

September 25, 2012

Investment Grade Credit

Europe

European Banks

Periphery Review: Tier 1

As discussed in [Reviewing Our Periphery Skew](#), September 12, when we closed out our underweight in Tier 1s in June, we did so by adding a number of Italian and Spanish high-steps. With the upcoming banking sector-specific risks highlighted in our [Periphery Skew](#) note and valuations on our periphery recommendations at or very close to 12-month highs, it's time to sell some of our Italian and Spanish Tier 1s.

Our starting point is a 10.2% YTC on the SANTAN £ 7.3% 19NC14 LT2 (high step to I+416bp) that we kept when reviewing our LT2 recommendations in [Periphery Review: LT2](#), September 17. In periphery Tier 1s, we want to definitely beat this yield by a good margin, or otherwise simply get more defensive, rather than go underweight.

Sell SANTAN £ 11.3% 14s at 101, YTC 10.6%, buy HBOS £ 6.461% at 78 (when liquidity allows), YTC of 11.5%, YTP 8.3%. Note that HBOS' step in 2018 is 5-year UKT+285bp, so not huge, but still, the optionality of a call or LME at this low-ish cash price makes these bonds still interesting, in our view. The SANTAN Tier 1s are almost the same yield as its own £ LT2s.

Sell € ISPIM 8.375% at 96, YTC 9.2% and buy ACAFP's retail € 6% at 73.25, YTP 8.6%. While it still has Emporiki, Agricole is clearly not out of the periphery woods yet, but there are confirmed bidders for Emporiki and we do not believe that it should trade close to an Italian bank.

Sell € ISPIM 8.047% at 91.75, YTC 10% and buy BPCEGP's retail €9% or 9.25%, with the 9.25% offered around 100.25, YTC in 2015 of 9.1%. Even a reg par call on January 1 would still give a good, if very short-term, yield on these. **We also like Lloyds' € 7.875% (also in \$) pref shares at 89, YTP 8.9%, although liquidity is difficult.**

We'd keep high-step BBVA in £ and € Tier 1s as we still believe that the YTCs are good on these (16% and 14%) and outstrip anything we can find in LT2s by a margin – for example, low-step BBVA and SANTAN callable LT2s are trading between 6% and 7.3% YTM in €. We'd also keep ABBEY \$8.963%, recognising that the call is out in 2030, giving us a nice yield and good duration. We also believe that we'd never be able to buy it back if we sold it.

Risk Factors

- Market conditions give further legs to the rally and periphery banks continue to outperform the core.
- The banking sector-specific risks turn out to be more severe than expected, meaning that maintaining an equal-weight in Tier 1, albeit with no periphery skew, is too bullish.

Due to the nature of the fixed income market, the issuers or bonds of the issuers recommended or discussed in this report may not be continuously followed. Accordingly, investors must regard this report as providing stand-alone analysis and should not expect continuing analysis or additional reports relating to such issuers or bonds of the issuers.

Morgan Stanley does and seeks to do business with companies covered in Morgan Stanley Research. As a result, investors should be aware that the firm may have a conflict of interest that could affect the objectivity of Morgan Stanley Research. Investors should consider Morgan Stanley Research as only a single factor in making their investment decision.

For analyst certification and other important disclosures, refer to the Disclosure Section, located at the end of this report.

+ = Analysts employed by non-U.S. affiliates are not registered with FINRA, may not be associated persons of the member and may not be subject to NASD/NYSE restrictions on communications with a subject company, public appearances and trading securities held by a research analyst account.

September 25, 2012
European Banks
Periphery Review: Tier 1

Although we have a longer-term constructive view on bank credit, we have clear concerns in the short term, where the raft of bank sector-specific risks – against the backdrop of numerous political and economic events – could weigh heavily on bank debt, where valuations are currently close to one-year highs. We outlined the numerous risks in [Reviewing Our Periphery Skew](#), and Joachim Fels, our co-head of Global Economics, recently commented on rising complacency in general, in his [Sunday Start](#), September 23.

Risks of Increasing Complacency

According to the CRIC cycle that our strategists and economists use – Crisis, Response, Improvement, Complacency – when Complacency becomes pervasive, it usually gives way to a renewed crisis. Joachim links his view of increasing complacency to evidence including the market looking through the fact that the economy remains stuck in what he describes as the ‘twilight zone’. He argues that weak advance PMI surveys out of the euro area and China last week confirmed a continuing contraction in manufacturing, and this has been borne out in further European business sentiment gauges this week. He also points to the disagreement on EBU (European Banking Union) and suggestions that Spain and Italy actually may not need ESM programmes (notably Schäuble on Spain). Joachim concludes that the current complacency reminds him of the March/April period, “when the post-LTRO improvement in markets induced governments and the ECB to relax prematurely, with well-known consequences”.

While we have a more cautious short-term view, as stated above, at the same time, we also believe that liquidity in bank debt will remain very patchy and, hence, when investors want to add, it may well prove difficult. Hence, **we are simply revisiting our recent recommendations and suggesting switches into ‘safer’ bonds, rather than reducing our current equal-weight in bank debt down to underweight.**

Skewed Towards Italians and Spanish

The key reason for this review is that within our equal-weight on bank debt, **we have been skewing our recommendations towards Italian and Spanish banks.** We’re basically long high-step Tier 1s and many with long calls/high swap gains.

Exhibit 1

Periphery Tier 1 Bonds – Now at, or Very Close to, 12-Month Highs

Ccy	Ticker	Cpn	Next call	Step	Amt o/s (m)	Bid	Offer	YTC* (%)	YTP/M (%)	Zsprd	12m high	12m low	Recommendation
\$	ABBEY	8.963	30/06/2030	L+282.5	366	107.0	109.0	8.4	7.6	585	109.0	90.0	Keep
£	BBVASM	9.1	21/10/2014	L+570	251	86.5	88.5	16.1	10.1	2,032	94.5	68.0	Keep
£	SANTAN	11.3	27/07/2014	L+766	679	101.0	102.5	10.6	10.8	971	103.0	85.0	Selling
€	ISPIM	8.375	14/10/2019	L+687	742	96.0	97.5	9.2	9.6	781	98.0	57.5	Selling
€	BBVASM	8.5	21/10/2014	L+574	645	89.75	90.75	13.9	9.3	1,328	91.0	73.0	Keep
€	ISPIM	8.047	20/06/2018	L+410	580	91.75	92.75	10.0	8.1	881	93.0	54.5	Selling

We’ll revisit Tier 1 more broadly in a later note – here, we just focus on the periphery bonds we’ve added since June.

- In [Closing Out Our Tier 1 Underweight](#), June 14, we added a number of high-coupon/high swap-gain Tier 1s, including £ BBVA 9.1%, £ SANTAN 11.3%, € ISPIM 8.375%, € BBVA 8.5% and € ISPIM 8.047%.
- In [Revisiting Swap Gains](#), July 13, we confirmed our preference for ABBEY’s \$ 8.963% Tier 1s, even post the tender on July 3 at 103 (6 points above market).

We continue to like high-step Tier 1s due to the increased certainty of call, and the long-dated calls, where we have a constructive view on the credit and the swap gains will always help, as will the fixed coupons for some time. However, many of these Tier 1s we added back in June have come an extremely long way, and while back then many looked cheap versus LT2s, this is no longer the case. Four of the bonds have been cash tendered at premia of up to 6 points above market price since mid-June, and they are all now trading above those tender prices.

When reviewing these Tier 1s, a good starting point is to bear in mind the YTC of 10.2% on SANTAN’s £ LT2 7.3% 19NC14 (steps to L+416bp), a bond which we recommended to continue to hold when we reviewed our periphery LT2s in [Periphery Review: LT2](#). With this in mind, we’d recommend now selling SANTAN in Tier 1, with a YTC of just 10.6% and the same 2014 call.

- **Sell SANTAN £ 11.3% at 101, YTC 10.6%, buy HBOS £ 6.461% at 78 (when liquidity allows), YTC of 11.5%, YTP 8.3%.** Note that the step in 2018 here is 5yr UKT+285bp, so not huge, but still, the optionality of a call or LME at this low-ish cash price makes these bonds still interesting to us.

Although it’s at its highs, **we’d keep ABBEY \$8.963%**, recognising that the call is out in 2030, giving us a nice yield and good duration. We also believe that we’d never be able to buy it back if we sold it.

September 25, 2012
European Banks
Periphery Review: Tier 1

Source: Bloomberg, Morgan Stanley Research; indicative levels as of September 25, 2012, *YTC, YTP and z spread use bid side if recommendation is 'Selling', offer side otherwise

We'd keep BBVA high-step £ 9.1% and € 8.5% in Tier 1s

as we still believe that the YTCs are good on these and outstrip anything we can find in LT2s by a margin – for example, low-step BBVA and SANTAN callable LT2s are trading between 6% and 7.3% YTM in € (YTCs are much higher, but we are cautious on calls, particularly SANTAN, which has been clear about its economic call policy). We'd also note that the BBVA £9.1% is the only bond here not within a hair's breadth of its one-year highs.

In terms of the ISPIM Tier 1 recommendations in Exhibit 1, again, although we like high-steps, they've come a very long way, and now with YTCs at 9.2% and 10.0% – and nearly 40 points off the year's lows – it makes sense to switch here. We got more constructive last week on Agricole in [Credit Agricole: Greece and Beyond](#), September 20, and hence:

- **Sell € ISPIM 8.375% at 96, YTC 9.2%, and buy the ACAFP \$8.375% Tier 1s**, offered at 100, with a YTC of 8.4%, with a step in 2019 to I+698bp, **or, staying in €, buy ACAFP € 7.875% at 98** (we recommended this in last week's Agricole note), with a YTC of 8.3% and a step to I+642bp in 2019. While it still has Emporiki, Agricole is clearly not out of the periphery woods at all – but we do not believe that it should trade this close to an Italian bank.
- **Sell € ISPIM 8.047% at 91.75, YTC 10% and buy the Agricoles above or look at the retail Tier 1 sector for ACAFP's € 6%** (again, recommended last week) at 73.25, YTP 8.6%. We actually prefer BPCEGP to ACAFP so, if they're available, **we'd buy BPCEGP's retail €9% or 9.25%, with the 9.25% offered around 100.25, YTC in 2015 of 9.1%**. Even a reg par call on January 1 would still give a good, if very short-term, yield on these. **We also like Lloyds' € 7.875%** (also in \$) at 89, YTP 8.9% and, as a pref share, these have the tax-disadvantage of paying coupons out of post-tax income, increasing the likelihood that Lloyds will want to be rid of these at some stage.

Note that retail bonds here enjoy a similar YTP to the YTCs of the high-steps we're recommending to sell. However, the retail bonds are normally of course lower cash, and have the optionality of a call at some point.

An Aside on SANTAN and BBVA Language

Spanish bank Tier 1 coupons can be cut if a bank makes a loss at the non-consolidated parent company level. Disclosure is weak and only in Spanish for the non-consolidated accounts of BBVA and Santander. While 2012 coupons are not at risk, given earnings in 2011, there is a

potential risk for 2013 coupons, given the additional provisions required under Royal Decree ('RD') 1 and 2.

Santander has a lot of headroom to keep paying Tier 1s, in our view, despite €2.9 billion of additional provisions to take in 2012 (after tax and the €900 million gain on the group's Colombian disposal). After adjusting for the provisions to be taken by Banesto (circa 40% of RD1 and 2), and normalising 2012 earnings (using 2011 as a proxy) for the RD1 provisions taken in 2011, we estimate that Santander will have an after-tax charge of €1.95 billion versus a net profit of €3.2 billion. Equally, with a two-year dividend stopper, we are convinced that Santander would wish to avoid this.

For BBVA Tier 1s, where we are keeping our recommendations, there is lower headroom, but we believe that they are still certainly very likely to pay coupons. BBVA has an after-tax cost of €2.8 billion for RD1 and 2 compared to a 2011 net profit of €2.7 billion, suggesting a shortfall and thus greater risk to coupons. However, with increased dividends from subsidiaries and affiliates, BBVA should have sufficient earnings to pay Tier 1s, and we doubt it would want to skip paying, particularly if Santander continues to pay.

A specific part of the Spanish Law means that if a bank that makes a loss in 2012 due to the Royal Decree cannot pay its Tier 1 coupons, then it can choose to defer the non-cumulative coupon and pay two coupons in the following year. Clearly, however, this would rely on the goodwill of the issuer.

We Prefer BBVA from a Risk/Reward Perspective

All things considered, from a purely risk perspective, we would have a preference for Santander Tier 1s, given the greater headroom, diversification and earnings capacity. However, considering where these trade versus their own LT2s and versus BBVA (including our view that, although less certain than Santander, BBVA will still pay coupons), we prefer BBVA from a risk/reward perspective.

and Smaller Italian Bank Tier 1s

We spent some time on Monte dei Paschi (MONTE) and Banco Popolare (BPIM) recently when we published [Periphery Review: Too Many Headwinds at MPS – Buy CDS](#), September 13. As these banks' Tier 1s optically look interesting from a low cash price point of view, it's worth noting our thoughts in this broader piece on periphery Tier 1s, even though we don't recommend the bonds. Neither appears compelling to us, considering that coupon pushers will expire early next year for BPIM, and that MONTE is standing ahead of taking state aid and a potential EC decision

September 25, 2012
European Banks
Periphery Review: Tier 1

on this which could include optional coupon bans. Naturally, in the face of LME, we would not recommend shorting cash bonds (hence the CDS recommendation).

Exhibit 2

BPIM and Monte Tier 1s – Unattractive Risk/Reward. Indicative Levels Only

Ticker	Ccy	Cpn	Next call	Amt o/s (m)	Step	Offer	YTP
BPIM	EUR	6.156	21/09/2017	78	L+228	68.0	8.1%
BPIM	EUR	6.756	21/06/2017	140	L+188	69.0	7.8%
BPIM	EUR	6.742	30/06/2015	373	L+525	81.5	9.5%
MONTE	EUR	6.675*	07/11/2012	243	L+630	63.75	10.4%

* Old 7.99; not called at first call date (February 2011), now floating coupons
Source: Morgan Stanley Research, Bloomberg

BPIM – LME Pusher Over

BPIM carried out an any and all cash tender offer on 12 subordinated securities at an average 5.3 points premium in February 2012. Amid the Tier 1s, BPIM € 6.156%, BPIM € 6.756% and BPIM € 6.742% had a 72%, 50% and 26% participation rate, respectively. **2012 coupons of all three bonds (annual, payable in June) have been pushed by this LME, yet the pusher is limited to redemption of pari/junior securities done within 12 months prior to the coupon payment, so that this catalyst stops in February 2013.** All three bonds have dividend pusher language, but our equity analysts do not expect dividends for the next two years. We'd note here that BPIM chose not to pay coupons on Banca Italease Tier 1s (XS0255673070) when that subsidiary reported a loss at the non-consolidated level (making coupons optional), and our equity analysts are forecasting a loss of €102 million for Banco Popolare in FY2012.

While BPIM is facing the same structural challenges as other mid-cap Italian banks, its asset quality seems to have been deteriorating at a lower rate than its peers. Indeed, BPIM is the only Italian bank we follow that saw flat LLP YoY at 1H12, when its peers registered significant increases. This may partly be due to its higher exposure to Northern Italy as opposed to Central/Southern Italy for Monte, for example. However, we'd highlight that BPIM has a historically lower coverage ratio than peers (28.7% at 1H12).

Monte – Still Too Many Uncertainties

As we went through in more detail in our September 13 note, we are cautious on Monte in the near term. Monte also LME'd its subordinated debt in June 2012, offering to exchange nine securities into new 3-year senior unsecured bonds (€ 7.25% July 2015s) at an average premium of 4.2 points. Looking at its Tier 1 (the old 7.99), participation was low at 31%, and unlike BPIM's Tier 1s, coupons were not pushed by the LME. We'd note that **Monte has so far been rather bondholder-friendly with its Tier 1s, paying coupons throughout the crisis and increasing the coupons' spread over Libor from 390bp to 630bp when it did not call the bonds in February 2011.** At that time, the Bank of Italy was requiring banks to pre-finance

calls and buybacks, but it revised these rules at the start of the year – hence the many tenders since then. With the bonds still trading at a low cash price and Monte looking at ways to raise additional capital, we'd not rule out another try at buying back more bonds, though we note that participation was low in June.

An interesting point here is that **Tier 1 coupons are pushed if payments are made on parity/junior securities** (there is no mention of additional share issuance being a pusher). **The new government-sponsored capital securities ('GSCS') Monte is to take are set to compensate the state even if Monte records a loss, in which case they pay in shares.**

At first look, this could potentially mean that, going forward, Tier 1s will have to be paid in any case, while until now coupons were optional if the bank had not paid an equity dividend or had insufficient distributable reserves (unconsolidated net profits of the prior year). However, the Tier 1 prospectus stipulates that dividend pushers would not include dividends on ordinary shares that consist solely of additional ordinary shares. While GSCSs are not ordinary shares, the prospectus does not tackle a situation where parity/junior securities would be paid with shares, so it is unclear how GSCSs would be treated in this case. As an aside here, we'd note that even though Commerzbank's buy-back of silent participations earlier this year looked like it ought to have pushed coupons on other Tier 1s, the bank simply noted that its legal advisors said that it did not. We would not have been able to tell this at all from the prospectus, hence we're not filled with confidence about opining on Monte's language either.

We'd finally highlight that Monte's Tier 1 coupons are not mandatory if "the bank is otherwise prohibited under applicable Italian banking laws or regulations from declaring a dividend or making a distribution on any class of its equity capital". This is to some extent (although we appreciate it is less strongly worded) similar to NORD/LB's (NDB) \$10.25 bond language, whereby coupons were prohibited if the bank was under a dividend ban (see [NDB's Coupons in Question](#), July 12). Given that the EC had yet to approve the state aid NDB had recourse to, and the EC historically imposing a two-year dividend ban on banks taking state aid, we were cautious on NDB Tier 1 bonds ahead of the ruling. However, even though the EC did impose a two-year dividend ban on NDB, it has been somewhat more flexible with the Landesbank than other banks which took state aid, in our view. Indeed, it accepted NDB's request to modify its Tier 1 bond documents and amend the sentence saying that it could not pay coupons if it was under a dividend ban. We suspect that this higher degree of understanding as regards to the bank may come from the fact that NDB did not need additional capital under regular stress tests or Basel 2.5 ratios; it only needed to reach the (somewhat arbitrary) 9% EBA ratio. We'd note that Monte

September 25, 2012

European Banks

Periphery Review: Tier 1

is in a similar situation as its €3.3 billion shortfall under the EBA stress tests came solely from the sovereign buffer

component of the tests.

September 25, 2012

European Banks

Periphery Review: Tier 1

Disclosure Section

Morgan Stanley & Co. International plc, authorized and regulated by Financial Services Authority, disseminates in the UK research that it has prepared, and approves solely for the purposes of section 21 of the Financial Services and Markets Act 2000, research which has been prepared by any of its affiliates. As used in this disclosure section, Morgan Stanley includes RMB Morgan Stanley (Proprietary) Limited, Morgan Stanley & Co International plc and its affiliates.

For important disclosures, stock price charts and equity rating histories regarding companies that are the subject of this report, please see the Morgan Stanley Research Disclosure Website at www.morganstanley.com/researchdisclosures, or contact your investment representative or Morgan Stanley Research at 1585 Broadway, (Attention: Research Management), New York, NY, 10036 USA.

For valuation methodology and risks associated with any price targets referenced in this research report, please email morganstanley.research@morganstanley.com with a request for valuation methodology and risks on a particular stock or contact your investment representative or Morgan Stanley Research at 1585 Broadway, (Attention: Research Management), New York, NY 10036 USA.

Analyst Certification

The following analysts hereby certify that their views about the companies and their securities discussed in this report are accurately expressed and that they have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report: Jackie Ineke.

Unless otherwise stated, the individuals listed on the cover page of this report are research analysts.

Global Research Conflict Management Policy

Morgan Stanley Research has been published in accordance with our conflict management policy, which is available at www.morganstanley.com/institutional/research/conflict/policies.

Important US Regulatory Disclosures on Subject Companies

As of August 31, 2012, Morgan Stanley beneficially owned 1% or more of a class of common equity securities of the following companies covered in Morgan Stanley Research: BBVA.

Within the last 12 months, Morgan Stanley managed or co-managed a public offering (or 144A offering) of securities of Banca Monte dei Paschi di Siena S.p.A., Intesa SanPaolo S.p.A., Lloyds Banking Group, Santander.

Within the last 12 months, Morgan Stanley has received compensation for investment banking services from Banca Monte dei Paschi di Siena S.p.A., BBVA, Credit Agricole S.A., Intesa SanPaolo S.p.A., Lloyds Banking Group, Santander, BPCE, HBOS.

In the next 3 months, Morgan Stanley expects to receive or intends to seek compensation for investment banking services from Banca Monte dei Paschi di Siena S.p.A., Banco Popolare, BBVA, Credit Agricole S.A., Intesa SanPaolo S.p.A., Lloyds Banking Group, Santander, BPCE, HBOS.

Within the last 12 months, Morgan Stanley has received compensation for products and services other than investment banking services from Banca Monte dei Paschi di Siena S.p.A., Banco Popolare, BBVA, Credit Agricole S.A., Intesa SanPaolo S.p.A., Lloyds Banking Group, Santander, BPCE, HBOS.

Within the last 12 months, Morgan Stanley has provided or is providing investment banking services to, or has an investment banking client relationship with, the following company: Banca Monte dei Paschi di Siena S.p.A., Banco Popolare, BBVA, Credit Agricole S.A., Intesa SanPaolo S.p.A., Lloyds Banking Group, Santander, BPCE, HBOS.

Within the last 12 months, Morgan Stanley has either provided or is providing non-investment banking, securities-related services to and/or in the past has entered into an agreement to provide services or has a client relationship with the following company: Banca Monte dei Paschi di Siena S.p.A., Banco Popolare, BBVA, Credit Agricole S.A., Intesa SanPaolo S.p.A., Lloyds Banking Group, Santander, BPCE, HBOS.

Morgan Stanley & Co. LLC makes a market in the securities of BBVA, Lloyds Banking Group, Santander.

The equity research analysts or strategists principally responsible for the preparation of Morgan Stanley Research have received compensation based upon various factors, including quality of research, investor client feedback, stock picking, competitive factors, firm revenues and overall investment banking revenues.

Morgan Stanley and its affiliates do business that relates to companies/instruments covered in Morgan Stanley Research, including market making, providing liquidity and specialized trading, risk arbitrage and other proprietary trading, fund management, commercial banking, extension of credit, investment services and investment banking. Morgan Stanley sells to and buys from customers the securities/instruments of companies covered in Morgan Stanley Research on a principal basis. Morgan Stanley may have a position in the debt of the Company or instruments discussed in this report.

Certain disclosures listed above are also for compliance with applicable regulations in non-US jurisdictions.

STOCK RATINGS

Morgan Stanley uses a relative rating system using terms such as Overweight, Equal-weight, Not-Rated or Underweight (see definitions below).

Morgan Stanley does not assign ratings of Buy, Hold or Sell to the stocks we cover. Overweight, Equal-weight, Not-Rated and Underweight are not the equivalent of buy, hold and sell. Investors should carefully read the definitions of all ratings used in Morgan Stanley Research. In addition, since Morgan Stanley Research contains more complete information concerning the analyst's views, investors should carefully read Morgan Stanley Research, in its entirety, and not infer the contents from the rating alone. In any case, ratings (or research) should not be used or relied upon as investment advice. 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.

Global Stock Ratings Distribution

(as of August 31, 2012)

For disclosure purposes only (in accordance with NASD and NYSE requirements), we include the category headings of Buy, Hold, and Sell alongside our ratings of Overweight, Equal-weight, Not-Rated and Underweight. Morgan Stanley does not assign ratings of Buy, Hold or Sell to the stocks we cover. Overweight, Equal-weight, Not-Rated and Underweight are not the equivalent of buy, hold, and sell but represent recommended relative weightings (see definitions below). To satisfy regulatory requirements, we correspond Overweight, our most positive stock rating, with a buy recommendation; we correspond Equal-weight and Not-Rated to hold and Underweight to sell recommendations, respectively.

September 25, 2012
European Banks
Periphery Review: Tier 1

Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)		
	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight/Buy	1108	37%	445	41%	40%
Equal-weight/Hold	1283	43%	499	46%	39%
Not-Rated/Hold	109	4%	34	3%	31%
Underweight/Sell	469	16%	115	11%	25%
Total	2,969		1093		

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.

Important Disclosures for Morgan Stanley Smith Barney LLC Customers

Citi Investment Research & Analysis (CIRA) research reports may be available about the companies or topics that are the subject of Morgan Stanley Research. Ask your Financial Advisor or use Research Center to view any available CIRA research reports in addition to Morgan Stanley research reports.

Important disclosures regarding the relationship between the companies that are the subject of Morgan Stanley Research and Morgan Stanley Smith Barney LLC, Morgan Stanley and Citigroup Global Markets Inc. or any of their affiliates, are available on the Morgan Stanley Smith Barney disclosure website at www.morganstanleysmithbarney.com/researchdisclosures.

For Morgan Stanley and Citigroup Global Markets, Inc. specific disclosures, you may refer to www.morganstanley.com/researchdisclosures and https://www.citigroupgeo.com/geopublic/Dislosures/index_a.html.

Each Morgan Stanley Equity Research report is reviewed and approved on behalf of Morgan Stanley Smith Barney LLC. This review and approval is conducted by the same person who reviews the Equity Research report on behalf of Morgan Stanley. This could create a conflict of interest.

Other Important Disclosures

Morgan Stanley & Co. International PLC and its affiliates have a significant financial interest in the debt securities of Banca Monte dei Paschi di Siena S.p.A., Banco Popolare, BBVA, Credit Agricole S.A., Intesa SanPaolo S.p.A., Lloyds Banking Group, Santander, BPCE, HBOS.

Morgan Stanley is not acting as a municipal advisor and the opinions or views contained herein are not intended to be, and do not constitute, advice within the meaning of Section 975 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Morgan Stanley produces an equity research product called a "Tactical Idea." Views contained in a "Tactical Idea" on a particular stock may be contrary to the recommendations or views expressed in research on the same stock. This may be the result of differing time horizons, methodologies, market events, or other factors. For all research available on a particular stock, please contact your sales representative or go to Client Link at www.morganstanley.com.

Morgan Stanley Research does not provide individually tailored investment advice. Morgan Stanley Research has been prepared without regard to the circumstances and objectives of those who receive it. Morgan Stanley recommends that investors independently evaluate particular investments and strategies, and encourages investors to seek the advice of a financial adviser. The appropriateness of an investment or strategy will depend on an investor's circumstances and objectives. The securities, instruments, or strategies discussed in Morgan Stanley Research may not be suitable for all investors, and certain investors may not be eligible to purchase or participate in some or all of them. Morgan Stanley Research is not an offer to buy or sell any security/instrument or to participate in any trading strategy. The value of and income from your investments may vary because of changes in interest rates, foreign exchange rates, default rates, prepayment rates, securities/instruments prices, market indexes, operational or financial conditions of companies or other factors. There may be time limitations on the exercise of options or other rights in securities/instruments transactions. Past performance is not necessarily a guide to future performance. Estimates of future performance are based on assumptions that may not be realized. If provided, and unless otherwise stated, the closing price on the cover page is that of the primary exchange for the subject company's securities/instruments.

The fixed income research analysts, strategists or economists principally responsible for the preparation of Morgan Stanley Research have received compensation based upon various factors, including quality, accuracy and value of research, firm profitability or revenues (which include fixed income trading and capital markets profitability or revenues), client feedback and competitive factors. Fixed Income Research analysts', strategists' or economists' compensation is not linked to investment banking or capital markets transactions performed by Morgan Stanley or the profitability or revenues of particular trading desks.

Morgan Stanley Research is not an offer to buy or sell or the solicitation of an offer to buy or sell any security/instrument or to participate in any particular trading strategy. The "Important US Regulatory Disclosures on Subject Companies" section in Morgan Stanley Research lists all companies mentioned where Morgan Stanley owns 1% or more of a class of common equity securities of the companies. For all other companies mentioned in Morgan Stanley Research, Morgan Stanley may have an investment of less than 1% in securities/instruments or derivatives of securities/instruments of companies and may trade them in ways different from those discussed in Morgan Stanley Research. Employees of Morgan Stanley not involved in the preparation of Morgan Stanley Research may have investments in securities/instruments or derivatives of securities/instruments of companies mentioned and may trade them in ways different from those discussed in Morgan Stanley Research. Derivatives may be issued by Morgan Stanley or associated persons.

With the exception of information regarding Morgan Stanley, Morgan Stanley Research is based on public information. Morgan Stanley makes every effort to use reliable, comprehensive information, but we make no representation that it is accurate or complete. We have no obligation to tell you when opinions or information in Morgan Stanley Research change apart from when we intend to discontinue equity research coverage of a subject company. Facts and views presented in Morgan Stanley

September 25, 2012
European Banks
Periphery Review: Tier 1

Research have not been reviewed by, and may not reflect information known to, professionals in other Morgan Stanley business areas, including investment banking personnel.

Morgan Stanley Research personnel may participate in company events such as site visits and are generally prohibited from accepting payment by the company of associated expenses unless pre-approved by authorized members of Research management.

Morgan Stanley may make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report.

To our readers in Taiwan: Information on securities/instruments that trade in Taiwan is distributed by Morgan Stanley Taiwan Limited ("MSTL"). Such information is for your reference only. Information on any securities/instruments issued by a company owned by the government of or incorporated in the PRC and listed in on the Stock Exchange of Hong Kong ("SEHK"), namely the H-shares, including the component company stocks of the Stock Exchange of Hong Kong ("SEHK")'s Hang Seng China Enterprise Index is distributed only to Taiwan Securities Investment Trust Enterprises ("SITE"). The reader should independently evaluate the investment risks and is solely responsible for their investment decisions. Morgan Stanley Research may not be distributed to the public media or quoted or used by the public media without the express written consent of Morgan Stanley. To our readers in Hong Kong: Information is distributed in Hong Kong by and on behalf of, and is attributable to, Morgan Stanley Asia Limited as part of its regulated activities in Hong Kong. If you have any queries concerning Morgan Stanley Research, please contact our Hong Kong sales representatives. Information on securities/instruments that do not trade in Taiwan is for informational purposes only and is not to be construed as a recommendation or a solicitation to trade in such securities/instruments. MSTL may not execute transactions for clients in these securities/instruments.

Morgan Stanley is not incorporated under PRC law and the research in relation to this report is conducted outside the PRC. Morgan Stanley Research does not constitute an offer to sell or the solicitation of an offer to buy any securities in the PRC. PRC investors shall have the relevant qualifications to invest in such securities and shall be responsible for obtaining all relevant approvals, licenses, verifications and/or registrations from the relevant governmental authorities themselves.

Morgan Stanley Research is disseminated in Brazil by Morgan Stanley C.T.V.M. S.A.; in Japan by Morgan Stanley MUFG Securities Co., Ltd. and, for Commodities related research reports only, Morgan Stanley Capital Group Japan Co., Ltd; in Hong Kong by Morgan Stanley Asia Limited (which accepts responsibility for its contents); in Singapore by Morgan Stanley Asia (Singapore) Pte. (Registration number 199206298Z) and/or Morgan Stanley Asia (Singapore) Securities Pte Ltd (Registration number 200008434H), regulated by the Monetary Authority of Singapore (which accepts legal responsibility for its contents and should be contacted with respect to any matters arising from, or in connection with, Morgan Stanley Research); in Australia to "wholesale clients" within the meaning of the Australian Corporations Act by Morgan Stanley Australia Limited A.B.N. 67 003 734 576, holder of Australian financial services license No. 233742, which accepts responsibility for its contents; in Australia to "wholesale clients" and "retail clients" within the meaning of the Australian Corporations Act by Morgan Stanley Smith Barney Australia Pty Ltd (A.B.N. 19 009 145 555, holder of Australian financial services license No. 240813, which accepts responsibility for its contents; in Korea by Morgan Stanley & Co International plc, Seoul Branch; in India by Morgan Stanley India Company Private Limited; in Indonesia by PT Morgan Stanley Asia Indonesia; in Canada by Morgan Stanley Canada Limited, which has approved of and takes responsibility for its contents in Canada; in Germany by Morgan Stanley Bank AG, Frankfurt am Main and Morgan Stanley Private Wealth Management Limited, Niederlassung Deutschland, regulated by Bundesanstalt fuer Finanzdienstleistungsaufsicht (BaFin); in Spain by Morgan Stanley, S.V., S.A., a Morgan Stanley group company, which is supervised by the Spanish Securities Markets Commission (CNMV) and states that Morgan Stanley Research has been written and distributed in accordance with the rules of conduct applicable to financial research as established under Spanish regulations; in the US by Morgan Stanley & Co. LLC, which accepts responsibility for its contents. Morgan Stanley & Co. International plc, authorized and regulated by the Financial Services Authority, disseminates in the UK research that it has prepared, and approves solely for the purposes of section 21 of the Financial Services and Markets Act 2000, research which has been prepared by any of its affiliates. Morgan Stanley Private Wealth Management Limited, authorized and regulated by the Financial Services Authority, also disseminates Morgan Stanley Research in the UK. Private UK investors should obtain the advice of their Morgan Stanley & Co. International plc or Morgan Stanley Private Wealth Management representative about the investments concerned. RMB Morgan Stanley (Proprietary) Limited is a member of the JSE Limited and regulated by the Financial Services Board in South Africa. RMB Morgan Stanley (Proprietary) Limited is a joint venture owned equally by Morgan Stanley International Holdings Inc. and RMB Investment Advisory (Proprietary) Limited, which is wholly owned by FirstRand Limited.

The information in Morgan Stanley Research is being communicated by Morgan Stanley & Co. International plc (DIFC Branch), regulated by the Dubai Financial Services Authority (the DFSA), and is directed at Professional Clients only, as defined by the DFSA. The financial products or financial services to which this research relates will only be made available to a customer who we are satisfied meets the regulatory criteria to be a Professional Client.

The information in Morgan Stanley Research is being communicated by Morgan Stanley & Co. International plc (QFC Branch), regulated by the Qatar Financial Centre Regulatory Authority (the QFCRA), and is directed at business customers and market counterparties only and is not intended for Retail Customers as defined by the QFCRA.

As required by the Capital Markets Board of Turkey, investment information, comments and recommendations stated here, are not within the scope of investment advisory activity. Investment advisory service is provided in accordance with a contract of engagement on investment advisory concluded between brokerage houses, portfolio management companies, non-deposit banks and clients. Comments and recommendations stated here rely on the individual opinions of the ones providing these comments and recommendations. These opinions may not fit to your financial status, risk and return preferences. For this reason, to make an investment decision by relying solely to this information stated here may not bring about outcomes that fit your expectations.

The trademarks and service marks contained in Morgan Stanley Research are the property of their respective owners. Third-party data providers make no warranties or representations relating to the accuracy, completeness, or timeliness of the data they provide and shall not have liability for any damages relating to such data. The Global Industry Classification Standard (GICS) was developed by and is the exclusive property of MSCI and S&P. Morgan Stanley bases projections, opinions, forecasts and trading strategies regarding the MSCI Country Index Series solely on public information. MSCI has not reviewed, approved or endorsed these projections, opinions, forecasts and trading strategies. Morgan Stanley has no influence on or control over MSCI's index compilation decisions. Morgan Stanley Research or portions of it may not be reprinted, sold or redistributed without the written consent of Morgan Stanley. Morgan Stanley research is disseminated and available primarily electronically, and, in some cases, in printed form. Additional information on recommended securities/instruments is available on request.

Morgan Stanley Research, or any portion thereof may not be reprinted, sold or redistributed without the written consent of Morgan Stanley.

Morgan Stanley Research is disseminated and available primarily electronically, and, in some cases, in printed form.

Additional information on recommended securities/instruments is available on request.

Cc2509

The Americas

1585 Broadway
New York, NY 10036-8293
United States
Tel: +1 (1)212 761 4000

Europe

20 Bank Street, Canary Wharf
London E14 4AD
United Kingdom
Tel: +44 (0) 20 7 425 8000

Japan

4-20-3 Ebisu, Shibuya-ku
Tokyo 150-6008
Japan
Tel: +81 (0)3 5424 5000

Asia/Pacific

1 Austin Road West
Kowloon
Hong Kong
Tel: +852 2848 5200