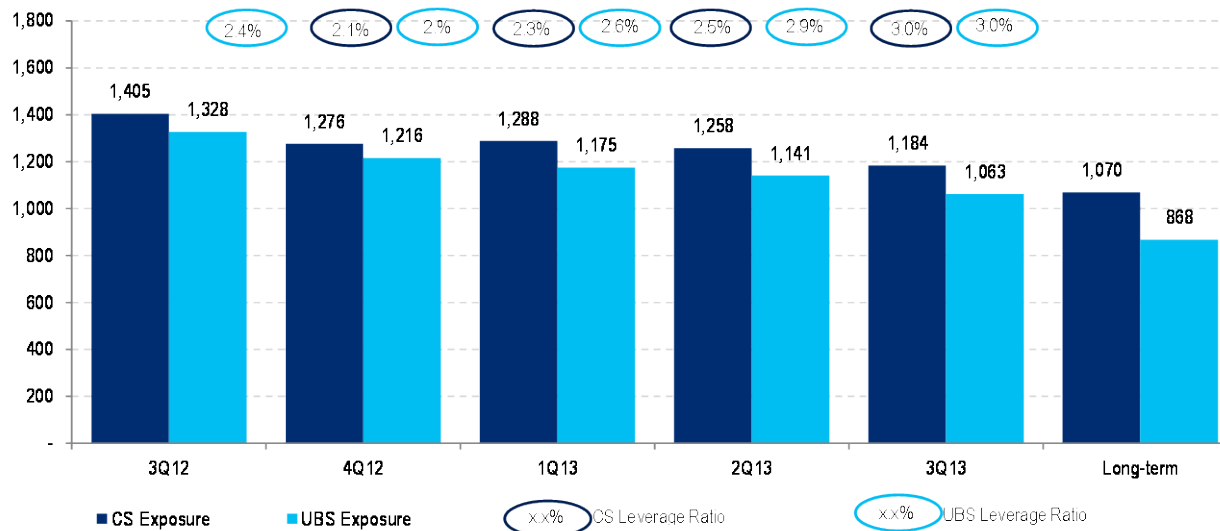
Source: Company Reports, Citi Research Estimates

Swiss Banks Lead the Way In Model Transformation

Swiss banks have achieved significant leverage reduction, led by UBS' radical FICCx

- UBS has reduced its FINMA Leverage Exposure by 20% yoy
 - At 3Q13, SFr195bn of the SFr1,063tn were in the Non-core and Legacy portfolios, implying a long-term exposure target of SFr868m (further 18%)
- Credit Suisse has reduced its FINMA Leverage Exposure by 16% yoy
 - Does not have plans to make cuts to the same extent as UBS within its FICC division
 - Has revised its long-term target of achieving a leverage exposure of SFr1,070bn (further 10%)

Figure 32. CS & UBS FINMA Exposures Progress: 3Q12 – 3Q13



Source: Company Reports, Citi Research

Ringfencing – Watering-down Liikanen

Potential Impact on Bank Structures

■ Conclusions from Liikanen report:

- Trading book ring-fence. Concept of ‘socially useful’: financing, corporate hedging and underwriting do not require separation.
- Potential for higher risk-weights on trading book and mortgage assets
- Emphasis on recovery & resolution plans including “a sufficiently larger layer of bail-inable debt”

■ European Commission proposal:

- To apply to 29 European banks
- Bank supervisor would be empowered to separate trading of securities and financial instruments on a case-by-case basis

■ Direction of travel:

- Prop trading and ownership/sponsorship of hedge funds is banned outright
- Market-making can stay in the Group as long as the supervisor does not decide that these activities need to be ring-fenced; in turn, determined by various metrics
- Trading in European sovereign bonds to be exempt

■ Progress & current status

- Rules to take effect from March 2020¹ (potential subsidiarisation requirement)

Volcker Rules Better Than Feared

Another Positive

- Final rules do not seem like they will severely restrict market-making ability for banks, as some had feared
- The quantitative trading metrics have been narrowed from 17 in the original proposal to 7 now (which are in fact already monitored and reported)
- The new rules does not intend to limit proprietary trading in US government, agency, state and municipal obligations
- On the timeline front, the Volcker rule implementation will be delayed by one year until July 2015, but there are near-term requirements to be met
- We believe the release of the final set of rules removes another regulatory overhang for US banks

European Financial Transaction Tax (EU FTT)

■ European Commission's (EC) Objective for EU FTT

- “harmonise legislation concerning indirect taxation on financial transactions”
- “ensure fair & substantial contribution from financial sector to cover the costs of recent crisis & create a level playing field with other sectors from taxation (VAT) point of view”
- “create appropriate disincentives for transactions that do not enhance the efficiency of financial markets”

■ Scope, Rate and Exemption

- **Scope:** Broad range of financial transactions conducted by Financial Services (FS) sector & certain types of activity located outside the FS sector.
 - To apply to both the sell- and buy-side with Cascading Effect
 - *Cascade Effect:* Every material modification to a transaction that is within the scope of the tax, which will lead to multiple layers of taxation over a transaction settlement chain
 - *Parties Liable: Residence & Issuance*
 - Residence Principle: Worldwide branches of EU11 institutions & all counterparties to trade with a EU11 entity that reside outside of EU11
 - Issuance Principle: Worldwide transactions of instruments issued in the EU11 regardless of the geographic residence of the entities party to the transaction.
- **Rate:** EC's proposed min. headline rate of 0.001% on the notional value of underlying derivatives contract and 0.01% on all other financial transactions.
- **Exemptions:** CCPs, CSDs, primary mkt. transactions (including underwriting), transactions with international bodies or institutions and transactions part of restructuring operations

Narrowing Scope of Original FTT Proposal

■ Progress & current status

- Original proposal dated 28 Sep'11 to adopt EU-wide FTT was not supported by all Member States
- EU11 agreed under the enhanced cooperation procedure on 14 Feb' 13 to adopt EU FTT subject to discussion
- EU 11's adoption is also subject to UK Govt.'s & European council's legal challenge

■ Direction of travel

- Negotiations and potential compromise over “government bonds and repo trades as well as how to deal with primary dealers – market makers and pension funds”
Algirdas Semeta, EU Tax Commissioner, Reuters 29 Dec 2013
- France pushing for modest stamp duty on share dealing; Italy concerned about impact on sovereign debt

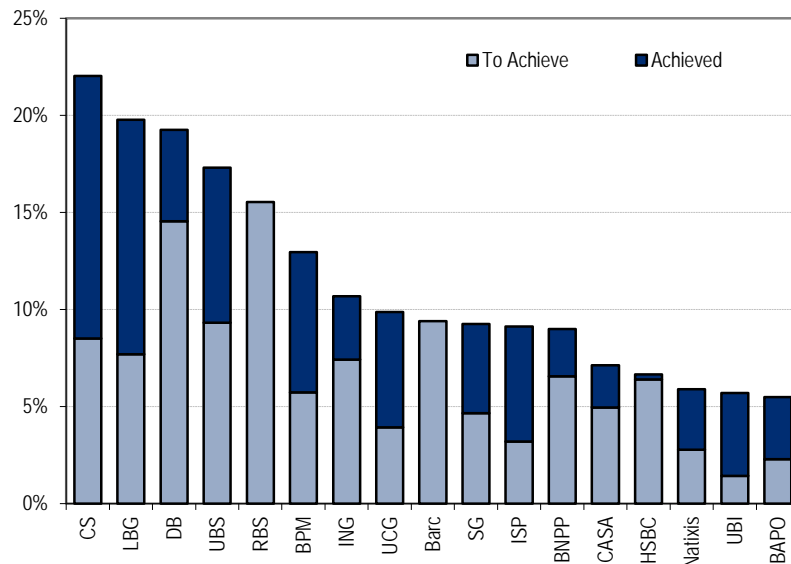
4) Restructuring & Recovery of Earnings

Restructuring Under-priced

Cost savings on track, more to come

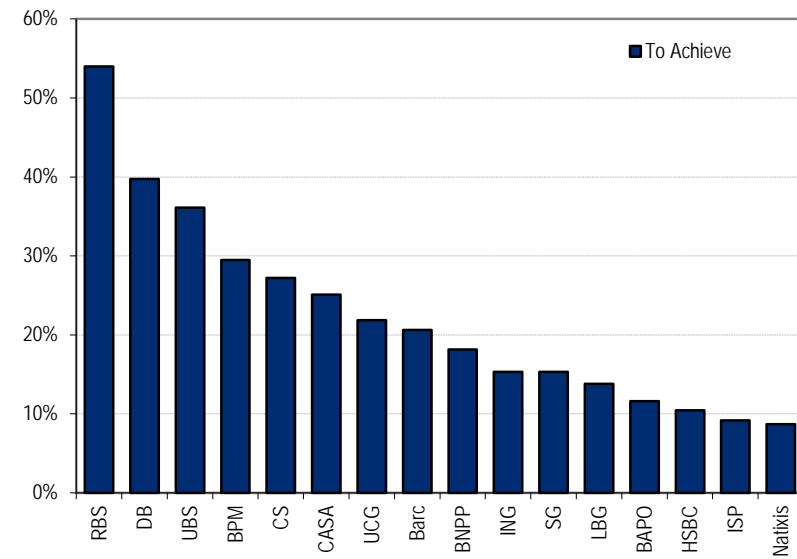
- Banks have targeted cost programmes of c10% of expense base, of which one-third has been achieved
 - The majority of benefits have yet to come through at the likes of Barclays, Deutsche and UBS, amongst others
- The largest cost savings in the near-term are likely to accrue from corporate & investment banking
 - Retail/commercial networks will also be rationalised over time to counter the challenging medium-term top-line outlook

Figure 33. Announced Cost Savings Targets (As % of 2013E Cost Base)



Source: Company Reports and Citi Research Estimates

Figure 34. Potential Cost Savings Targets to be Achieved (As % of 2013E Post-Provision Profit)

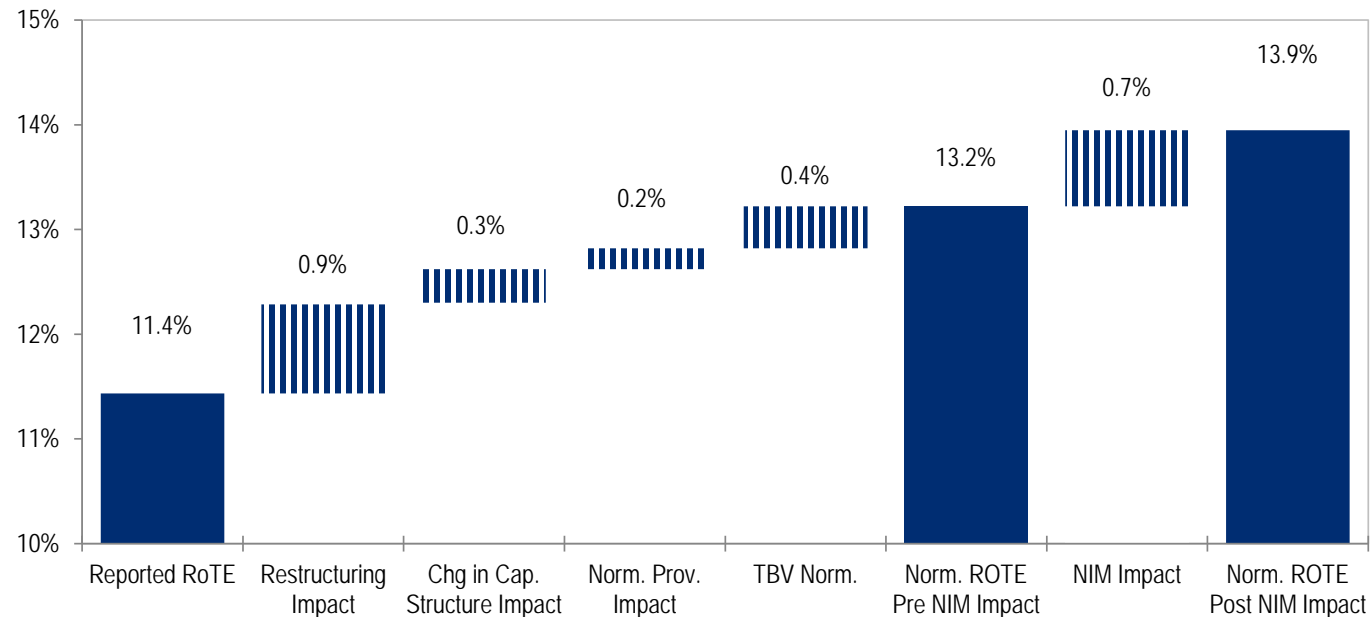


Source: Company Reports and Citi Research Estimates

Illustration of Normalised Sector Returns

Restructuring could add c1% to sector returns

Figure 35. RoTE Normalised for Restructuring, Change in Capital Structure, Provision, Tangible Book Value & +100 bps Upside in Yield Curve



Source: Citi Research;

Notes: 1) NIM impact is assumed on parallel + 100 bps upside in yield curve. In some cases symmetrical movement is assumed to reach on +100bpsparallel shift NIM impact.

2) TBV is normalised for surplus/deficit B3 capital at end 2015E; 3) Change in capital structure is shift of focus to AT1& T2'fail-in' capital;

4)See below for banks covered in this analysis

Stocks covered in analysis:

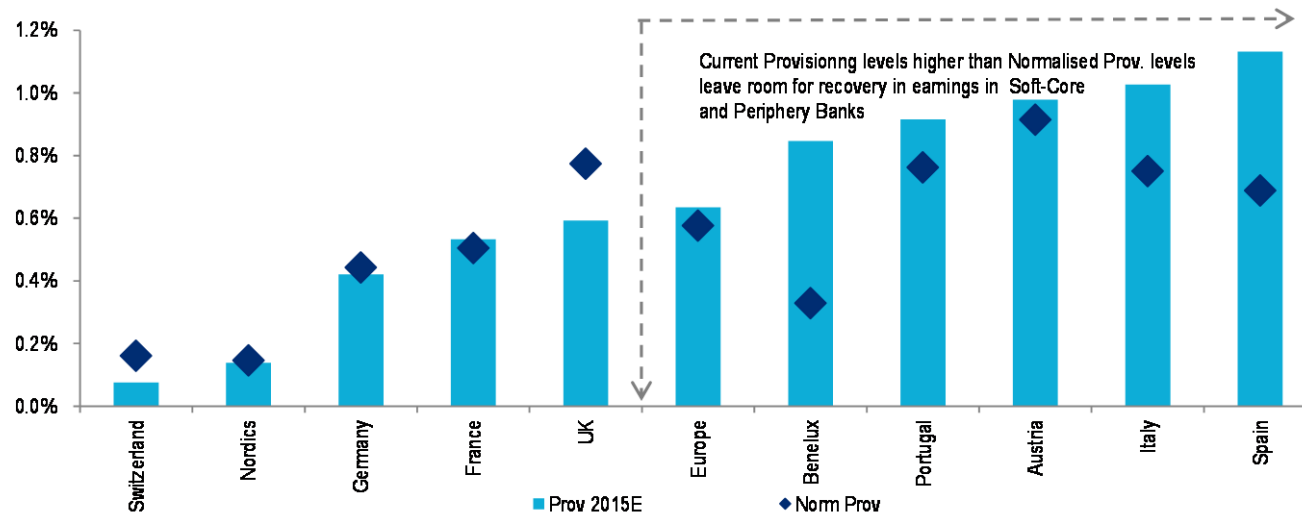
| | | | | |
|-----------------|-----------------|----------------------|--------------------|-----------|
| Banco Popolare | BP Milano | HSBC | RBS | UBS |
| Banco Santander | Commerzbank | ING | SE Banken AB | UniCredit |
| Bankinter | Credit Agricole | Intesa Sanpaolo | Societe Generale | |
| Barclays | Credit Suisse | KBC | Standard Chartered | |
| BBVA | Deutsche Bank | Lloyds Banking Group | Swedbank | |
| BNP Paribas | DnB | Nordea | UBI Banca | |

Moving Towards Normalised Provisioning

Market focus should gradually shift from balance sheet metrics towards normalised' provisioning and returns

- Upfront AQR risk remains elevated for the periphery – 4Q13 front-loaded likely
- Provisioning could potentially normalise ahead of expectations and drive further earnings upgrades
- Italian, Spanish and Benelux banks could benefit the most from provisioning normalization

Figure 36. Country-wise Provisioning, 2015E and Normalised Provisioning

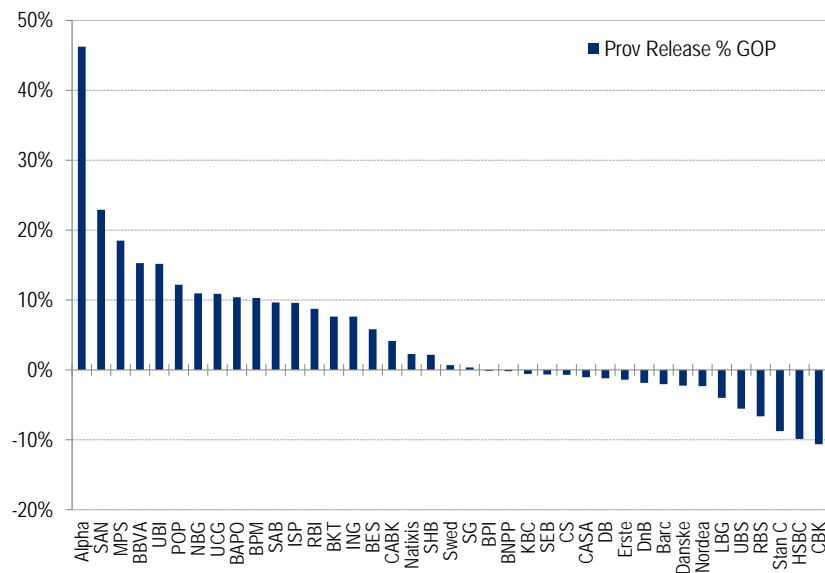


Source: Citi Research Estimates

Bank-by-bank P&L Impact of Provision Normalisation

We favour BES, BBVA, CaixaBank and UniCredit for periphery exposure

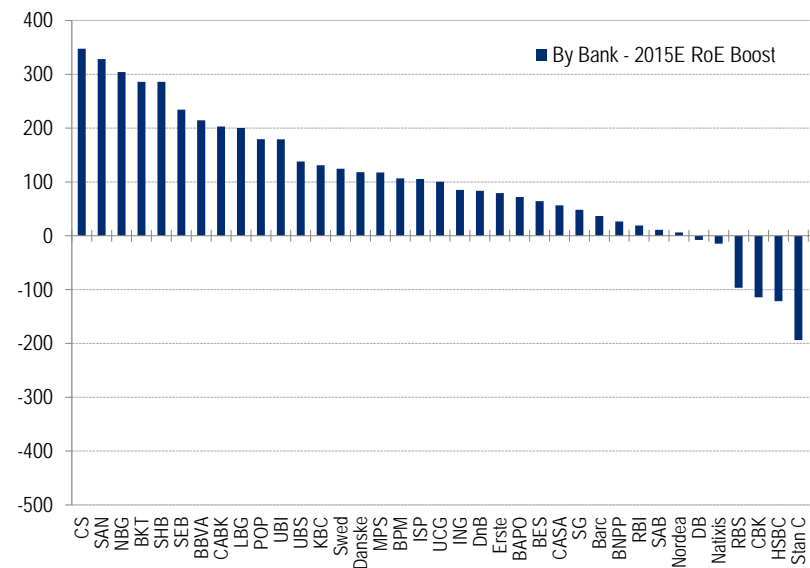
Figure 37. P&L Impact Upon Normalisation % GOP, 2015E



Source: Company Reports & Citi Research Estimates

Note: We define normalised provisioning as long term provisioning levels

Figure 38. Change (bps) in RoTE, 2015E, Upon Provision Normalisation



Source: Company Reports & Citi Research Estimates

Note: We define normalised RoTE as 2015E RoTE adjusted for 1) Long term provisioning levels 2) B3 Capital Surplus/Deficit 3) Restructuring 4) P&L Impact of change in cost of funding due to change in capital structure (AT1 & T2)

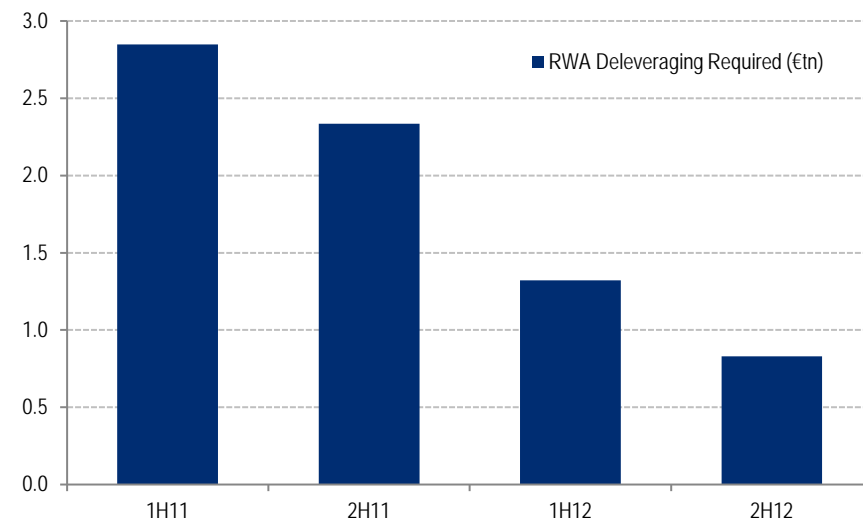
5) Deleveraging

How Much More Deleveraging? – Fully-Loaded BIII CET1 Ratio

Deleveraging needs shrinking fast – break-even point at end-2013

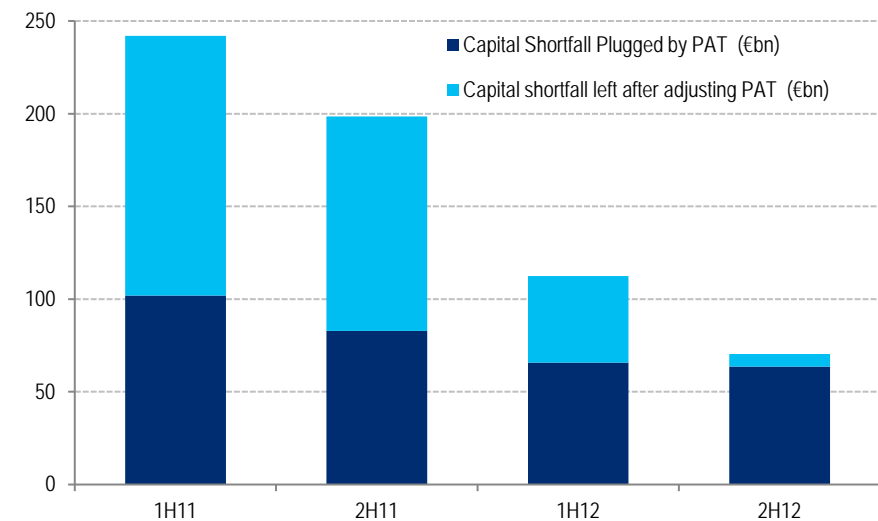
- Deleveraging needs have shrunk dramatically from c€3trn at mid-2011, to under €1trn at end-2012
- €70bn shortfall at end-2012 likely to have been covered by end-2013 (trailing 2012 earnings of €64bn)
- Analysis based on EBA monitoring exercise for Group 1 banks (T1 capital > €3bn & internationally active), carried out assuming full B3 implementation

Figure 39. How Much More RWA Deleveraging is Required



Source: EBA, Citi Research

Figure 40. Capital Shortfall to be Plugged by Profit after Tax

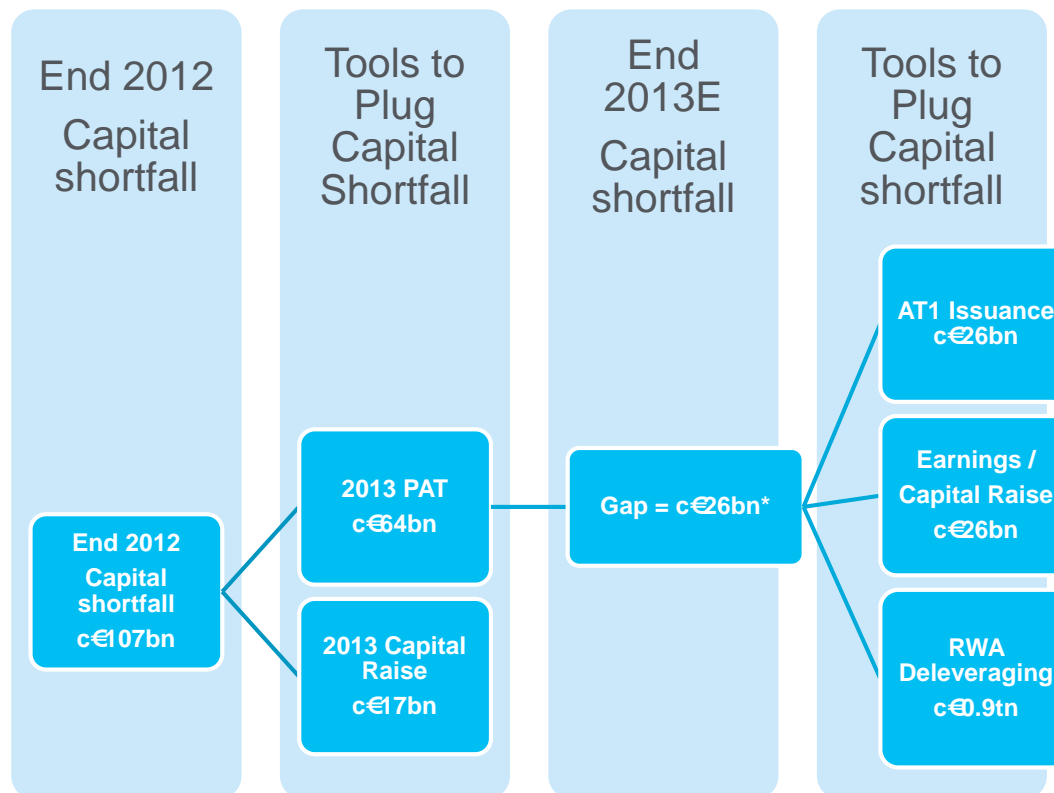


Source: EBA, Citi Research

How Much More Deleveraging? – Basel III Leverage Ratio

- Further capital shortfall to be largely met by retained earnings and AT1 issuance, with some non-core deleveraging

Figure 41. Capital Shortfall – Basel III Leverage Ratio



Source: Citi Research, EBA ; * Gap of €29bn = Total €107bn shortfall less est. €64bn earnings and est. €17bn capital raising;

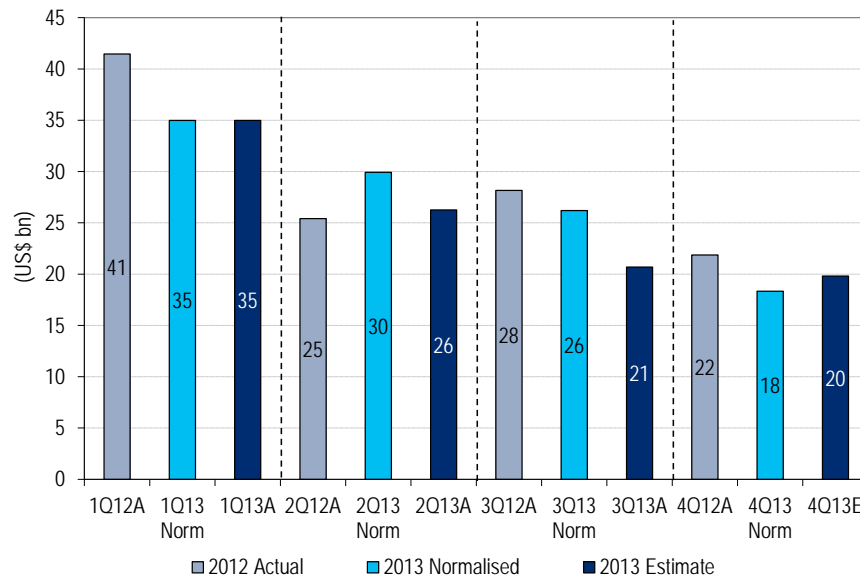
Note: Capital Raise is assumed for banks anticipated to have been part of scope of EBA monitoring exercise at end 2012 and may not include all banks

6) Capital Markets

Uneven Handover From FICC to Equity

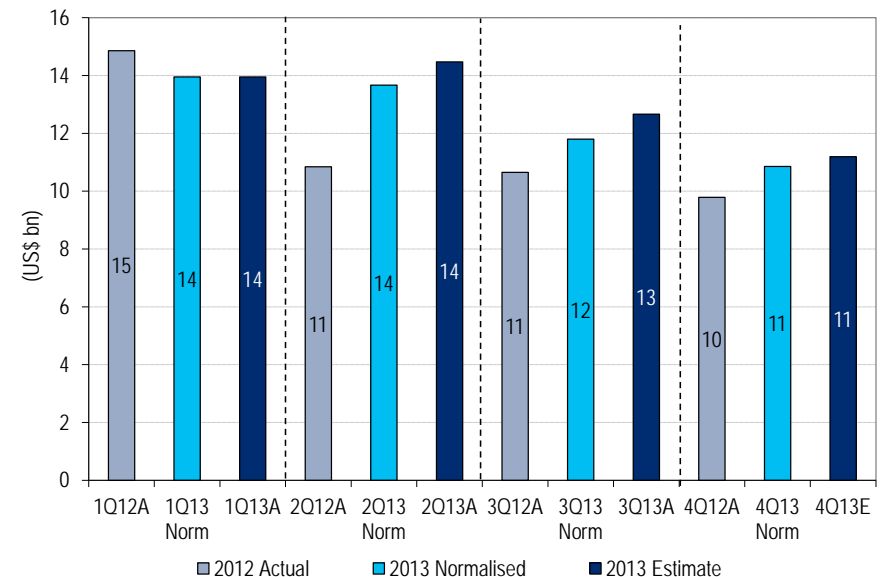
- Global FICC revenues -14% (9M13); expect FY -13% YoY
 - Weakness driven by Rates (prior year EZ strength) & FX (low volatility)
 - Liquidity continues to be a headwind on FICC; expect slightly more muted 1Q/4Q rebound
- Global EQ revenues +13% yoy (9M13); stronger momentum over 2Q-3Q13 (+26%); expect FY +13% YoY
 - Across-the-board strength – Cash, Derivatives and Prime finance. Expect 4Q13 EQ & ECM to continue YoY strength
 - Handover from FICC to EQ on-going, but uneven

Figure 42. FICC Rev Pool – Actual/Normalised/Forecast, 2012 & 2013



Source: Company Reports, Citi Research Estimates
Note: Based on 14 Global Wholesale Banks

Figure 43. Equity Rev Pool – Actual/Normalised/Forecast, 2012 & 2013



Source: Company Reports, Citi Research Estimates
Note: Based on 14 Global Wholesale Banks, of which Goldman Sachs has been restated following sale of insurance business

FICC Franchise Momentum – On-going Consolidation

- US banks gained c.3pp since 2006, largely at expense of European banks. We expect this could continue – given heightened focus on leverage ratios – but likely offset by gains from greater €-based disintermediation notably benefiting BNPP, Deutsche Bank and SocGen
- Industry consolidation - market shares of Top 6 increased by c6pp since 2006
 - Driven by retrenchment of smaller players to their core geographies & products or exits
 - UBS' 'radical FICCx' now followed by CS' more moderate restructuring and will likely be followed by other second-tier global and regional franchises

Figure 44. Global FICC Market Shares – By Underlying Revenue, 3Q13

| | 2006 | 2007 | 1H08 | 2009 | 2010 | 2011 | 2012 | 9M'13 | 9M'13 vs. 2006 |
|-----------------|-------|-------|-------|-------|-------|-------|-------|-------|-------------------|
| JP Morgan | 8.8% | 8.5% | 7.2% | 9.4% | 10.2% | 12.5% | 11.6% | 13.9% | 508 bps |
| Deutsche Bank | 8.3% | 9.7% | 11.8% | 8.5% | 10.5% | 11.3% | 10.5% | 10.0% | 166 bps |
| Bank of America | 10.0% | 10.0% | 8.8% | 9.1% | 9.8% | 8.1% | 9.6% | 9.0% | -96 bps |
| Goldman Sachs | 9.6% | 11.5% | 12.3% | 13.9% | 10.5% | 8.4% | 9.0% | 8.6% | -97 bps |
| Barclays | 10.3% | 14.7% | 15.0% | 11.1% | 10.2% | 9.5% | 10.0% | 8.6% | -163 bps |
| HSBC | 3.6% | 3.2% | 4.8% | 4.7% | 4.7% | 4.6% | 5.0% | 6.4% | 282 bps |
| Credit Suisse | 5.6% | 5.4% | 4.1% | 5.2% | 5.1% | 4.4% | 5.4% | 5.5% | -10 bps |
| RBS | 10.9% | 9.7% | 5.4% | 7.4% | 6.4% | 5.8% | 6.0% | 5.2% | -567 bps |
| BNP Paribas | 2.8% | 3.5% | 3.6% | 6.2% | 5.6% | 6.2% | 5.1% | 4.6% | 189 bps |
| Morgan Stanley | 6.8% | 6.7% | 5.9% | 4.8% | 5.7% | 6.1% | 5.1% | 4.3% | -250 bps |
| Nomura | 3.5% | 2.6% | 2.7% | 1.5% | 2.2% | 3.1% | 3.9% | 3.9% | 40 bps |
| Soc Gen | 2.1% | 1.9% | 2.9% | 2.9% | 2.5% | 2.6% | 3.1% | 3.1% | 101 bps |
| UBS | 4.8% | 2.4% | 1.6% | 1.5% | 3.7% | 4.8% | 1.9% | 1.7% | -310 bps |
| Credit Agricole | 2.3% | 2.0% | 1.5% | 1.8% | 1.7% | 1.8% | 1.8% | 1.7% | -59 bps |
| US | 45.9% | 44.8% | 46.5% | 49.2% | 47.5% | 45.9% | 47.4% | 49.2% | 331 bps |
| Europe | 50.6% | 52.6% | 50.8% | 49.3% | 50.3% | 51.0% | 48.7% | 46.9% | -371 bps |
| Top 6 | 57.6% | 62.5% | 67.3% | 64.0% | 62.5% | 60.6% | 62.7% | 63.5% | 585 bps |
| Rest | 42.4% | 37.5% | 32.7% | 36.0% | 37.5% | 39.4% | 37.3% | 36.5% | -585 bps |

Source: Company Reports and Citi Research Estimates

Note: JPM excl. tax-equivalent adjustment component; JPM, BoA, Barc and Nomura proforma for acquisitions of Bear Stearns, Merrill Lynch, and Lehman Bros respectively

Equities Franchise Momentum – Profile Exits

- European banks have maintained market share in Equities despite exits from players like CASA and RBS
 - CS largest market share gainer since 2006 (c3ppt) to c10% primarily driven by prime brokerage
- Industry consolidation – as with FICC, driven by retrenchment of smaller players
 - Market shares of Top 6 increased by c.5pp since 2006
 - Top players have stronger Prime finance market shares
 - Consolidation on-going => CASA, RBS exiting; Nomura shrinking

Figure 45. Global Equities Market Shares – By Underlying Revenue, 3Q13

| | 2006 | 2007 | 1H08 | 2009 | 2010 | 2011 | 2012 | 9M'13 | 9M'13 vs. 2006 |
|-----------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|-------------------|
| Morgan Stanley | 9.4% | 10.0% | 13.1% | 8.0% | 9.3% | 11.9% | 12.7% | 12.4% | 307 bps |
| Goldman Sachs | 15.9% | 16.2% | 16.7% | 17.3% | 14.6% | 15.6% | 15.3% | 12.4% | -349 bps |
| Credit Suisse | 7.0% | 7.6% | 8.3% | 10.1% | 10.8% | 9.9% | 10.0% | 9.6% | 266 bps |
| JP Morgan | 8.0% | 6.7% | 4.0% | 7.5% | 8.2% | 8.6% | 9.6% | 9.5% | 150 bps |
| Barclays | 5.6% | 5.5% | 5.8% | 4.9% | 6.2% | 5.6% | 7.5% | 8.2% | 260 bps |
| UBS | 9.3% | 8.3% | 8.8% | 6.8% | 7.9% | 8.0% | 7.0% | 8.1% | -120 bps |
| Bank of America | 10.0% | 9.9% | 10.2% | 7.6% | 6.8% | 7.1% | 7.1% | 8.1% | -196 bps |
| Deutsche Bank | 7.5% | 7.3% | 6.0% | 6.4% | 7.4% | 6.5% | 6.5% | 7.0% | -48 bps |
| Soc Gen | 5.7% | 5.3% | 5.1% | 6.8% | 5.7% | 6.4% | 5.8% | 6.5% | 86 bps |
| Nomura | 3.8% | 5.1% | 3.6% | 4.8% | 4.9% | 4.7% | 4.6% | 4.9% | 109 bps |
| BNP Paribas | 4.5% | 4.4% | 4.1% | 4.6% | 4.7% | 5.6% | 4.5% | 4.3% | -20 bps |
| HSBC | 1.2% | 1.2% | 1.9% | 1.1% | 1.2% | 1.9% | 1.5% | 1.8% | 58 bps |
| Credit Agricole | 3.7% | 3.7% | 3.0% | 3.2% | 3.9% | 3.7% | 2.7% | 1.2% | -254 bps |
| RBS | 2.7% | 2.7% | 2.8% | 3.2% | 1.7% | -% | -% | -% | -270 bps |
| US | 49.1% | 48.9% | 50.7% | 48.2% | 45.5% | 47.8% | 49.9% | 48.4% | -66 bps |
| Europe | 47.1% | 46.1% | 45.7% | 47.0% | 49.5% | 47.5% | 45.6% | 46.7% | -43 bps |
| Top 6 | 55.1% | 54.4% | 56.7% | 54.5% | 57.1% | 59.6% | 62.0% | 60.2% | 513 bps |
| Rest | 44.9% | 45.6% | 43.3% | 45.5% | 42.9% | 40.4% | 38.0% | 39.8% | -513 bps |

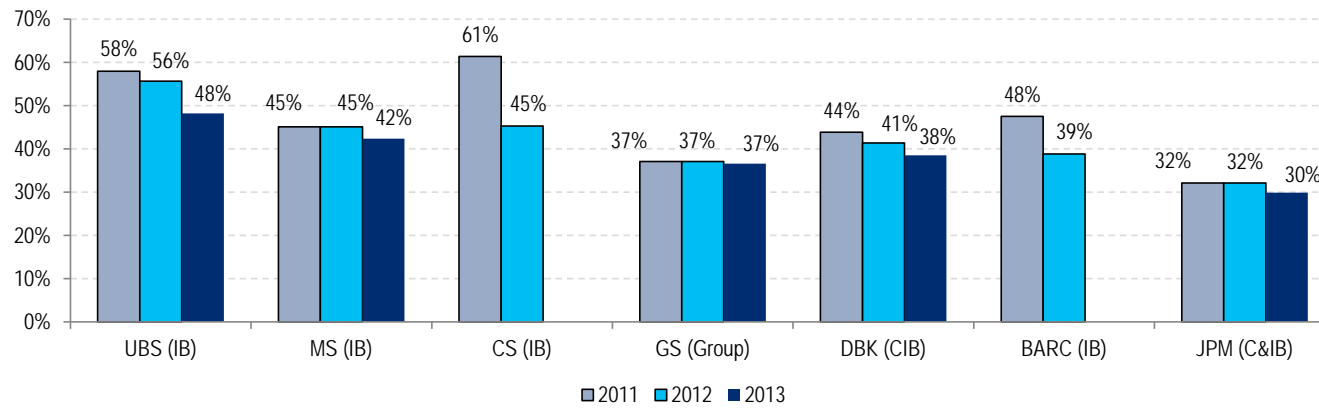
Source: Company Reports and Citi Research Estimates

Note: JPM, BoA, Barc and Nomura proforma for acquisitions of Bear Stearns, Merrill Lynch, and Lehman Bros respectively

Declining Comp-to-Revenue Trends

- Pendulum continues to swing in favour of shareholders
- Further decline in comp-to-revenue ratios following 5ppt decline in 2012
- Barclays is the exception – deferred comp and/or scope for 4Q13 flexing?

Figure 46. Select Wholesale Banks Comp-Revenue – 2011-2013



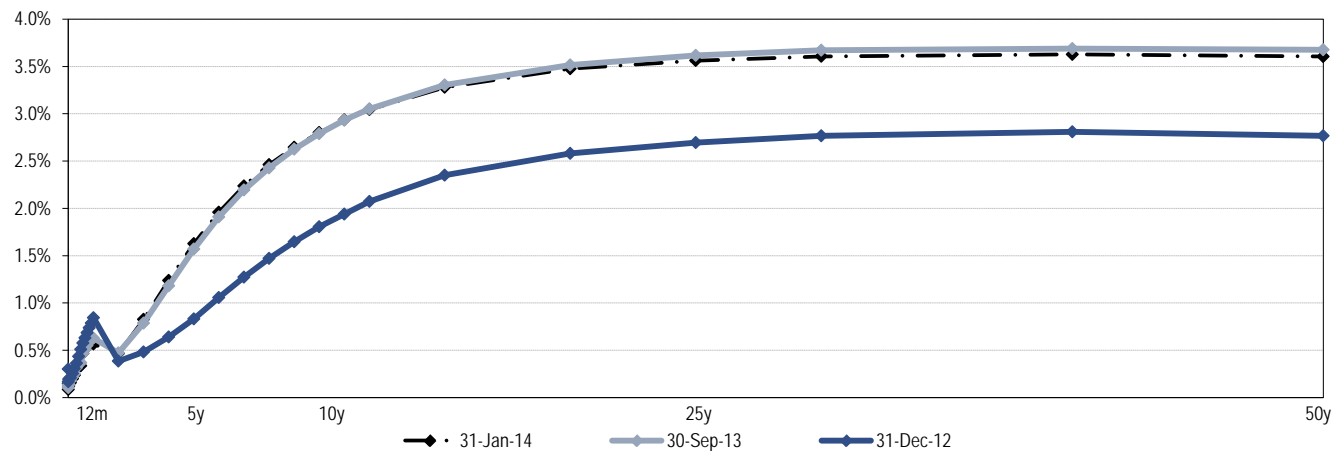
Source: Company Reports; Citi Research

7) Banks & Rates Cycle

Steeper Curves Helps “Under-earning” USD Balance Sheets

- Over the past 12 months, 4-5 year yields have moved by: GBP curve 90-110bps; USD 60-90bps; € up 40-50bps; SFr up 30-50bps
- Our economists' models suggest gap between FOMC's forecast path of Fed Funds rate and the rate implied by FOMC's own forecasts of economic conditions has been growing
- Over time, this may provide scope for re-pricing & improving NIMs, notably for banks with surplus USD deposit balances
- UK international banks and major Swiss banks remain best-positioned

Figure 47. US Swap Curve



Source: Bloomberg, Citi Research

Credit Suisse WM Sensitivity to Rates

Figure 48. Credit Suisse – Wealth Management Sensitivity

| | AuM (SFr m) | P&L (SFr m) | Specific Margin (bps) | Overall Margin (bps) | Comments |
|--|-------------|-------------|-----------------------|----------------------|---|
| (1) Shift from Cash to Bonds/Equities | 24.4 | 142 | 58.3 | 1.8 | |
| 1% Shift to Bonds | 8.1 | 24 | 30.0 | | Assume +30bps margin |
| 1% Shift to Equities | 8.1 | 49 | 60.0 | | Assume +60bps margin |
| 1% Shift to Discretionary Mandates | 8.1 | 69 | 85.0 | | Assume +85bps margin |
| (2) Higher Equity Markets | 17.1 | 102 | 60.0 | 1.3 | |
| 10% Rise in Equity Markets | 17.1 | 102 | 60.0 | | Assume +60bps margin |
| (3) Improved Risk Appetite | 812.1 | 246 | 30.3 | 3.0 | |
| 10% Increase in Transaction Margin | 812.1 | 246 | 30.3 | | 2013E Transaction revenue margin |
| (4) Higher Interest Rates | 203.0 | 350 | 17.2 | 4.3 | |
| 100bps parallel shift | 203.0 | 350 | 17.2 | | A 100bp parallel shift in major interest rates would lead to approx. CHF75-100m additional quarterly revenues over time |
| (5) Weaker Swiss Franc | | 344 | | | |
| 5% Weaker USD/CHF | | 249 | | | A 10% movement in the USD/CHF rate affects 9M13 pre-tax income by CHF 467 m; 80% WM-driven |
| 5% Weaker USD/EUR | | 95 | | | A 10% movement in the EUR/CHF rate affects 9M13 pre-tax income by CHF 178 m; 80% WM-driven |
| Total Revenue/PBT Impact | | 1,185 | | | |
| Marginal Cost/Income Ratio | | 168 | 20.0% | | Assume 20% marginal cost-income ratio |
| Total PBT Impact | | 1,017 | | | |
| 2015E Wealth Management PBT | | 3,568 | | | |
| 2015E Group PBT | | 8,231 | | | |
| As a % of 2015E WM PBT | | 28.5% | | | |
| As a % of 2015E Group PBT | | 12.4% | | | |
| AuM | 812.1 | | | | 3Q13 |
| Memo | | | | | |
| % Bonds | 25.0% | | | | Based on Julius Baer disclosure, 1H13 presentation p40 |
| % Equities | 21.0% | | | | Based on Julius Baer disclosure, 1H13 presentation p40 |
| % Discretionary Mandates | 29.0% | | | | Based on Julius Baer disclosure, 1H13 presentation p40 |
| % Cash & Deposits | 25.0% | | | | Based on Julius Baer disclosure, 1H13 presentation p40 |
| Source: Citi Research | | | | | |

UBS WM Sensitivity to Rates

Figure 49. UBS – Wealth Management Sensitivity

| | AuM (SFr m) | P&L (SFr m) | Specific Margin (bps) | Overall Margin (bps) | Comments |
|--|-------------|-------------|-----------------------|----------------------|---|
| (1) Shift from Cash to Bonds/Equities | 26.1 | 152 | 58.3 | 1.8 | |
| 1% Shift to Bonds | 8.7 | 26 | 30.0 | | Assume +30bps margin |
| 1% Shift to Equities | 8.7 | 52 | 60.0 | | Assume +60bps margin |
| 1% Shift to Discretionary Mandates | 8.7 | 74 | 85.0 | | Assume +85bps margin |
| (2) Higher Equity Markets | 18.3 | 110 | 60.0 | 1.3 | |
| 10% Rise in Equity Markets | 18.3 | 110 | 60.0 | | Assume +60bps margin |
| (3) Improved Risk Appetite | 871.0 | 185 | 21.3 | 2.1 | |
| 10% Increase in Transaction Margin | 871.0 | 185 | 21.3 | | |
| (4) Higher Interest Rates | 217.8 | 600 | 27.6 | 6.9 | |
| 100bps parallel shift | 217.8 | 600 | 27.6 | | Assume 60% of SFr1bn benefit to WM & R&C |
| (5) Weaker Swiss Franc | | 369 | | | |
| 5% Weaker USD/CHF | | 267 | | | A 10% movement in the USD/CHF rate affects 9M13 pre-tax income by CHF 467 m (CS data, prorata for UBS; 80% WM-driven) |
| 5% Weaker USD/EUR | | 102 | | | A 10% movement in the EUR/CHF rate affects 9M13 pre-tax income by CHF 178 m (CS data, prorata for UBS; 80% WM-driven) |
| Total Revenue/PBT Impact | | 1,416 | | | |
| Marginal Cost/Income Ratio | | 209 | 20.0% | | Assume 20% marginal cost-income ratio |
| Total PBT Impact | | 1,207 | | | |
| 2015E Wealth Management PBT | | 3,427 | | | |
| 2015E Group PBT | | 7,822 | | | |
| As a % of 2015E WM PBT | | 35.2% | | | |
| As a % of 2015E Group PBT | | 15.4% | | | |

AuM 871.0

Memo

| | | |
|--------------------------|-------|--|
| % Bonds | 25.0% | Based on Julius Baer disclosure, 1H13 presentation p40 |
| % Equities | 21.0% | Based on Julius Baer disclosure, 1H13 presentation p40 |
| % Discretionary Mandates | 29.0% | Based on Julius Baer disclosure, 1H13 presentation p40 |
| % Cash & Deposits | 25.0% | Based on Julius Baer disclosure, 1H13 presentation p40 |

Source: Citi Research

Julius Baer Sensitivity to Rates

Figure 50. Julius Baer – Group Sensitivity

| | AuM (SFr m) | P&L (SFr m) | Specific Margin (bps) | Overall Margin (bps) | Comments |
|--|----------------|----------------|-----------------------------|-------------------------|---|
| (1) Shift from Cash to Bonds/Equities | 7.5 | 44 | 58.3 | 1.8 | |
| 1% Shift to Bonds | 2.5 | 7 | 30.0 | | Assume +30bps margin |
| 1% Shift to Equities | 2.5 | 15 | 60.0 | | Assume +60bps margin |
| 1% Shift to Discretionary Mandates | 2.5 | 21 | 85.0 | | Assume +85bps margin |
| (2) Higher Equity Markets | 5.2 | 31 | 60.0 | 1.3 | |
| 10% Rise in Equity Markets | 5.2 | 31 | 60.0 | | Assume +60bps margin |
| (3) Improved Risk Appetite | 249.0 | 50 | 20.2 | 2.0 | |
| 10% Increase in Transaction Margin | 249.0 | 50 | 20.2 | | 2013E Transaction and Other revenue margin |
| (4) Higher Interest Rates | 62.3 | 107 | 17.2 | 4.3 | |
| 100bps parallel shift | 62.3 | 107 | 17.2 | | A 100bp parallel shift in major interest rates would lead to c.CHF75-100m additional quarterly revenues over time (CS data, prorata for Bear) |
| (5) Weaker Swiss Franc | | 105 | | | |
| 5% Weaker USD/CHF | | 76 | | | A 10% movement in the USD/CHF rate affects 9M13 pre-tax income by CHF 467 m (CS data, prorata for Baer; 80% WM-driven) |
| 5% Weaker USD/EUR | | 29 | | | A 10% movement in the EUR/CHF rate affects 9M13 pre-tax income by CHF 178 m (CS data, prorata for Baer; 80% WM-driven) |
| Total Revenue/PBT Impact | | 338 | | | |
| Marginal Cost/Income Ratio | | 46 | 20.0% | | Assume 20% marginal cost-income ratio |
| Total PBT Impact | | 291 | | | |
| 2015E Group PBT | | 968 | | | |
| <hr/> | | | | | |
| As a % of 2015E Group PBT | | 30.1% | | | |
| <hr/> | | | | | |
| AuM | 249 | | | | Per IMS on 15-Nov-13 |
| Memo | | | | | |
| % Bonds | 25.0% | | | | Based on Julius Baer disclosure, 1H13 presentation p40 |
| % Equities | 21.0% | | | | Based on Julius Baer disclosure, 1H13 presentation p40 |
| % Discretionary Mandates | 29.0% | | | | Based on Julius Baer disclosure, 1H13 presentation p40 |
| % Cash & Deposits | 25.0% | | | | Based on Julius Baer disclosure, 1H13 presentation p40 |
| Source: Citi Research | | | | | |

UK International Banks – Normalisation of NIMs and LLPs

Figure 51. Sensitivity Analysis – UK International Banks

HSBC – NIM (rows) and LLP (columns) Sensitivity Analysis

| HSBC (NII-LLP)/ATA | | 2015E | 2013E | 20-Yr Avg | 12-Yr Avg |
|-----------------------|-------|--------------|--------|--------------|-----------|
| 2013E | 2.05% | 1.10% | 1.07% | 0.89% | 0.79% |
| 2015E | 2.10% | 1.12% | 1.10% | 0.91% | 0.82% |
| 12-Yr Avg | 2.79% | 1.56% | 1.53% | 1.35% | 1.26% |
| 20-Yr Avg | 2.84% | 1.59% | 1.56% | 1.38% | 1.29% |
| PBT Uplift, £m | | | | | |
| 2013E | 2.05% | -544 | -1,074 | -4,563 | -6,282 |
| 2015E | 2.10% | 0 | -529 | -4,019 | -5,738 |
| 12-Yr Avg | 2.79% | 8,322 | 7,793 | 4,303 | 2,585 |
| 20-Yr Avg | 2.84% | 8,923 | 8,394 | 4,905 | 3,186 |
| PBT Uplift, % | | | | | |
| 2013E | 2.05% | -3% | -6% | -24% | -33% |
| 2015E | 2.10% | 0% | -3% | -21% | -30% |
| 12-Yr Avg | 2.79% | 44% | 41% | 23% | 14% |
| 20-Yr Avg | 2.84% | 47% | 44% | 26% | 17% |

STAN – NIM (rows) and LLP (columns) Sensitivity Analysis

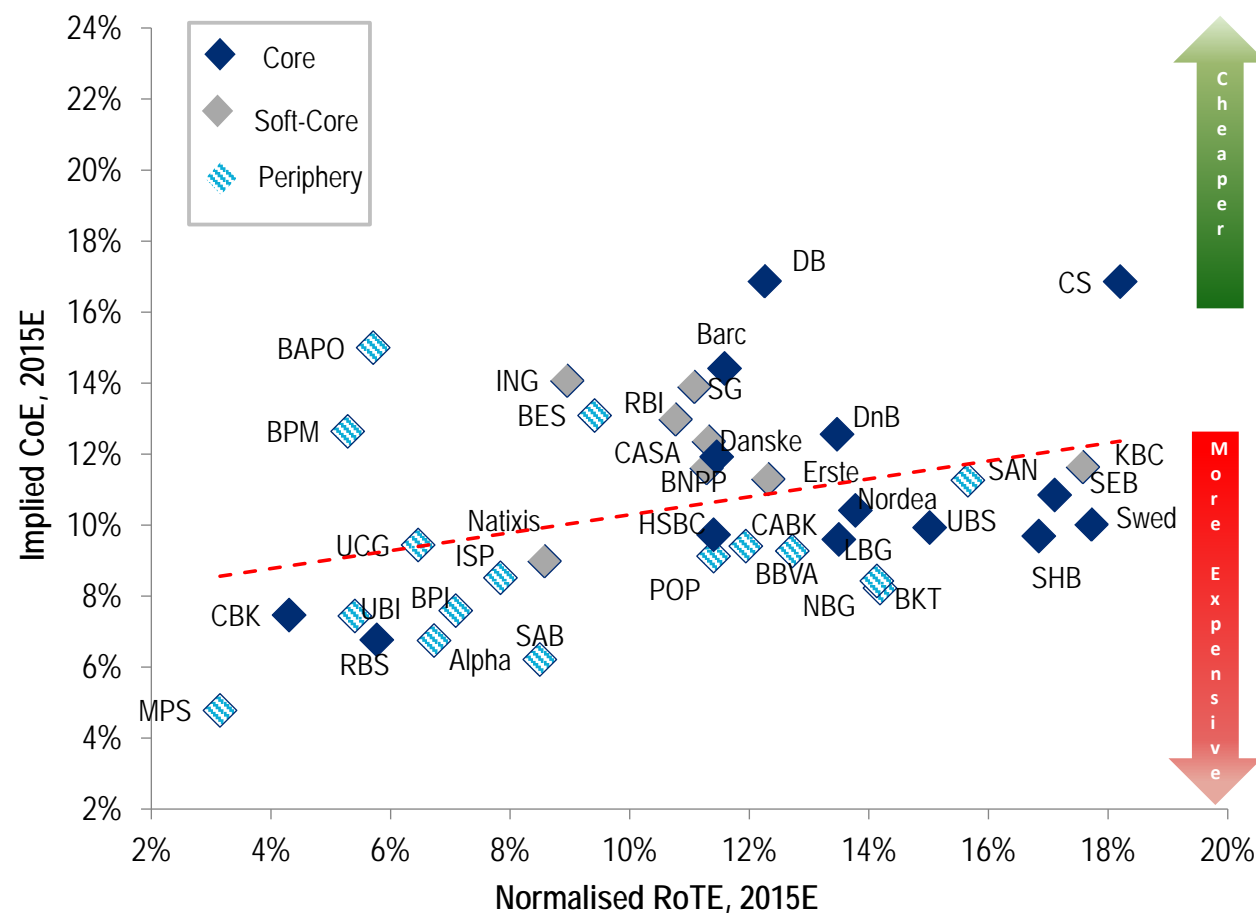
| STAN (NII-LLP)/ATA | | 2015E | 2013E | 12-Yr Avg | 20-Yr Avg |
|-----------------------|-------|--------------|-------|-----------|--------------|
| 2013E | 2.18% | 1.46% | 1.44% | 1.35% | 1.29% |
| 2015E | 2.23% | 1.49% | 1.48% | 1.39% | 1.33% |
| 12-Yr Avg | 2.60% | 1.77% | 1.76% | 1.68% | 1.62% |
| 20-Yr Avg | 2.85% | 1.97% | 1.96% | 1.88% | 1.81% |
| PBT Uplift, £m | | | | | |
| 2013E | 2.18% | 0 | -45 | -439 | -758 |
| 2015E | 2.23% | 199 | 154 | -240 | -560 |
| 12-Yr Avg | 2.60% | 1,586 | 1,540 | 1,146 | 827 |
| 20-Yr Avg | 2.85% | 2,523 | 2,478 | 2,084 | 1,764 |
| PBT Uplift, % | | | | | |
| 2013E | 2.18% | 0% | -1% | -7% | -13% |
| 2015E | 2.23% | 3% | 2% | -4% | -10% |
| 12-Yr Avg | 2.60% | 27% | 26% | 20% | 14% |
| 20-Yr Avg | 2.85% | 43% | 42% | 36% | 30% |

Source: Citi Research Estimates

8) Valuation

Implied CoE vs. Normalised RoTE

Figure 52. Fully Normalised RoTE vs Implied CoE, 2015E



Source: Company Reports & Citi Research Estimates

Note: We define normalised RoTE as 2015E RoTE adjusted for 1) Long term provisioning levels; 2) B3 Capital Surplus/Deficit; 3) Restructuring; 4) P&L Impact of change in cost of funding due to change in cost of funding due to change in capital structure (AT1 & T2)

Europe Still Attractive on Price/GOP or PPP

Renewed investor interest in the 'former' problem child

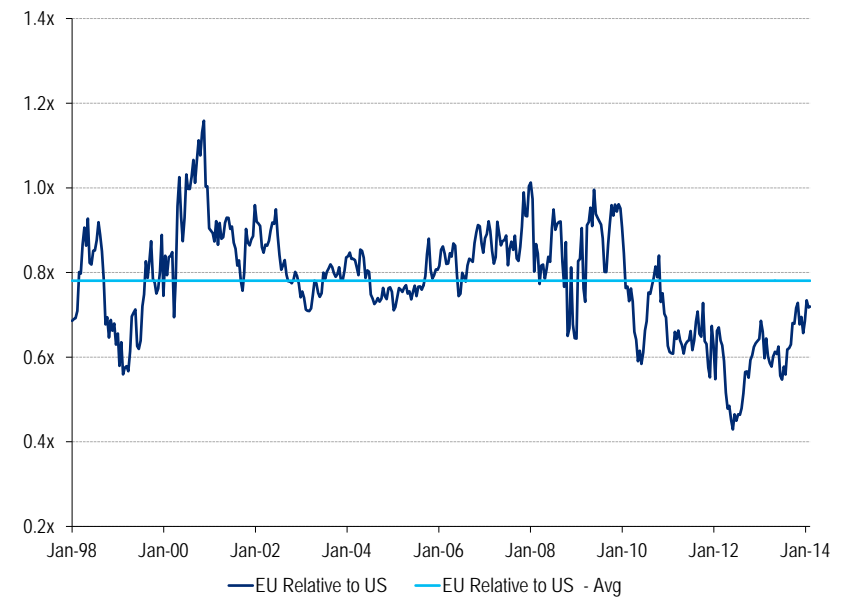
- Citi European banks coverage universe is trading at 5.3x P/GOP (+1 year) or 0.8x the current US average
- Our EU bank coverage universe has traded at pre-Eurozone crisis average of 6.2x (c85%), or 0.7x US banks vs. a 15-year average of 0.8x.
- Bank stocks trading at more than 20% discount to their 15-year P/GOP history include: Barclays, BES and Deutsche Bank

Figure 53. European Banks Sector 1 Yr Forward P/GOP (Jan 98-Jan 14)



Source: Citi Research, Company Reports, dataCentral

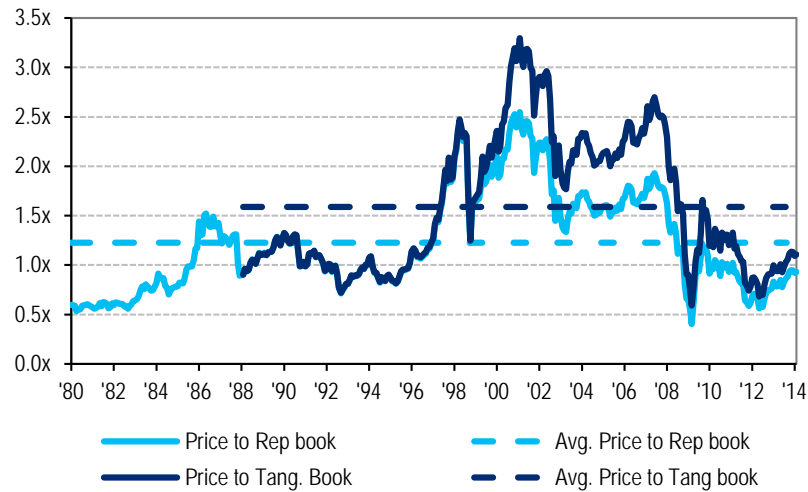
Figure 54. European vs US Banks Sector 1 Yr Forward P/GOP (Jan 98-Jan 14)



Source: Citi Research, Company Reports, dataCentral, SNL Financial

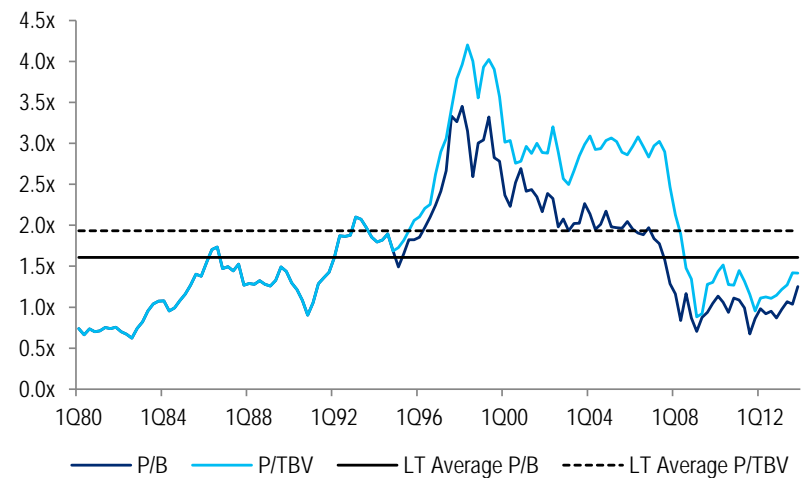
Banks Price-to-Reported & Price-to-Tangible Book Value

Figure 55. European Banks' P/B and P/TB



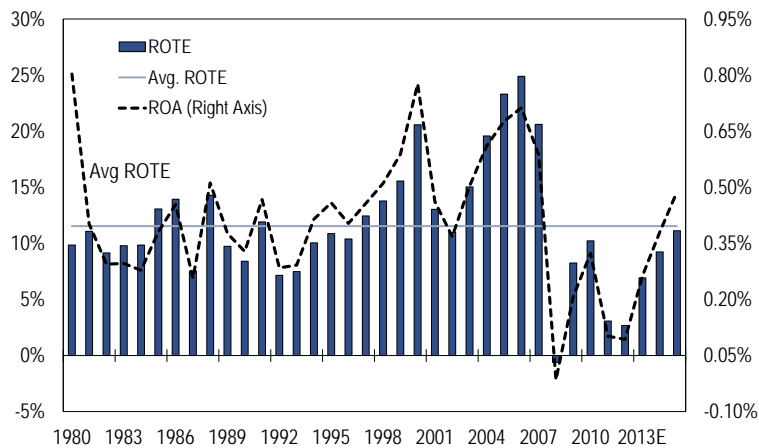
Source: Citi Research, Wordscope, Powered by dataCentral; Based on data for Citi Research Coverage

Figure 56. US Banks' P/B and P/TB



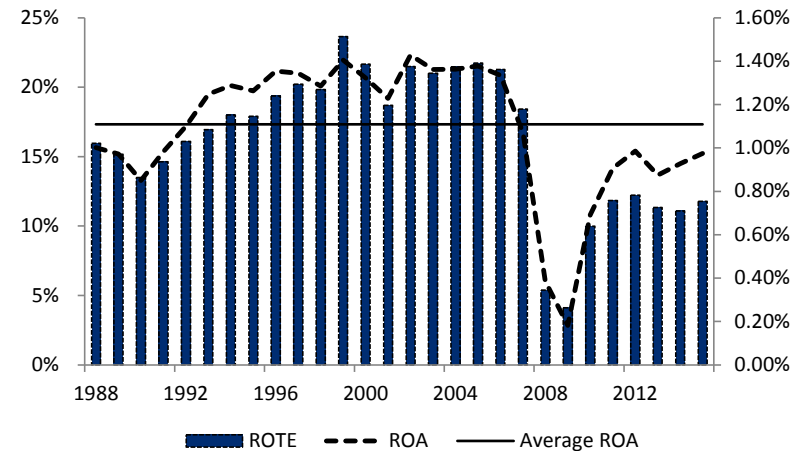
Source: Citi Research, SNL Financial, Powered by dataCentral; Based on data for Citi Research Coverage

Figure 57. European Bank ROTEs



Source: Citi Research, Wordscope, Powered by dataCentral; Based on data for Citi Research Coverage

Figure 58. US Bank ROTEs

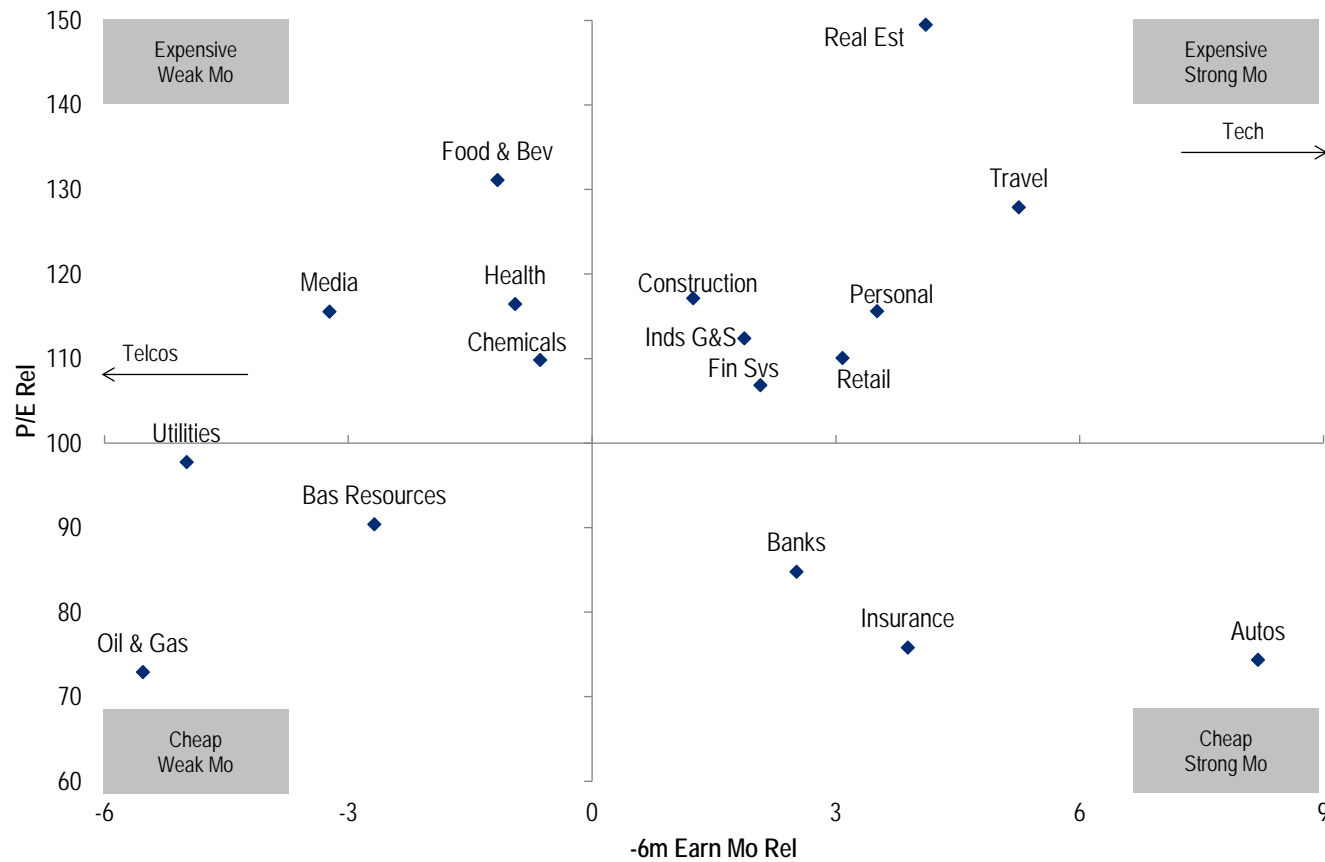


Source: Citi Research, SNL Financial, Powered by dataCentral; Based on data for Citi Research Coverage

Top vs. Bottom Quartile Valuation (Strategists)

Banks cheap with positive earnings momentum

Figure 59. 6 Months Earnings Momentum and PE Relative



Source: Citi Research

9) Country Views

UK Banks: Understanding the Upside

- **Neutral UK Domestic Banks** – Macro improving, but overall valuations look full. We believe Barclays offers near-term catalysts of a seasonal revenue uptick, additional cost take-out and further asset shrinkage. Buy Barclays. Neutral Lloyds. Sell / High Risk RBS.
- **Overweight UK International Banks** – EM vulnerability concerns look overdone; beginning of the end of margin pressure; renewed focus on costs and adapting business models. Greater long-term upside potential. Buy Standard Chartered. Buy HSBC.
- **NIM Trends** – FLS has resulted in lower time deposit rates, easing funding costs, but we expect new deposit rates will now begin to stabilise. In contrast Asia margins were under pressure, especially in trade & cash management, but now look to have troughed.
- **Volumes** – Modest UK growth to return as deleveraging eases and demand improves. International credit growth to slow slightly.
- **Cost Control** – Simplification programs, non-core business exits, industry capacity reduction. More can still be done.
- **Asset Quality** – Reassuring UK indicators, ongoing recovery in Ireland. Benign Asian asset quality, LatAm concerns.
- **Regulation** – Constantly evolving. Leverage a new capital constraint, Pillar 2 concerns, Ring-fencing on the horizon.
- **International Connectivity** – FX, Trade & Cash connectivity. Asian wholesale growth opportunity.

Figure 60. Valuation – UK Banks

| Bank | RIC | Rec | Curr | Share Price | | | Adj. P/E | | Tangible | | | | Div. Yld | Mkt Cap |
|--------------------|--------|---------|------|-------------|--------|------|----------|-------|----------|---------|---------|---------|----------|---------|
| | | | | Now | Target | +/-% | 2014E | 2015E | P/B 14E | P/B 15E | ROE 14E | ROE 15E | 2014E | €bn |
| Barclays | BARC.L | Buy | p | 265 | 345 | +30% | 7.9x | 6.8x | 0.86x | 0.80x | 11.2% | 12.3% | 4.7% | 51 |
| HSBC | HSBA.L | Buy | p | 635 | 770 | +21% | 10.7x | 9.6x | 1.25x | 1.17x | 12.1% | 12.6% | 5.1% | 144 |
| Lloyds Banking Grp | LLOY.L | Neutral | p | 83 | 85 | +2% | 11.2x | 10.9x | 1.49x | 1.32x | 14.0% | 12.8% | 1.8% | 72 |
| RBS | RBS.L | Sell/H | p | 343 | 290 | -16% | 14.5x | 11.6x | 0.90x | 0.85x | 6.2% | 7.6% | 0.0% | 47 |
| Standard Chartered | STAN.L | Buy | p | 1270 | 1650 | +30% | 9.4x | 8.5x | 1.19x | 1.09x | 13.1% | 13.5% | 4.6% | 37 |

Source: powered by dataCentral, Citi Research, Prices at 11th February, 2014

French Banks – Breaking the ‘Tangible Book Value’ Ceiling

■ French Big Picture: ‘Slowdown not Showdown’

- Low growth = more cost control & capital return
- Pragmatic government: small impact from banking reforms, supportive approach on rates & liquidity

■ Attractive Core Franchises

- French Retail Cash Cow
- CIB better positioned at BNPP & SG: Leaders in €-DCM & EQ derivs, Financing >10% RoE
- International Retail: LT growth (esp. Ru & Ro opportunity at SocGen). Italian risk manageable

■ Improved Balance Sheets & Capital

- Capital: faster improvement than expected, by reducing capital intensive positions
- Leverage & liquidity: Structurally high (bias to low risk assets) but declining. Regulators see as ‘backstop not race to the top’. Liquidity model reviewed towards less short term & currency mismatches

■ Recommendations: O/W French Banks – Breaking ‘Tangible Book Value’ Ceiling: Buy BNP Paribas (capital return, c30% market cap by end 2015E), Buy SocGen (international retail upside), Buy CASA (simplification and shift from CIB to allow rerating), Neutral on Natixis (capital return & restructuring priced-in, execution risks)

Figure 61. Valuation – French Banks

| Bank | RIC | Rec | Curr | Share Price | | | Adj. P/E | | Tangible | | | | Div. Yld | Mkt Cap |
|------------------|---------|---------|------|-------------|--------|-------|----------|-------|----------|---------|---------|---------|----------|---------|
| | | | | Now | Target | +/- % | 2014E | 2015E | P/B 14E | P/B 15E | ROE 14E | ROE 15E | | |
| BNP Paribas | BNPP.PA | Buy | E | 60 | 71 | +18% | 11.1x | 9.1x | 1.04x | 0.97x | 9.8% | 11.0% | 4.1% | 75 |
| Credit Agricole | CAGR.PA | Buy | E | 10.39 | 12 | +16% | 9.6x | 8.3x | 1.00x | 0.92x | 10.0% | 10.8% | 3.6% | 26 |
| Natixis | CNAT.PA | Neutral | E | 4.62 | 4.60 | -1% | 11.9x | 11.2x | 1.00x | 0.95x | 8.7% | 8.7% | 4.2% | 14 |
| Societe Generale | SOGN.PA | Buy | E | 44 | 55 | +24% | 9.6x | 7.5x | 0.87x | 0.80x | 9.0% | 10.6% | 4.0% | 35 |

Source: powered by dataCentral, Citi Research, Prices at 11th February, 2014

Swiss Banks – Geared to Rising Rates

- **Overweight Swiss Wholesale Banks** – Buy global Investment Bank and Wealth Management franchises CS and UBS. Self help through cost-cutting and a refocusing of business models (away from capital-intensive FICC). Valuation gap caused by regulatory uncertainty. Neutral on wealth manager Julius Baer, as valuation looks full.
- **Regulation** – Significant regulatory uncertainty has been caused by SFr28bn operational RWA add-on imposed on UBS (with a smaller add-on expected for CS) and the Swiss FinMin “discussing” a 6-10% leverage ratio according to media reports. While ‘gold-plating’ to 6% leverage ratio cannot be ruled-out, we see several mitigating factors that should limit risks and even help restore the capital return story.
- **Leverage & Self-Help** – Swiss banks are among the leaders in leverage reduction, led by UBS’ radical FICC restructuring and CS’ more gradual restructuring. Further Wealth Management, Non-Core and Infrastructure cost savings to be back-loaded over 2014-15.
- **WM & Interest Rate Sensitivity** – The deposit franchises of WM operations are a large source of funding but also results in significant gearing towards the rates cycle. This would also be boosted by any improvement in investor confidence and could compound improvements in revenue margin via more transactional activity and a shift towards more profitable asset classes.

Figure 62. Valuation – Swiss Banks

| Bank | RIC | Rec | Curr | Share Price | | | Adj. P/E | | Tangible | | | | Div. Yld | Mkt Cap |
|----------------|---------|---------|------|-------------|--------|------|----------|-------|----------|---------|---------|---------|----------|---------|
| | | | | Now | Target | +/-% | 2014E | 2015E | P/B 14E | P/B 15E | ROE 14E | ROE 15E | | |
| Credit Suisse | CSGN.VX | Buy | SFr | 27 | 34 | +24% | 9.9x | 7.7x | 1.21x | 1.08x | 13.6% | 16.1% | 2.7% | 36 |
| EFG Internatnl | EFGN.S | Neutral | SFr | 13 | 14 | +9% | 11.9x | 9.8x | 1.90x | 1.63x | 17.3% | 18.0% | 1.9% | 2 |
| Julius Baer | BAER.VX | Neutral | SFr | 41 | 45 | +11% | 14.8x | 11.4x | 4.33x | 3.47x | 23.5% | 33.8% | 1.7% | 7 |
| UBS | UBSN.VX | Buy | SFr | 18 | 22 | +19% | 12.8x | 9.9x | 1.58x | 1.51x | 12.7% | 15.5% | 2.7% | 58 |
| Vontobel | VONN.S | Buy | SFr | 33 | 36 | +6% | 11.0x | 9.5x | 1.32x | 1.22x | 12.0% | 12.8% | 4.2% | 2 |

Source: powered by dataCentral, Citi Research, Prices at 11th February, 2014

German Banks – Concerns Overdone at Deutsche Bank

- **Commerzbank: Shrinking To Glory** – At the end of 2012 Commerzbank outlined a series of financial targets for end-2016. This included a target reduction in non-core assets to <€90bn from €151bn. In 9M13 Commerzbank has already achieved an 18% reduction, or €27bn, split €9bn public finance, €16bn CRE, €3bn shipping. Commerzbank will provide updated financial targets with the full-year results, where we expect them to announce an acceleration in NCA run-down to <€65bn by 2016. This could result in meaningful extra capital release, boosting the CET1 ratio. The acceleration also has the effect of reducing our loan loss forecast in later years. We have a Neutral/High Risk rating, target price €10.7.
- **Deutsche Bank: Getting Fit for 2015** – Deutsche Bank remains confident on achieving its €250bn leverage exposure reduction, having achieved €86bn over 2H13. In particular, derivatives trade compression could drive up to 50% reduction of the c€300bn derivatives PFE add-on. On litigation we believe Deutsche is past the worst; nonetheless, we forecast c€1.5bn over 2014-15E. Stable businesses are on the up having delivered €4.6bn IBIT in 2013 (25% improvement from €3.7bn in 2012) with further back-loaded cost synergies to come; these businesses largely justify DBK's current market cap. Although DBK has lost FICC market share, it has adjusted its IB cost base and held on to pre-tax margins (34% in 2013 vs 33% in 2012). We have a Buy rating, target price €45.

Figure 63. Valuation – German Banks

| Bank | RIC | Rec | Curr | Share Price | | | Adj. P/E | | Tangible | | | | Div. Yld | Mkt Cap |
|---------------|----------|---------|------|-------------|--------|------|----------|-------|----------|---------|---------|---------|----------|---------|
| | | | | Now | Target | +/-% | 2014E | 2015E | P/B 14E | P/B 15E | ROE 14E | ROE 15E | 2014E | |
| Commerzbank | CBKG.DE | Neutral | E | 13 | 10.70 | -19% | 15.4x | 10.9x | 0.61x | 0.58x | 4.0% | 5.4% | 0.0% | 15 |
| Deutsche Bank | DBKGn.DE | Buy | E | 36 | 45 | +27% | 6.1x | 5.1x | 0.81x | 0.73x | 13.7% | 14.9% | 2.1% | 36 |

Source: powered by dataCentral, Citi Research, Prices at 11th February, 2014

Spanish Banks: Well Prepared for 2014

- AQR Homework Largely Done - Spanish Banks Largely Done with Loan Reclassifications
 - Process started in 1Q13, well ahead of any other Euro Area country, Completed in 4Q13
 - ECB has stated that it is satisfied with the process of restructured loan reclassifications and amount of provisions taken
- Asset Quality Deterioration Stops in 2015
 - NPL Ratios to Peak in 2015 for Citi Spanish Universe & System NPL Ratio Should Stabilise at c15-16% by 2016-17
- Cleaning Up the Legacy by c 2018
 - CABK and BBVA should show the greatest decline in provisions through 2016; POP is most burdened by problem assets
 - Foreclosed Assets Being Cleared Out: BKT & CABK most active on foreclosure sales; POP made a profit on foreclosure sales in 2Q13,
 - Developer Loan Exposures Remain Meaningful: POP most exposed and least covered
- Net Interest Margins Recovering
 - Margins Are Partly Being Helped by Higher Loan Yields.....But Mostly by Lower Deposit Costs
- Capital Benefits from DTA Forbearance – but Dividends Are Under Pressure

Figure 64. Valuation – Spanish Banks

| Bank | RIC | Rec | Curr | Share Price | | | Adj. P/E | | Tangible | | | | Div. Yld | Mkt Cap |
|-----------------|---------|-----------|------|-------------|--------|------|----------|-------|----------|---------|---------|---------|----------|---------|
| | | | | Now | Target | +/-% | 2014E | 2015E | P/B 14E | P/B 15E | ROE 14E | ROE 15E | | |
| Banco Popular | POP.MC | Sell/H | E | 5.45 | 4.15 | -24% | 18.9x | 12.8x | 1.33x | 1.27x | 7.2% | 10.1% | 1.3% | 11 |
| Banco Santander | SAN.MC | Neutral/H | E | 6.54 | 6.60 | +1% | 11.0x | 11.4x | 1.42x | 1.39x | 13.2% | 12.4% | 7.6% | 76 |
| Bankinter | BKT.MC | Neutral | E | 1.47 | 1.45 | -1% | 19.8x | 13.8x | 1.45x | 1.31x | 7.6% | 10.0% | 1.3% | 17 |
| BBVA | BBVA.MC | Neutral/H | E | 5.99 | 5.75 | -4% | 22.5x | 15.3x | 1.68x | 1.68x | 7.6% | 11.3% | 1.3% | 5 |
| Bco de Sabadell | SABE.MC | Sell/H | E | 9.04 | 9.00 | -0% | 18.9x | 13.3x | 1.44x | 1.37x | 7.7% | 10.6% | 4.1% | 52 |
| CaixaBank | CABK.MC | Neutral | E | 2.31 | 1.70 | -26% | 27.7x | 15.4x | 1.05x | 1.00x | 3.8% | 6.6% | 0.9% | 9 |

Source: powered by dataCentral, Citi Research, Prices at 11th February, 2014

Italian Banks – Valuations Up With Events

- **Summary View: Italian banks** – Some macro indicators are improving, but asset quality remains a key concern for the market. Also valuation doesn't look so cheap in terms of P/TBV, more attractive on P/GOP.
- **Profitability** – We expect bank ROTE to reach on average c8% in 2017, below the historical level due to higher capital level and still lower interest rate environment vs the past (affecting NII). Key profitability driver remains NII and cost of risk. Sovereign conditions have improved, and if it continues, it would support lower cost of funding for Italian banks. Volumes are continuing to shrink, and asset repricing is a management priority.
- **Asset Quality** – Italian banks have high level of NPLs (still growing) and low level of coverage (decreased versus pre-crisis level), leaving investors uncertain on the magnitude of the pending AQR. NPL disposals are key for the market (eg bad bank?) Also, optionality in recovery if macroeconomic conditions improve could be an area of focus.
- **Capital** – The overall capital position of the larger Italian banks seems adequate, if we do not assume any larger shock from AQR then the one in our estimates. There are three banks pending capital increases.
- **Costs** – Banks are still showing a significant focus in improving the cost base with further cost cutting coming from efficiency in the network (branch closure/conversion and staff). More can still be done.
- **Consolidation** - Market might consider the risk/opportunity of further consolidation if macroeconomic conditions continue to improve, possible after the results of the asset quality review.

Figure 65. Valuation – Italian Banks

| Bank | RIC | Rec | Curr | Share Price | | | Adj. P/E | | Tangible | | | | Div. Yld | Mkt Cap |
|------------------|---------|-----------|------|-------------|--------|------|----------|-------|----------|---------|---------|---------|----------|---------|
| | | | | Now | Target | +/-% | 2014E | 2015E | P/B 14E | P/B 15E | ROE 14E | ROE 15E | | |
| Banco Popolare | BAPO.MI | Neutral | E | 1.37 | na | | 11.7x | 8.7x | 0.40x | 0.38x | 3.5% | 4.5% | 1.9% | 2 |
| BP Milano | PMIL.MI | Neutral | E | 0.47 | .45 | -4% | 12.8x | 10.1x | 0.44x | 0.42x | 3.5% | 4.2% | 0.0% | 2 |
| Intesa Sanpaolo | ISP.MI | Neutral/H | E | 2.14 | 2.10 | -2% | 16.9x | 12.3x | 0.96x | 0.92x | 5.8% | 7.6% | 3.0% | 35 |
| Mediobanca | MDBI.MI | Buy/H | E | 7.14 | 8.00 | +12% | 11.0x | 9.3x | 0.85x | 0.79x | 7.7% | 8.5% | 1.9% | 6 |
| Monte dei Paschi | BMPS.MI | Sell/H | E | 0.19 | .15 | -19% | <0 | 26.1x | 0.68x | 0.66x | -5.6% | 2.6% | 0.0% | 2 |
| UBI Banca | UBI.MI | Neutral/H | E | 5.96 | 5.80 | -3% | 23.6x | 18.2x | 0.74x | 0.73x | 3.2% | 4.0% | 1.9% | 5 |
| UniCredit | CRDI.MI | Buy/H | E | 5.78 | 6.60 | +14% | 17.3x | 11.3x | 0.71x | 0.68x | 4.2% | 6.2% | 1.8% | 33 |

Source: powered by dataCentral, Citi Research, Prices a 11th February, 2014

Nordic Banks – The 3Rs

■ Regulation:

- Uncertainties remain in the regulatory front.
- 25% risk weighted floor on mortgages and tougher leverage measures

■ Return of Capital:

- Nordic banks have high capital ratios and, despite higher regulatory requirements and political noise, we expect the Swedish banks to move from a capital rebuild to a capital return phase.
- **Dividend Vikings:** In FY13 season, positive dividend surprises from 4 out of 6 Nordic banks: Danske restarted dividends for the first time since 2007; SHB and Swedbank announced 70%+ payout ratios while DnB beat

■ Restructuring and Recovery:

- Danske looks set to benefit from Danish economic recovery and new CEO's cost and income initiatives. Company targets to improve ROE to 9% by 2015 and to 12% in the long term.
- SEB has room for further CIR improvement.

Figure 66. Valuation – Nordic Banks

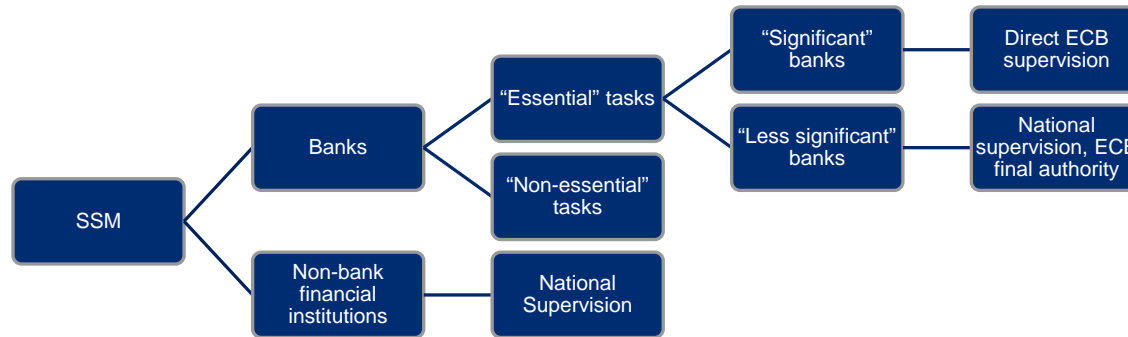
| Bank | RIC | Rec | Curr | Share Price | | | Adj. P/E | | Tangible | | | | Div. Yld | Mkt Cap |
|--------------|-----------|---------|------|-------------|--------|------|----------|-------|----------|---------|---------|---------|----------|---------|
| | | | | Now | Target | +/-% | 2014E | 2015E | P/B 14E | P/B 15E | ROE 14E | ROE 15E | 2014E | €bn |
| Danske Bank | DANSKE.CO | Buy | DKr | 138 | 150 | +9% | 12.0x | 9.7x | 1.03x | 0.96x | 8.9% | 10.3% | 2.9% | 19 |
| DnB | DNB.OL | Neutral | NKr | 108 | 115 | +6% | 9.4x | 8.9x | 1.19x | 1.07x | 13.3% | 12.6% | 2.3% | 21 |
| Nordea | NDA.ST | Buy | SKr | 90 | 101 | +12% | 11.8x | 10.8x | 1.49x | 1.41x | 13.1% | 13.4% | 5.4% | 42 |
| SE Banken AB | SEBa.ST | Buy | SKr | 86 | 90 | +4% | 11.9x | 11.1x | 1.70x | 1.58x | 14.9% | 14.8% | 4.3% | 22 |
| SHB | SHBa.ST | Neutral | SKr | 326 | 280 | -14% | 13.6x | 12.9x | 1.87x | 1.74x | 14.3% | 14.0% | 3.8% | 24 |
| Swedbank | SWEDa.ST | Neutral | SKr | 176 | 180 | +2% | 11.6x | 11.0x | 1.85x | 1.77x | 16.5% | 16.5% | 6.5% | 23 |

Source: powered by dataCentral, Citi Research, Prices at 11th February, 2014

10) All You Want To Know On Banking Union

SSM – The First Pillar of Banking Union

Figure 67. Single Supervisory Mechanism



Source: Public Information

All you need to know about SSM

- **What is it?:** The Single Supervisory Mechanism will create a new system of financial supervision comprising the ECB and the national competent authorities (NCA) of participating EU countries.
- **Why?:** To overcome financial fragmentation and breaking the sovereign-bank link.
- **When?:** ECB will assume its new banking supervision responsibilities from November 2014.
- **Who?:** EA countries participate automatically in the SSM. Non-EA Member States can also choose to participate by their NCA entering into “close cooperation” with the ECB.
- **How many credit institutions will be supervised?:**
 - It is expected that the ECB will directly supervise around 130 credit institutions, representing c85% of total banking assets in the euro area. Includes banks with assets >€30bn or over 20% of home country's GDP
 - These credit institutions will be identified according to criteria to determine their significance. In each participating country, at least the three most significant credit institutions will be subject to direct supervision by the ECB, irrespective of their absolute size.
 - All other credit institutions in the participating countries will continue to be supervised by the NCA. The ECB can decide at any time to exercise direct supervision of any one of these credit institutions in order to ensure consistent application of high supervisory standards.
- **How will it be organised?:**
 - A Supervisory Board will be established to plan and carry out the ECB's supervisory tasks, undertake preparatory work and propose complete draft decisions for adoption by the ECB's Governing Council. It will be composed of:
 - a Chair (appointed for a non-renewable term of five years);
 - a Vice-Chair (chosen from among the members of the ECB's Executive Board);
 - four ECB representatives; one representative of the NCA of each participating country

All you need to know about BRRD

BRRD: Bail-in to avoid Bail-out

■ What?

- **The Bank Recovery & Resolution Directive (BRRD):** To avoid taxpayer bail-out of banks, the European Commission proposed a common framework of rules and powers (see IP/12/570 and MEMO/12/416) in June 2012 to help EU countries intervene to better manage banks in difficulty. This law applies to all 28 Member States.

■ When?

- The European Parliament and the Member States reached agreement on this framework on 11 December 2013, subject to technical finalisation and formal approval by both institutions
- The Council and the European Parliament are expected to formally approve the text early next year.
- New rules enter into force from 1 Jan 2015 and allow authorities to intervene decisively before problems occur (e.g. recovery & resolution planning) or early on if they do (e.g. power to appoint an administrator)
- The bail-in tool will apply from **1 Jan 2016** (instead of 2018)

■ How?

- Harmonised rulebook on how the costs of bank failure are allocated
- Banks have to make plans & authorities to take preventative steps to deal with bank failure
- Shareholders and other creditors will bear losses first
- Tap national, prefunded resolution funds that each Member State has to build to a level of 1% of covered deposits within 10 years
- Deposits under €100,000 exempt; above €100,000 after all other secured creditors claims are absorbed

All you need to know about SRM

SRM – SRF

■ What is it?

- **The Single Resolution Mechanism** complements the Single Supervisory Mechanism which was proposed by the Commission in September 2012.
- Aimed at significantly weakening the sovereign-bank which should, in turn, serve to reduce financial fragmentation

■ Who will sponsor bank bailouts and how will it work?

- It would be financed by bank levies raised at national level
- **Single Resolution Fund (SRF)**: A hybrid fund (€55bn) would initially consist of national compartments and their progressive mutualisation over a 10-year transitional phase (10% pa)

■ When can SRF be accessed?

- After bail-in, national resolution fund used first
- Would require a two-thirds majority of the board of the resolution authority to approve any large-scale use of bailout funds – (i) liquidity support of > 20 per cent of fund (ii) recapitalisation support of >10% of fund (iii) access to fund once €5bn has been utilised in any single calendar year
- One country does not mean one vote. Votes would be weighted by what's known as the “ECB capital key” ie the largest countries get the most say

■ Who will execute bank resolution?

- European Commission will be the main executioner

Comments on SRM

■ Key issues

- **Funding**: (i) During initial build-up, bridge financing will be available from national sources, backed by bank levies, or from ESM (ii) Lending between national funds will also be possible (iii) In case of insufficient ex-ante funds, the DGS will collect immediate ex-post contributions from the banking sector
- Under the compromise, a new “resolution board” would be made up of an executive director, 4 full-time appointed members and representatives of national authorities of all participating countries
- European Council, following Commission proposal, can object or call for changes

■ Next steps

- Council negotiation with European Parliament with aim of agreeing SRM legislation by May 2014
- Commitment from Member States to negotiate an intergovernmental agreement on functioning of SRF by 1 March 2014

All you need to know about DGS

DGS: Deposit Guarantee Scheme

■ What is it?

- The mechanism aims at robust financial sector is ensuring bank deposits in all Member States are guaranteed up to €100 000 per depositor per bank if a bank fails
- Reform targets faster payouts – from 20 days to 7 days
- Aimed at preventing panic withdrawals by depositors from their banks
- The proposal also includes strengthened financing, notably through a significant level of ex-ante funding
- A single supranational DGS is not planned at this stage

■ How?

- Target = minimum of 1% of covered deposits to be collected from banks over a 10-year period.
- In case of insufficient ex-ante funds, the DGS will collect immediate ex-post contributions from the banking sector. As a last resort, it will have access to alternative funding arrangements such as loans from public or private third parties.
- Voluntary mechanism of mutual borrowing between the DGSs from different EU countries

■ When?

- The European Parliament and EU member States are in the final stages of negotiation on this important text which should be formally approved early next year.

Figure 68. European Banks Recommendations

| Bank | RIC | Rating | Currency | Last Price | Target Price | Country | Bank | RIC | Rating | Currency | Last Price | Target Price | Country |
|-----------------|-----------|--------|----------|------------|--------------|-------------|-------------------------|----------|--------|----------|------------|--------------|-------------|
| Alpha Bank | ACBr.AT | 2 | E | 0.71 | | Greece | ING Groep | ING.AS | 1 | E | 10.16 | 11.60 | Netherlands |
| Banco BPI | BBPI.LS | 2H | E | 1.57 | 1.60 | Portugal | Intesa Sanpaolo | ISP.MI | 2H | E | 2.14 | 2.10 | Italy |
| Banco Espirito | BES.LS | 1H | E | 1.19 | 1.50 | Portugal | Julius Baer | BAER.VX | 2 | SFr | 40.71 | 45.00 | Switzerland |
| Banco Popolare | BAPO.MI | 2 | E | 1.37 | | Italy | KBC | KBC.BR | 1 | E | 46.11 | 50.00 | Belgium |
| Banco Popular | POP.MC | 3H | E | 5.45 | 4.15 | Spain | Lloyds Banking Grp | LLOY.L | 2 | p | 83.38 | 0.85 | UK |
| Banco Santander | SAN.MC | 2H | E | 6.54 | 6.60 | Spain | Mediobanca | MDBI.MI | 1H | E | 713.50 | 8.00 | Italy |
| Bco de Sabadell | SABE.MC | 3H | E | 2.31 | 1.70 | Spain | Monte dei Paschi | BMPS.MI | 3H | E | 0.19 | 0.15 | Italy |
| Bank of Ireland | BKIR.I | 3H | E | 0.30 | 0.15 | Ireland | National Bank of Greece | NBGr.AT | 2 | E | 3.65 | | Greece |
| Bankinter | BKT.MC | 2 | E | 5.99 | 5.75 | Spain | Natixis | CNAT.PA | 2 | E | 4.62 | 4.60 | France |
| Barclays | BARC.L | 1 | p | 264.70 | 345.00 | UK | Nordea | NDA.ST | 1 | SKr | 90.00 | 101.00 | Sweden |
| BBVA | BBVA.MC | 2H | E | 9.04 | 9.00 | Spain | Piraeus Bank | BOPr.AT | 2 | E | 1.92 | | Greece |
| BNP Paribas | BNPP.PA | 1 | E | 60.34 | 71.00 | France | Raiffeisen Bank Intl | RBIV.VI | 3 | E | 28.75 | 26.80 | Austria |
| BP Milano | PMII.MI | 2 | E | 0.47 | 0.45 | Italy | RBS | RBS.L | 3H | p | 343.20 | 290.00 | UK |
| CaixaBank | CABK.MC | 2 | E | 4.84 | 4.60 | Spain | SE Banken AB | SEBa.ST | 1 | SKr | 86.30 | 90.00 | Sweden |
| Commerzbank | CBKG.DE | 2H | E | 13.17 | 10.70 | Germany | SHB | SHBa.ST | 2 | SKr | 325.70 | 280.00 | Sweden |
| Credit Agricole | CAGR.PA | 1 | E | 10.39 | 12.00 | France | Societe Generale | SOGN.PA | 1 | E | 44.27 | 55.00 | France |
| Credit Suisse | CSGN.VX | 1 | SFr | 27.45 | 34.00 | Switzerland | Standard Chartered | STAN.L | 1 | p | 1,270.00 | 1,650.00 | UK |
| Danske Bank | DANSKE.CO | 1 | Dkr | 137.60 | 150.00 | Denmark | Swedbank | SWEDa.ST | 2 | SKr | 175.80 | 180.00 | Sweden |
| Deutsche Bank | DBGn.DE | 1 | E | 35.51 | 45.00 | Germany | UBI Banca | UBI.MI | 2H | E | 5.96 | 5.80 | Italy |
| DnB | DNB.OL | 2 | NKr | 108.40 | 115.00 | Norway | UBS | UBSN.VX | 1 | SFr | 18.49 | 22.00 | Switzerland |
| EFG Internatnl | EFGN.S | 2 | SFr | 12.90 | 14.00 | Switzerland | UniCredit | CRDI.MI | 1H | E | 5.78 | 6.60 | Italy |
| Erste Bank | ERST.VI | 2 | E | 28.30 | 25.00 | Austria | Vontobel | VONN.S | 1 | SFr | 33.40 | 35.50 | Switzerland |
| HSBC | HSBA.L | 1 | p | 635.40 | 770.00 | UK | | | | | | | |

Source: dataCentral, Citi Research. Prices as at 11 February, 2014

Also mentioned in document: (BAC.N; US\$16.86; 1); (JPM.N; US\$57.63; 1); (GS.N; US\$164.95; 2)

11) Macro Section

Citi Economic Research Forecasts Overview 2013-16F

Data taken from Citi Economists' publication [Global Economic Outlook and Strategy - January 2014](#): Willem Buiter et al

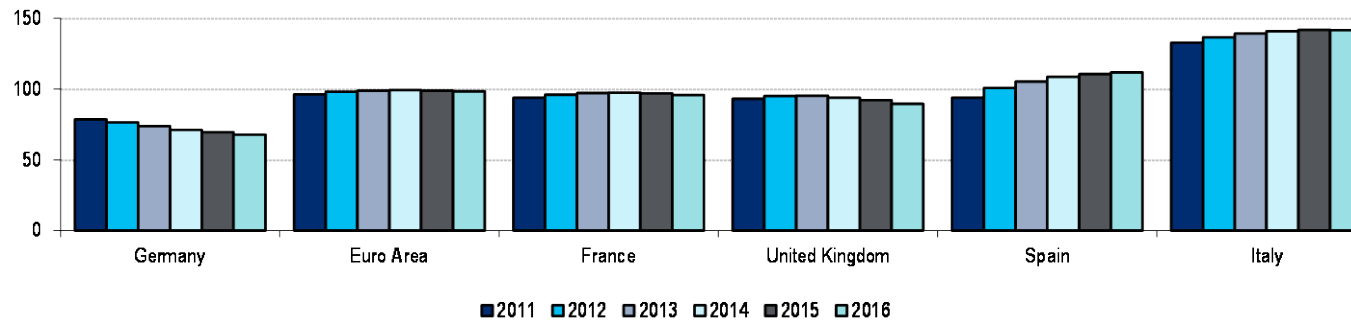
Figure 68. Citi Economic Forecasts Overview (2013-2016F)

| | GDP Growth (%) | | | | CPI Inflation (%) | | | | Unemployment (%) | | |
|------------------|----------------|-------|-------|-------|-------------------|-------|-------|-------|------------------|-------|-------|
| | 2013F | 2014F | 2015F | 2016F | 2013F | 2014F | 2015F | 2016F | 2013F | 2014F | 2015F |
| Global | 2.5 | 3.3 | 3.4 | 3.6 | 2.6 | 3.0 | 3.1 | 3.4 | 7.2 | 7.0 | 6.7 |
| United States | 1.9 | 3.1 | 3.1 | 3.2 | 1.1 | 1.5 | 1.7 | 2.2 | 7.4 | 6.4 | 5.9 |
| Japan | 1.7 | 1.6 | 1.0 | 1.2 | 0.3 | 2.6 | 1.6 | 1.6 | 4.1 | 3.8 | 3.8 |
| Euro Area | -0.4 | 1.1 | 1.3 | 1.4 | 1.4 | 0.9 | 0.8 | 1.2 | 12.1 | 12.0 | 11.7 |
| ■ Germany | 0.5 | 2.0 | 2.1 | 1.8 | 1.5 | 1.5 | 1.8 | 1.9 | 5.3 | 5.2 | 5.0 |
| ■ France | 0.2 | 0.9 | 1.1 | 1.4 | 1.0 | 1.2 | 1.3 | 1.5 | 10.5 | 10.6 | 10.3 |
| ■ Italy | -1.8 | 0.3 | 0.3 | 0.4 | 1.3 | 0.5 | -0.3 | 0.4 | 12.2 | 12.7 | 12.6 |
| ■ Spain | -1.2 | 0.9 | 1.1 | 1.4 | 1.5 | -0.2 | -0.1 | 0.1 | 26.4 | 25.6 | 24.6 |
| ■ Greece | -3.4 | -1.9 | -0.4 | 1.1 | -0.9 | -2.7 | -2.4 | -1.4 | 27.6 | 28.2 | 27.8 |
| ■ Ireland | 0.0 | 2.1 | 2.2 | 3.5 | 0.7 | 0.3 | 0.9 | 1.0 | 13.1 | 11.1 | 10.1 |
| ■ Portugal | -1.6 | 0.2 | 0.8 | 0.7 | 0.4 | -0.4 | -0.9 | -0.2 | 16.3 | 15.0 | 14.2 |
| ■ Netherlands | -1.0 | 0.5 | 0.9 | 1.2 | 2.5 | 1.2 | 1.3 | 1.4 | 8.3 | 8.7 | 8.5 |
| Sweden | 0.9 | 2.3 | 2.7 | 2.8 | 0.0 | 0.5 | 1.8 | 2.4 | 8.0 | 7.8 | 7.5 |
| Switzerland | 2.0 | 2.0 | 2.0 | 2.2 | -0.2 | -0.2 | 0.9 | 1.1 | 3.1 | 2.7 | 2.3 |
| United Kingdom | 1.9 | 3.3 | 3.2 | 2.7 | 2.6 | 1.8 | 1.9 | 2.2 | 7.6 | 6.7 | 5.6 |
| Emerging Markets | 4.6 | 4.8 | 5.0 | 5.4 | 4.7 | 5.1 | 5.4 | 5.1 | 5.6 | 5.6 | 5.6 |
| China | 7.7 | 7.3 | 7.0 | 7.5 | 2.6 | 3.3 | 3.7 | 3.8 | 4.1 | 4.2 | 4.3 |
| India | 4.8 | 5.6 | 6.7 | 7.3 | 10.0 | 8.3 | 7.5 | 7.5 | - | - | - |

Source: Citi Economics Research (GEOS: 22 January, 2014)

Long-Term Forecasts – Fiscal Balance, 2013-18F

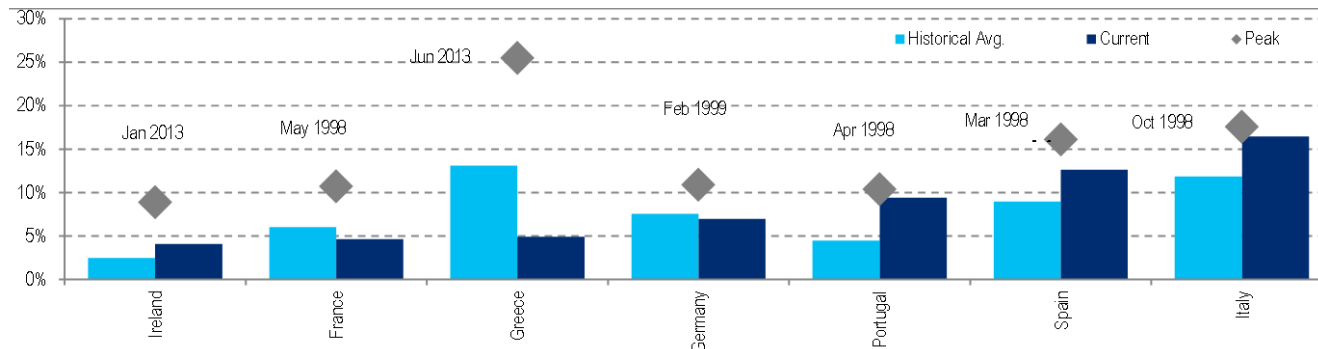
Figure 69. Sovereign Debt-To-GDP Ratio Forecasts



Source: OECD and Citi Economics Forecasts. Note: All forecasts are Citi Economist's forecasts except those marked with an asterisk. *IMF WEO 8 October 2013

Bank-Sov. Link Grows, But Below Peak Levels

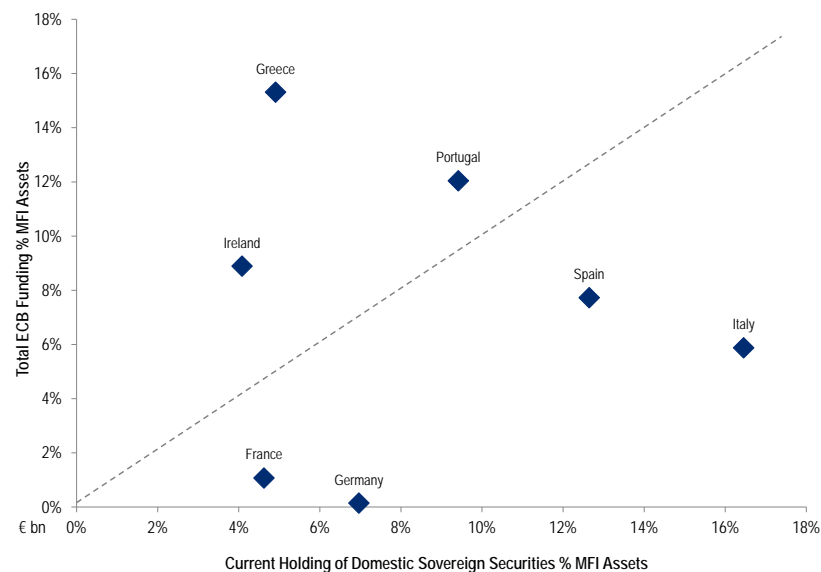
Figure 70. Total Exposure of MFIs to Domestic General Government as a % Balance Sheet



Source: Citi Economics Research, Current: Last updated for Aug 2013

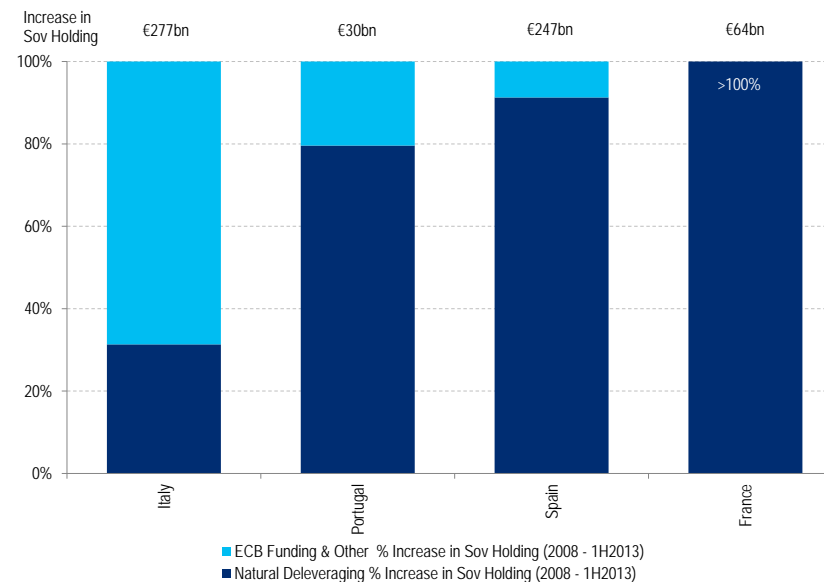
Deleveraging & Banks' Sovereign Holdings

Figure 71. Sovereign Holdings vs ECB Funding



Source: Citi Research, ECB, Havers, Note: Current: Last updated for Aug 2013

Figure 72. Funding of Sovereign Holdings – Natural Deleveraging vs ECB Funding



Source: Citi Research, ECB, Havers, Note: Current: Last updated for Aug 2013

Potential ECB Actions In 'Lower-for-Longer' Macro Environment

■ Door firmly open to easing:

- **Strengthening 'forward guidance'** – some easing and additional liquidity injections
- **Downside risks of inflation** – respond with rate cut
- **Tightening of money market rates** – ECB to provide additional new liquidity

■ Potential ECB actions to further ease policy:

- **Cut refinancing rate** – by 15bps (as early as March)
- **Negative deposit rates** – could make it more expensive for banks to hoard money (unlikely)
- **Enhancing guidance** – Could be achieved simply by extending inflation forecasts, publishing longer-dated numbers or even qualitatively linking guidance to credit dynamics (least binding)
- **FX interventions** – Could work by expanding ECB balance sheet , which combined with a weakening Euro could benefit inflation expectations and boost exporter competitiveness (not discussed in depth)
- **Additional LTRO** – Potentially through a 1-year facility to maintain equilibrium in the EGB market. Also scope for linking the LTRO to the demand for credit, especially at SME level



Notes

Citi Research

Appendix A-1

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