

May 9, 2012

Investment Grade Credit

European Banks

Who Will Catch the Falling Banks?

Moody's review has been pushed back, but we don't believe that indicates any softening in approach. With many bonds expected to drop out of the IG indices, or at least go sub-IG at Moody's, we believe there are few investors willing to step in – at least at current levels – to meet any forced sellers/nervous holders.

We took our O/W LT2 down to E/W on March 26, and had already gone U/W on Tier 1s on February 8 after getting generically more bullish overall on banks in early December. While the background of French and Greek elections was a clear worry, a very specific catalyst for our move on banks was the upcoming Moody's review.

Downgrades in LT2 could be 5-6 notches, not 'just' 2-3, in our view. We are concerned that investors haven't fully grasped that LT2 will be affected by Moody's downgrades of senior ratings *plus* removal of support notching – with BNP's LT2s potentially dropping five notches to Baa3 and UBS' six notches to Ba1, for example.

59% of the € iBoxx Tier 1 index will have dropped out once Moody's downgrades are done, compared to 1 January 2012, we expect. LT2 indices will see dropouts too, with an expected 19% in the same time period. The volume of falling angels – €18 billion of Tier 1 and €17 billion of LT2 – is unprecedented and hence we are concerned about subsequent price action.

Will HY buyers save them? We don't think so. Our survey of HY investors suggests most don't have to closely follow an index and a move from 25% to 32% of the €HY iBoxx index, still wouldn't make those who don't look at banks now suddenly get interested. In our view, prices have to cheapen significantly from here to attract them; the same going for insurers who have spent years de-risking bank capital. Retail investors are ratings insensitive, but demand here is not enough to avoid a price correction, in our view.

Over a long time, we expect mandates to loosen and new financials-capital funds to be set up. HY investors and hedge/ macro funds generically will become buyers when bonds get cheap enough, but for now, we retain our U/W on Tier 1s and our focus on the better-rated LT2s.

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Composition of iBoxx €HY Main Index

Index	Constituents as at 01/03/2012	Post expected ratings changes
Total bonds	377, €180.9 bn	400, €199.9 bn
o/w banks	87, €44.2 bn	113, €63.2 bn

Source: Markit iBoxx; Morgan Stanley Research

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Many bank ratings are continuing relentlessly along the path to high yield (HY), following the flood of ratings changes over the past six months stemming from methodology changes, sovereign downgrades and credit-specific factors. Our own particular focus has been on the implications for investment grade (IG) index membership given the ratings thresholds attached to the mandates of a large part of the traditional bank capital investor base. Here, we address the question of where the bonds which get downgraded to 'junk' will ultimately settle in terms of indices and buyer base. We focus on the iBoxx HY indices, but also with an eye to eligibility criteria of the Bank of America-Merrill Lynch (BAML) and Barcap HY indices, given their widespread use.

Tier 1 and LT2 IG Universe: Shrinking Rapidly

Since 1 January, 14% of the € Tier 1 and 12% of the € LT2 iBoxx indices have already gone to sub-IG, and we expect many more bonds to drop out after the rating reviews. Indeed, once Moody's has concluded its reviews on the 114 European banks (expected by the end of June) and S&P has finished its Spanish banks ratings actions (expected by the end of May), we expect a further 45% bonds to fall out of the € Tier 1 and 7% out of the € LT2 indices. **This would take the Tier 1 and LT2 indices down to 41% and 81% of their membership sizes compared to the beginning of the year, excluding the new entrants.**

Ratings Update: Recent Actions

Among the bonds which have fallen out of the IG indices over the past couple of months due to their composite ratings going to sub-IG are ISPIM, UCGIM and SOCGEN Tier 1s and a selection of RBS LT2s – a risk we flagged in [High Likelihood of High Yield](#), January 31, 2012. Once Moody's concludes its bank ratings reviews, we continue to expect another chunk of bonds to drop out of the iBoxx indices – see Exhibits 1 and 2.

Exhibit 1

Tier 1s Expected to Drop Out of the Indices Post Moody's Upcoming Downgrades

Ticker	Ccy	Coupon in %	Moody's	Fitch	S&P
ISPIM	EUR	9.5	Baa2	BB+	BB+
ISPIM	EUR	8.375	Baa2	BB+	BB+
ISPIM	EUR	8.047	Baa2	BB+	BB+
BBVASM	EUR	8.5	Baa2	BB+	BB+
UBS	EUR	4.28	Baa3	BB+	BBB-
UBS	EUR	7.152	Baa3	BB+	BBB-
BPCEGP	EUR	9.25	Baa3	BB+	BBB-
BPCEGP	EUR	9	Baa3	BB+	BBB-
BPCEGP	EUR	6.117	Baa3	BB+	BBB-
DANBNK	EUR	4.878	Baa3	BBB-	BBB-
NYKRE	EUR	9	Baa2		BBB
BACR	EUR	4.875	Baa3	BB+	BBB
BACR	EUR	4.75	Baa3	BB+	BBB
NYKRE	EUR	4.901	Baa2		BBB
ACAFP	EUR	7.875	Baa3	BBB	BBB-
ACAFP	EUR	8.2	Baa3	BBB	BBB-
SEB	EUR	9.25	Ba1	BBB	BBB-
SEB	EUR	7.0922	Ba1	BBB	BBB-
BBVASM	GBP	9.1	Baa2	BB+	BB+
DANBNK	GBP	5.563	Baa3	BBB-	BBB-
DANBNK	GBP	5.6838	Baa3	BBB-	BBB-
BACR	GBP	6	Baa3	BB+	BBB
DNBNO	GBP	6.0116	Baa3		BBB
SANTAN	GBP	11.3	Baa2	BB+	BBB-
ACAFP	GBP	5.136	Baa3	BBB	BBB-
ACAFP	GBP	8.125	Baa3	BBB	BBB-
ACAFP	GBP	7.589	Baa3	BBB	BBB-
BBVASM	USD	5.919	Baa2	BB+	BB+
UBS	USD	6.243	Baa3	BB+	BBB-
DANBNK	USD	5.914	Baa3	BBB-	BBB-
BACR	USD	6.278	Baa3	BB+	BBB
SANTAN	USD	2	Baa2	BB+	BBB-
ACAFP	USD	8.375	Baa3	BBB	BBB-
ACAFP	USD	9.75	Baa3	BBB	BBB-
ACAFP	USD	6.637	Baa3	BBB	BBB-

Source: S&P, Moody's, Fitch, Morgan Stanley Research; does not take into account any expected S&P and Fitch actions.

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Exhibit 2

LT2s Expected to Drop Out of the Indices after Upcoming Moody's Downgrades

Ticker	Ccy	Coupon in %	Moody's	Fitch	S&P
MONTE	EUR	5	Baa2	BB+	
MONTE	EUR	5.6	Baa2		BBB-
LLOYDS	EUR	4.875	Baa3	BBB-	BB+
LLOYDS	EUR	4.375	Baa3	BBB-	BB+
CMZB	EUR	7.75	Ba1	BB+	BBB
CMZB	EUR	6.375	Ba1	BB+	BBB
LLOYDS	EUR	4.5	Baa3	BBB-	BB+
NDB	EUR	6	Baa2		
CMZB	GBP	6.625	Ba1	BB+	BBB
RBS	GBP	7.875	Baa3	BBB-	
CMZB	USD	7.25	Ba1	BB+	BBB
LLOYDS	USD	6	Baa3	BBB-	BB+
LLOYDS	USD	9.875	Baa2		BBB-

Source: S&P, Moody's, Fitch, Morgan Stanley Research; does not take into account any expected S&P and Fitch actions.

On Monday, April 30, **S&P downgraded 11 banks following the 2-notch downgrade of Spain to BBB+ the week before**, and placed 7 banks on CreditWatch Negative (CWN), kept 3 on CWN and one bank on CreditWatch Positive (CWP). Santander and BBVA were both downgraded by two notches, to A-/A-2 and BBB+/A-2, and placed on negative outlook. Sabadell was lowered to sub-IG at the senior level (BB+/B), remaining on CWN, Bankinter was cut to BBB-/A-3/CWN, and Caixabank, Bankia and Popular were not downgraded, but all placed on CWN. The agency has stated that any negative actions are likely to be limited to 1 or 2 notches, with the reviews expected to conclude by the end of May.

It has not only been the Moody's and S&P threatened downgrades that the market has had to contend with recently – Fitch also rolled out its new bank capital ratings methodology on March 8. In total, the agency downgraded 1067 securities, affirmed 14, upgraded 23 and withdrew 1 rating. The results were largely in line with our expectations, as published most recently in [Moody's: Moving Closer to High Yield](#), February 17, 2012, and **hence our expectations of the securities to go to sub-IG overall remain unchanged**.

Market Impact: Worse than Expected

We appreciate that a number of Tier 1 index dropouts, including large names like UniCredit, have recently happened without much disturbance to the market. However, **the sheer volume of bonds dropping out in the next couple of months will be unprecedented – following the Moody's**

downgrades, we expect €18 billion of Tier 1 and €17 billion of LT2 to have dropped out of the € IG indices since the start of the year. Linked to this, while many investors assure us that five years ago a sub-IG rating was a major problem, nowadays most mandates have a typical '10% off index/sub-IG' bucket. Our concern is that these '10% buckets' may well now be at least half full with a number of fallen bank angels, or indeed, bonds like ECNs. With over half of € Tier 1s expected to exit the index versus January 2012 membership, and a good chunk of LT2s exiting or finding themselves with, or close to, sub-IG ratings at Moody's, **we wonder how much capacity might be left in that '10% bucket' two months from now.**

59% iBoxx € Tier 1 and 19% of € LT2 to Drop Out

Looking at the composition of the €Tier 1 index at the beginning of 2012, it included 38 bonds with a notional value of €30.4 billion, 35 of which are European issuers with a notional of €28.4 billion. Of the 38, six had dropped out already by the April end rebalancing, due to rating downgrades, with the amount outstanding dropping to less than €500 million after liability management exercises (LMEs) or being less than one year away from their first call date (note 5 and 10 bonds have dropped out, respectively, across the £ and \$ Tier 1 indices in the same period). In addition, we expect 18 more European bank issued bonds to drop out in the near term based on our rating expectations alone, which leaves only 14 bonds in the index with a notional value of around €12.5 billion, ignoring bonds that may additionally drop out after LMEs. In this piece, we have focused purely on future European bank-issued dropouts, so any downgrades of non-European bank sub debt will exacerbate the trend. Note that none of the European bank-issued € Tier 1s in the iBoxx indices are expected to drop out next month due to being less than a year away from their first call dates; hence, our 18 dropout candidates are purely ratings-driven.

Among the LT2 indices, we expect to see fewer exits versus the T1 indices, since LT2s have more headroom in ratings to sub-IG. We'd also note that we've seen additions to the LT2 index since January, adding €2.6 billion to the € LT2 index and \$8.8 billion to the \$ LT2 index, thus partially offsetting the near-term expected exits due to ratings downgrades – in volume terms.

€ Indices Most Affected by Dropouts

Exhibit 3 shows the size of the iBoxx T1 and LT2 index as of January 2012 and what we expect the indices to look like after the conclusion of rating agency reviews. Among the indices, the composition of the € indices will be most affected by the dropouts. For the purpose of our analysis, we have adjusted

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for the impact of new bonds that have entered the indices since December to offset the increase in the number of bonds in the indices after downgrades. Since January 2012, among the names we follow, LLOYDS \$9.875%, STANLN \$5.7%, NDASS €4.625%, DNBNO €4.75%, RBS €10.5% and RBS \$ 9.5% have entered the LT2 index.

Exhibit 3

iBoxx T1 and LT2 Index Expectations

	Constituents as of Jan 2012	Bonds dropped out and expected to go to sub-IG*	Post expected ratings changes	New bonds	Total
€ T1	38, 30.4 bn	24, 17.9 bn	14, 12.5 bn	-	14, 12.5 bn
£ T1	37, 14.6 bn	14, 4.6 bn	23, 9.9 bn	-	23, 9.9 bn
\$ T1	71, 77.8 bn	18, 17.4 bn	53, 60.4 bn	1, 1.5 bn	54, 61.9 bn
€ LT2	95, 88.6 bn	19, 16.9 bn	76, 71.7 bn	4, 2.6 bn	80, 74.3 bn
£ LT2	82, 32.3 bn	10, 2.2 bn	72, 30.1 bn	-	72, 30.1 bn
\$ LT2	139, 150.7 bn	11, 8.7 bn	128, 141.9 bn	8, 8.8 bn	136, 150.7 bn

Source: Markit iBoxx; Morgan Stanley Research; *focusing purely on European bank-issued members of the iBoxx indices

Ratings Changes Clearly Matter to Investors

With so many bonds dropping out of IG indices and entering the HY indices, we do wonder about the investor base for these securities. We understand that many benchmarked funds would be forced/encouraged sellers on a downgrade to sub-IG, though, as suggested above, they have 'off-index buckets' and have introduced softened mandates with grace periods and liquidity consideration criteria. Meanwhile, many actively managed funds may not be forced sellers, since many have the flexibility to hold sub-IG paper but would reduce exposure eventually. Hence, most investors have no 'immediate' sell requirements – but would be gradual sellers, with the exception of retail funds, which are not as sensitive to ratings.

A more worrying aspect is that a number of investors are driven by the 'worst' rating a bond receives, so they may be forced sellers if a bond hits sub-IG at one agency, but still stays in an index. In Appendix 1 we show those bonds expected to stay in the index, but be sub-IG at Moody's, following the expected Moody's changes.

Investors not following iBoxx indices will still care about the sub-IG status of bonds as they may drop out of other popular indices, such as BAML and Barcap, based on their respective index rating rules. Note that both the iBoxx and BAML indices look at 'average' ratings for each bond, while **the Barcap indices are more sensitive to ratings changes, using the middle rating if a bond is rated by all three agencies, the lower rating if rated by any two agencies** and the actual

rating if rated by only one agency. Hence, we expect our analysis on the iBoxx indices to be roughly applicable to investors following the BAML indices (note the same rating criteria are applicable for both the HY and IG indices).

Where Do Bonds Go Once They Drop Out of the IG Indices?

Markit iBoxx produces a €-denominated index covering high yield bonds, the iBoxx € High Yield main cum crossover LC index. This currently includes 377 bonds with a notional size of €180.9 billion. Banks make up nearly 25% of the high yield index, and we naturally expect this to increase in the near term, to 32%. iBoxx does not have a HY index for \$- and £-denominated issues. There is no cap on the overall size of the index but the HY index is calculated as constrained and unconstrained to address the concern about excess weight of individual issuers. The maximum weight of an issuer in the constrained indices is set to 3% of the overall index market value and adjusted on a monthly basis.

iBoxx € HY Index: Bank Members to Grow by 43%

We expect the iBoxx €HY index to grow by €19 billion, or 10.5% and for HY bank bonds in the index to increase by 43% (see Exhibit 4), to accommodate those bonds which will fall out of the IG iBoxx €T1 and €LT2 indices and which we think could find a home in the iBoxx €HY index. Again, this is using our expectations for ratings after the Moody's downgrades and considering the index rules (note that the expected S&P downgrades linked to Spain will not affect the conclusions here).

Exhibit 4

Composition of iBoxx €HY Main Index

Index	Constituents as at 01/05/2012	Post expected ratings changes
Total bonds	377, €180.9 bn	400, €199.9 bn
o/w banks	87, €44.2 bn	113, €63.2 bn

Source: Markit iBoxx; Morgan Stanley Research

Interestingly, looking at the *overall* iBoxx IG corporate index, the ratings distribution will not materially change following Moody's expected downgrades, according to our estimates. However, the proportion of bonds in the A-range falls from 10.3% to 8.7%, while about 2.5% of the index is expected to drop out.

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Considering Other Options: BAML and BarCap Indices

While we have historically followed the iBoxx indices as the data is widely available, we appreciate that most investors follow other indices such as the BAML or BarCap HY indices. Indeed, **92% of the 37 European real money high yield investors we surveyed below follow BAML indices.**

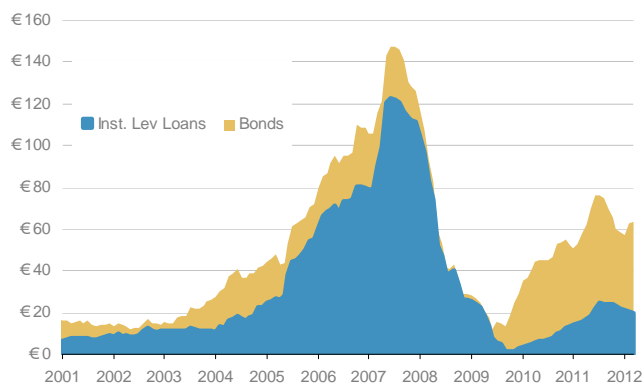
Appendix 2 shows the eligibility criteria for iBoxx, BAML and BarCap indices. On the whole, these are fairly similar and hence our conclusions for iBoxx should follow closely the other indices.

Sizing the European High Yield Bond Market

Even prior to the relentless downgrading of financials, the European high yield market has been one of the fastest growing asset classes, the non-financials component having grown 540% in less than a decade. Since 2008, the nominal value of the market has nearly doubled, owing in large part to loan-to-bond refinancings and the downgrades of investment grade companies into high yield territory. According to the iBoxx High Yield Main Index, the EUR high yield market now comprises €130.0 billion in non-financials and €40.1 billion in financials by market value (note that Exhibit 4 gives notional sizes rather than market value).

Exhibit 5

Supply Is Driven by Loan to Bond Refinancings in Non-Financials (T12M Gross Supply)



Source: LCDComps, Dealogic, Morgan Stanley Research

Most of the discussion on technicals in the high yield market has surrounded tepid fund inflows and the ability of the market to absorb a large quantum of leveraged loans needing to be refinanced in the bond market. For the first, inflows to European high yield funds have lagged the rush into US funds, with investors preferring to take their European high yield risk via global high yield funds. For the second, thanks to amend-to-extend activity, fresh mezzanine fund-raising,

and a yield-hungry US market, we are less worried about supply originating in the loan market overwhelming the bond market (for more details, see [High Yield: Dollars for Europe](#), February 3, 2012). Instead, it is the risk of increasing volumes of fallen angels falling into high yield benchmark indices that worries us more and risks distorting portfolio allocation flows.

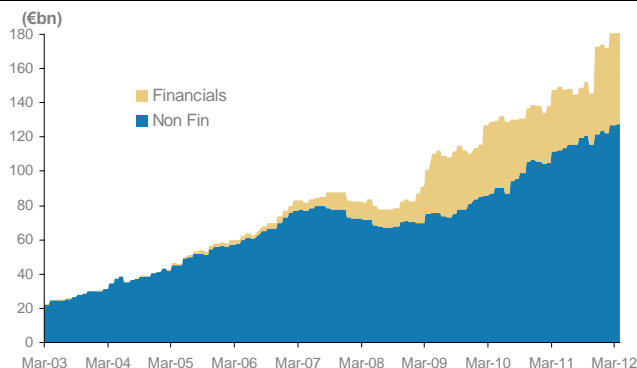
In non-financials, peripheral telcos and utilities are most at risk of creating a big splash, with names like ELEPOR right on the line (and already in many high yield portfolios), and large structures like FNCIM and TITIM not too many notches away. While these names seem certain to be picked up by investors benchmarked to high yield indices, **the question is who will catch downgraded financials.**

High Yield Financials – A Relative Newcomer

As Exhibit 6 illustrates, the advent of high yield financials is a relatively new phenomenon, given the lack of original issue high yield in the space. Until 2011, high yield financials comprised mostly the Greek, Irish and Portuguese banks, including both senior bonds and bank capital. Following a string of sovereign downgrades and methodology revisions, many “core” T1 and LT2 bonds fell into high yield indices at the end of last year, boosting the financials share of the overall high yield index from 19% of notionals in September of 2011 to nearly 30% this month (note in the above section, the 25% quoted refers to bank notionals; this 30% refers to financials as a whole).

Exhibit 6

Financials Are Growing in Importance Due to Downgrades (Composition of Par Value)



Source: Markit iBoxx

Undeniably financials are now an important driver of overall high yield index returns. But to what extent are they being supported by traditional high yield real money investors? We surveyed a sample of 37 European real money high yield investors, accounting for €38.2 billion in

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AUM and found that 65% follow an index that includes financials. However, **a good share of investors exercise their ability to diverge from their benchmark**, sometimes significantly. Thus, high yield investors do not “have to buy” T1 bonds that fall into their benchmarks, removing one pillar of support.

Exhibit 7

Summary Survey Results

Which benchmark index family do you follow?			
	BAML	BARCAP	
By count:	92%	8%	
By assets:	89%	11%	
Does the index you follow include financials?			
	Yes	No	
By count:	65%	35%	
By assets:	67%	33%	
How closely do you follow your benchmark on a scale of 1-5?*			
	1 to 2	2.5 to 3.5	4 to 5
By count:	38%	46%	16%
By assets:	35%	53%	12%

Source: Morgan Stanley Research, * 5 meaning ‘we follow the index very closely’, 1 meaning ‘we can deviate from our benchmark a great deal’

We also asked investors if the proportion of financials in the index moved from 29% to 36%, would they consider looking at financials, if they did not already? **Not a single one of the respondents said they would.** Many cited the need to hire another analyst to look at the sector full time as a constraint. In sum, we do not think high yield real money will be very supportive of T1/LT2 on downgrade.

Survey Conclusions

- Most high yield investors (65%) now have financials in their benchmark.
- Most high yield investors vary their portfolios a good deal from their benchmark index.
- With respect to financials, most investors are underweight relative to the index. Index weight of financials does not appear to drive investment decisions.
- Investors not yet involved in financials are not likely to get involved anytime soon.
- In sum, we do not expect the high yield real money community to support T1/LT2 on a downgrade.

What about Insurers?

We’ve focused our analysis on the potential actions of traditional HY investors, but considering insurance companies are not constrained by a bond being in or out of a particular index, it’s worth a comment on this possible buyer base too. The first point to make here is rationally the lower the credit quality of a bond (in this case as measured via credit ratings) the higher should be the capital charged by any insurer against holding a bond. Hence all else being equal, in order for an insurer to get the same return on capital employed from two bonds, the yield on a lower-rated one needs to be higher than that of a higher-rated bond.

At the moment this requirement is not generally embedded in existing regulatory frameworks governing European insurers. However, this will all change with the introduction of Solvency II (likely from 2014), the upgrade the European insurance regulatory regime. We have discussed this in detail within previous research (see [European Insurance: Investment Impact: Bank Senior Unsecured Debt](#), October 20, 2011). The broad principles are similar both for subordinated and senior bank paper, as investments for insurers (i.e., longer duration, lower rated instruments) will have higher capital charges than shorter-duration, higher-rated instruments, and as a result will need to yield more if they are to be equally attractive to insurers as investors.

The Solvency II framework does not distinguish between industry sectors. Banks very typically yield much more than a similarly rated corporate bond (indeed, many senior bank issues have the same ballpark yield as HY corporates) and insurers, like everyone else (if not more so), have yield targets to meet in order to cover product guarantees, for example. As a result, we still expect insurers to be well invested in the bank space. However, given insurers’ macro concerns, in our view this will be more focused on the senior space following active derisking of bank capital portfolios in recent years.

Looking at the deal analysis of the very few LT2s issued in the past year (many have in fact been the result of LME, rather than fresh issuance), insurers and pension funds tend to take up on average 12-13% of the issues. However, we’d argue that even six months ago, the ratings scene was quite different and we doubt many would have guessed UBS LT2, for example, could well be sub-IG by Moody’s in the near future.

Ultimately, again we do not see insurers as an obvious buyer of any HY financials looking for a home. Naturally, that could easily change as prices cheapen – but again, this would go against the de-risking mode we’ve seen now for some time, and

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also, it would be a function of price, which supports our cautious view on LT2s heading for sub-IG. We're left with the ratings-insensitive retail investor base which should not be underestimated and where we see consistent, low-level buying even now. In our view, though, this low-level buying is not enough to offset a broader price correction in bank bonds that go HY. On a more positive note, though, we do expect that new funds will be set up to invest in such products (again, driven by price) and mandates will be further loosened – a trend we have already seen at work throughout the past four years – which will ultimately give a broader spectrum of real money investors the opportunity to buy HY bank bonds, over time.

Background: Applying Further Stress

In Appendix 3, we stress the ratings of the current European members of the iBoxx IG Tier 1 and LT2 indices across currencies using the updated Fitch ratings and our expectations for Moody's upcoming downgrades (see Appendix 1 in [LT2 Risk-Off: Ratings Trades](#), April 2, 2012). We have also assumed a 1-notch downgrade for Santander and BBVA's sub debt ratings, as S&P stated in its April 30 release that these banks' SACPs may still be lowered, despite the senior ratings staying stable.

As mentioned above, given that Fitch's ratings actions were largely in line with our previous expectations, **we continue to expect to see a number of national champions such as Barclays' prefs, BBVA, Intesa, Danske and UBS Tier 1s fall out of the IG indices** (see Exhibit 1), as well as **CMZB, Monte and certain Lloyds and RBS LT2s to fall out of the indices post Moody's** (see Exhibit 2).

As we flagged in [Moody's: Moving Closer to High Yield](#), February 17, 2012, **BYLAN and other Lloyds/ RBS-issued LT2s and in Tier 1, DB's € 5.33% and 9.5% Tier 1s, along with BACR, CS, ABBEY £ 6.222%, COVBS £ 6.092% Tier 1s** come within 1 notch of going sub-IG on an aggregate basis (note the DB € 8% Tier 1 has two notches of headroom as it does not have a Moody's rating).

Note also that after the Moody's changes, **even UBS LT2s are expected to have just two notches** to go before falling out of the indices. At the Moody's level alone, we expect a Ba1 rating.

Stressing Sovereign Ratings – The Next Dropouts

In addition, given the downwards ratings pressure over the medium term for several European sovereigns, as evidenced by a growing number of negative outlooks (see Exhibit 8), we have added an additional stress to the constituents of the iBoxx IG indices. We have made the blanket assumption of a

one-notch cut to standalone ratings where the sovereign is on negative outlook at either Fitch or S&P (as Moody's recent sovereign ratings actions are to be taken into account in their current review and should therefore be incorporated in the Moody's downgrade assumptions). An exception to this is for RBS' and Lloyds' ratings at Fitch, which were recently affirmed after the change of outlook on the sovereign to negative. This blanket assumption on sovereign downgrades is arbitrary and for the purposes of our stress test only.

While we appreciate that sovereign downgrades do not always translate into downgrades to banks' financial strength on a one-for-one basis, evidence from previous sovereign-related actions suggest a close correlation. As an aside, we'd note that sovereign downgrades typically affect ratings at the senior level in two ways – directly through support uplift assumptions, and indirectly through the link to the bank's unsupported rating – while sub debt ratings are affected by the changes to financial strength alone.

Exhibit 8

Current Sovereign Ratings and Outlooks

	Moody's		S&P		Fitch	
	Rating	Outlook	Rating	Outlook	Rating	Outlook
UK	Aaa	Negative	AAA	Stable	AAA	Negative
Germany	Aaa	Stable	AAA	Stable	AAA	Stable
France	Aaa	Negative	AA+	Negative	AAA	Negative
Austria	Aaa	Negative	AA+	Negative	AAA	Stable
Netherlands	Aaa	Stable	AAA	Negative	AAA	Stable
Belgium	Aa3	Negative	AA	Negative	AA	Negative
Spain	A3	Negative	BBB+	Negative	A	Negative
Italy	A3	Negative	BBB+	Negative	A-	Negative
Switzerland	Aaa	Stable	AAA	Stable	AAA	Stable
Denmark	Aaa	Stable	AAA	Stable	AAA	Stable
Sweden	Aaa	Stable	AAA	Stable	AAA	Stable
Norway	Aaa	Stable	AAA	Stable	AAA	Stable

Source: Moody's, Fitch, S&P, Morgan Stanley Research; data as at May 4, 2012

In Tier 1, once additional sovereign-related downgrades are included, **BNP and BACR Tier 1s, ABBEY £ 6.222 and COVBS £ 6.092% Tier 1s drop out of the indices**, according to our estimates.

Meanwhile, in LT2, UCGIM € 6.125% and KNFP € 4.375% LT2s fall out of the iBoxx € LT2 indices, according to our estimates. RBAIV € 6.625%, FRLBP € 4.375%, BACRED £ 5.375% LT2s move closer to the edge, with just one notch to go to sub-IG. UCGIM's € 4.5%, € 5.75%, £ 6.375% and \$ 6% LT2s as well as SocGen \$ 5.75% LT2s move to just two notches away from sub-IG post Moody's and the additional potential sovereign-related downgrades.

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An Aside – Index Eligibility for CRD4-Compliant Tier 1s

As an aside, we don't expect new-style CRD4 compliant instruments with equity conversion triggers to qualify for inclusion in the indices, as per a Markit iBoxx release from November 2009, *Optionally and Mandatory convertible bonds are not eligible for the Markit iBoxx €, £ and \$ investment grade and high yield indices*. However, 'new' Tier 1s with write-down features (rather than conversion), such as the Intesa €9.5% and the UCGIM €9.375%, have been eligible for the IG indices, though Rabobank's \$8.375% did not qualify for inclusion in the index. This is due to its 'Substitution and Variation clause upon the occurrence of a Basel III Capital Event or a Capital Event', which effectively means that the securities can be substituted if they are deemed not compliant with Basel III rules.

Risk Factors

- Moody's downgrades are far less severe than they have indicated or what we expect.
- A strong improvement in sentiment in Europe increases demand for bank bonds, which generally yield more than corporates to begin with, meaning any downgrades have far less of an impact than we are expecting.
- As Moody's downgrades have been well flagged, any forced sellers or concerned holders have already sold, so there is far less selling pressure than we anticipate and prices stay firm.

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Appendix 1

Bonds Likely to Go to Sub-IG at Moody's but Remain in the Indices

ISIN	Ticker	Ccy	Coupon in %	Moody's	S&P	Fitch	Notches to sub-IG post Moody's*
Tier 1							
XS0176823424	DB	EUR	5.33	Baa2	BBB	BBB-	1
DE000A1ALVC5	DB	EUR	9.5	Baa2	BBB	BBB-	1
FR0010306738	BNP	EUR	4.73	Baa3	BBB+	BBB	2
FR0010456764	BNP	EUR	5.019	Baa3	BBB+	BBB	2
FR0010638338	BNP	EUR	7.781	Baa3	BBB+	BBB	2
FR0010661314	BNP	EUR	8.667	Baa3	BBB+	BBB	2
XS0238196942	SHBASS	EUR	4.194	Baa2	BBB+	BBB+	4
XS0397801357	BACR	GBP	14	Baa2	BBB	BBB-	1
FR0010306787	BNP	GBP	5.945	Baa3	BBB+	BBB	2
FR0010348557	BNP	GBP	5.954	Baa3	BBB+	BBB	2
FR0010533026	BNP	GBP	7.436	Baa3	BBB+	BBB	2
XS0303911795	SHBASS	GBP	6.4611	Baa2	BBB+	BBB+	4
XS0179407910	HSBC	GBP	5.844	Baa1	A-	A-	7
XS0189704140	HSBC	GBP	5.862	Baa1	A-	A-	7
XS0155141830	BACR	USD	6.86	Baa2	BBB	BBB-	1
XS0269453139	BACR	USD	5.926	Baa2	BBB	BBB-	1
XS0371612762	CS	USD	8.25	A3	BBB	BB+	1
USF1058YHV32	BNP	USD	5.186	Baa3	BBB+	BBB	2
USF1058YHX97	BNP	USD	7.195	Baa3	BBB+	BBB	2
US40430LAA70	HSBC	USD	5.911	Baa1	BBB+	BBB+	5
USW5816FCM42	NDASS	USD	5.424	Baa2	BBB+	BBB+	5
XS0453319039	NBHSS	USD	8.375	Baa2	BBB+	BBB+	5
Lower Tier 2							
XS0326869665	BYLAN	EUR	5.75	Ba2		BBB+	1
XS0145620281	LLOYDS	EUR	5.875	Baa2	BBB-	BBB-	1
XS0717735400	LLOYDS	EUR	11.875	Baa2	BBB-	BBB-	1
XS0497187640	LLOYDS	EUR	6.5	Baa2	BBB-	BBB-	1
XS0128842571	RBS	EUR	6	Baa3	BBB-	BBB-	1
XS0167127447	RBS	EUR	4.875	Baa3	BBB-	BBB-	1
XS0271858606	RBS	EUR	4.35	Baa3	BBB-	BBB-	1
XS0356705219	RBS	EUR	6.934	Baa3	BBB-	BBB-	1
XS0618847775	UCGIM	EUR	6.125	A3	BBB		1
FR0010002113	KNFP	EUR	4.375	A1	BBB+		2
XS0619437147	RBIAS	EUR	6.625	A2	A-		2
XS0619548216	ABNANV	EUR	6.375	A1	BBB+	BBB	4
XS0200985207	UBS	EUR	4.5	A1	BBB	BBB+	4
XS0268105821	UBS	EUR	4.125	A1	BBB	BBB+	4
XS0200676160	UCGIM	EUR	4.5	A3	BBB	BBB+	4
XS0322918565	UCGIM	EUR	5.75	A3	BBB	BBB+	4
DE0005934426	HVB	EUR	6	Baa2	BBB+	BBB+	5
FR0010410068	KNFP	EUR	4.125	A1	BBB+	BBB+	5
FR0010468546	KNFP	EUR	4.5	A1	BBB+	BBB+	5

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GB0004037171	LLOYDS	GBP	11	Baa2	BBB-	BBB-	1
XS0041971275	LLOYDS	GBP	10.5	Baa2	BBB-	BBB-	1
XS0066120915	LLOYDS	GBP	9.375	Baa2	BBB-	BBB-	1
XS0100515336	LLOYDS	GBP	6.375	Baa2	BBB-	BBB-	1
XS0043098127	LLOYDS	GBP	9.625	Baa2	BBB-	BBB-	1
XS0109722990	LLOYDS	GBP	6.625	Baa2	BBB-	BBB-	1
XS0149620691	LLOYDS	GBP	5.875	Baa2	BBB-	BBB-	1
XS0195762991	LLOYDS	GBP	5.75	Baa2	BBB-	BBB-	1
XS0717735582	LLOYDS	GBP	10.75	Baa2	BBB-	BBB-	1
XS0503834821	LLOYDS	GBP	7.625	Baa2	BBB-	BBB-	1
XS0366686284	LLOYDS	GBP	6.9625	Baa2	BBB-	BBB-	1
XS0090254722	RBS	GBP	6.5	Baa3	BBB-	BBB-	1
XS0050948958	RBS	GBP	9.625	Baa3	BBB-	BBB-	1
XS0062270581	UBS	GBP	8.75	A1		BBB+	2
XS0257741834	UBS	GBP	5.25	A1		BBB+	2
XS0331313055	UBS	GBP	6.375	A1	BBB	BBB+	4
XS0326211801	UCGIM	GBP	6.375	A3	BBB	BBB+	4
US53947QAA58	LLOYDS	USD	6.5	Baa2	BBB-	BBB-	1
US80932SAG84	LLOYDS	USD	4.25	Baa2	BBB-	BBB-	1
US90261XBY76	UBS	USD	5.875	A1	BBB	BBB+	4
XS0619547838	ABNANV	USD	6.25	A1	BBB+	BBB	4
US90466MAC38	UCGIM	USD	6	A3	BBB	BBB+	4

Source: Bloomberg, Morgan Stanley Research; *notches of headroom left in aggregate ratings to sub-IG post the upcoming expected downgrades at Moody's

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Appendix 2

Eligibility Rules for iBoxx, Barcap and BAML High Yield Indices

	BAML Global Bond Indices			Markit iBoxx	Barcap	
Main Indices	HE00 - Euro High Yield Index	HL00 - Sterling High Yield Index	HOA0 - US High Yield Master II Index	iBoxx € High Yield	Pan-European High Yield Bond Index	U.S. Corporate High Yield Bond Index
Ccy	EUR	GBP	USD	EUR	• EUR • GBP • SEK	USD
Corporate Bond Rating	Sub-IG, based on average of Moody's, S&P & Fitch			Sub-IG, based on average of Moody's, S&P & Fitch	Sub-IG, based on: • If rated by 3 agencies, using the middle rating of Moody's, S&P & Fitch after dropping highest and lowest ratings • If rated by 2 agencies, the lower of the two • If rated by 1 agency, that is used	
Bond Type	<ul style="list-style-type: none"> Fixed coupon Original issue zero coupon securities Debt issued simultaneously in Eurobond & domestic markets 144a PIKs, including toggle notes Fixed-to-floating, as long as callable within the fixed rate period 			<ul style="list-style-type: none"> Plain vanilla bonds Zero coupon bonds FRNs with EURIBOR as reference rate without cap or floor Sinking funds with known redemption schedules Bonds with American or European call options Bonds with poison put options Bonds with make-whole call or tax changes all provisions Event-driven bonds such as rating and registration-sensitive bonds PIKs Callable perps Callable fixed-to-floaters 	<ul style="list-style-type: none"> Fixed-rate bullets Puttable bonds Callable bonds Soft bullets Fixed-rate and fixed to floating capital securities 	<ul style="list-style-type: none"> Corporate Bonds Fixed-rate bullets Puttable bonds Callable bonds Sec Rule 144A securities Original issue zero coupon
Maturity	<ul style="list-style-type: none"> for fixed coupons, >1yr to final maturity for callable perps, >1yr from first call date for fixed-to-floating, >1yr from last call prior to date bond transitions to floating 			<ul style="list-style-type: none"> for fixed coupons, >1yr to final maturity for callable perps and fixed-to-float, >1yr from first call date 	<ul style="list-style-type: none"> >1yr to maturity, regardless of maturity for fixed-to-floater bonds, >1yr to conversion date for fixed-to-float perps, >1yr to first call date 	<ul style="list-style-type: none"> >1yr to maturity, regardless of maturity
Minimum Size	€100 mn	£50 mn		€150 mn	€100 mn or equivalent	\$150 mn
Securities excluded	<ul style="list-style-type: none"> Defaulted Bond with warrants Euro legacy currency securities 	<ul style="list-style-type: none"> Defaulted Bond with warrants 	<ul style="list-style-type: none"> Defaulted DRD eligible securities 	<ul style="list-style-type: none"> Structured notes Index-linked notes Bonds with redemption linked to an entity other than the issuer Private placements Convertibles Distressed* or defaulted bonds (D by Fitch or S&P, or no longer rated by Moody's) Bonds trading flat Bonds where restructuring has been offered to bondholders *Distressed defined as where: <ul style="list-style-type: none"> Exchange constitutes monetary loss has been offered to bondholders Involuntary exchange has been offered to bondholders Covenants were violated Tender offer in which the price is significantly below par/ accreted value was made 	<ul style="list-style-type: none"> Unrated bonds, or bonds with a D rating using the middle rating Bond with equity-type features (eg. warrants, convertibles, cocos) Private placements FRNs Inflation-linked bond EM debt PIK Govt-related Securitized issues Fixed-rate perps, with no incentive to call bonds 	<ul style="list-style-type: none"> Non-corporate bonds Structured Notes with embedded swaps or other special features Bond with equity-type features (eg. warrants, convertibles, cocos) FRNs Eurobonds PIK Defaulted bonds EM debt
Rebalancing	Last calendar day of month			Last business day of month	Month-end	

Source: Company data, Morgan Stanley Research

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Appendix 3

iBoxx € Tier 1 Index

ISIN	Ticker	Coupon	Moody's	Fitch	S&P	Notches to sub IG	Moody's notches	Notches to sub-IG post Moody's	S&P (Spanish review)	Sovereign (S&P)	Sovereign (Fitch)	Notches to sub-IG
XS0545782020	ISPIM	9.5	Baa2	BB+	BB+	1	4	-3		1	1	-5
XS0456541506	ISPIM	8.375	Baa2	BB+	BB+	1	4	-3		1	1	-5
XS0371711663	ISPIM	8.047	Baa2	BB+	BB+	1	4	-3		1	1	-5
XS0457228137	BBVASM	8.5	Baa2	BB+	BB+	1	3	-2	1	1	1	-5
DE000A0D1KX0	UBS	4.28	Baa3	BB+	BBB-	1	3	-2		0	0	-2
XS0336744650	UBS	7.152	Baa3	BB+	BBB-	1	3	-2		0	0	-2
FR0010814558	BPCEGP	9.25	Baa3	BB+	BBB-	1	3	-2		1	1	-4
FR0010871269	BPCEGP	9	Baa3	BB+	BBB-	1	3	-2		1	1	-4
FR0010535971	BPCEGP	6.117	Baa3	BB+	BBB-	1	3	-2		1	1	-4
XS0287195233	DANBNK	4.878	Baa3	BBB-	BBB-	2	4	-2		0	0	-2
XS0347918640	NYKRE	9	Baa2		BBB	2	4	-2		0	0	-2
XS0205937336	BACR	4.875	Baa3	BB+	BBB	2	3	-1		0	1	-2
XS0214398199	BACR	4.75	Baa3	BB+	BBB	2	3	-1		0	1	-2
XS0201146064	NYKRE	4.901	Baa2		BBB	3	4	-1		0	0	-1
FR0010814434	ACAFP	7.875	Baa3	BBB	BBB-	3	3	0		1	1	-2
FR0010603159	ACAFP	8.2	Baa3	BBB	BBB-	3	3	0		1	1	-2
XS0454821462	SEB	9.25	Ba1	BBB	BBB-	2	2	0		0	0	0
XS0337453202	SEB	7.0922	Ba1	BBB	BBB-	2	2	0		0	0	0
XS0176823424	DB	5.33	Baa2	BBB-	BBB	4	3	1		0	0	1
DE000A1ALVC5	DB	9.5	Baa2	BBB-	BBB	4	3	1		0	0	1
DE000A0TU305	DB	8		BBB-	BBB	2	0	2		0	0	2
FR0010306738	BNP	4.73	Baa3	BBB	BBB+	5	3	2		1	1	0
FR0010456764	BNP	5.019	Baa3	BBB	BBB+	5	3	2		1	1	0
FR0010638338	BNP	7.781	Baa3	BBB	BBB+	5	3	2		1	1	0
FR0010661314	BNP	8.667	Baa3	BBB	BBB+	5	3	2		1	1	0
XS0238196942	SHBASS	4.194	Baa2	BBB+	BBB+	7	3	4		0	0	4
BE0119806116	FBAVP	4.625	Baa1	BBB	A-	8	2	6		1	1	4
XS0178404793	HSBC	5.3687	A3	A-	BBB+	10	3	7		0	1	6
XS0188853526	HSBC	5.13	A3	A-	BBB+	10	3	7		0	1	6

Source: Markit iBoxx, note we include only the bonds issued by European banks/ entities, Bloomberg; Morgan Stanley Research; shading means the aggregate rating has gone to sub-IG

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Appendix 3 (Cont.)

iBoxx £ Tier 1 Index

ISIN	Ticker	Coupon	Notional	Moody's	Fitch	S&P	Notches to sub IG	Moody's notches	Notches to sub-IG post Moody's	S&P (Spanish review)	Sovereign (S&P)	Sovereign (Fitch)	Notches to sub-IG
XS0457234291	BBVASM	9.1	251,050,000	Baa2	BB+	BB+	1	3	-2	1	1	1	-5
XS0214342569	DANBNK	5.563	150,000,000	Baa3	BBB-	BBB-	2	4	-2		0	0	-2
XS0279056419	DANBNK	5.6838	500,000,000	Baa3	BBB-	BBB-	2	4	-2		0	0	-2
XS0222208539	BACR	6	750,000,000	Baa3	BB+	BBB	2	3	-1		0	1	-2
XS0285087358	DNBNO	6.0116	350,000,000	Baa3		BBB	2	3	-1		0	0	-1
XS0441528949	SANTAN	11.3	679,400,000	Baa2	BB+	BBB-	2	3	-1	1	1	1	-4
FR0010291997	ACAFP	5.136	198,600,000	Baa3	BBB	BBB-	3	3	0		1	1	-2
FR0010814418	ACAFP	8.125	291,050,000	Baa3	BBB	BBB-	3	3	0		1	1	-2
FR0010575654	ACAFP	7.589	171,850,000	Baa3	BBB	BBB-	3	3	0		1	1	-2
GB00B177CL57	COVBS	6.092	120,000,000	Baa3	BBB-		1	0	1		0	1	0
XS0502105454	ABBEY	6.222	300,002,000		BBB-	BBB-	1	0	1		0	1	0
XS0397801357	BACR	14	1,750,000,000	Baa2	BBB-	BBB	4	3	1		0	1	0
FR0010306787	BNP	5.945	450,000,000	Baa3	BBB	BBB+	5	3	2		1	1	0
FR0010348557	BNP	5.954	162,850,000	Baa3	BBB	BBB+	5	3	2		1	1	0
FR0010533026	BNP	7.436	200,000,000	Baa3	BBB	BBB+	5	3	2		1	1	0
GB0001777449	NWIDE	7.971	200,000,000	Baa3	BBB	BBB	4	0	4		0	1	3
GB0001777886	NWIDE	7.859	100,000,000	Baa3	BBB	BBB	4	0	4		0	1	3
GB0033627968	NWIDE	6.25	125,000,000	Baa3	BBB	BBB	4	0	4		0	1	3
XS0184519139	NWIDE	5.769	400,000,000	Baa3	BBB	BBB	4	0	4		0	1	3
GB00B120GX99	NWIDE	6	140,000,000	Baa3	BBB	BBB	4	0	4		0	1	3
XS0303911795	SHBASS	6.4611	100,000,000	Baa2	BBB+	BBB+	7	3	4		0	0	4
XS0188550114	ABBEY	5.827	109,999,000	Baa1	BBB	BBB-	5	0	5		0	1	4
XS0124569566	ABBEY	7.037	131,944,000	Baa2	BBB+	BBB-	5	0	5		0	1	4
XS0203782551	RABOBK	5.556	350,000,000	A2		A	9	3	6		1	0	5
XS0179407910	HSBC	5.844	700,000,000	Baa1	A-	A-	10	3	7		0	1	6
XS0189704140	HSBC	5.862	300,000,000	Baa1	A-	A-	10	3	7		0	1	6
XS0110560165	HSBC	8.208	500,000,000	A3	A-	BBB+	10	3	7		0	1	6
XS0129229141	STANLN	8.103	600,000,000	A3	BBB+	A-	10	0	10		0	1	9

Source: Markit iBoxx, note we include only the bonds issued by European banks/ entities, Bloomberg; Morgan Stanley Research; shading means the aggregate rating has gone to sub-IG

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Appendix 3 (Cont.)

iBoxx \$ Tier 1 Index

ISIN	Ticker	Coupon	Notional	Moody's	Fitch	S&P	Notches to sub IG	Moody's notches	Notches to sub-IG post Moody's	S&P (Spanish review)	Sovereign (S&P)	Sovereign (Fitch)	Notches to sub-IG
US05530RAB42	BBVASM	5.919	600,000,000	Baa2	BB+	BB+	1	3	-2	1	1	1	-5
US90264AAA79	UBS	6.243	1,000,000,000	Baa3	BB+	BBB-	1	3	-2		0	0	-2
USK22272CP99	DANBNK	5.914	750,000,000	Baa3	BBB-	BBB-	2	4	-2		0	0	-2
US06738C8284	BACR	6.278	1,000,000,000	Baa3	BB+	BBB	2	3	-1		0	1	-2
XS0418031778	SANTAN	2	980,992,500	Baa2	BB+	BBB-	2	3	-1	1	1	1	-4
USF22797FK97	ACAFP	8.375	1,000,000,000	Baa3	BBB	BBB-	3	3	0		1	1	-2
FR0010772244	ACAFP	9.75	1,350,000,000	Baa3	BBB	BBB-	3	3	0		1	1	-2
USF22797FJ25	ACAFP	6.637	889,928,000	Baa3	BBB	BBB-	3	3	0		1	1	-2
XS0531067659	CS	7.875	1,500,000,000		BB+	BBB	1	0	1		0	0	1
XS0155141830	BACR	6.86	681,033,000	Baa2	BBB-	BBB	4	3	1		0	1	0
XS0269453139	BACR	5.926	533,064,000	Baa2	BBB-	BBB	4	3	1		0	1	0
XS0371612762	CS	8.25	1,500,000,000	A3	BB+	BBB	5	4	1		0	0	1
USF1058YHV32	BNP	5.186	1,069,804,000	Baa3	BBB	BBB+	5	3	2		1	1	0
USF1058YHX97	BNP	7.195	1,100,000,000	Baa3	BBB	BBB+	5	3	2		1	1	0
US002927AA95	ABBEY	8.963	797,988,000	Baa2	BBB	BBB-	4	0	4		0	1	3
US40430LAA70	HSBC	5.911	1,000,000,000	Baa1	BBB+	BBB+	8	3	5		0	1	4
USW5816FCM42	NDASS	5.424	600,000,000	Baa2	BBB+	BBB+	7	2	5		0	0	5
XS0453319039	NBHSS	8.375	1,000,000,000	Baa2	BBB+	BBB+	7	2	5		0	0	5
USG84228AT58	STANLN	6.409	750,000,000	Baa2	BBB	BBB+	6	0	6		0	1	5
US853254AC43	STANLN	7.014	750,000,000	Baa2	BBB	BBB+	6	0	6		0	1	5
XS0365481935	STANLN	8.125	925,000,000	Baa2	BBB	BBB+	6	0	6		0	1	5
USG4637HAB45	HSBC	10.176	900,000,000	A3	A-	BBB+	10	3	7		0	1	6
USG463802037	HSBC	4.61	1,250,000,000	A3	A-	BBB+	10	3	7		0	1	6
XS0347919457	STANLN	9.5	1,500,000,000	A3	BBB+	A-	10	0	10		0	1	9
XS0180995945	RABOBK	5.26	733,234,000	A2	A-	A	13	3	10		1	0	9
XS0431744282	RABOBK	11	2,868,297,000	A2	A-	A	13	3	10		1	0	9
XS0203891840	RABOBK	5.254	754,930,000	A2	A+	A	15	3	12		1	0	11
US404280AJ87	HSBC	6.8	1,500,000,000	A1	AA-	A-	16	3	13		0	1	12

Source: Markit iBoxx, note we include only the bonds issued by European banks/ entities, Bloomberg; Morgan Stanley Research; shading means the aggregate rating has gone to sub-IG

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Appendix 3 (Cont.)

iBoxx € Lower Tier 2 Index

ISIN	Ticker	Coupon	Moody's	Fitch	S&P	Notches to sub IG	Moody's support	Moody's post	S&P (Spanish review)	Sovereign (S&P)	Sovereign (Fitch)	Notches to sub-IG
XS0503326083	MONTE	5	Baa2	BB+		1	2	2	-3	1	1	-5
XS0540544912	MONTE	5.6	Baa2		BBB-	2	2	2	-2	1	1	-4
XS0165449736	LLOYDS	4.875	Baa3	BBB-	BB+	1	2	0	-1	0	0	-1
XS0203871651	LLOYDS	4.375	Baa3	BBB-	BB+	1	2	0	-1	0	0	-1
DE000CB83CF0	CMZB	7.75	Ba1	BB+	BBB	1	2	0	-1	0	0	-1
DE000CB83CE3	CMZB	6.375	Ba1	BB+	BBB	1	2	0	-1	0	0	-1
XS0214965534	LLOYDS	4.5	Baa3	BBB-	BB+	1	2	0	-1	0	0	-1
XS0520938647	NDB	6	Baa2			2	2	0	0	0	0	0
XS0326869665	BYLAN	5.75	Ba2	BBB+		1	0	0	1	0	0	1
XS0145620281	LLOYDS	5.875	Baa2	BBB-	BBB-	3	2	0	1	0	0	1
XS0717735400	LLOYDS	11.875	Baa2	BBB-	BBB-	3	2	0	1	0	0	1
XS0497187640	LLOYDS	6.5	Baa2	BBB-	BBB-	3	2	0	1	0	0	1
XS0128842571	RBS	6	Baa3	BBB-	BBB-	2	1	0	1	0	0	1
XS0167127447	RBS	4.875	Baa3	BBB-	BBB-	2	1	0	1	0	0	1
XS0753308807	RBS	10.5		BBB-	BBB-	1	0	0	1	0	0	1
XS0271858606	RBS	4.35	Baa3	BBB-	BBB-	2	1	0	1	0	0	1
XS0356705219	RBS	6.934	Baa3	BBB-	BBB-	2	1	0	1	0	0	1
XS0618847775	UCGIM	6.125	A3		BBB	5	2	2	1	1	1	-1
FR0010002113	KNFP	4.375	A1		BBB+	8	2	4	2	1	1	0
XS0619437147	RBIAS	6.625	A2		A-	8	3	3	2	1	0	1
FR0010969410	FRLBP	4.375			BBB+	3	0	0	3	1	1	1
XS0619548216	ABNANV	6.375	A1	BBB	BBB+	10	2	4	4	1	0	3
XS0289338609	RZB	4.5	A2		A-	8	1	3	4	1	0	3
XS0200985207	UBS	4.5	A1	BBB+	BBB	10	3	3	4	0	0	4
XS0268105821	UBS	4.125	A1	BBB+	BBB	10	3	3	4	0	0	4
XS0200676160	UCGIM	4.5	A3	BBB+	BBB	8	2	2	4	1	1	2
XS0322918565	UCGIM	5.75	A3	BBB+	BBB	8	2	2	4	1	1	2
DE0005934426	HVB	6	Baa2	BBB+	BBB+	7	2	0	5	1	0	4
XS0754846235	DNBNO	4.75			A	5	0	0	5	0	0	5
FR0010410068	KNFP	4.125	A1	BBB+	BBB+	11	2	4	5	1	1	3
FR0010468546	KNFP	4.5	A1	BBB+	BBB+	11	2	4	5	1	1	3
XS0213101230	ISPIM	3.75	A3	BBB+	BBB	8	3	0	5	1	1	3
XS0258143477	ISPIM	4.375	A3	BBB+	BBB	8	3	0	5	1	1	3
XS0526326334	ISPIM	5.15	A3	BBB+	BBB	8	3	0	5	1	1	3
XS0452166324	ISPIM	5	A3	BBB+	BBB	8	3	0	5	1	1	3
XS0365303675	ISPIM	5.75	A3	BBB+	BBB	8	3	0	5	1	1	3
DE000DB5DCW6	DB	5		A-	BBB+	6	0	0	6	0	0	6
NL0000113892	INTNED	4.625	A1	A-		9	1	2	6	1	0	5
XS0468940068	LBBER	5.875	Baa2	A		6	0	0	6	0	0	6
XS0110673950	SOCGEN	6.625	A2	BBB+	BBB+	10	1	3	6	1	1	4
XS0383634762	SOCGEN	6.125	A2	BBB+	BBB+	10	1	3	6	1	1	4
ES0213211099	BBVASM	4.375	A2	A-	BBB	10	3	0	7	1	1	4
XS0187033864	BACR	4.5	Baa1	A-	BBB+	9	2	0	7	0	1	6
XS0525912449	BACR	6	Baa1	A-	BBB+	9	2	0	7	0	1	6
XS0611398008	BACR	6.625	Baa1	A-	BBB+	9	2	0	7	0	1	6
XS0342289575	BACR	6	Baa1	A-	BBB+	9	2	0	7	0	1	6

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XS0130171159	CS	6.375	Aa3	A-	BBB	12	3	2	7		0	0	7
XS0229097034	CS	3.625	Aa3	A-	BBB	12	3	2	7		0	0	7
XS0550466469	ACAFP	3.9	A1	A	BBB+	13	2	3	8		1	1	6
XS0432092137	ACAFP	5.875	A1	A	BBB+	13	2	3	8		1	1	6
XS0343877451	ACAFP	5.971	A1	A	BBB+	13	2	3	8		1	1	6
XS0497179035	NDASS	4.5	Aa3	A+		12	1	3	8		0	0	8
FR0000486730	BFCM	6.5	A1	A	A-	14	2	3	9		1	1	7
FR0010015982	BFCM	5	A1	A	A-	14	2	3	9		1	1	7
XS0548803757	BFCM	4	A1	A	A-	14	2	3	9		1	1	7
XS0201169439	SANTAN	4.5	A2	A-	BBB+	11	2	0	9	1	1	1	6
XS0320303943	BNP	5.431	A1	A	A	15	2	3	10		1	1	8
XS0429484891	RABOBK	5.875	Aa1		A+	14	2	2	10		1	0	9
BE0931376793	FBAVP	4.25	A2	A-	A	13	1	2	10		1	1	8
BE0933514839	FBAVP	5.757	A2	A-	A	13	1	2	10		1	1	8
XS0229593529	INTNED	3.5	A1	A-	A-	13	1	2	10		1	0	9
XS0366066149	INTNED	6.125	A1	A-	A-	13	1	2	10		1	0	9
XS0527239221	NWIDE	6.75	Baa1	A	BBB+	10	0	0	10		0	1	9
XS0750702507	POHBK	5.75		A	A+	10	0	0	10		1	0	9
FR0011000231	CRLOG	5.454	Aa3		A	11	0	1	10		1	1	8
XS0743689993	NDASS	4.625		A+	A+	11	0	0	11		0	0	11
XS0222053315	HSBC	3.625	A1	AA-	A-	16	2	0	14		0	1	13
XS0433028254	HSBC	6	A1	AA-	A-	16	2	0	14		0	1	13
XS0353643744	HSBC	6.25	A1	AA-	A-	16	2	0	14		0	1	13
XS0544654162	NDASS	4	Aa3	A+	A+	18	1	3	14		0	0	14
XS0386569296	NDASS	6.25	Aa3	A+	A+	18	1	3	14		0	0	14
XS0323411016	STANLN	5.875	A2	A+	A	15	0	0	15		0	1	14
XS0557252417	RABOBK	3.75	Aa1	AA-	A+	21	2	2	17		1	0	16

Source: Markit iBoxx, note we include only the bonds issued by European banks/ entities, Bloomberg; Morgan Stanley Research; shading means the aggregate rating has gone to sub-IG

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European Banks
Who Will Catch the Falling Banks?

Appendix 3 (Cont.)

iBoxx £ Lower Tier 2 Index

ISIN	Ticker	Coupon	Moody's	Fitch	S&P	Notches to sub-IG	Moody's downgrade	Moody's support removal	Notches to sub-IG post Moody's	S&P (Spanish review)	Sovereign (S&P)	Sovereign (Fitch)	Notches to sub-IG
XS0101360161	CMZB	6.625	Ba1	BB+	BBB	1	2	0	-1		0	0	-1
XS0079432299	RBS	7.875	Baa3	BBB-		1	1	0	0		0	0	0
GB0004037171	LLOYDS	11	Baa2	BBB-	BBB-	3	2	0	1		0	0	1
XS0041971275	LLOYDS	10.5	Baa2	BBB-	BBB-	3	2	0	1		0	0	1
XS0066120915	LLOYDS	9.375	Baa2	BBB-	BBB-	3	2	0	1		0	0	1
XS0100515336	LLOYDS	6.375	Baa2	BBB-	BBB-	3	2	0	1		0	0	1
XS0043098127	LLOYDS	9.625	Baa2	BBB-	BBB-	3	2	0	1		0	0	1
XS0109722990	LLOYDS	6.625	Baa2	BBB-	BBB-	3	2	0	1		0	0	1
XS0149620691	LLOYDS	5.875	Baa2	BBB-	BBB-	3	2	0	1		0	0	1
XS0195762991	LLOYDS	5.75	Baa2	BBB-	BBB-	3	2	0	1		0	0	1
XS0717735582	LLOYDS	10.75	Baa2	BBB-	BBB-	3	2	0	1		0	0	1
XS0503834821	LLOYDS	7.625	Baa2	BBB-	BBB-	3	2	0	1		0	0	1
XS0366686284	LLOYDS	6.9625	Baa2	BBB-	BBB-	3	2	0	1		0	0	1
XS0090254722	RBS	6.5	Baa3	BBB-	BBB-	2	1	0	1		0	0	1
XS0050948958	RBS	9.625	Baa3	BBB-	BBB-	2	1	0	1		0	0	1
XS0270002669	BACRED	5.375			BBB	2	0	0	2		1	1	1
XS0062270581	UBS	8.75	A1	BBB+		8	3	3	2		0	0	2
XS0257741834	UBS	5.25	A1	BBB+		8	3	3	2		0	0	2
XS0068009637	BACR	9.5	Baa1	A-		6	2	0	4		0	1	3
XS0145065602	COOPWH	5.875	Baa2	BBB+		4	0	0	4		0	1	3
XS0188218183	COOPWH	5.75	Baa2	BBB+		4	0	0	4		0	1	3
XS0189539942	COOPWH	5.875	Baa2	BBB+		4	0	0	4		0	1	3
XS0620315902	COOPWH	9.25	Baa2	BBB+		4	0	0	4		0	1	3
XS0274155984	COOPWH	5.625	Baa2	BBB+		4	0	0	4		0	1	3
XS0331313055	UBS	6.375	A1	BBB+	BBB	10	3	3	4		0	0	4
XS0326211801	UCGIM	6.375	A3	BBB+	BBB	8	2	2	4		1	1	2
XS0371048330	DNBNO	7.25	A1		A	10	2	3	5		0	0	5
XS0188046543	ISPIM	5.625	A3	BBB+	BBB	8	3	0	5		1	1	3
XS0161798417	SOCGEN	5.4	A2	BBB+	BBB+	10	1	3	6		1	1	4
XS0134886067	BACR	5.75	Baa1	A-	BBB+	9	2	0	7		0	1	6
XS0429325748	BACR	10	Baa1	A-	BBB+	9	2	0	7		0	1	6
XS0334370565	BACR	6.75	Baa1	A-	BBB+	9	2	0	7		0	1	6
XS0118514446	CS	7	Aa3	A-	BBB	12	3	2	7		0	0	7
XS0047364947	NWIDE	8.625	Baa1	A		7	0	0	7		0	1	6
XS0405953257	ACAFP	7.375	A1	A	BBB+	13	2	3	8		1	1	6
XS0336248082	CS	6.75	Aa2	A-	BBB+	14	3	2	9		0	0	9
XS0440403797	SANTAN	7.3	A2	A-	BBB+	11	2	0	9	1	1	1	6
XS0034981661	ABBEY	11.5	A3	A	BBB	10	0	0	10		0	1	9
XS0041864512	ABBEY	10.125	A3	A	BBB	10	0	0	10		0	1	9
XS0361244311	ABBEY	9.625	A3	A	BBB	10	0	0	10		0	1	9
XS0142073419	BNP	5.75	A1	A	A	15	2	3	10		1	1	8
XS0366066222	INTNED	6.875	A1	A-	A-	13	1	2	10		1	0	9
XS0235423406	NWIDE	5.25	Baa1	A	BBB+	10	0	0	10		0	1	9
XS0103012893	ABBEY	6.5	A3	A	BBB	10	0	0	10		0	1	9
XS0159497162	HSBC	5.75	A1	AA-	A-	16	2	0	14		0	1	13
XS0498768315	HSBC	6	A1	AA-	A-	16	2	0	14		0	1	13
XS0326347373	HSBC	6.375	A1	AA-	A-	16	2	0	14		0	1	13
XS0356452929	HSBC	7	A1	AA-	A-	16	2	0	14		0	1	13
XS0387079907	HSBC	6.75	A1	AA-	A-	16	2	0	14		0	1	13
XS0355789271	STANLN	7.75	A2	A+	A	15	0	0	15		0	1	14

Source: Markit iBoxx, note we include only the bonds issued by European banks/ entities, Bloomberg; Morgan Stanley Research; shading means the aggregate rating has gone to sub-IG

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European Banks
Who Will Catch the Falling Banks?

Appendix 3 (Cont.)

iBoxx \$ Lower Tier 2 Index

ISIN	Ticker	Coupon	Moody's	Fitch	S&P	Notches to sub IG	Moody's downgrade	Moody's support removal	Notches to sub-IG post Moody's	S&P (Spanish review)	Sovereign (S&P)	Sovereign (Fitch)	Notches to sub-IG
US261561AB06	CMZB	7.25	Ba1	BB+	BBB	1	2	0	-1		0	0	-1
US4041A3AG79	LLOYDS	6	Baa3	BBB-	BB+	1	2	0	-1		0	0	-1
XS0717735822	LLOYDS	9.875	Baa2		BBB-	2	2	0	0		0	0	0
US53947QAA58	LLOYDS	6.5	Baa2	BBB-	BBB-	3	2	0	1		0	0	1
XS0753308559	RBS	9.5		BBB-	BBB-	1	0	0	1		0	0	1
US80932SAG84	LLOYDS	4.25	Baa2	BBB-	BBB-	3	2	0	1		0	0	1
USF43628AB60	SOCGEN	5.75	A2		BBB+	7	1	3	3		1	1	2
US90261XBY76	UBS	5.875	A1	BBB+	BBB	10	3	3	4		0	0	4
XS0619547838	ABNANV	6.25	A1	BBB	BBB+	10	2	4	4		1	0	3
US90466MAC38	UCGIM	6	A3	BBB+	BBB	8	2	2	4		1	1	2
US00080QAB14	RBS	4.65	A3	BBB-	BBB-	5	1	0	4		0	0	4
XS0432830734	BACR	10.179	Baa1	A-	BBB+	9	2	0	7		0	1	6
XS0334249223	BACR	6.05	Baa1	A-	BBB+	9	2	0	7		0	1	6
US06739GBP37	BACR	5.14	Baa1	A-	BBB+	9	2	0	7		0	1	6
US002920AC09	ABBEY	7.95	Baa1	A	BBB	9	1	0	8		0	1	7
US22546QAD97	CS	5.4	Aa2	A-	BBB+	14	3	2	9		0	0	9
US22541HCC43	CS	6	Aa2	A-	BBB+	14	3	2	9		0	0	9
USN4578BLH51	INTNED	5.125	A1	A-	A-	13	1	2	10		1	0	9
XS0736418962	STANLN	5.7	A3	A+	A-	13	0	0	13		0	1	12
US65557HAA05	NDASS	4.875	Aa3	A+	A+	18	1	3	14		0	0	14
US404280AG49	HSBC	6.5	A1	AA-	A-	16	2	0	14		0	1	13
US404280AH22	HSBC	6.5	A1	AA-	A-	16	2	0	14		0	1	13
XS0323650787	STANLN	6.4	A2	A+	A	15	0	0	15		0	1	14

Source: Markit iBoxx, note we include only the bonds issued by European banks/ entities, Bloomberg; Morgan Stanley Research; shading means the aggregate rating has gone to sub-IG

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Global Stock Ratings Distribution

(as of April 30, 2012)

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	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight/Buy	1115	38%	459	42%	41%
Equal-weight/Hold	1254	43%	474	44%	38%
Not-Rated/Hold	100	3%	25	2%	25%
Underweight/Sell	471	16%	124	11%	26%
Total	2,940		1082		

Data include common stock and ADRs currently assigned ratings. An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months.

Analyst Stock Ratings

Overweight (O). The stock's total return is expected to exceed the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Equal-weight (E). The stock's total return is expected to be in line with the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Not-Rated (NR). Currently the analyst does not have adequate conviction about the stock's total return relative to the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Underweight (U). The stock's total return is expected to be below the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Unless otherwise specified, the time frame for price targets included in Morgan Stanley Research is 12 to 18 months.

Analyst Industry Views

Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

In-Line (I): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.

Cautious (C): The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.

Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index.

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