Financial Institutions Ratings and Research

April 2, 2014

SCOPE Scope Ratings

www.scoperatings.com

Introducing Scope's European Bank Ratings and Research

Scope is publishing credit ratings on 18 large banks in seven countries across Europe, as the first step in its rating coverage of the banking industry. Offering a new set of analyses and ratings on the banking industry, which might differ in part from other existing rating narratives, should contribute to a wider diversity of opinions, in time benefitting institutional investors and other market participants.

The European banking sector is emerging from a lengthy period of crisis in a stronger financial shape than it entered in. However, investors in bank securities are more exposed than before to the risk of the firms they invest in. "Too big to fail" will probably still hold true in the future, but the burden to avoid bank failures is likely to be on investor and creditor bailin rather than on taxpayer bailout. Compared to either insolvency or public bailout, creditor bailin is emerging as the least unappealing outcome in the case of important banks becoming critically stressed and unable to survive without some form of support.

Scope Ratings			
Financial Institution	**Issuer Credit Strength Rating (ICSR)**	**Senior unsecured Rating**	**Rating Outlook**
Banco Santander SA	A	A	Stable
Barclays Bank plc	A	A	Stable
BBVA SA	A	A	Stable
BNP Paribas SA	AA-	AA-	Stable
BPCE SA	A+	A+	Stable
Commerzbank AG	BBB+	BBB+	Positive
Credit Agricole SA	A	A	Positive
BFCM SA (Credit Mutuel)	A	A	Stable
Credit Suisse AG	A+	A+	Stable
Deutsche Bank AG	A-	A-	Stable
HSBC Holdings plc	AA-	AA-	Stable
ING Bank NV	A	A	Stable
KBC Group NV	A-	A-	Stable
Lloyds Bank plc	A	A	Stable
Rabobank	A+	A+	Stable
Royal Bank of Scotland plc*	BBB+	BBB+	Stable
Societe Generale SA	A	A	Stable
UBS AG	A	A	Stable

**Note: Ratings benefit from a one-notch rating uplift due to the UK government's majority ownership*

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Scope is publishing credit ratings on 18 large banks in seven countries across Europe, as the first step in its rating coverage of the banking industry. We believe that offering a new set of analyses and ratings on the banking industry, potentially differing in part from other existing rating narratives, could contribute to a wider diversity of opinions, in time benefitting institutional investors and other market participants.

The European banking sector is emerging from a lengthy period of turmoil – the global financial crisis of 2007-2009 followed by the EU sovereign and banking crisis of 2010-2013. Profound adjustments driven by regulators and policy makers over several years have led to a successful rebooting of banks in some countries, while in others the legacy clean-up and restructuring remain work-in-progress, but generally on the right track. Substantially higher levels and quality of liquidity and capital demanded by Basel 3 and CRD 4-CRR, the forthcoming Banking Union for firms in the euro area (EA), and especially the emerging resolution and recovery regime – arguably the most transformational regulatory change for European banks in many years – are all creating a new and safer landscape across the industry.

However, safer on average as many banks may be compared to the pre-crisis years, investors in bank securities are more exposed than before to the risk of the firms they invest in. "Too big to fail" will probably still hold true in the future, but the burden to avoid bank failures is likely to be on investors and creditors rather than on the taxpayers. In the case of important banks becoming critically stressed and unable to survive without some form of support, creditor bailin is emerging as the least unappealing outcome, compared to either insolvency or taxpayer bailout.

What Scope's bank ratings are

Scope's linchpin rating for banks is the Issuer Credit-Strength Rating (ICSR), assigned on a AAA-to-D scale with "+" and "-" additional sub-categories for rating categories from AA to B (incl.). The ICSR represents a credit opinion on a bank's ability to meet its contractual financial commitments on a timely basis and in full while remaining a going concern.

The rating assigned to each long-term security or class of long-term securities is based on (i) the issuer's credit strength (reflected by the ICSR) and (ii) the terms and conditions of the debt instrument itself. In the near future we will assign short-term ratings for the rated banks' financial commitments with a maturity of 13 months or less.

We do not plan to use additional rating scales or symbols for components of the main ratings, reflecting our view that a plethora of rating categories and sub-categories can and usually do blur the main credit message and add unnecessary confusion for rating users.

Scope will also rate banks' subordinated debt and capital instruments, based on its existing methodology. For example, for banks with ICSRs in the A range Tier 2 and Additional Tier 1 (AT1) securities will be rated one and respectively two notches below the ICSR; for banks with ICSRs in the BBB range the number of notches down will be two and three, respectively. Additional notching down from the ICSR may be warranted by security-specific features such as a relatively high trigger point. Scope does not however aim to rate retroactively legacy hybrid securities issued mostly in the pre-crisis years. Neither does it plan to follow the practice of assigning "equity credit" for junior securities and then based on such metrics to make adjustments to banks' regulatory capital positions.

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ING Bank NV	A	A	Stable
KBC Group NV	A-	A-	Stable
Lloyds Bank plc	A	A	Stable
Rabobank	A+	A+	Stable
Royal Bank of Scotland plc*	BBB+	BBB+	Stable
Societe Generale SA	A	A	Stable
UBS AG	A	A	Stable

**Note: Ratings benefit from a one-notch rating uplift due to the UK government's majority ownership*

What our bank ratings reflect

Looking at the track record of defaults related to regulated financial institutions across Europe and beyond, rare as they may be in recent history, we note that they were not the consequence of commercial bankruptcies like in other industry sectors but of regulatory action -- ranging from the bank being prevented from making payments on specific categories of liabilities, such as junior securities, all the way to it being placed into insolvency proceedings. However, severe regulatory action would never relate to credit-healthy banks but only to firms which are in a financially critical situation, thus posing an immediate threat to depositors and to the financial system. Also, as evidenced when the financial crisis erupted, bank regulators may themselves be overcome by rapidly occurring negative developments, such as a funding and liquidity shortage, with their belated reaction coming as a surprise.

Consequently, our bank credit ratings and analyses aim to reflect proactively the extent to which banks' credit fundamentals evolve, either away from or towards the probability of severe regulatory action leading to default-like outcomes.

What are the key drivers of our rating methodology

Scope drafted its bank rating methodology aiming it to be anchored in the realities and dynamics of the post-crisis banking landscape which is now emerging. Other goals which underpin the methodology are the need to keep it straightforward and transparent, avoiding unnecessary complications, and also to focus the rating assessments on the future rather than on the past. Specifically:

Resolution and bailin: In banking systems with existing or emerging resolution and recovery regimes our ratings for specific liabilities reflect not only a bank's credit risk but also their priority of claim under resolution. Accordingly, for banks with ICSRs of BB+ and below senior unsecured debt ratings will be notched down from the ICSR. However, for banks with investment-grade ICSRs (BBB- and above), which is the situation of all 18 rated banks, there is no notching between the ICSR and the senior unsecured debt rating at this time. The latter reflects the remote likelihood of resolution for these banks, and the even more remote likelihood that if it does occur senior unsecured liabilities will actually be bailed in.

Liability seniority waterfall for EU banks:

1. Additional Tier 1
2. Tier 2
3. Other subordinated debt
4. Senior unsecured debt and non-eligible deposits (wholesale and institutional)
5. Non-covered eligible deposits (individuals and SME)
6. Deposit guarantee scheme (for covered deposits)
7. Covered Bonds

Scope considers that a credible resolution and recovery regime should strengthen the stability and predictability of ICSRs over time, as insolvency proceedings scenarios become more remote. This is especially relevant when accompanied by enhanced supervisory rules and practices. These are well advanced in Switzerland, the US and several countries in the European Union and in time the successful implementation of the Single Supervisory Mechanism (SSM) should further strengthen them across the entire euro area (EA).

In the case of a severely stressed bank, if and when resolution is initiated its credit fundamentals are likely to stabilize and potentially even improve. This would be recognized by the ICSR, although the ratings for various categories of the bank's bailinable liabilities will be lowered further as warranted.

Diminished likelihood of state support: In resolution-based banking systems timely external state support for distressed banks (bailout) is becoming a more improbable scenario. Accordingly it is not a rating booster for the ICSR, notably for financially healthy banks. The possibility of some external support needs to be assessed for systemically important banks with ICSRs of BBB- and below, but this would not be tantamount to readily assuming this scenario as likely to take place.

Notching up a rating based on expected state support could be envisioned only if (i) we had valid reasons to assume state support would be forthcoming in a timely manner, and (ii) these reasons are clear and transparent enough to be highlighted in our analysis. Among the 18 rated banks it is only RBS's ICSR and senior unsecured debt ratings which are boosted by a one-notch uplift due to the firm's majority ownership by the UK government.

No automatic links between banks and sovereigns: At this time Scope does not plan to assign public ratings on sovereigns although it does assess the credit risk of various sovereigns as a significant input in the ratings of banks or other issuers. However, we do not see a valid analytical reason for correlating bank ratings and sovereign assessments via mechanistic links. This is especially so for larger, geographically diversified banking groups.

Furthermore, the emergence of the Banking Union should contribute to further delinking bank ratings from home sovereigns in the euro area (EA), as will the implementation of resolution and recovery measures across the EU which in essence aim to privatize bank rescues. Among the 18 rated banks, this aspect is particularly relevant in the case of BBVA and Santander.

The economic assessment of a bank's main market(s) – which is not necessarily tantamount to a national government's sovereign assessment – is part of our analysis underpinning that bank's rating, informing on trends in its asset quality, funding or revenue generation.

Fundamental assessment is anchored in a bank's business model: When we assess the viability and sustainability of bank's business models we make appropriate comparisons to be able to identify outliers and to flag early-warning indicators coming from misalignment of business models with financial fundamentals (e.g. funding, asset and revenue mix) and market conditions.

In the broadest terms we cluster banking activities into three categories: retail and commercial banking (RCB), wholesale and investment banking (WIB) and wealth and asset management (WAM). Within these categories we then analyse activities in terms of (i) specific business lines and main products and (ii) geographies. For example, we look separately at a cross-border bank's domestic and foreign retail and commercial banking activities.

We consider that looking at a bank's financial metrics in combination with its business model enhances the analytical value of the numbers and ratios which the respective bank displays.

Peer-group approach: In our view a bank's credit dynamics can only be fully understood in a peer-group context. Peer-group analysis is embedded in the rating assessment from the start (not as a latter-stage "health check" tool) due to the fact that our ratings and analyses assess bank credit risk from a relative perspective – across time but also compared to domestic and cross-border peers.

With respect to the 18 rated banks, we position them into three broad business model-driven peer groups: (i) universal banks including RCB, WIB and WAM alike; (ii) international retail and commercial banks which derive a significant majority of their earnings from retail – both domestic and in foreign markets; and (iii) predominantly domestic retail and commercial banks with less significant earnings generated by non-domestic retail activities. The table below illustrates this:

Scope Ratings European Peer Groups		
International Wholesale	**International Retail**	**Domestic Retail**
Barclays	BBVA	Credit Mutuel Group
BNP Paribas	Commerzbank	Groupe BPCE
Credit Suisse	ING Bank	Lloyds
Deutsche Bank	KBC	Rabobank
HSBC	RBS	Crédit Agricole
Société Générale	Santander	
UBS		

We should highlight that in light of many banks reassessing their strategies further shifts in business models are likely which should lead to changes in the composition of our cross-border peer groups. For example, severe stresses during the crisis years have led some large banking groups to scale down significantly their WIB activities – e.g. ING Bank, RBS, Commerzbank, Credit Agricole, BPCE or UBS.

Regulatory risk is growing: This risk can manifest itself both with respect to prudential and conduct risk. While investors have focused historically on the former (e.g., the risk that a prudentially non-compliant bank would be subject to regulatory action), the latter has been becoming increasingly relevant. Spurred by many banks' questionable behaviour before and during the crisis, regulatory bodies across many jurisdictions including in Europe are focusing more on banks' conduct in both retail sectors and wholesale markets.

We believe that regulatory risk is more elevated for banks with material investment banking and trading activities and a high degree of interconnectedness, and at its highest for banks with any of the following: (i) past instances of prudential and conduct problems; (ii) risky business models and strategies; and (iii) more borderline prudential metrics.

Forecasts of bank financials underpin forward-looking ratings: Scope's rating opinions on banks are geared toward future expected trends and developments. This is true about both rating drivers and rating-change drivers. In fact these drivers represent the body of our reports, rather than historical descriptive narratives.

Scope supplements its assessments with forward-looking metrics and estimates, thus not limiting itself to assessing past performance alone. Financial estimates for balance sheet and earnings are based on data and information disclosed publicly by the banks. The framework for this area of analysis is detailed by Scope's separate methodology report titled "Forecasting Bank Financials". Overall, Scope adopts a cautious view and relies on plausible but conservative scenarios in its forecast analysis.

All rating reports include both historical data going back to year-end 2007 and financial forecasts for 2014-2015.

Relevance of market metrics and market sentiment: Although market metrics (CDS or bond spreads, share prices) do not drive our bank ratings, the message their relative positioning conveys is assessed as a relevant variable in the analysis. The crisis years made it painfully clear that market sentiment can create significant tailwinds and especially headwinds for a bank's ability to fund itself or to raise equity. In fact, the crisis has shown that it can become on its own a forceful agent of change.

Public vs. non-public information

The ratings assigned to the 18 European banks were not solicited by the issuers from Scope. A majority of the published rating reports have benefitted from issuer participation. Each report indicates clearly these details on its front page.

During the last decade or so, and especially since the onset of the crisis, public disclosure of the larger banks – including the rated banks – has improved significantly in both volume and quality and the degree of transparency on risk is now higher than ever. This can be found in increasingly voluminous annual reports, Pillar-3 reports, and detailed investor presentations accompanying quarterly results or other public events. Sources of information for the general background on banks include central bank reports, regulators' public statistics, reports from international organizations, comparative databases, industry reports, as well as market metrics.

In the future public information may be supplemented by information which may not be public in the case of issuers engaging in a rating relationship with Scope.

Under no circumstances would Scope assign or monitor a rating if the amount and quality of information, be it public or non-public, were not sufficient for an analytically consistent and balanced assessment.

Scope's ratings underpinned by strengthening credit fundamentals

The ratings being assigned to the 18 large European banks reflect several marked improvements in the banking sector's condition when compared to the state it was in at the onset of the crisis:

- Comprehensive strengthening of the regulatory environment both at national levels and at EU levels. This has led to a successful rebooting of banks in many countries, although challenges, stresses and uncertainties remain.

- More intrusive and effective risk-based supervision. After the crisis took hold supervisors have started to focus on areas less investigated before the crisis, such as liquidity and funding or business models, in addition to initiating ongoing stress-test processes.

- Business and balance-sheet de-risking and related adjustments in business models, although more radical shifts have been mostly the result of regulators' and policy makers' steering (for banks which had been given public support). By far the main strategic shift has been pulling back from wholesale and investment banking activities by financially stressed groups.

- Asset deleveraging, especially from cross-border wholesale banking and trading areas.

- Liquidity positions which are more ample and also of better quality (pre-crisis liquid assets included classes of high-risk structured products).

- Better funding mix, with reduced mismatching, notably away from short-term wholesale funds. Increased funding reliance on wholesale deposits (with relatively opaque disclosure) calls however for a note of caution.

- With respect to capital, significantly higher levels as well as improved mix (more equity and capital instruments with going-concern loss-absorbing clauses). As highlighted by the ECB, on aggregate Tier 1 capital of EA banks rose almost 60% between 2008 and 2012 – from 8% to 12.7%.

- Higher degree of market scrutiny which should keep banks "on their toes" more so than before the crisis. The implementation of resolution and bailin steps should enhance this even further as creditors and investors become even more sensitized to bank credit risk.

The credit improvements are also evident from the positive trend in several financial ratios, which we show on aggregate for a European peer group comprised of 44 large banks (including the rated banks). The trend in aggregate ratios also illustrates ongoing pressures on both revenue generation and asset-quality metrics (*see Appendix*). That said, Scope's profitability forecasts, undertaken using conservative estimates, show improving trends for a large majority of the rated banks. We point out however that the estimated improvement appears to be mainly the consequence of some reduction in credit costs in 2015 and only to a lesser extent from top-line revenue growth.

Challenges ahead

Despite the improvements and readjustments significant challenges and potential threats are still ahead – both in the short and medium term. These challenges and threats are reflected in Scope's rating drivers and rating-change drivers and are highlighted in each rating report.

Difficult macro landscape, including popular backlash to austerity: A majority of European economies see stagnation, ongoing recession or at best modest growth – albeit from different levels. A significant challenge remains growing popular backlash against austerity which could bring new and potentially threatening dynamics to the economic and political situation of some EU countries.

Low interest rates potentially leading to higher risk-taking: While helping borrowers make payments on their loans and keeping EU economies from falling further, low rates do not shore up banks' earnings (low net interest margins) and drive many of them to search for higher yields. Accordingly many banks, considering that the crisis is behind them, may aim going up the risk curve, thus potentially planting the seeds of the next crisis when the cycle will peak again.

Sudden or unexpected interest-rate hikes: The medium-term threat is not so much of rates being lifted up – something that is a "when" rather than an "if" scenario -- but of a sudden or unexpected shift upwards. This scenario is not our base case, but nonetheless cannot be ignored. Banks with asset-liability mismatches could be impacted more materially, as would firms with more borderline loan assets.

Shadow-banking threats: Occurring outside clear regulatory frameworks (capital, liquidity, conduct, credit-risk management, etc.), an unchecked growth of credit provided by shadow bank-like entities could lead to renewed troubles ahead. Regulated banks would not be sheltered from excessive bubbles and from pockets of risk developing elsewhere in the financial system.

Fragmentation: Successfully implementing the Banking Union should lead one day to a better-integrated single market across the EA banking landscape but for the time being this remains an aspirational goal. While "balkanization" may be a term too far, we believe that in Europe a certain degree of banking-market fragmentation and understandable national bias will remain. Even with pan-EA supervision, banks in each country will still have to deal with the national economic, fiscal and political realities which surround them.

Overcapacity: During the decade and a half before the crisis started the banking industry in West European countries boosted significantly its capacity to offer an ever increasing range of financial products and services to an ever widening customer base. The lack of growth potential is a threat for the banking industry as much as credit uncertainty and low margins. As banks are refocusing on boosting earnings, efficiency and costs re-emerge as a key challenge. To be sure, the banking industry shed significant capacity during the crisis. The ECB reported that in 2012 there were 158 inhabitants per bank employee, vs. 145 at the beginning of the crisis.

Cyber-security: Financial safety and financial matters are invariably at the top of everybody's concerns and the electronic meltdown of a bank account is a major nightmare for any business or household. In fact there are large swaths of the population which still do not trust the safety of online banking. Banks are investing significant resources in boosting cyber-security, as well as increasing cooperation. A bank hit by a major cyber-incident could suffer significantly in the absence of rapid and convincing remediation.

Key trends

Based on the assessment above and relating to some key takeaways of the rating reports, Scope's bank analysts see the following trends developing for 2014:

- Benefitting from more regulatory clarity and feeling that they are now closer to the enhanced prudential metrics they were asked to reach – especially on capital and liquidity – many large banks, from both core and peripheral countries, are increasingly turning again to "value-creation" strategies. The crisis years, in which they were mostly concerned with being able to navigate the demanding regulatory changes and policy challenges, leave now place for new earnings targets and growth strategies. However profitability targets like ROE remain more subdued than pre-crisis levels and on average risk aversion should remain in place for the time being.

- Actual bank earnings should remain under some pressure, due to the mix of persistently low net interest margins, low volume growth and still elevated credit expenses. Preparing for the ECB's forthcoming Asset Quality Review (AQR), several banks have boosted provisions early on thus hoping to avoid being affected by the supervisory review later. This aspect has been visible in the latest bank reporting round. If carried out thoroughly, this process should ease the burden of the AQR later in the year on banks with more stressed loan portfolios.

- It is plausible that the AQR – and the subsequent stress test – will not reveal large holes in banks' balance sheets. The purpose of the regulatory exercise is to clear the air through better consistency and transparency on EA banks' asset quality, not to create new material uncertainties and scare off again market participants. Specific problems with some banks are likely to be addressed by the new ECB supervisors but perhaps not primarily through public channels. It remains to be seen how effective the process will end up being and whether national politics will be avoided when deciding on remedial steps.

- Market funding conditions should continue to display relative stability, the geopolitical situation permitting. Despite the prospect of debt bailins for banks in resolution, the issuance of senior unsecured debt should continue. Banks are especially aiming to boost their bailinable cushion by issuing more capital instruments (AT1 and Tier 2). Another funding source likely to grow further is corporate and other wholesale deposits. In the case of weaker banks in peripheral markets which would still experience funding challenges, it is possible that the ECB extend LTRO past end-2014 (or replace these facilities with similar funds but possibly at higher rates).

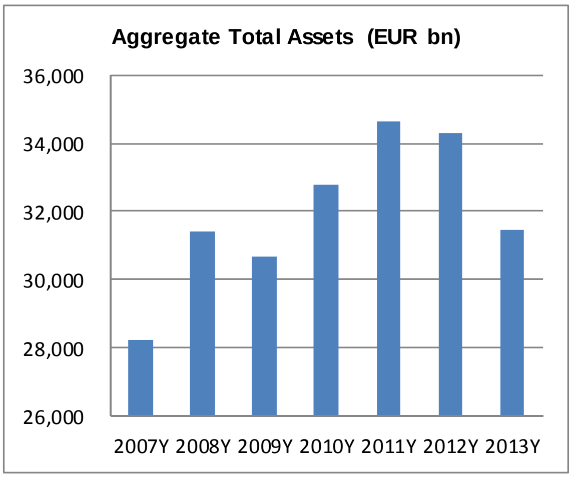
- Following several difficult years it is plausible that the national consolidation will resume some time later this year. Unlike the crisis years, the process would no longer be driven solely by regulatory and state aid-related steering – such as the consolidation of failing banks into financially stronger national peers – but also by banks' focus on strengthening their franchises, balance sheets and earnings potential. Some cross-border M&As are also a possibility, as stronger capitalized banks in core countries seek to acquire weakened institutions elsewhere which offer the right upside potential. This process may at times also be partially driven by some of the large and more complex groups wishing to adjust their structures to the new resolution regime, for example by building strengths and flexibilities in their business models and balance sheets which would make them more resolvable.

To conclude

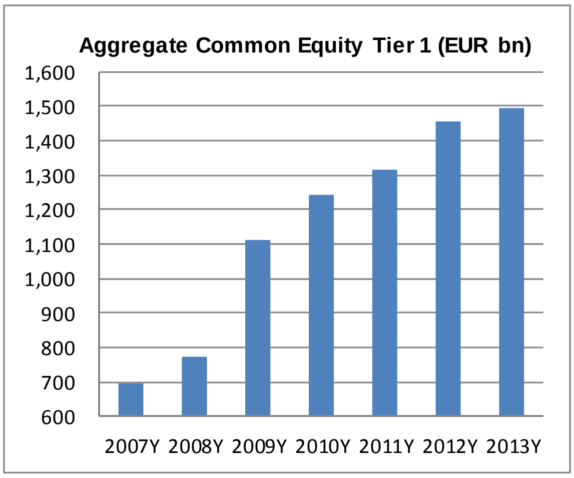
Scope believes that going forward credit ratings for European banks need to take account of a few essential new factors:

- As creditor bailin is replacing taxpayer bailout state support-based rating uplifts can no longer be justified except in very specific cases.
- Resolution and recovery frameworks should enhance the stability and predictability of the ratings of systemically important banks.
- The privatization of bank rescues brought about by resolution and bailin, as well as the emergence of the Banking Union, should contribute further to delinking large-bank credit from the credit of their home sovereigns.
- The gradually improving credit fundamentals of many banks at the tail-end of the crisis – including stronger prudential metrics – should be appropriately reflected in forward-looking credit ratings.

Appendix: Key Financial Ratios (*aggregate of 44 large European banks)*



Source: SNL Financial, Scope Ratings
Note : we use 2013H1 or 2012FY numbers as a proxy for banks which haven't reported 2013FY results



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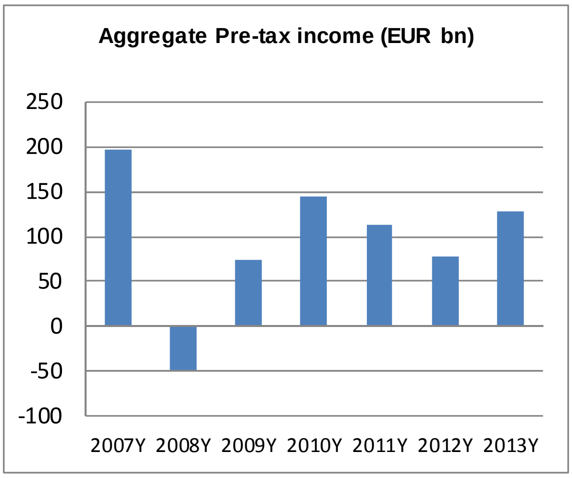

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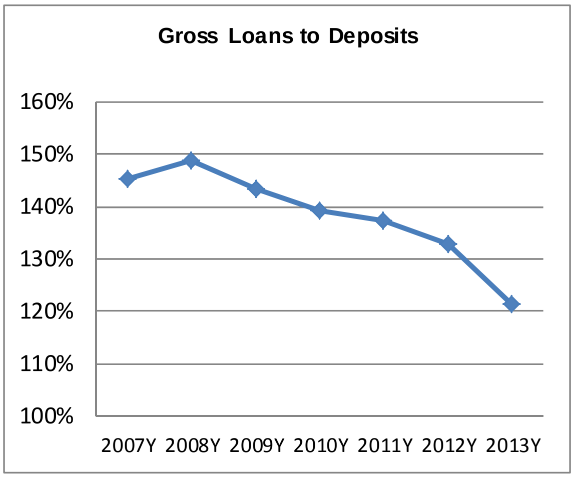

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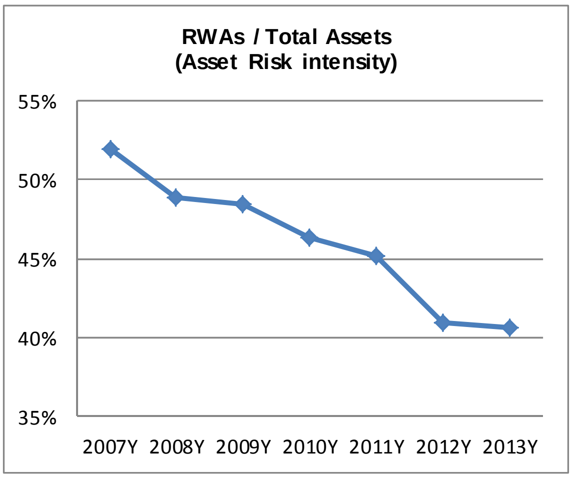

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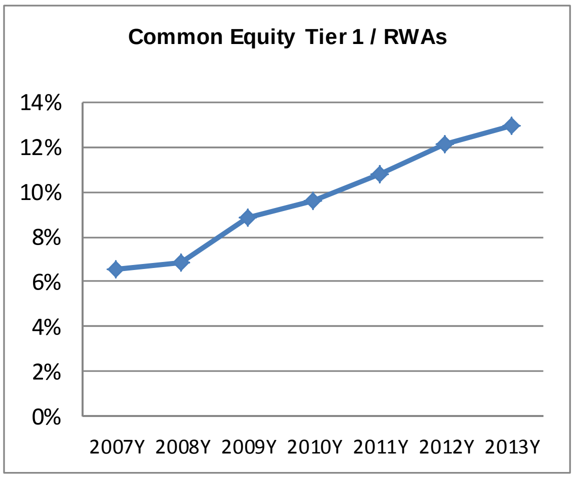
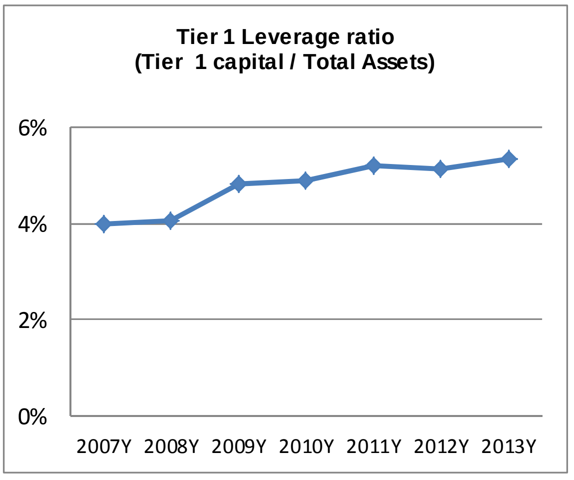
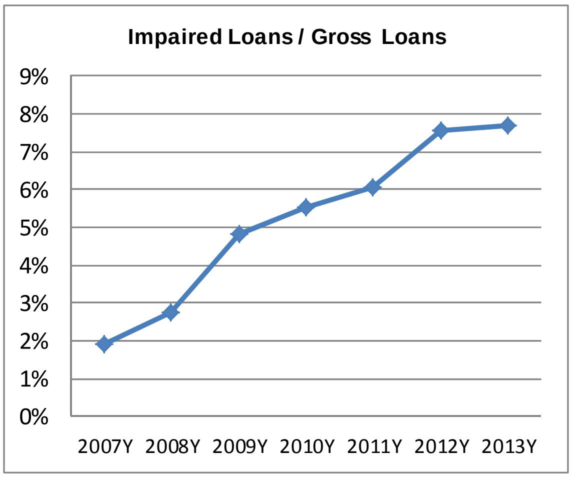


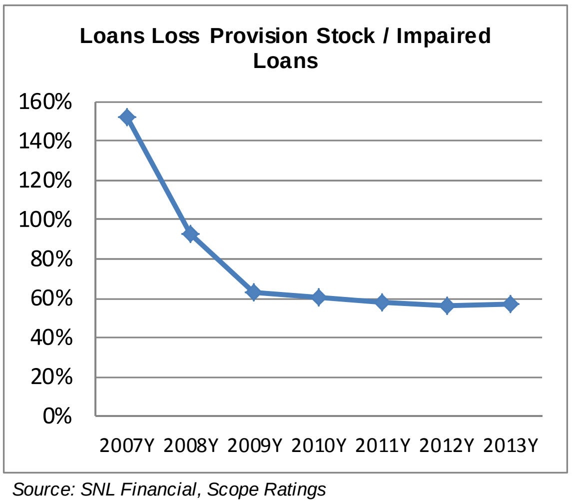
Source: SNL Financial, Scope Ratings



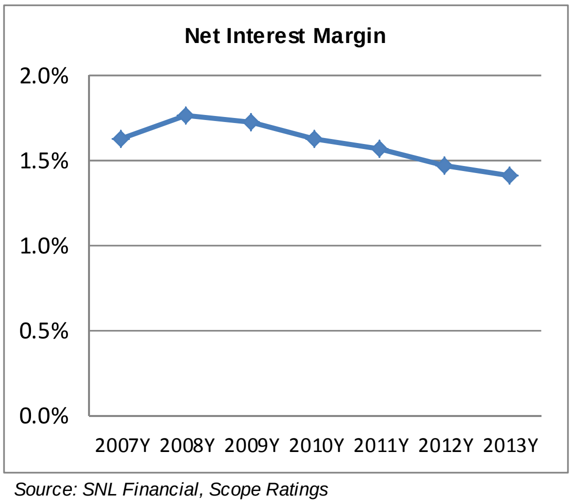
Source: SNL Financial, Scope Ratings



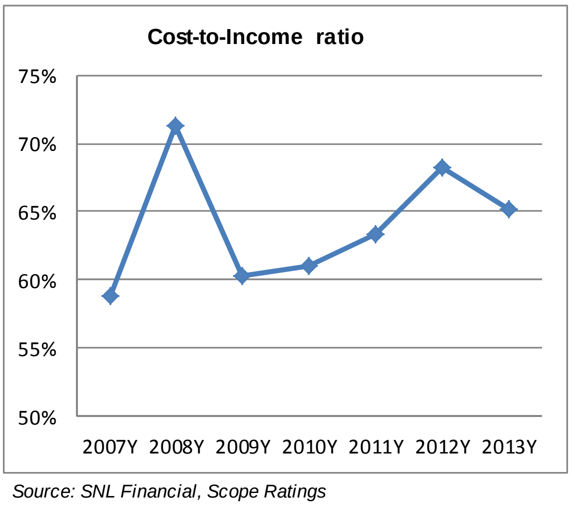
Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



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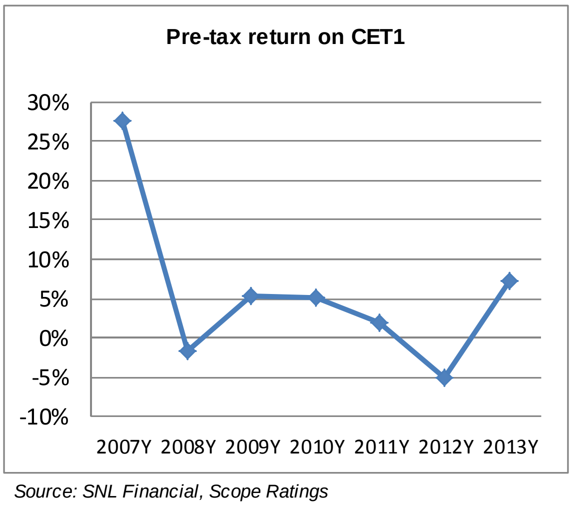

Source: SNL Financial, Scope Ratings

The 44 large European banks

ABN AMRO
Allied Irish Banks
Banca Monte dei Paschi di Siena
Banca Popolare di Milano
Banco Espírito Santo
Banco Popolare
Banco Popular Español
Banco Sabadell
Bank of Ireland
Bankia
Bankinter
Banque Federative du Credit Mutuel
Barclays
BBVA
BCP
BNP Paribas
CaixaBank
Caixa Geral de Depositos
Commerzbank
Credit Agricole Group
Credit Suisse
Danske Bank
Deutsche Bank
DNB
Erste Bank
Groupe BPCE
Handelsbanken
HSBC
ING Groep
Intesa Sanpaolo
KBC
Lloyds Banking Group
Nordea
Nykredit
Rabobank
RBS
RZB
Santander
SEB
Société Générale
Swedbank
UBI
UBS
Unicredit

Banco Santander SA
Issuer Rating Report

A STABLE OUTLOOK
Financial Institutions

Overview

Scope Ratings assigns an Issuer Credit-Strength Rating (ICSR) of A to Banco Santander SA, with a stable outlook. The rating is driven by the bank's strong retail and commercial banking business model, successfully replicated across several geographies in both developed and emerging markets, and producing a reliable and well-diversified earnings stream. This, in turn, translates into significant organic capital generation at the group level. Having withstood the global financial crisis, the Spanish real estate market collapse and the euro area sovereign crisis without damage to capital, the business model of Santander has proven its resilience to shocks in our view.

The weak macro environment in Spain continues to impact profitability and asset quality, which remains a concern, but the Spanish economy is showing some signs of improvement and a recovery should have positive impacts on asset quality in the coming years. We highlight, however, that we do not automatically link Santander's credit standing with a sovereign assessment on Spain, due to the banking group's business, revenue and risk diversification across several geographies.

The profitable emerging markets businesses, at present, are a key strength of the group, but are also potentially a material risk should weaknesses develop in specific markets. The ratings on Banco Santander SA are based on Santander Group's credit fundamentals and support. The A rating is not applicable to unguaranteed debt issued by subsidiaries of Banco Santander SA.

Ratings (assigned on April 2, 2014)

Issuer Credit-Strength Rating	**A**
Outlook	Stable
Senior Unsecured Debt	A

Unsolicited ratings with issuer participation.

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Rating drivers (Summary)

The ratings drivers, in decreasing order of importance in the rating assignment, are:

- (+) A business model that withstood crisis challenges: cost-efficient provision of retail and commercial banking services (high pre-provision income buffer to absorb credit charges) and resilient group profitability.
- (+) Globally diversified revenue and earnings streams with strong market positions in several key markets, including Spain, Brazil, UK, Mexico, Chile and Poland.
- (−) A challenging macro environment in Spain hurting asset quality and profitability.
- (+) Ongoing improvement of capital, liquidity and funding position in recent years.
- (−) Intervention by host or home regulators could limit intragroup capital and liquidity flows across geographies at times of stress.

Rating change drivers

Turnaround in Spanish asset quality and profitability. Several macro indicators point to the start of an improvement in the macro environment in Spain. If this improvement is sustained, it should eventually lead to a stabilization and possible reversal of domestic asset quality trends (albeit with some lags). Management expects the Spanish cost of risk to decline from 143bps of loans in 2013 to c. 100bps in 2014 and to normalize further in the following years. Our forecasts include a slower decline in loan loss provisions in Spain (to 125 bps of loans in 2014 and 100 bps in 2015).

Further improvement in capital standing. Santander's organic capital generation has been significant over the past few years and our estimates point to further capital build-up in 2014 and 2015, which is already reflected in the current rating. However, we would see favorably any actions aimed at improving the CRD4 capital standing of Santander, particularly compared with other G-SIFIs in Europe.

Material deterioration of Brazilian asset quality. Despite accounting for only 10% of group loans, Brazil accounts for 38% of pre-provision profit and a third of net profit. A deterioration in asset quality metrics in Brazil could significantly impact the group's profitability.

Material increase in mortgage arrears in the UK due to future rate hikes. Santander UK is mainly a mortgage bank, with 90% of the loan book consisting of mortgages. The average loan to value is relatively low at 51% and asset performance in the UK is good (NPL ratio of 2%, cost of risk of 24 bps of loans in 2013). However, with the equivalent of EUR 230bn in loans, a material increase in the loss rate could have a significant impact on group profitability. An increase in the risk profile of the UK loan book, potentially driven by material portfolio diversification away from mortgages, could also have a negative impact on ratings.

The positive effect of the forthcoming Banking Union. We note the increased regulatory convergence across EU banking systems, especially for firms within the euro area, as a factor materially attenuating the potential impact on Santander's credit fundamentals of the home sovereign situation. We consider that the emergence later this year of a Banking Union (BU) for the euro area, underpinned by the Single Supervisory Mechanism (SSM) and a Single Resolution Mechanism (SRM), could be a positive rating driver to the extent that it will further de-link the credit standing of Santander from that of its home sovereign. At this time, such an outcome is not yet certain, but the current steps towards the creation of the BU are encouraging.

Event risk. Santander has been very active in M&A both before and during the crisis, acquiring banking franchises in several countries, including the UK, the US, Germany and Poland. This strategy goes beyond the group's more traditional effort to grow in Latin America, where the bank rightly claims to have a cultural-related competitive advantage. So far most acquisitions and mergers have been effectively and successfully integrated, but the risk remains that potentially unexpected large transactions could have negative consequences on the group's fundamentals, including prudential metrics.

Recent events

2013 results

In 2013, Santander earned EUR 4.37bn in net profit, a 90% increase from 2012. The main driver of the increased profitability was the reduction in impairments, specifically on Spanish real estate assets, which had been already heavily provisioned for in 2012. Total assets shrank by 12%, driven by deleveraging in Europe as well as by forex impacts, including the depreciation of the Brazilian real. Asset quality kept deteriorating, driven by Spain, while the other main divisions all presented stable or improving NPL ratios. At the end of 2013, the group NPL ratio stood at 5.64% with coverage of 62%.

Monetization of DTAs

With the approval of the Royal Decree-Law 14/2013, effective from January 1, 2014, Spanish banks will be allowed to convert some deferred tax assets generated by time differences (arising from non-deductible provisions for loans and foreclosed assets and by employee pension payments) into tax credits.

Tax credits are valuable assets that do not depend on future profitability and therefore will no longer be deducted under CRD4 capital rules. The latest reported CRD4 CET1 Ratio of 10.9% (transitional basis) in December 2013 already includes this impact, which management has estimated at 100bps.

Brazilian capital upstreaming

On September 27, 2013, Santander Brazil announced a capital management exercise aimed at optimizing its capital structure: the plan included the distribution of BRL 6bn in excess capital and the issue of an equivalent amount of AT1 and Tier 2 securities; the Santander parent company has agreed to subscribe the securities pro-quota. While the main objective of the exercise was to improve the return on equity of the Brazilian subsidiary, the action also strengthened capital at the parent company level.

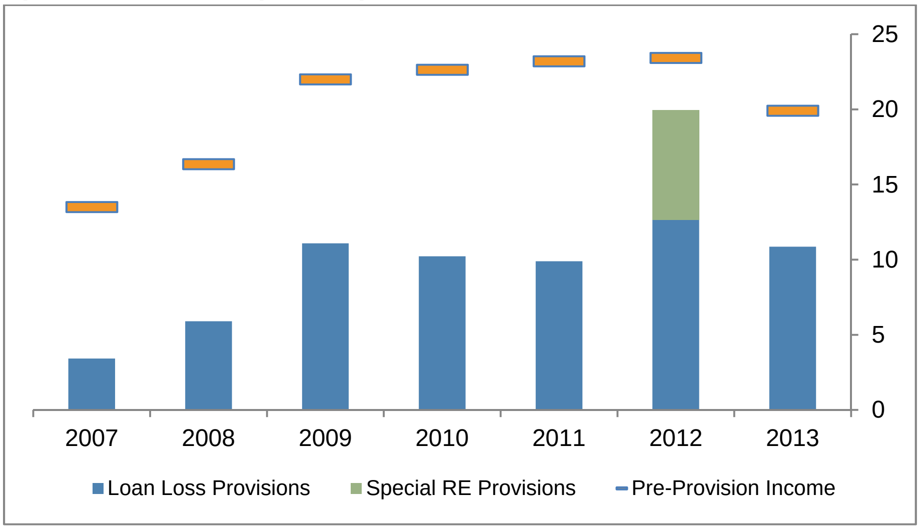
Rating drivers (Details)

1. **A business model that withstood crisis challenges: cost efficient provision of retail and commercial banking services (high pre-provision income buffer to absorb credit charges) and resilient group profitability.**

Santander's diversified retail business model has had a good track record in recent years. Despite significant challenges due to the burst of a domestic credit and real estate boom, as well as a sovereign crisis, the group was able to survive and emerge in a reassuring shape thanks to its earnings resilience. With a group cost-income ratio of approximately 47% (average 2011-2013), Santander makes on average about EUR 22bn in pre-provision profit annually. This gives it a buffer that can absorb a wide range of adverse asset quality shocks.

As shown in Chart 1, the profit buffer was sufficient to absorb losses throughout the crisis.

Chart 1: Recurring profitability absorbed credit provisions in 2007-2013, including special provisions on Spanish real estate (EUR bn)



Source: Company data, Scope Ratings

Indeed, Santander has not posted a single quarter of net losses since the beginning of the global financial crisis. This fact gives us some comfort about the group's protection against future risks: our forward-looking estimates point to a pre-provision profit buffer of approximately EUR 20bn in 2014, which would act as a first line of defence against adverse asset quality shocks.

We have stressed our group earnings and capital forecasts for Santander under several different adverse asset quality shock scenarios to test the bank's vulnerability to such shocks:

1. Significant Spanish asset quality deterioration.
   Santander Spanish total loan book (ex-real estate) is c. EUR 160bn. Although significant loss provisions have already been taken on real estate-related assets, NPLs are still accumulating in Spain, with business loans and residential mortgages remaining a concern. Our estimates include a mild decline in loan loss charges in Spain, but we stressed our estimates and note that a trebling of the Spanish loan-loss charges (from c. 140 bps to 420 bps of loans) would still see Santander profitable at the group level.

2. Significant Brazilian asset quality deterioration.
   The Brazilian loan book is the equivalent of c. EUR 70bn. While asset quality has so far remained relatively benign, fast credit growth in recent years raises the question of unrecognized asset risk in the country. On our numbers, Santander group could absorb a significant deterioration in Brazilian asset quality out of ordinary profitability before taking a hit to capital. In fact, Brazilian loan loss provisions would have to rise from the current 7% to over 15% of total loans to wipe out estimated group profits in 2014.

3. Significant UK mortgage asset quality deterioration
   Santander UK's total loan book is the equivalent of c. EUR 230bn. This mostly comprises mortgages (90% of total) with a relatively low LTV ratio of 51% on average. In the past three years, the loss rate in the UK has averaged 27 bps, reflecting the low-risk products as well as the high degree of collateralization, but also an exceptionally favorable interest rate environment, which has helped affordability. We currently model a modest increase in the loss rate in the UK, but this is unlikely to jeopardise group profitability. Even assuming an increase in the loss rate to 100bps of loans, the UK would post a pre-tax loss equivalent to just over EUR 200m, leaving the group with a pre-tax profit of over EUR 4bn.

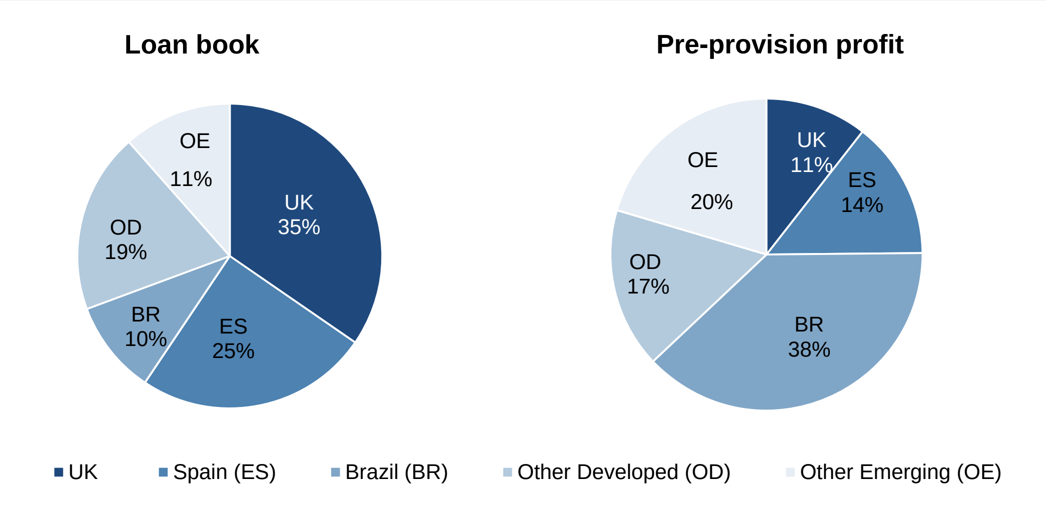
While each individual asset quality shock mentioned above could be absorbed by the bank's operating profitability cushions, there remains the more remote possibility of multiple shocks materializing at the same time and eroding Santander's capital base.

2. Globally diversified revenue and earnings streams with strong market positions in several key markets, including Spain, Brazil, UK, Mexico, Chile, Poland

Significant geographical diversification is a key positive driver for Santander's rating. The group comprises several retail and commercial banks in the Americas and Europe, servicing over 100 million customers globally.

As shown in Chart 2, mature markets still account for a majority of the loan book (c. 80%), but the bulk of Santander's earnings power is actually derived from the emerging markets franchises.

Chart 2: Loan book and operating profit split



Source: Company data, Scope Ratings

The Santander franchise has been built over several years, mostly through acquisitions. In that respect, we believe Santander's track record in acquisitions and integrations is positive so far. Since 2007, it has acquired several competitors in its core geographies at attractive prices, often benefitting from public backstops to risk, as was the case with the acquisition of Bradford & Bingley and Alliance & Leicester in the UK. Other major acquisitions in recent years include ABN AMRO Banco Real in Brazil, Sovereign Bank in the US and Zachodni WBK and Kredyt bank in Poland, as well as the SEB retail business in Germany. We note that, despite a strong appetite for inorganic growth, Santander's franchise remains fairly focused, with top three market positions in most of its core markets (see Table 1 for details).

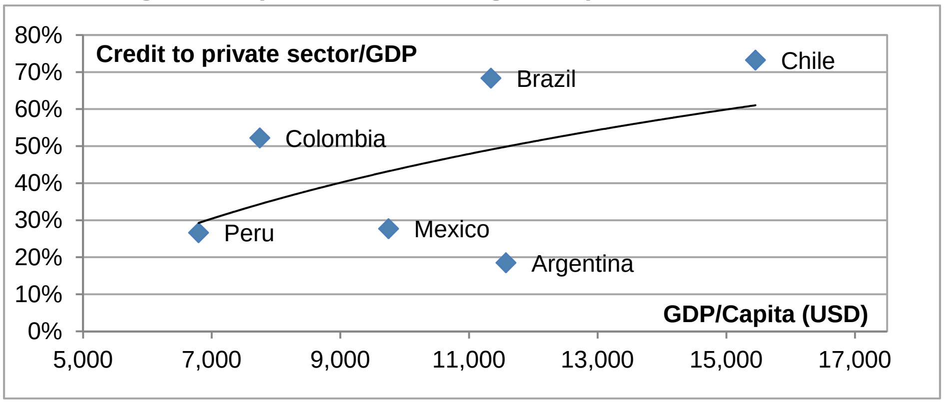
Table 1: Santander has a leading franchise with strong market shares in its core countries

	Spain	Mexico	Brazil	Chile	UK	Poland
Market Share (%)	13%	14%	11%	18%	11%	9%
Market Position (#)	2	3	3*	1	4	3

Source: Company data
**market position refers to private banks*

The emerging market franchise remains the main source of revenue and earnings growth for Santander. We note that, while some further catch-up in credit penetration compared with developed markets remains likely, both Chile and Brazil have a higher bank credit/GDP ratio than most other countries in Latin America (see Chart 3). As such, we expect revenue growth in these countries to be slower compared with the past few years.

Chart 3: High credit penetration limits growth potential in Brazil and Chile



Source: World Bank, Scope Ratings

As such, our positive view of the Group's international franchise relates not only to its growth potential, but especially to the earnings smoothing provided by the diversification: it would take synchronised recessions in the different countries of operation to seriously threaten group solvency.

3. A challenging macro environment in Spain hurting asset quality and profitability

The economic consensus on Spain has improved in recent months on the back of a number of positive data points. Starting in summer 2012, the picture emerging from Markit's PMI readings has brightened. Manufacturing PMIs began to signal expansion in Spain since July 2013 and have continued to improve since. GDP was marginally positive in Q3 and Q4 of 2013 and the unemployment rate has declined slightly from the peak of Q1 2013.

According to European Commission forecasts, Spain's GDP will grow 1% in 2014 and 1.7% in 2015. If this scenario materialises, we would expect the asset quality picture to improve. We note, however, that there are still significant headwinds to a sustained growth recovery in Spain. These include:

- A still challenged fiscal situation (government deficit/GDP of 7.2% and public debt/GDP at 94.3% in 2013. Source: European Commission). The fiscal drag will likely keep weighing on the Spanish recovery in the coming years.
- A significantly negative net international investment position (-91.4% of GDP in 2012, Source: Eurostat), resulting from a prolonged period of accumulated current account deficits. On this particular statistic, Spain is very much comparable to Greece (-109% of GDP), Portugal (-115% of GDP) and Ireland (-112% of GDP).

As such, we believe Spain remains prone to a relapse into recession and have therefore taken a cautious approach in forecasting forward profitability for Santander's Spanish unit. Nevertheless, as explained above, we deem Santander's profitability capable of absorbing significant asset quality shocks and hence do not consider Spanish asset quality an immediate threat to group solvency.

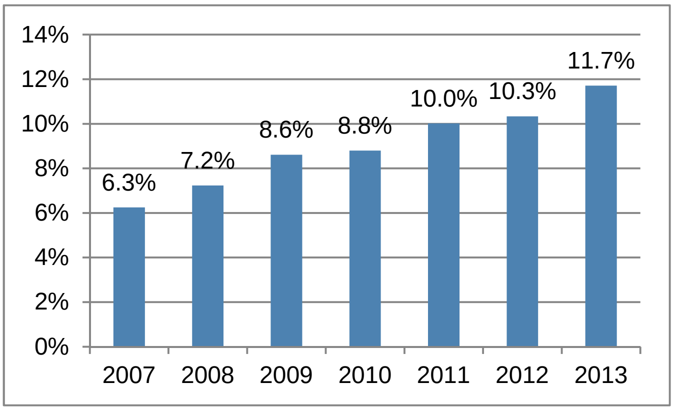
We do not anticipate a credit event on Spanish sovereign risk. However, the large exposure to Spanish sovereign risk remains a concern: according to the latest EBA data (June 2013), Santander had EUR 66bn in Spanish sovereign risk (including bonds and loans), equivalent to 123% of the group core capital base. In a simplified exercise (not accounting for tax impacts and offsetting management actions), for every 10% haircut to Spanish sovereign debt, Santander's consolidated core capital ratio would decline by 123bps. In other words, a 30% haircut would translate into a EUR 20bn loss and leave Santander on a 6.3% core capital ratio (based on EBA June 2013 data).

Overall, the challenged macro environment weighs negatively on the credit assessment of the group.

4. Ongoing improvement of capital, liquidity and funding position in recent years

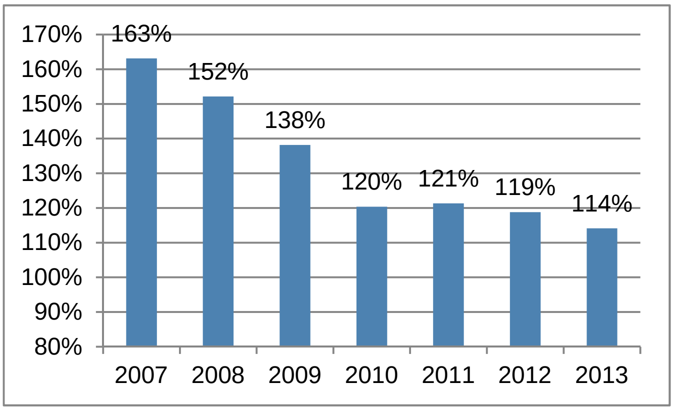
Santander is an efficient capital-generating operation on a group basis. Since 2007, the Basel 2 capital ratio has moved from 6.3% to 11.7% (Chart 4.a), while tangible equity increased from EUR 57bn to EUR 81bn. The key to such an impressive capital build-up has been the high risk-adjusted asset profitability (RoRWA of 1.6% on average in 2007-2013), despite the performance drags in Spain and the high-risk intensity of Santander's balance sheet.

Chart 4.a: Santander Core Tier 1 capital ratio evolution (Basel 2), 2007-2013



Source: Company data, Scope Ratings

Chart 4.b: Santander gross Loan/Deposit evolution, 2007-2013



Source: Company data, Scope Ratings

As of December 31, 2013, Santander's capital position was satisfactory on a Basel 2 basis. Looking forward, the bank has a CRD4 CET1 Ratio (fully loaded) target of 9% in 2014, which is at the lower end of its peer group. Santander has not yet disclosed its actual CRD4 capital position on a fully loaded basis. On a phase-in basis, CRD4 CET1 Ratio is at 10.9%. A high average risk weighting of Santander's balance sheet partly mitigates the weak capital standing on a CRD4 basis.

Going forward, we believe Santander's capital position is set to improve further. Based on our projected return on RWAs (1.1% in 2014 vs 0.84% in 2013) and assuming flat RWAs (vs a decline in 2013), and a 25% cash dividend pay-out, Santander would still generate c. 80 bps of capital per year. Such capital generation capacity is strongly supportive of the bank's credit rating.

The funding and liquidity position has also significantly improved since the beginning of the crisis: the group's loan-to-deposit ratio went from over 160% in 2007 to c.114% in 2013 (Chart 4.b), and Santander has repaid the entirety of its LTRO loans in Spain, while it still retains some exposure in Portugal (EUR 4.5bn) and in the European consumer finance business (EUR 1bn). The sovereign crisis in Spain has accelerated the reduction in wholesale funding, which declined from EUR 162bn in 2010 to EUR 133bn in 2013. This has been the result of aggressive deposit acquisition (organic and inorganic) on the one hand and fast asset deleveraging, especially in Spain and Portugal, on the other. Going forward, there is still scope to rebalance the funding profiles of some subsidiaries, but we see the group funding profile as adequate and in line with international peers, so we do not expect a further significant decline at the group level.

5. Intervention by host or home regulators could limit intragroup capital and liquidity flows across geographies at times of stress

The recent financial crisis has shown that, in a period of stress, intragroup capital and liquidity mobility across geographies can significantly diminish, limiting a cross-border banking group's financial flexibility at a time when it needs it the most. Faced with such restrictions, steps ranging from the listing of a minority stake to the disposal of the entire business may be used by some banking groups as alternatives to unlocking capital from a subsidiary, for example. The extent to which cross-border banking groups have such alternatives at their disposal represents a mitigation to this risk.

Against this background, we look favorably at cross-border banking organizations that display reassuring capital and liquidity metrics not only at group level, but also at the subsidiary level.

The recent capital upstream from Brazil (where common equity was replaced by hybrids via the payment of a special dividend) partly allays concerns about intra-group capital mobility. During the Q4 2013 results conference call, Santander said that the parent company capital position was around 12% on a fully loaded CRD4 basis.

Peer comparison

At Scope Ratings, we compare banks within peer groups at domestic and cross border levels.

Santander's national peer group comprises mainly BBVA, Bankia and Caixabank, although it also includes mid-sized banks such as Sabadell, Popular and Bankinter. While Santander and BBVA pursued an international expansion whereby Spain now represents approximately one-quarter and one-half of their respective loan portfolios, the rest of their peers are largely domestic lenders.

At the cross border level, we compare Santander with large and diversified retail banks, including Unicredit, KBC, RBS, ING, Erste Bank, Nordea, Danske Bank, Commerzbank and RZB, as well as BBVA. The peer group is heterogeneous but its components share a predominant weight of retail in the banks' business model and exposure to several developed and emerging markets. Several of the above names fall under the definition of systemically important financial institutions and as such are required to carry additional capital buffers (1% in the case of Santander).

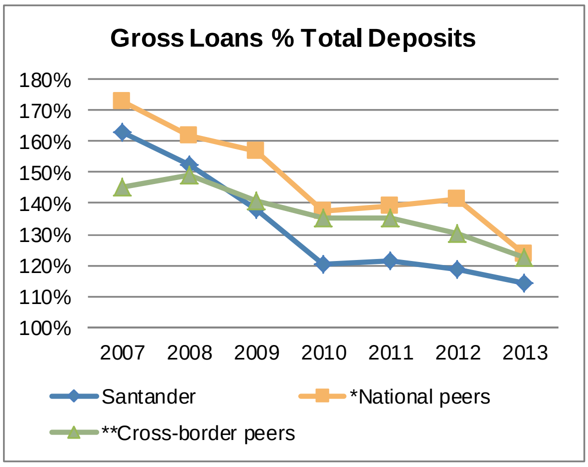
Despite the asset quality problems from its home business, Santander compares favourably with both domestic and international peers when it comes to asset quality and profitability. Compared with domestic peers, this can be ascribed to the well-executed diversification strategy. The profitability gap with international peers, on the other hand, reflects a higher (risk-adjusted) revenue productivity of banking assets in Latin America as well as the superior cost efficiency of Santander's operations. With a group cost-to-income ratio of approximately 50% in 2013, Santander is among the most efficient banks in Europe. While we anticipate some decline in revenue margins in Latin America as the credit markets deepen and the business mix shifts towards secured credit, we expect the process of convergence in profitability to be slow and gradual (although not linear).

From a funding and liquidity perspective, Santander's deleveraging in Spain and aggressive deposit acquisition campaigns in Spain and the UK have succeeded in bringing down the group's loan-to-deposit ratio to c.114% from over 160% in 2007, which is lower than both national and cross-border peers.

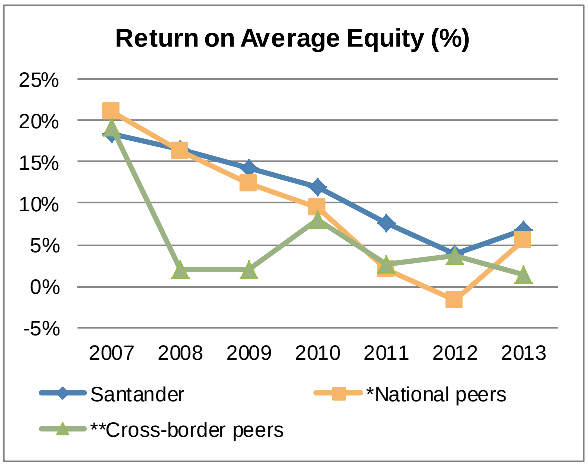
The strong and resilient group profitability has contributed to generating capital, although the bank remains at the lower end of its peer group on a fully loaded CRD4 CET1 Ratio basis. This is largely due to the high loan content of Santander's balance sheet. The bank leverage ratio is in line with its peer group.

Santander's capital position could benefit, in time, from a convergence towards a more level playing field due to RWA harmonisation, where Spanish practices are particularly conservative.

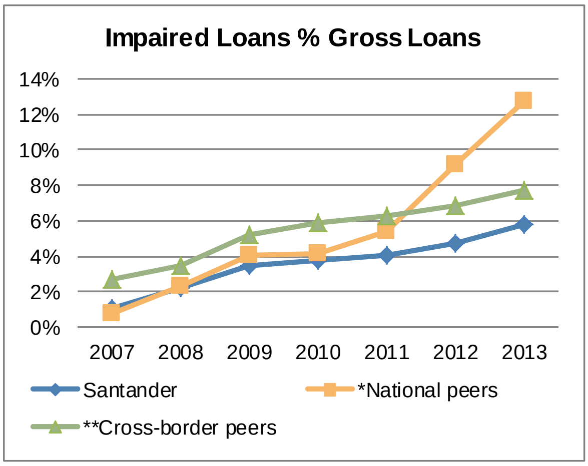
Peer Comparison - Santander group



Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



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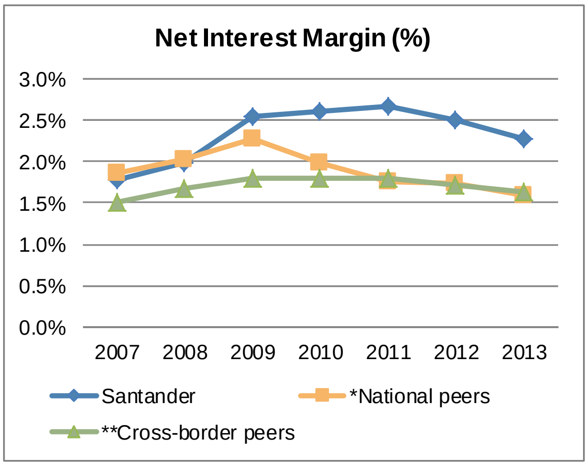

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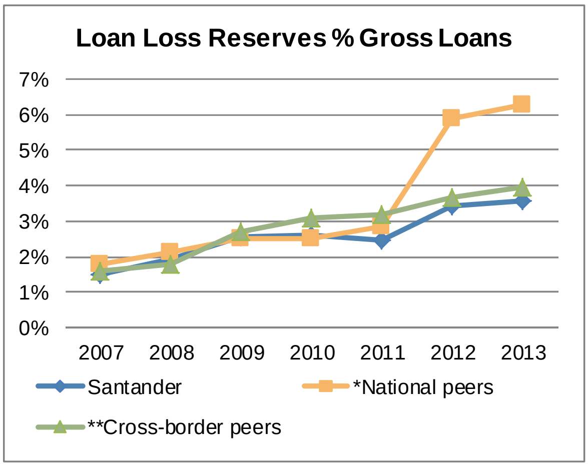
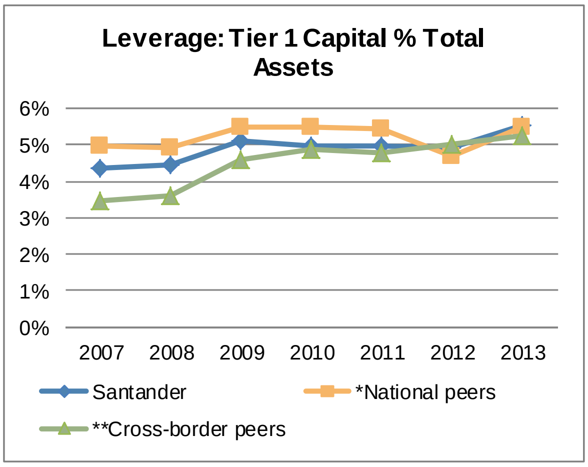


Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings

*National peers : Santander, BBVA, Caixabank, Bankia, Sabadell, Popular, Bankinter.
**Cross-border peers based on business model : Santander, BBVA, Unicredit, RBS, Erste Bank, RZB AG, Commerzbank, Nordea, KBC, Danske Bank, ING Bank.
Notes: Cross-border peer group averages exclude RZB in 2013

Selected Financial Information - Santander group

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Balance sheet summary (EUR billion)									
Assets									
Cash and balances with central banks	31.1	45.8	34.9	77.8	96.5	118.5	77.1	79.3	75.3
Interbank assets	57.6	78.8	79.8	79.9	51.7	73.9	75.0	75.0	75.0
Total securities	132.0	124.7	174.0	174.3	154.0	152.1	142.2	135.1	128.4
of which debt instruments	109.3	109.3	151.5	150.6	143.8	141.3	132.4	125.8	119.5
equity instruments	22.8	15.4	22.5	23.7	10.2	10.7	9.8	9.3	8.8
Derivatives	50.1	107.9	69.1	82.8	114.4	120.5	68.8	68.2	68.9
Gross customer loans	579.8	639.4	700.4	742.0	767.3	744.5	693.8	693.8	704.6
of which impaired loans	6.1	14.0	24.0	27.9	31.3	35.3	40.3	40.3	36.3
Total funded assets	859.8	954.1	1,045.8	1,134.2	1,140.6	1,152.8	1,051.4	1,045.7	1,047.5
Total Assets	**912.9**	**1,049.6**	**1,110.5**	**1,217.0**	**1,251.0**	**1,269.6**	**1,115.6**	**1,109.4**	**1,111.8**
Liabilities									
Interbank liabilities	112.9	129.9	142.1	140.1	143.1	153.0	109.9	106.6	103.4
Senior debt	233.3	236.4	212.0	192.9	197.4	206.0	175.5	157.9	142.1
Derivatives	53.1	95.6	64.7	82.7	110.4	116.8	64.3	63.7	64.3
Customer deposits	355.4	420.2	507.0	616.4	632.5	626.6	607.8	620.0	638.6
Subordinated debt + hybrid securities	36.2	38.9	36.8	30.5	23.0	18.2	16.1	14.5	13.1
Total Liabilities	**855.4**	**989.6**	**1,036.7**	**1,137.5**	**1,170.2**	**1,188.3**	**1,035.7**	**1,025.5**	**1,024.3**
Ordinary equity	48.1	50.4	61.5	65.0	65.8	71.6	70.4	74.4	78.0
Minority interests	2.4	2.4	5.2	5.9	6.4	9.4	9.3	9.3	9.3
Total Liabilities and Equity	**912.9**	**1,049.6**	**1,110.5**	**1,217.0**	**1,251.0**	**1,269.6**	**1,115.6**	**1,109.4**	**1,111.8**
Core Tier 1 Capital [1]	*32.2*	*37.2*	*48.4*	*53.2*	*56.7*	*57.6*	*57.3*	*61.3*	*65.0*
Income Statement summary (EUR billion)									
Net interest income	14.4	17.5	26.3	29.0	29.1	29.9	25.9	25.8	26.7
Net fee & commission income	7.9	8.3	9.1	9.7	10.2	10.3	9.8	9.8	10.2
Net trading income	3.0	3.5	4.2	2.6	2.3	2.7	3.5	3.0	3.0
Operating Income	**26.4**	**30.9**	**40.2**	**41.7**	**42.8**	**43.4**	**39.8**	**39.3**	**40.6**
Operating expenses	12.9	14.5	18.2	19.1	19.6	20.0	19.8	20.0	20.3
Loan loss provision charges	3.4	6.3	11.6	10.4	9.9	12.6	10.9	10.7	10.5
Non-recurring items	1.9	1.1	0.2	-0.2	-4.7	-5.3	-1.8	-0.6	-1.7
Pre-Tax Profit	**12.0**	**11.2**	**10.6**	**12.0**	**8.6**	**5.5**	**7.2**	**8.1**	**8.1**
Income tax	2.3	1.8	1.2	2.9	2.5	2.3	1.9	1.7	2.0
Net profit attributable to minority interests	0.6	0.5	0.5	0.9	0.8	0.9	1.0	1.0	1.2
Net Income Attributable to Parent	**9.1**	**8.9**	**8.9**	**8.2**	**5.4**	**2.3**	**4.4**	**5.3**	**4.9**

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] Basel 2 basis

Ratios - Santander group

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Funding/Liquidity									
Gross loans % Total deposits	163.1%	152.1%	138.2%	120.4%	121.3%	118.8%	114.1%	111.9%	110.3%
Total deposits % Total funds	47.7%	50.5%	56.0%	62.4%	63.0%	62.4%	66.8%	68.9%	71.2%
Wholesale funds % Total funds	52.3%	49.5%	44.0%	37.6%	37.0%	37.6%	33.2%	31.1%	28.8%
ASSET MIX, QUALITY AND GROWTH									
Total loans % Funded assets	67.4%	67.0%	67.0%	65.4%	67.3%	64.6%	66.0%	66.3%	67.3%
Impaired loans % Gross loans	1.0%	2.2%	3.4%	3.8%	4.1%	4.7%	5.8%	5.8%	5.1%
Loan loss reserves % Impaired loans	143.2%	89.1%	74.4%	70.0%	60.2%	72.0%	61.8%	61.8%	61.8%
Gross loan growth (%)	8.0%	10.3%	9.6%	5.9%	3.4%	-3.0%	-6.8%	0.0%	1.6%
Impaired loan growth (%)	31.6%	130.5%	71.7%	16.0%	12.2%	12.9%	14.2%	0.0%	-10.0%
Funded assets growth (%)	8.6%	11.0%	9.6%	8.5%	0.6%	1.1%	-8.8%	-0.5%	0.2%
EARNINGS									
Net interest income % Revenues	54.7%	56.8%	65.4%	69.4%	68.1%	68.9%	65.2%	65.6%	65.8%
Fees & commissions % Revenues	29.8%	26.8%	22.6%	23.2%	23.9%	23.6%	24.6%	25.0%	25.1%
Trading income % Revenues	11.2%	11.2%	10.6%	6.3%	5.4%	6.2%	8.7%	7.5%	7.4%
Other income % Revenues	4.3%	5.2%	1.4%	1.2%	2.6%	1.2%	1.5%	1.8%	1.8%
Net Interest Margin (%)	2.0%	2.2%	2.9%	2.9%	2.8%	2.9%	2.6%	2.7%	2.8%
Pre-provision Income % Risk-weighted assets (RWAs)	2.6%	3.2%	3.9%	3.7%	4.1%	4.2%	4.1%	4.0%	4.2%
Loan loss provision charges % Pre-provision income	25.4%	38.4%	52.6%	45.9%	42.7%	54.0%	54.6%	55.1%	51.6%
Loan loss provision charges % Gross loans (cost of risk)	0.6%	1.0%	1.8%	1.5%	1.3%	1.7%	1.6%	1.6%	1.6%
Cost income ratio (%)	48.9%	47.1%	45.3%	45.7%	45.7%	46.0%	49.9%	50.8%	50.0%
Net Interest Income / Loan Loss Charges (x)	4.2	2.8	2.3	2.8	2.9	2.4	2.4	2.4	2.6
Return on average equity (ROAE) (%)	19.5%	18.0%	16.0%	13.0%	8.2%	3.3%	6.2%	7.3%	6.4%
Return on average funded assets (%)	0.7%	0.6%	0.6%	0.5%	0.3%	0.1%	0.3%	0.3%	0.3%
Retained earnings % Prior year's book equity	10.9%	8.6%	9.1%	7.7%	5.1%	1.7%	4.6%	5.6%	4.9%
Pre-tax return on core tier 1 capital	37.1%	30.0%	22.0%	22.6%	15.2%	9.6%	12.6%	13.1%	12.5%
CAPITAL AND RISK PROTECTION [1]									
Common equity tier 1 ratio (common equity tier 1 capital % RWAs)	6.3%	7.2%	8.6%	8.8%	10.0%	10.3%	11.7%	12.6%	13.3%
Tier 1 leverage ratio (%)	4.4%	4.3%	5.1%	5.0%	5.0%	4.9%	5.5%		
Median of tier 1 leverage ratio and core tier 1 ratio (%)	5.3%	5.8%	6.9%	6.9%	7.5%	7.6%	8.6%		
Total loss coverage (core tier 1 + loan loss provisions) % RWAs	7.9%	9.7%	11.8%	12.0%	13.3%	14.9%	16.8%	17.7%	17.9%
Non-senior bailinable debt Cushion (as % of Total liabilities)	5.0%	4.6%	4.2%	3.4%	2.7%	1.6%	1.6%		
Asset risk intensity (RWAs % Total assets)	56.4%	49.0%	50.6%	49.7%	45.2%	43.9%	43.9%	43.9%	43.9%

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] CRD 4 basis capital position not disclosed. CET1 Ratio based on Basel 2 Core Tier 1 capital

METHODOLOGIES USED FOR THIS REPORT

For the rating and analysis contents of this report, Scope has used the following methodologies which were published on www.scoperatings.com:

"Bank Rating Methodology" (February 2014)

"Forecasting Bank Financials Methodology" (February 2014)

Forecasting bank financials: Forward-looking estimates are an important analytical tool underpinning Scope's bank ratings. These forecasts cover the current financial year (before final year-end figures are published by the bank) plus the forthcoming two years. Depending on the complexity of the bank being assessed, different forecasting tools will be used. For a majority of banks operating primarily commercial and retail banking franchises (loans and deposits) the analysis is underpinned by an **accounting** forecast of the balance sheet and profit and loss account. For more complex groups with multiple ranges of activities – notably those with material wholesale and investment banking operations – Scope uses an **analytical** forecast, relying on the bank's business-line reporting to come up with plausible estimates. For all banks Scope also includes a **regulatory metrics** forecast, considering the growing importance of this aspect in bank analysis.

For complex banks, divisional data is used to forecast profit and loss accounts and basic divisional balance sheet metrics. For less complex banks, a line-by-line forecasting of major P&L elements is forecast.

For balance sheet forecasts, Scope estimates of all major balance sheet lines, using the P&L estimates to complete the forecast of the capital/shareholders' equity line. This comprehensive methodology for estimating the balance sheet is used for all the banks in our universe, irrespective of size and complexity.

Lastly, our forecasts include assessments of the major regulatory metrics: Tier 1 and CET 1 (historically CT1), Leverage, Liquidity Coverage Ratio, and Net Stable Funding Ratio (the latter two when and if sufficient public information to compute them is available).

Scope will not aim to forecast financials when it considers the public disclosure of the bank as insufficient for a transparent and credible outcome.

All Scope's bank financial forecasts are based on public information. For its forecasts Scope will not use any non-public information or data, even if such information or data were provided by rated banks. Scope's forecasting process is transparent, with a detailed roadmap provided in its *"Forecasting bank financials"* methodology.

Banque Fédérative du Crédit Mutuel SA

Issuer Rating Report

A STABLE OUTLOOK

Financial Institutions

Overview

Scope Ratings assigns an Issuer Credit-Strength Rating (ICSR) of A to Banque Fédérative du Crédit Mutuel with a stable outlook. This rating reflects the stable and well-established retail franchise and overall strong fundamentals of the bank and its much-improved liquidity. At the same time, the rating also reflects the less-clear governance of the firm and the geographical divide within the group, which gives Crédit Mutuel much less of a unified structure than its French mutualist peers.

The ratings on Banque Fédérative du Crédit Mutuel (BFCM) are based on Crédit Mutuel Group's (CMut) credit fundamentals and support. Caisse Centrale du Crédit Mutuel (CCCM) has delegated its capital markets functions to BFCM, thence the assignment of our ratings to BFCM. However, the A rating is not applicable to unguaranteed debt issued by subsidiaries of BFCM.

Ratings (assigned on April 2, 2014)

Issuer Credit-Strength Rating	**A**
Outlook	Stable
Senior Unsecured Debt	A

Unsolicited ratings without issuer participation.

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Rating drivers (Summary)

The ratings drivers, in decreasing order of importance in the rating assignment, are:

- (+) A very strong franchise. The Crédit Mutuel and CIC networks together hold the third largest market share in French loans and deposits.
- (−) The governance of CMut is perfectible and has grown more and more complex with time.
- (+) The balance sheet of the bank is low-risk, and its capital base strong.
- (+) Crédit Mutuel has made few, but always smart, acquisitions over the years.

Rating change drivers

(↑) Any improvement in the governance process of Crédit Mutuel should be a positive development. So far, the bank has managed to cut costs and optimize resources by joining 11 regional banks within the so-called "CM11-CIC" group, the largest by far. Any further concentration of regional banks would, in our view, help strengthen the unity and cohesion of the group further.

(↓) Even if quite remote, an acceleration of the divide within the Crédit Mutuel Group could bring Crédit Mutuel Arkéa (the combination of the Britany, South-West and Massif Central federations) to leave the group. Crédit Mutuel Arkéa strikes us as being fully autonomous from the rest of the group; therefore an operational break-up would not create massive business disruption.

Recent events

CMut Group reported its FY 2013 results on March 6. Crédit Mutuel Group reported yearly net profits of EUR 2.651bn, up 23.3% on 2012. These good numbers were driven by a 4.8% growth in revenues coupled with flat operating expenses, leading to a 17% increase in pre-provision profits. Loan loss charges are up 10.4% to EUR 1.384m, and correspond to a group cost of risk of 39bps. The non-performing loan ratio increased to 4.4% (versus 3.95% in 2012), and CMut maintained its NPL coverage ratio at 66.1%.

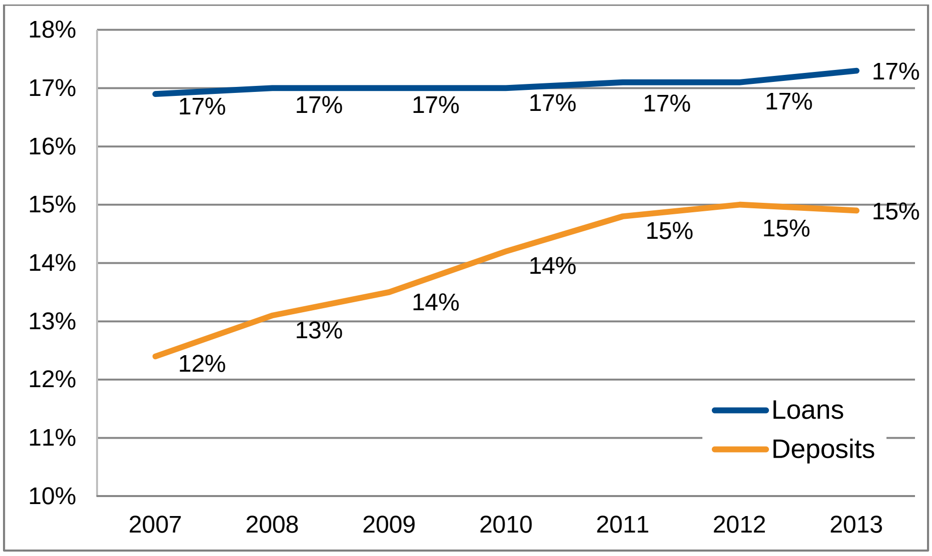
Rating drivers (Details)

1. A very strong franchise

There are three different aspects to Crédit Mutuel's business that strike us as quite special versus other French banks:

1. The two main networks of the group (the regional banks of Crédit Mutuel and the regional banks of the CIC group) represent the third largest market share in loans and deposits in France (Chart 1). Interestingly, while CMut's market shares in loans have not changed materially over the years, the bank has nonetheless increased its weight in deposits. The market share gap between loans and deposits has significantly narrowed over the last 6-7 years.

Chart 1: Loan and Deposit market shares – Crédit Mutuel Group



Source: Company data

2. In bancassurance, Assurances Crédit Mutuel ranks among the first bancassurers in France (together with Crédit Agricole's Prédica). The difference between the two groups is that Crédit Mutuel has been more successful in non-life insurance (where the bank is number one in France).

3. The main competitive advantage of Crédit Mutuel versus its French peers has been its long-standing focus on technology. This leadership is expressed at two levels: first electronic and digital banking, where the product includes an integrated mobile phone network offering, and also alarm systems through the subsidiary EPS, number one in France. Second, the bank is first in electronic payments in France with 2 billion transactions registered by affiliated retailers in 2012.

2. The governance of Crédit Mutuel is perfectible

2.1. In theory, a complex but comprehensible structure

The governance of Crédit Mutuel has become quite complex over the years and the different corporate and organizational layers make the identification of responsibility more difficult to assess.

The current problems can be traced back to the origins of the group itself. Technically, the first Crédit Mutuel in France was created in 1893 in the Lyon region. Progressively though, the western side of France quickly became the most important location of Crédit Mutuel local banks, while at the same time the first Crédit Mutuel banks were founded in German-occupied Alsace. As a result, from 1918 onwards, the Crédit Mutuel franchise has been built up independently and quite strongly in two different French regions. After forty years of co-existence, the unified Crédit Mutuel Group as we know it today was created in 1958 with the foundation of a Central Body for the whole group, the Confédération Nationale du Crédit Mutuel.

Up until today, CMut Group seems to play by the same rules as other comparable mutualist networks in France. The role of the Central Body and the rules of internal support are both defined in the Monetary and Financial Code, articles l511-30 and l511-31. According to these articles, the central body of a mutualist organization must "maintain the cohesion of the network it belongs to, and ensure that the operations of affiliated banks are in order. To this end, the central body is expected to take every necessary step, in particular to guarantee the liquidity and solvency of all the affiliates and of the network as a whole".

CMut is divided into 18 regional groups. Each regional group includes:

- Local banks, collecting deposits and granting loans with high delegation powers.
- Regional banks (owned by local banks).
- A regional Federation, i.e. a not-for-profit organization defining the strategy and implementing the controls of the whole regional group.

According to article r511-3 of the Monetary and Financial Code, "the ACPR[1] can, for the benefit of mutualist groups and after receiving the opinion of the central body, deliver a collective agreement to a regional bank for the benefit of this bank and all the local banks that are affiliated to this regional bank, provided that the liquidity and solvency of these local banks are guaranteed as a result of this affiliation".

As a result, there are two levels of internal support: regional and national; we assume that solvency and liquidity issues need to be sorted out at a regional level before being escalated to the level of the Confédération Nationale.

The Confédération Nationale du Crédit Mutuel is the central body of the whole group (including the 2,000-odd local banks and the 18 regional groups). The regional federations are all affiliated to Confédération Nationale. The Confédération Nationale sits at the top of the hierarchy. It is also a not-for-profit organization. The Confédération Nationale represents CMut vis-à-vis the authorities and is responsible for defending and promoting its interests. The Confédération Nationale also oversees the proper operations of its affiliated banks, supervises the regional groups and ensures the overall cohesion of the network.

Along the Confédération Nationale, at the top level, there is the Caisse Centrale du Crédit Mutuel (or CCCM), the central financing bank. It manages treasury for the regional groups and organizes the pooling of Crédit Mutuel's financial resources. Its capital is jointly owned by the regional banks.

[1] The French banking regulator, or Autorité de Contrôle Prudentiel et de Résolution

2.2. In practice, the build-up of powerful decentralized franchises

Because of the principle of “collective agreement” as authorized by Article r511-3 of the Monetary and Financial Code, the regional groups can actually operate and pretty much thrive on a stand-alone basis, as solvency and liquidity are guaranteed at regional and local levels. This also means that it can be tempting, particularly for regional banks that have been used to their independence, to build up their own product engines, their own subsidiaries and their own bond issue programs. As a result, CMut has for many years seen the proliferation of many different competing entities operating in the same business line, but in different regions. As of year-end 2012, the annual report of Crédit Mutuel listed three property subsidiaries, three equipment leasing companies, three property leasing companies, three consumer credit subsidiaries, four insurance companies, seven private equity companies and four asset management companies.

Faced with such duplications, the most powerful regional banks have tried to consolidate by encouraging “Interfederal Groups” to bring together shared services, common funding and liquidity, common purchasing, partnerships, etc. The Crédit Mutuel Centre-Est Europe (CMCEE) was born of the merger of three regional groups in the east of France.

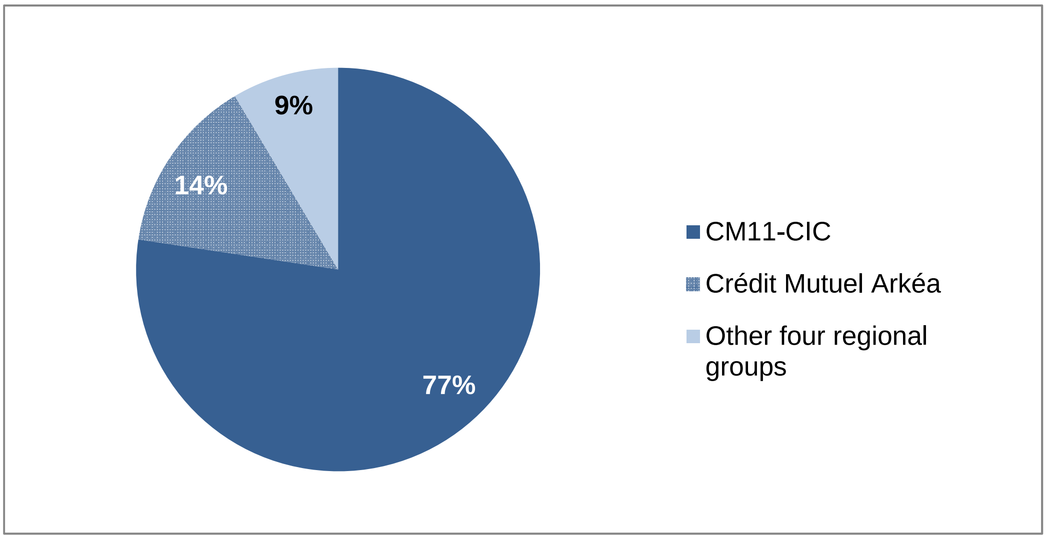
Between 1993 and 2012, the CMCEE (now renamed Caisse Fédérale de Crédit Mutuel - CFCM) joined forces with 10 other regional federations to become the CM11-CIC Group. CM11-CIC is an interregional group gathering 11 out of the 18 regional groups of Credit Mutuel. This means, in practice, that all these 11 Federations have agreed to consider CFCM as their Regional Bank. It also means that the “collective agreement” ruling the liquidity and the solvency of CM11-CIC now happens between CFCM (as central body), the 11 Federations and their corresponding local banks.

On the other side of the country, Crédit Mutuel de Bretagne has tried to build a competing alternative to the growing CM11-CIC. Crédit Mutuel de Bretagne, Crédit Mutuel du Sud-Ouest and Crédit Mutuel Massif Central have created Crédit Mutuel Arkéa in 2002, built on the same principles (even if on a much smaller scale) as CM11-CIC.

As a result, there are now only four Regional Groups that are organized “independently” from the two large interfederal groups: Crédit Mutuel Nord Europe, Crédit Mutuel Océan, Crédit Mutuel Maine-Anjou Basse-Normandie and Crédit Mutuel Antilles-Guyane.

As can be seen on Chart 2, CM11-CIC represents 77% of the assets of the whole Crédit Mutuel versus 14% for Arkéa and 9% for the rest of the group.

Chart 2: Breakdown of total assets of CMut Group (by big regional group)



Source: company data

2.3. As a result, a more complex cash circulation between entities

As a result of this extremely decentralized organization, the main risk attached to CMut would be frictions with regard to the cash circulation from one group to another in case of solvency and/or liquidity problems.

Things may be further complicated by the attributes of CCCM; in theory, the financing arm of the group and a pillar of the "third level" of Crédit Mutuel governance, together with the Confédération Nationale. We note that with time, CCCM has passed a lot of its prerogatives to BFCM, the financing arm of CM11-CIC, despite the expected "neutral" qualities of CCCM. Indeed, since 2002 and 2005, the back office and front office functions of CCCM have been delegated to BFCM. The capital markets activities of CCCM have also been delegated to BFCM. To quote from the CCCM annual report: "on the different markets, CCCM now only appears as an issuer of CDs and as deposit borrower; everything else is done internally within the Crédit Mutuel Group. The increase of the CM-CIC entity from CM5-CIC to CM10-CIC and then CM11-CIC has seen the traditional franchise of CCCM collapse. BFCM is now substituting for CCCM as lender/borrower to/from the regional banks".

This paragraph shows another sign of the growing decentralization of CMut and the fact that national solvency and liquidity firewalls are being increasingly dealt with at local levels, which could create a problem in the unlikely case of a credit event.

3. The balance sheet of Crédit Mutuel Group is strong

To sum up:

- The weight of derivatives in the group's balance sheet is extremely limited (around 1% of total assets).
- The weight of repos in the group's funding is extremely limited (never more than 5% of total funding over the last six years).
- The capital metrics of the company are among the strongest in France. The fully-phased Basel 3 leverage ratio in particular stood at 5.6% at year-end 2013. The fully-phased Basel 3 CET1 ratio amounted to 14.2%, which is at the top of the peer group both in France and abroad.

- Lastly, even if perfectible, the liquidity metrics of CMut have significantly improved over the last years, as demonstrated by Table 1 below. In particular, the loans-to-deposits ratio has gone down (partly as a result of the increasing reliance by Crédit Mutuel on covered bond issues) and the weight of wholesale funds as a percentage of total funding has gone down as well. This is positive, but in our view, the group's liquidity and funding remain to some extent a work in progress. Even if 2013 numbers are not fully available yet, it is our understanding that the loans-to-deposit ratio has fallen by another five percentage points in 2013.

Table 1: Liquidity and funding metrics of CMut

	2006	2007	2008	2009	2010	2011	2012
Loans % deposits	165.50%	173.98%	167.77%	152.13%	146.97%	132.90%	124.07%
Liquid assets % short-term funds	88.40%	78.86%	59.32%	63.67%	63.09%	63.00%	77.31%
Wholesale funds % total funds	59.39%	62.38%	58.25%	51.84%	47.89%	44.87%	43.03%
ST wholesale funds % total funds	42.81%	48.88%	49.25%	42.43%	37.89%	34.13%	31.38%
Deposits % total funds	40.49%	37.60%	41.18%	47.84%	52.09%	55.06%	56.89%
Loans % total assets	45.61%	45.90%	48.35%	50.08%	52.00%	50.16%	46.64%
Repos % ST wholesale funds	0.00%	1.15%	1.09%	2.86%	4.87%	2.33%	1.00%

Source: Company data, Scope Ratings estimates

4. The acquisition policy of the group has been smart

Compared with other French banks, Crédit Mutuel made fewer, but wiser, acquisitions.

Following the acquisition of CIC by BFCM in 1998, which enabled CMut to participate fully in the domestic consolidation of the French banking sector, Crédit Mutuel launched into a series of opportunistic acquisitions. Although few and far between, these acquisitions were sensible and made at a reasonable cost. At year-end 2012, the bank reported around EUR 4.852bn of goodwill. As a matter of comparison, goodwill stood at EUR 14.7bn for CA Group in 2012 (after a peak at more than EUR 20.5bn in 2008), EUR 10.6bn for BNP Paribas, EUR 5.2bn for Société Générale (following a peak at EUR 7.4bn in 2010), and EUR 4.3bn for Groupe BPCE (EUR 5.7bn in 2009). It is interesting to note that BFCM (belonging to CM11-CIC) is the vehicle that carried most of the major acquisitions since 1998 (CIC, also a part of the CM11-CIC sub-group, bought the minority stakes in Banque Marocaine du Commerce Extérieur and BPM in Italy). Interestingly, where all French banks favored either Italy and Greece or an expansion in Central & Eastern Europe, CMut chose Germany, France and consumer lending.

- In June 2008, BFCM acquired 100% of the subsidiary of the Spanish Banco Popular in France (18 branches in the Paris area, the southeast and the southwest).
- In November 2008, BFCM acquired 51% of the capital of Cofidis, the captive consumer credit operation of the retail group 3 Suisses. The acquisition enabled Cofidis to launch into outside partnerships and Crédit Mutuel to expand in Spain, Portugal, Belgium, Italy, Czech Republic, Slovakia and Hungary.
- In December 2008, BFCM acquired 100% of the capital of Citibank Germany (soon to be renamed Targobank). The entity then had 300 branches and 3.4 million clients. On top of the intrinsic qualities of the Citi franchise in Germany, the acquisition enabled CMut to benefit from the Citi retail IT structure.
- In 2012, Crédit Mutuel Nord Europe bought Citibank Belgium (442,000 clients and 34 branches) while Assurances Crédit Mutuel purchased the Spanish Agrupacio Mutua.

Adding the net profits of the different acquisitions (including CIC) and comparing them to the goodwill of the bank gives a 2012 yearly return of more than 15%; way above the cost of capital.

Peer comparison

At Scope Ratings, we compare banks within peer groups at domestic and cross-border levels.

Domestically, Crédit Mutuel Group is comparable to BNP Paribas, Société Générale, Crédit Agricole Group and BPCE.

Looking at the performance of CMut versus domestic peers, it is interesting to note that on many metrics the five rated banks show very similar rankings. This is particularly the case of liquidity metrics, since the loans-to-deposits ratio of all French banks is comprised between 110% and 130%. CMut displayed one of the highest loans-to-deposits ratios of French banks in 2012, despite a major improvement since 2007, when the LTD ratio of the bank was around 170%.

In asset quality terms, French banks are clearly divided between domestically-biased and internationally-biased banks. Among the former (CA Group, Crédit Mutuel and BPCE), CMut shows impaired loans metrics that rank well among peers, with a coverage ratio within average levels.

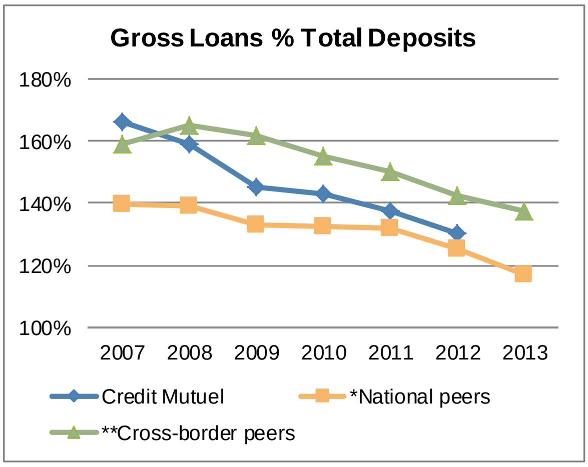
It is worth noting that Crédit Mutuel has been leading the French banks profitability pack together with BNP Paribas. This is due to a low cost of risks versus peers.

At an international level, we have positioned Crédit Mutuel as a domestic pure play, together with banks such as Lloyds, Rabobank and Intesa.

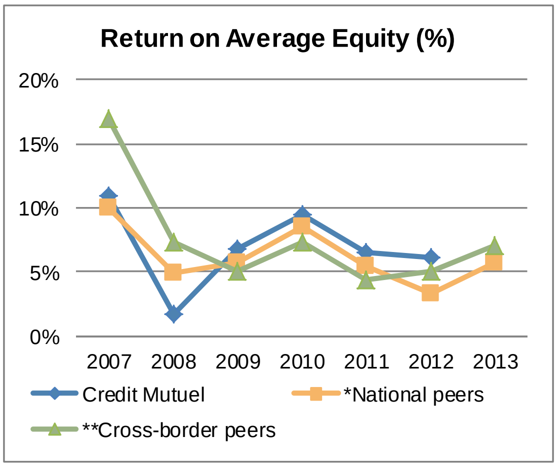
Considering the high quality of CMut’s balance sheet, it is not surprising to see the bank significantly outperform European peers. Even on the loans-to-deposits ratio, which was the problematic metric of the bank, CMut is best in class among European peers in 2012 (despite the standards of the peer group on this particular ratio not being particularly high). The asset quality metrics are also good. As for leverage, at 5.6% in 2013, we believe the bank to be extremely well-positioned.

Overall, we find the financial fundamentals of Crédit Mutuel quite solid, but we are worried by the evolving governance of the group, which we consider far from satisfactory.

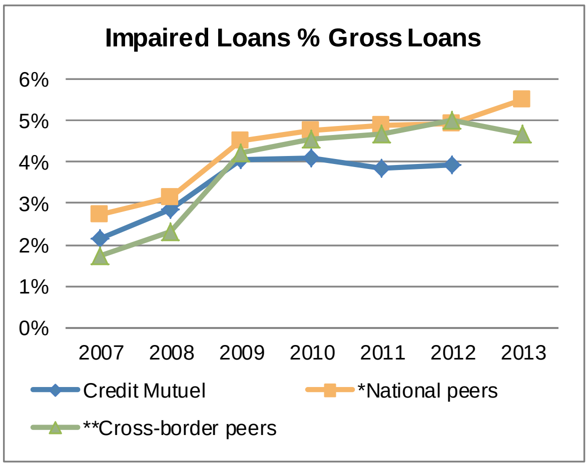
Peer Comparison - Credit Mutuel Group



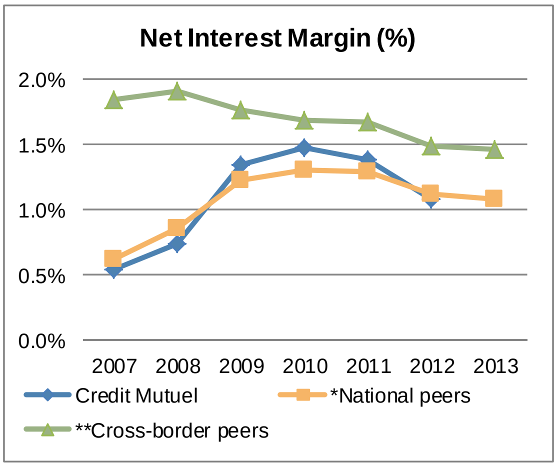
Source: SNL Financial, Scope Ratings



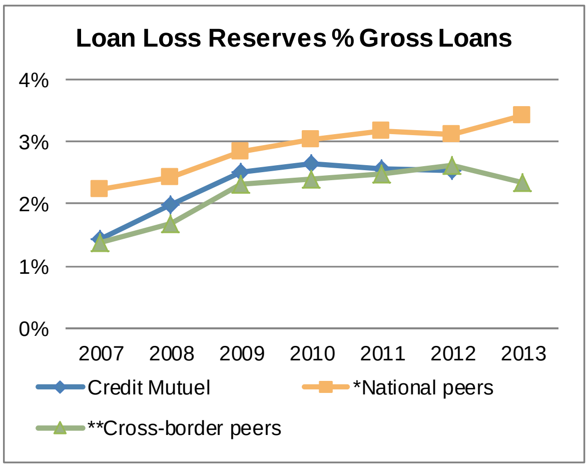
Source: SNL Financial, Scope Ratings



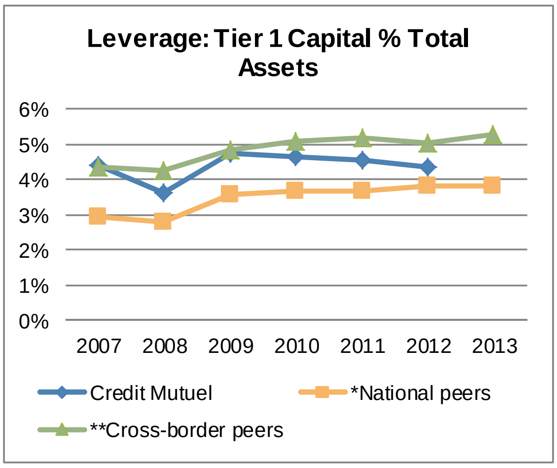
Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings

*National peers: BNP Paribas, Credit Agricole Group, Credit Mutuel Group, Groupe BCPE, Societe Generale
**Cross-border peers: Groupe BPCE, Credit Mutuel Group, Intesa, DNB ASA, Credit Agricole Group, CaixaBank, Sw edbank, Lloyds Banking group, Wells Fargo & Co., Rabobank Group

Notes: Cross-border peer group excludes Credit Mutuel Group in 2013 as w ell as Intesa for the Net Interest Margin and the Return on Average Equity. We use H1 2013 numbers as a 2013 proxy for Intesa on all other ratios.

Selected Financial Information - Credit Mutuel Group

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Balance Sheet summary (EUR billion)									
Assets									
Cash and balances with central banks	8.3	18.1	10.7	8.7	8.6	16.3	n/a	n/a	n/a
Interbank assets	49.9	48.7	44.3	47.5	46.8	59.6	n/a	n/a	n/a
Total securities	179.7	158.8	164.4	165.4	161.6	167.8	n/a	n/a	n/a
of which debt instruments	145.7	132.4	130.0	131.1	128.2	131.2	n/a	n/a	n/a
of which equity instruments	32.6	25.3	34.4	34.2	33.3	36.6	n/a	n/a	n/a
Derivatives	9.8	13.8	6.4	4.0	5.3	6.7	n/a	n/a	n/a
Gross customer loans	288.5	314.2	327.8	340.6	354.5	362.8	n/a	n/a	n/a
of which impaired loans	6.3	9.0	13.3	14.0	13.7	14.3	n/a	n/a	n/a
Total funded assets	543.1	566.4	569.9	584.7	598.3	638.9	n/a	n/a	n/a
Total Assets	**553.3**	**581.7**	**579.0**	**591.3**	**605.2**	**645.2**	**n/a**	**n/a**	**n/a**
Liabilities									
Interbank liabilities	86.5	84.9	67.3	54.1	56.8	50.6	n/a	n/a	n/a
Senior debt	134.1	138.2	121.4	126.3	119.7	123.7	n/a	n/a	n/a
Derivatives	10.2	15.4	9.2	6.6	6.9	6.3	n/a	n/a	n/a
Customer deposits	173.3	197.6	225.7	238.6	258.3	278.0	n/a	n/a	n/a
Subordinated debt + hybrid securities	6.5	8.6	7.4	8.1	7.4	6.7	n/a	n/a	n/a
Total Liabilities	**526.4**	**556.7**	**548.4**	**557.9**	**570.8**	**606.8**	**n/a**	**n/a**	**n/a**
Ordinary equity	26.4	24.7	29.6	32.3	33.4	37.4	n/a	n/a	n/a
Minority interests	0.4	0.4	1.0	1.1	1.0	1.0	n/a	n/a	n/a
Total Liabilities and Equity	**553.3**	**581.7**	**579.0**	**591.3**	**605.2**	**645.2**	**n/a**	**n/a**	**n/a**
Core Tier 1 Capital [1]	*24.4*	*21.1*	*24.8*	*24.9*	*25.2*	*25.3*	*n/a*	*n/a*	*n/a*
Income Statement summary (EUR billion)									
Net interest income	2.7	4.0	7.4	8.2	7.8	6.3		n/a	n/a
Net fee & commission income	2.7	2.6	3.3	3.6	3.4	3.3		n/a	n/a
Net trading income	2.7	0.1	0.5	0.2	-0.2	1.2		n/a	n/a
Operating Income	**10.6**	**9.0**	**13.6**	**14.8**	**14.1**	**14.4**	**15.3**	**n/a**	**n/a**
Operating expenses	6.5	6.7	8.4	8.9	9.0	9.6	9.7	n/a	n/a
Loan loss provision charges	0.2	1.9	2.4	1.6	1.8	1.2	1.4	n/a	n/a
Non-recurring items	0.0	0.0	0.0	0.0	0.1	0.0	0.0	n/a	n/a
Pre-Tax Profit	**3.9**	**0.4**	**2.7**	**4.2**	**3.4**	**3.5**	**4.2**	**n/a**	**n/a**
Income tax	1.1	0.0	0.9	1.1	1.1	1.3	1.5	n/a	n/a
Net profit attributable to minority interests	0.1	0.0	0.1	0.1	0.1	0.1	0.1	n/a	n/a
Net Income Attributable to Parent	**2.7**	**0.4**	**1.8**	**2.9**	**2.1**	**2.2**	**2.7**	**n/a**	**n/a**

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] CRD 4 basis from 2012 onwards

Ratios - Credit Mutuel Group

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Funding/Liquidity									
Gross loans % Total deposits	166.4%	159.0%	145.3%	142.8%	137.3%	130.5%	n/a	n/a	n/a
Total deposits % Total funds	43.3%	46.0%	53.5%	55.9%	58.4%	60.6%	n/a	n/a	n/a
Wholesale funds % Total funds	56.7%	54.0%	46.5%	44.1%	41.6%	39.4%	n/a	n/a	n/a
Asset Mix, Quality and Growth									
Gross loans % Funded assets	53.1%	55.5%	57.5%	58.3%	59.2%	56.8%	n/a	n/a	n/a
Impaired loans % Gross loans	2.2%	2.9%	4.0%	4.1%	3.9%	4.0%	n/a	n/a	n/a
Loan loss reserves % Impaired loans	65.7%	69.1%	62.2%	64.6%	66.1%	64.4%	n/a	n/a	n/a
Gross loan growth (%)	28.0%	8.9%	4.3%	3.9%	4.1%	2.3%	n/a	n/a	n/a
Impaired loan growth (%)	-3.8%	43.6%	47.7%	5.6%	-2.1%	4.5%	n/a	n/a	n/a
Funded assets growth (%)	14.0%	4.3%	0.6%	2.6%	2.3%	6.8%	n/a	n/a	n/a
Earnings									
Net interest income % Revenues	25.3%	44.3%	54.2%	55.3%	55.0%	44.1%			
Fees & commissions % Revenues	25.4%	29.2%	24.5%	24.3%	23.8%	22.8%			
Trading income % Revenues	25.9%	1.1%	3.9%	1.5%	-1.2%	8.1%			
Other income % Revenues	23.4%	25.4%	17.4%	19.0%	22.4%	25.0%			
Net interest margin (%)	0.6%	0.8%	1.5%	1.6%	1.5%	1.2%			
Pre-provision Income % Risk-weighted assets (RWAs)	2.4%	1.1%	2.5%	2.8%	2.4%	2.5%	n/a	n/a	n/a
Loan loss provision charges % Pre-provision income	5.2%	83.1%	45.8%	27.9%	35.4%	25.7%	n/a	n/a	n/a
Loan loss provision charges % Gross loans (cost of risk)	0.1%	0.6%	0.8%	0.5%	0.5%	0.3%	n/a	n/a	n/a
Cost income ratio (%)	61.3%	74.2%	61.3%	60.5%	64.0%	66.9%	n/a	n/a	n/a
Net Interest Income / Loan loss charges (x)	12.5	2.1	3.1	5.0	4.3	5.2			
Return on average equity (ROAE) (%)	10.8%	1.7%	6.7%	9.4%	6.5%	6.1%	n/a	n/a	n/a
Return on average funded assets (%)	0.3%	0.1%	0.2%	0.3%	0.2%	0.2%	n/a	n/a	n/a
Retained earnings % Prior year's book equity	11.4%	1.7%	7.4%	9.8%	6.6%	6.4%	n/a	n/a	n/a
Pre-tax return on common equity tier 1 capital	4.7%	-0.2%	3.5%	4.6%	4.5%	5.2%	n/a	n/a	n/a
Capital and Risk Protection [1]									
Common equity tier 1 ratio (common equity tier 1 capital % RWAs)	14.0%	10.5%	11.7%	12.1%	12.0%	12.0%	14.2%	n/a	n/a
Tier 1 leverage ratio (%)	4.4%	3.6%	4.7%	4.7%	4.6%	4.3%	5.6%		
Median of tier 1 leverage ratio and common equity tier 1 ratio (%)	9.2%	7.0%	8.2%	8.4%	8.3%	8.2%	9.9%		
Total loss coverage (CET 1 capital + loan loss provisions) % RWAs	16.4%	13.5%	15.6%	16.5%	16.3%	17.9%	n/a	n/a	n/a
Non-senior bailinable debt cushion (as % of total liabilities)	1.2%	1.5%	1.3%	1.5%	1.3%	1.1%	n/a	n/a	n/a
Asset risk intensity (RWAs % total assets)	31.4%	34.7%	36.6%	34.7%	34.8%	30.0%	n/a	n/a	n/a

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] CRD 4 basis from 2012 onwards

METHODOLOGIES USED FOR THIS REPORT

For the rating and analysis contents of this report, Scope has used the following methodologies which were published on www.scoperatings.com:

"Bank Rating Methodology" (February 2014)

"Forecasting Bank Financials Methodology" (February 2014)

Forecasting bank financials: Forward-looking estimates are an important analytical tool underpinning Scope's bank ratings. These forecasts cover the current financial year (before final year-end figures are published by the bank) plus the forthcoming two years. Depending on the complexity of the bank being assessed, different forecasting tools will be used. For a majority of banks operating primarily commercial and retail banking franchises (loans and deposits) the analysis is underpinned by an **accounting** forecast of the balance sheet and profit and loss account. For more complex groups with multiple ranges of activities – notably those with material wholesale and investment banking operations – Scope uses an **analytical** forecast, relying on the bank's business-line reporting to come up with plausible estimates. For all banks Scope also includes a **regulatory metrics** forecast, considering the growing importance of this aspect in bank analysis.

For complex banks, divisional data is used to forecast profit and loss accounts and basic divisional balance sheet metrics. For less complex banks, a line-by-line forecasting of major P&L elements is forecast.

For balance sheet forecasts, Scope estimates of all major balance sheet lines, using the P&L estimates to complete the forecast of the capital/shareholders' equity line. This comprehensive methodology for estimating the balance sheet is used for all the banks in our universe, irrespective of size and complexity.

Lastly, our forecasts include assessments of the major regulatory metrics: Tier 1 and CET 1 (historically CT1), Leverage, Liquidity Coverage Ratio, and Net Stable Funding Ratio (the latter two when and if sufficient public information to compute them is available).

Scope will not aim to forecast financials when it considers the public disclosure of the bank as insufficient for a transparent and credible outcome.

All Scope's bank financial forecasts are based on public information. For its forecasts Scope will not use any non-public information or data, even if such information or data were provided by rated banks. Scope's forecasting process is transparent, with a detailed roadmap provided in its *"Forecasting bank financials"* methodology.

Barclays Bank plc
Issuer Rating Report

A STABLE OUTLOOK
Financial Institutions

Overview

Barclays Bank plc's Issuer Credit-Strength Rating (ICSR) of A is driven by its business model, with inherently volatile investment banking activities being offset to some extent by more stable retail and business banking activities primarily in the UK. While progress has been made, management still needs to execute on capital, leverage and financial targets as well as repair reputational damage. If successful, Barclays will be better positioned to generate more sustainable earnings.

The A rating also applies to senior unsecured debt issued by Barclays's parent, Barclays plc. However, the rating is not applicable to unguaranteed debt issued by subsidiaries of Barclays Bank plc.

Ratings (assigned on April 2, 2014)

Issuer Credit-Strength Rating	**A**
Outlook	Stable
Senior Unsecured Debt	A

Unsolicited ratings with issuer participation.

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Rating drivers (Summary)

The rating drivers, in decreasing order of importance in the rating assignment, are:

- (−) Inherently volatile investment banking activities account for nearly half of earnings.
- (+) Strong earnings from retail banking in the UK and the global card business lend stability.
- (+) Solid liquidity risk management.
- (+) Strategic focus on meeting leverage and capital requirements.
- (−) Reputational and conduct issues continue to hamper performance.

Rating change drivers

Increased profitability from non-investment banking activities would add further stability to Barclays' earnings and credit profile. Management is targeting a group return on equity (ROE) in excess of cost of equity in 2016. This will be achieved by improving returns in businesses such as Wealth & Investment Management and Africa Retail and Business Banking as well as restructuring the loss-making European Retail and Business Banking. Within Europe Retail and Business Banking, GBP 9.0bn of low-performing legacy RWA is being run-off (about half of these are in Italy and one-third in Spain).

Meeting and sustaining leverage and capital targets. Last June, the UK's Prudential Regulatory Authority (PRA) introduced a 7% PRA stressed CET1 ratio target to be met by year-end 2013 and a minimum 3% leverage ratio target to be met by June 2014. Compared with international standards, these are accelerated timelines. At year-end 2013, Barclays had largely met these targets. However, in light of evolving requirements, Barclays has announced that it is aiming for a CRD 4 3.5% to 4.0% leverage ratio from year-end 2015. Barclays also confirmed that it was on track to achieve its target of a 10.5% CET1 ratio in 2015. With further capital buffer requirements coming into effect and management's desire to maintain a buffer of up to 1.5%, Barclays is targeting a CET1 ratio in 2019 of 11.5% to 12%.

Inability to address evolving regulatory changes. These include ring-fencing in the UK's 2013 Banking Reform Act, new foreign banking organization rules in the US regarding capital and leverage and various issues related to investment banking activities such as central clearing and the review of trading books.

Further and substantial conduct costs. Barclays faces ongoing investigations regarding capital raisings in 2008, LIBOR, other benchmarks and foreign exchange rates as well as power trading activities in the US between 2006 and 2008. We note that investigations are becoming broader in scope and penalties higher.

Material deterioration in liquidity profile. During 2013, Barclays reduced its liquidity pool to GBP 127bn, from GBP 150bn at year-end 2012. This was done to reduce balance sheet leverage as well as to optimize the size of the liquidity pool. At year-end 2013, the liquidity pool remained in excess of internal and regulatory requirements and management has stated that there are no plans to further reduce the liquidity pool materially. However, as Barclays' business model remains sensitive to market confidence, we would view negatively a material deterioration in the Group's liquidity profile.

Recent events

2013 results

For 2013, adjusted attributable profit was GBP 2.4bn, down from GBP 4.6bn in the prior year. The decline was driven by GBP 1.2bn in restructuring costs and lower fixed income, currency and commodities (FICC) income within the Investment Bank. According to management, the 17% decline in FICC income was in line with the median for European peers. The adjusted profit figure does not include GBP 2bn in provisions for PPI and interest rate hedging products redress, goodwill impairments and own credit charges. On a statutory basis, profit was GBP 540m compared to a loss of GBP 624m in the prior year.

Rating drivers (Details)

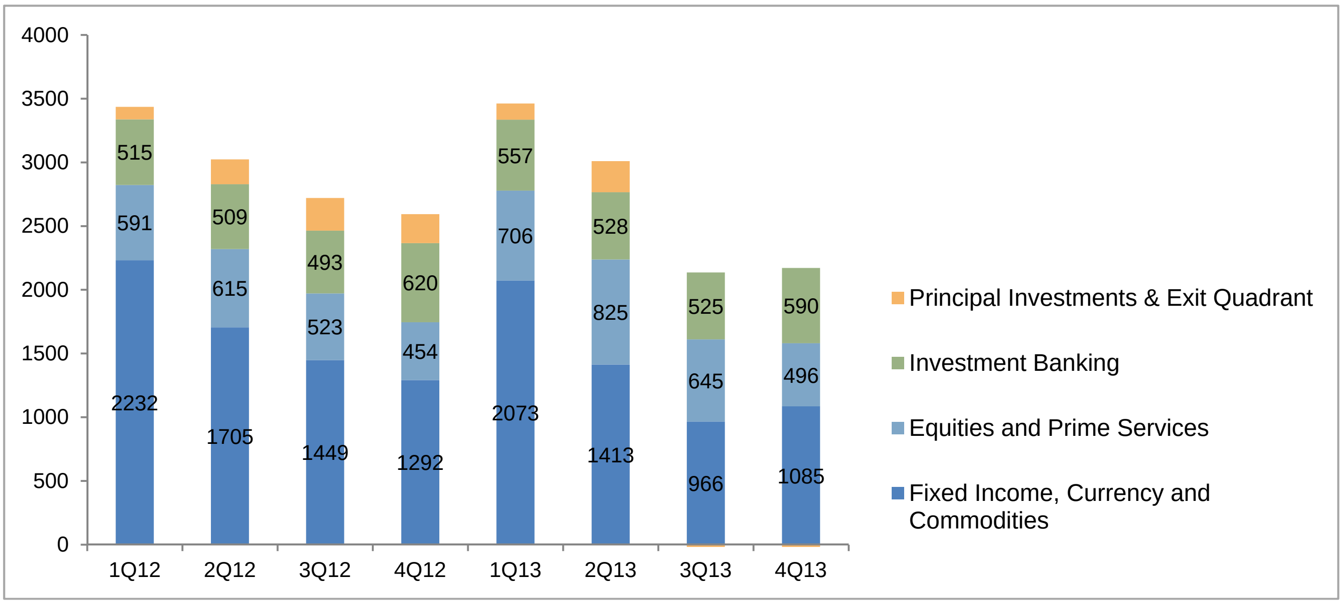
1. Inherently volatile investment banking activities account for nearly half of earnings

In September 2008, Barclays acquired the North American operations of Lehman for GBP 1bn, significantly changing its business profile. Prior to the acquisition, investment banking activities had accounted for about one-third of Barclays' earnings. Now, the Investment Bank is the largest business within Barclays, contributing near half of total earnings. As stated in its February 2013 strategic review, the "Investment Bank will remain a large and very important part of the Group going forward."

With the new regulatory environment and the retrenchment of competitors, the Investment Bank is one of the few global players with a particular strength in FICC and leading positions in the two largest investment banking markets, North America and the UK. Barclays maintains that the business aims to minimize earnings volatility, with performance in down markets expected to be better than its peers.

In 2013, the Investment Bank generated GBP 2.5bn in profit before tax, accounting for nearly half of total Group profit. Within the Investment Bank, FICC activities account for just over half of total revenues. Barclays, however, continues to invest in its equity business and is aiming to increase the contribution of revenues from equities and investment banking. Barclays has identified GBP 79bn of legacy RWA within the Investment Bank and aims to reduce this to GBP 36bn by 2015 (2013: GBP 42bn). The largest remaining component is a GBP 19bn portfolio of interest rate derivatives.

Chart 1: Investment Bank income by business line (GBP m)



Source: Company data, Scope Ratings

Barclays faces continued investor concerns about the size of the Investment Bank and its profitability in light of increased capital requirements. In 2013, the Investment Bank reported a ROE of 8.2% compared to management's target of 11-12% in 2015. For Barclays as a whole, management has committed to generating a ROE above the cost of equity (currently defined as 11.5%) in 2016.

2. Strong earnings from retail banking in the UK and the global card business lend stability

Positively, retail and business banking activities and in particular, UK Retail and Business Banking (UK RBB) and global cards (Barclaycard), help to stabilize Group earnings. The UK RBB division benefits from a leading franchise in its home market, the UK. There is a focus on the mass affluent and business clients as well as providing a differentiated customer experience through digital channels. Barclays holds about a 10% share of the UK mortgage market. Barclaycard is the 8th largest consumer payments company globally and ranks in the top three in all markets except the US where it is in the top ten.

In 2013, the returns on equity for the UK RBB and Barclaycard businesses were 4.9% and 8.3%, respectively. On an adjusted basis which excludes provisions for PPI redress, the respective ROEs were much higher at 11.5% and 18.4%.

Table 1: 2013 earnings by business division

	Total Income (GBP m)	Profit before Tax (GBP m)	ROAE (%)
UK Retail and Business Banking	4,523	1,195	11.5
Europe Retail and Business Banking	666	-996	-45.2
Africa Retail and Business Banking	2,617	404	0.4
Barclaycard	4,786	1,507	18.4
Investment Bank	10,733	2,523	8.2
Corporate Banking	3,115	801	3.1
Wealth & Investment Mgt	1,839	-19	-1.0
Head Office	-124	-248	
Group	**28,155**	**5,167**	**4.5**

Note: Income is net of insurance claims. Profit and ROAE figures are on an adjusted basis which excludes GBP 2bn of PPI and interest rate hedging costs in the UK Retail and Business Banking, Barclaycard and Corporate Banking divisions, GBP 0.8bn of goodwill impairment in the Wealth & Investment Mgt. division and GBP 0.2bn of own credit charges. Source: Company data, Scope Ratings

3. Solid liquidity risk management

Recognizing the need for a solid funding structure, Barclays aims to align the sources and uses of funding. Retail and commercial loans are largely funded by customer deposits while other assets together with other loans are funded by long term wholesale debt and equity.

Barclays has increased customer deposits and reduced reliance on wholesale unsecured funding. In 2013, the reported loan to deposit ratio was 101%, down from 118% in 2011. At year-end 2013, Group wholesale funding amounted to GBP 186bn (2011: 265bn), with GBP 82bn (2011: GBP 130bn) maturing in less than one year. The average maturity of wholesale funding, net of the liquidity pool, was at least 69 months (2011: 58 months). The use of short-term wholesale funding appears relatively high but has been declining and this is offset to some extent by the large liquidity pool. Barclays states that the liquidity pool is sufficient to fund the business for an estimated 42 months with no access to wholesale markets.

The liquidity pool is managed on a centralized basis and is available to meet liquidity needs across the Group. At year-end 2013, the liquidity pool stood at GBP 127bn, with GBP 43bn in cash and deposits with central banks. An additional GBP 62bn is held in government bonds, of which over 85% are comprised of UK, US, Japanese, French, German, Danish, Swiss and Dutch securities. At year-end 2013, Barclays estimated its Liquidity Coverage Ratio to be 102% (2012: 126%) and its Net Stable Funding Ratio to be 110% (2012: 112%).

Table 2: Barclays 2013 funding structure (GBP bn)

Assets		Liabilities	
Customer loans and advances	430	Customer deposits	428
Trading portfolio assets	63	Repos	196
Reverse repos	133		
Reverse repos	53	Trading portfolio liabilities	53
Derivative financial instruments	323	Derivative financial instruments	319
Liquidity pool	127	< 1 year wholesale debt	82
Other assets	119	> 1 year wholesale debt and equity	164

Note: Other assets include available for sale investments, trading portfolio assets, financial assets designated at fair value and loans and advances to banks. Source: Company data, Scope Ratings

4. Strategic focus on meeting leverage and capital requirements

Barclays navigated through the financial crisis with less difficulty than some other UK and global peers. The Group continued to generate earnings and took measures to strengthen its liquidity and capital position, avoiding direct aid from the UK government. Throughout the second half of 2008, Barclays raised over GBP 12bn in capital, including approximately GBP 700m to purchase Lehman. Further, in 2009, Barclays sold its asset management business (Barclays Global Investors) to Blackrock for USD 13.5bn, realizing a gain of GBP 6.3bn.

Under the new management team, Barclays decided to address the PRA's leverage and capital requirements quickly as investor concerns about capital had materially impacted the Group's valuation. Last July, Barclays announced a plan to meet the PRA's 3% leverage ratio target by June 2014 and has largely done so at year-end 2013. From June to December 2013, Barclays' PRA leverage ratio increased from 2.18% to 2.97%. Actions taken to achieve the target included a GBP 5.8bn rights issue in October 2013, the issuance of GBP 2.1bn of Additional Tier 1 securities and reducing the balance sheet by GBP 140bn, excluding forex impacts. The PRA's leverage ratio is calculated on the fully loaded CRD 4 Tier 1 capital base adjusted for certain PRA defined deductions and a PRA adjusted CRD 4 leverage exposure figure.

On a fully-loaded CRD 4 basis, Barclays' leverage ratio was 3.1% at year-end 2013. This is based on an estimated leverage exposure of GBP 1,377bn (June 30, 2013: GBP 1,559bn). Within this, major exposures include GBP 320bn for derivatives, GBP 92bn for securities financing transactions and GBP 179bn for undrawn commitments. The Group continues to refine its risk capital allocation framework – with risk weighted measures being supplemented by a "leverage lens." The 3.1% figure does not take into consideration the Basel Committee's final rules for calculating the Basel 3 leverage ratio published on January 12, 2014. Based on an initial analysis, Barclays estimates that these changes would decrease the CRD 4 leverage ratio by approximately 20bps.

Barclays has recently provided details on its capital plans which incorporate the progressive implementation of CRD 4 requirements. For 2015, the Group expects its Basel 3 fully loaded CET1 ratio to reach 10.5% and RWAs to be at GBP 440bn. At year-end 2013, these were 9.3% and GBP 436bn, respectively. Management has also stated that it will not increase its dividend payout ratio target from 40% until capital targets have been achieved. In 2019, Barclays estimates that its CET1 ratio will be in the range of 11.5% to 12%, which includes a 2.5% capital conservation buffer, a 2% G-SIFI buffer, a Pillar 2A buffer of 1.4% and a management buffer of up to 1.5%. With regard to leverage, Barclays is now aiming for a 3.5% to 4% fully loaded CRD 4 leverage ratio from year-end 2015.

5. Reputational and conduct issues continue to hamper performance

2012 was a particularly difficult year for Barclays in regards to conduct issues. Barclays made a GBP 290m settlement relating to the manipulation of LIBOR rates and added GBP 2.5bn in provisions for PPI and interest rate hedging products. In August 2012, Antony Jenkins, the previous head of retail and business banking was appointed as CEO, replacing the previous CEO who came from the investment banking business. With this change, we sense that the Group is aiming for a more balanced business profile, with all businesses garnering management attention.

In the fall of 2012, the new CEO announced the Transform program, which involves turnaround, the return of acceptable numbers and sustaining forward momentum, with balance sheet optimization and costs being key focus areas. In addition, there are efforts to run Barclays the "right way" with the "right culture." These institutional and cultural changes are likely to take time to become embedded. With its 2013 results announcement, Barclays published for the first time its "Balanced Scorecard" which includes six metrics to measure performance in the areas of customers and clients, colleagues, citizenship and conduct as well as two metrics for returns and capital.

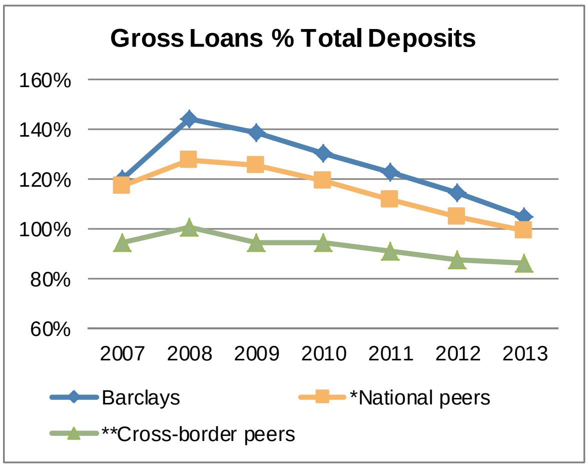
Peer comparison

Within the UK, Barclays is among the top four players that dominate the market. However, the Group cannot be easily compared with the other UK banks due to its more investment banking driven business model. Lloyds and RBS are primarily UK-focused retail and commercial banks and continue to be partly owned by the UK government. In comparison to HSBC, Barclays' has more significant investment banking activities but also operates in different markets geographically. Barclays does not have the same exposure to emerging markets as HSBC – Barclays is active in Africa while HSBC is active in Asia as well as Latin America.

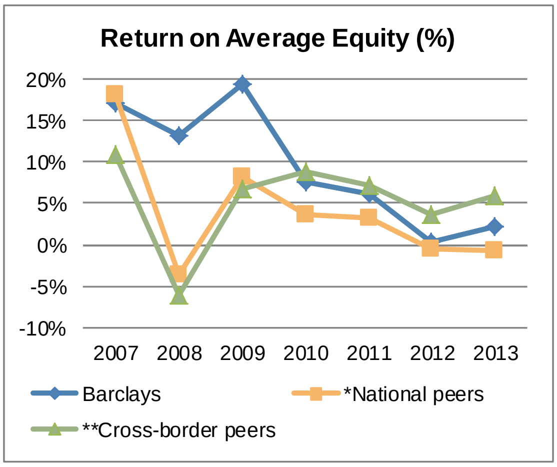
At Scope Ratings, we compare banks within peer groups and Barclays has been included in the peer group of large universal banks. This peer group includes HSBC, BNP Paribas, Societe Generale, Deutsche Bank, UBS and Credit Suisse as well as Citigroup, Bank of America and JP Morgan in the United States.

As shown on the following page, Barclay's profitability and capital position are below the average for cross-border peers. Earnings have been negatively impacted by legacy assets as well as by conduct issues. Moreover, both the proportion of operating income derived from trading income and the cost-income ratio are higher than average due to the size of the Investment Bank within the Group. Unsurprisingly, Barclays is taking measures to address these relative weaknesses. In order to improve earnings, Barclays is managing costs and focusing investment on more stable businesses. For example, within Africa Retail and Business Banking, Barclays is integrating its businesses across 12 African countries with a home market in South Africa. Within Europe Retail and Business Banking, Barclays is restructuring, managing risks and reducing costs to return the business to profitability in 2015. And urged by the PRA, Barclays is bolstering its capital and balance sheet leverage. In addition, under the new Federal Reserve rules for foreign banks, Barclays will need to meet enhanced capital and leverage requirements for its operations in the US.

Peer Comparison - Barclays plc



Source: SNL Financial, Scope Ratings



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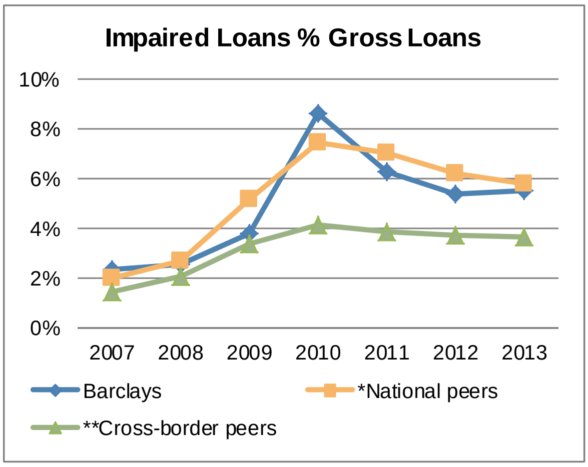

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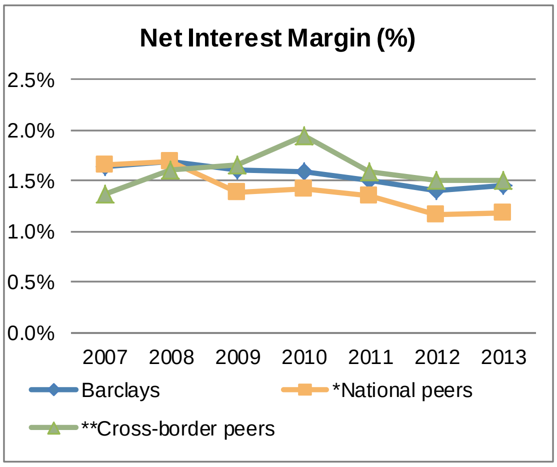

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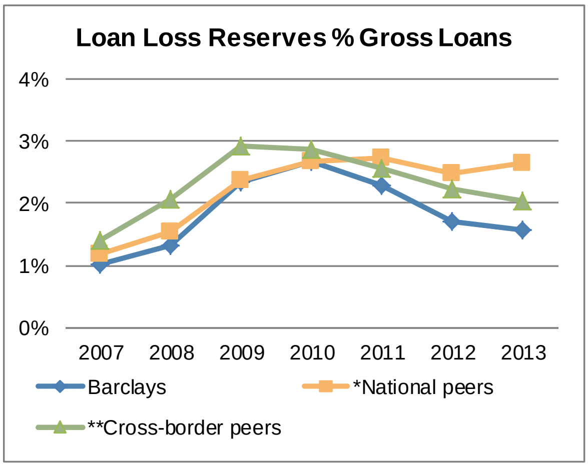

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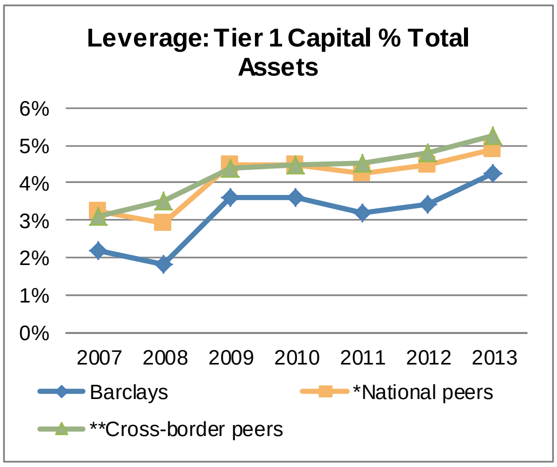

Source: SNL Financial, Scope Ratings

*National peers: Barclays, HSBC, Lloyds, RBS

**Cross-border peers: Bank of America Corp, Barclays, BNP Paribas, Citigroup Inc, Credit Suisse, Deutsche Bank, HSBC, JP Morgan Chase, Societe Generale, UBS

Selected Financial Information - Barclays plc

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Balance Sheet summary (GBP billion)									
Assets									
Cash and balances with central banks	5.8	30.0	81.5	97.6	106.9	86.2	45.7	55.3	63.8
Interbank assets	42.0	49.4	42.7	40.2	49.8	43.0	39.6	37.6	36.9
Total securities	451.2	404.3	367.2	455.3	386.7	418.8	428.6	411.2	401.8
of which debt instruments	403.6	355.0	323.8	406.6	348.5	380.5	368.8	350.4	339.9
of which equity instruments	43.4	39.2	32.5	36.8	33.8	34.0	54.9	56.0	57.2
Derivatives	248.1	984.8	416.8	420.3	539.0	469.2	324.3	321.6	321.7
Gross customer loans	374.4	501.5	459.5	466.2	465.3	455.1	457.5	466.5	475.7
of which impaired loans	8.8	12.7	17.2	40.0	29.5	24.5	25.2	25.2	23.9
Total funded assets	979.1	1,084.9	975.5	1,084.1	1,034.2	1,025.6	991.6	990.9	998.1
Total Assets	**1,227.4**	**2,053.0**	**1,378.9**	**1,489.6**	**1,562.1**	**1,488.3**	**1,312.3**	**1,308.8**	**1,316.2**
Liabilities									
Interbank liabilities	92.3	116.5	77.9	79.3	92.1	78.6	56.2	50.6	48.0
Senior debt	393.0	437.5	451.6	523.7	438.7	431.3	373.1	354.5	336.7
Derivatives	248.3	968.1	403.4	405.5	527.9	462.7	320.6	318.0	318.1
Customer deposits	312.3	346.0	328.7	356.0	376.8	396.8	436.0	457.8	480.7
Subordinated debt + hybrid securities	18.2	29.8	25.8	28.5	24.9	24.0	21.7	21.7	22.8
Total Liabilities	**1,194.9**	**2,005.6**	**1,320.5**	**1,427.4**	**1,498.1**	**1,428.3**	**1,248.3**	**1,243.3**	**1,247.1**
Ordinary equity	23.3	33.0	47.3	50.9	54.4	50.6	53.3	55.0	58.4
Minority interests	9.2	10.8	11.2	11.4	9.6	9.4	8.6	8.6	8.6
Total Liabilities and Equity	**1,227.4**	**2,053.0**	**1,378.9**	**1,489.6**	**1,562.1**	**1,488.3**	**1,312.3**	**1,308.8**	**1,316.2**
Core Tier 1 Capital [1]	*16.7*	*24.4*	*38.4*	*42.9*	*43.1*	*38.4*	*40.4*	*42.0*	*43.9*
Income Statement summary (GBP billion)									
Net interest income	9.6	11.5	11.9	12.5	12.2	11.7	11.6		
Net fee & commission income	7.7	6.5	8.4	8.9	8.6	8.5	8.7		
Net trading income	4.9	1.8	7.1	9.4	9.8	4.1	7.2		
Operating Income	**23.0**	**21.2**	**29.2**	**31.5**	**31.2**	**24.9**	**27.9**	**28.9**	**29.8**
Operating expenses	13.5	13.4	16.7	19.6	20.3	21.0	20.5	20.8	20.7
Loan loss provision charges	2.8	5.4	8.1	5.7	5.6	3.3	3.1	3.1	3.0
Non-recurring items	0.3	3.5	7.0	0.2	1.0	0.3	-1.2	0.0	0.0
Pre-Tax Profit	**7.1**	**5.7**	**11.4**	**6.1**	**5.8**	**0.8**	**2.9**	**5.0**	**6.1**
Income tax	2.0	0.5	1.1	1.5	1.9	0.6	1.6	1.5	1.8
Net profit attributable to minority interests	0.7	0.9	0.9	1.0	0.9	0.8	0.8	1.3	1.6
Net Income Attributable to Parent	**4.4**	**4.4**	**9.4**	**3.6**	**2.9**	**-0.6**	**0.5**	**2.2**	**2.6**

Source: SNL Financial and Scope Ratings estimates. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] CRD 4 basis from 2012 onwards

Ratios - Barclays plc

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Funding/Liquidity									
Gross loans % Total deposits	119.9%	144.9%	139.8%	130.9%	123.5%	114.7%	104.9%	101.9%	99.0%
Total deposits % Total funds	38.3%	37.1%	37.2%	36.1%	40.4%	42.6%	49.0%	51.6%	54.0%
Wholesale funds % Total funds	61.7%	62.9%	62.8%	63.9%	59.6%	57.4%	51.0%	48.4%	46.0%
Asset Mix, Quality and Growth									
Gross loans % Funded assets	38.2%	46.2%	47.1%	43.0%	45.0%	44.4%	46.1%	47.1%	47.7%
Impaired loans % Gross loans	2.4%	2.5%	3.7%	8.6%	6.3%	5.4%	5.5%	5.4%	5.0%
Loan loss reserves % Impaired loans	32.7%	51.4%	62.5%	31.0%	35.8%	31.9%	28.8%	28.8%	30.4%
Gross loan growth (%)	24.5%	33.9%	-8.4%	1.5%	-0.2%	-2.2%	0.5%	5.3%	5.2%
Impaired loan growth (%)	104.7%	43.6%	35.2%	133.0%	-26.3%	-17.0%	2.8%	0.0%	-5.0%
Funded assets growth (%)	14.4%	10.8%	-10.1%	11.1%	-4.6%	-0.8%	-3.3%	-0.1%	0.7%
Earnings									
Net interest income % Revenues	41.7%	54.1%	40.9%	39.8%	39.1%	46.8%	41.6%		
Fees & commissions % Revenues	33.5%	30.6%	28.9%	28.2%	27.6%	34.3%	31.3%		
Trading income % Revenues	21.5%	8.6%	24.2%	30.0%	31.5%	16.7%	25.9%		
Other income % Revenues	3.4%	6.6%	6.1%	2.1%	1.8%	2.2%	1.2%		
Net interest margin (%)	1.2%	1.3%	1.3%	1.3%	1.2%	1.2%	1.2%		
Pre-provision Income % Risk-weighted assets (RWAs)	2.7%	1.8%	3.3%	3.0%	2.8%	1.0%	2.1%	1.9%	2.1%
Loan loss provision charges % Pre-provision income	29.1%	69.5%	64.7%	47.7%	51.2%	85.7%	41.6%	38.3%	33.3%
Loan loss provision charges % Gross loans (cost of risk)	0.8%	1.3%	1.7%	1.3%	1.2%	0.7%	0.7%	0.7%	0.7%
Cost income ratio (%)	58.4%	63.2%	57.2%	62.2%	64.9%	84.3%	73.6%	72.0%	69.5%
Net Interest Income / Loan loss charges (x)	3.4	2.1	1.5	2.2	2.2	3.5	3.8		
Return on average equity (ROAE) (%)	20.5%	15.6%	23.4%	7.3%	5.6%	-1.2%	1.0%	4.0%	4.7%
Return on average funded assets (%)	0.3%	0.3%	0.6%	0.2%	0.2%	0.0%	0.0%	0.1%	0.2%
Retained earnings % Prior year's book equity	10.5%	18.3%	26.9%	6.1%	4.3%	-2.7%	n/a	3.1%	3.4%
Pre-tax return on common equity tier 1 capital	42.3%	23.6%	29.6%	14.2%	13.4%	2.1%	7.1%	11.8%	13.8%
Capital and Risk Protection [1]									
Common equity tier 1 ratio (common equity tier 1 capital % RWAs)	4.7%	5.6%	10.0%	10.8%	11.0%	8.2%	9.3%	9.7%	10.0%
Tier 1 leverage ratio (%)	2.2%	1.8%	3.6%	3.6%	3.2%	3.4%	4.3%		
Median of tier 1 leverage ratio and common equity tier 1 ratio (%)	3.5%	3.7%	6.8%	7.2%	7.1%	5.8%	6.8%		
Total loss coverage (CET 1 capital + loan loss provisions) % RWAs	5.8%	7.6%	13.7%	14.5%	13.7%	11.9%	13.4%	11.3%	11.7%
Non-senior bailinable debt cushion (as % of total liabilities)	1.5%	1.7%	2.0%	2.0%	1.7%	1.7%	1.9%	1.9%	2.0%
Asset risk intensity (RWAs % total assets)	28.8%	21.1%	27.8%	26.7%	25.0%	26.0%	27.0%	33.2%	33.2%

Source: SNL Financial and Scope Ratings estimates. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] CRD 4 basis from 2012 onwards

METHODOLOGIES USED FOR THIS REPORT

For the rating and analysis contents of this report Scope has used the following methodologies which were published on www.scoperatings.com:

"Bank Rating Methodology" (February 2014)

"Forecasting Bank Financials Methodology" (February 2014)

Forecasting bank financials: Forward-looking estimates are an important analytical tool underpinning Scope's bank ratings. These forecasts cover the current financial year (before final year-end figures are published by the bank) plus the forthcoming two years. Depending on the complexity of the bank being assessed, different forecasting tools will be used. For a majority of banks operating primarily commercial and retail banking franchises (loans and deposits) the analysis is underpinned by an **accounting** forecast of the balance sheet and profit and loss account. For more complex groups with multiple ranges of activities – notably those with material wholesale and investment banking operations – Scope uses an **analytical** forecast, relying on the bank's business-line reporting to come up with plausible estimates. For all banks Scope also include a **regulatory metrics** forecast, considering the growing importance of this aspect in bank analysis.

For complex banks, divisional data is used to forecast profit and loss accounts and basic divisional balance sheet metrics. For less complex banks, a line-by-line forecasting of major P&L elements is forecast.

For balance-sheet forecasts, Scope estimates of all major balance sheet lines, using the P&L estimates to complete the forecast of the capital/shareholders' equity line. This comprehensive methodology for estimating the balance sheet is used for all the banks in our universe, irrespective of size and complexity.

Lastly, our forecasts include assessments of the major regulatory metrics: Tier 1 and CET 1 (historically CT1), Leverage, Liquidity Coverage Ratio, and Net Stable Funding Ratio (the latter two when and if sufficient public information to compute them is available).

Scope will not aim to forecast financials when it considers the public disclosure of the bank as insufficient for a transparent and credible outcome.

All Scope's bank financial forecasts are based on public information. For its forecasts Scope will not use any non-public information or data, even if such information or data were provided by rated banks. Scope's forecasting process is transparent, with a detailed roadmap provided in its *"Forecasting bank financials"* methodology.

BBVA SA
Issuer Rating Report

SCOPE | A STABLE OUTLOOK | Financial Institutions

Overview

Scope Ratings assigns an Issuer Credit-Strength Rating (ICSR) of A to BBVA SA, with a stable outlook. The rating is based to a large extent on the strength and reliability of BBVA's retail and commercial banking franchises in several countries and on the strong market positioning in its main countries of operation.

The high degree of diversification has helped BBVA deliver significant profits, despite the stressed operating environment in Spain, and enabled it to generate capital organically. The bank has withstood harsh conditions, peaking with a collapse in its domestic real estate market and significant stress to funding markets and to domestic sovereign risk in 2011 and 2012. Throughout the period, the bank's capital base has kept growing.

The challenging macro environment in Spain continues to weigh negatively on the group's earnings capacity due to the continued high provisions required by a growing NPLs stock. However, the Spanish economy has started to improve, although from a very low base. The recovery, if sustained, should have a positive impact on asset quality in the coming years and help improve the sustainability of public debt, which remains a concern to us. We would underscore, however, that we do not automatically link BBVA's rating with the credit standing of the Spanish sovereign. This rating is not applicable to unguaranteed subsidiaries of the rated parent.

Ratings (assigned on April 2, 2014)

Issuer Credit-Strength Rating	**A**
Outlook	Stable
Senior Unsecured Debt	A

Unsolicited ratings with issuer participation.

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Rating drivers (Summary)

The rating drivers, in decreasing order of importance in the rating assignment, are:

- (+) Retail-focused, globally-diversified revenue and earnings streams with strong market positions in several key markets (Spain, US Sunbelt, Mexico, Argentina, Chile, Venezuela, Colombia, Peru and Turkey).
- (−) Large exposure to Spanish credit and sovereign risk remains a key factor.
- (+) Significant improvement in capital and liquidity position in recent years.
- (−) Intervention by host or home regulators could limit intragroup capital and liquidity flows across geographies at times of stress.

Rating change drivers

Turnaround in Spanish asset quality and profitability. Despite early indications of a turnaround in the macro environment in Spain, NPLs are still accumulating and profitability remains depressed. A sustained improvement in the asset quality metrics and profitability of the Spanish business would be a significant positive change driver.

Significant worsening of Mexican earnings capacity and asset quality. BBVA group's profitability currently relies on Mexico contributing 86% of total pre-tax income in 2013. Should the earnings capacity and asset quality of the Mexican business be dented, the capital generation of BBVA could be impacted.

Further deterioration in Spain's fiscal metrics. A further increase in Spanish Government debt/GDP ratio or a failure to bring the deficit under control would negatively affect the economic value of BBVA's government loans and bond portfolio.

The positive effect of the forthcoming Banking Union. We note the increased regulatory convergence across EU banking systems, especially for firms within the euro area, as a factor materially attenuating the potential impact of the home sovereign situation on BBVA's credit fundamentals. We consider that the emergence later this year of a Banking Union (BU) for the euro area, underpinned by the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM), could be a positive rating driver to the extent that it will further de-link the credit standing of BBVA from that of its home sovereign. At this time, such an outcome is not yet certain, but the current steps towards the creation of the BU are encouraging.

Recent events

2013 results

BBVA reported a net attributable profit of EUR 2.23bn in 2013, up 33% year-on-year, mainly as a result of the lower provisions for Spanish real estate compared with 2012. Total assets were about EUR 600bn, down 6% from 2012, due to a shrinking loan book in Spain and negative forex impacts in some emerging markets.

The non-performing asset ratio continued to increase (6.8% at the end of 2013), mainly because of the reclassification of refinanced assets as non-performing, as recently required by the Bank of Spain, as well as a shrinking loan book. The coverage ratio at a group level stands at about 60%. Spain remained a drag on asset quality and profitability in 2013, while Mexico contributed most of the group earnings.

Monetization of DTAs

The Royal Decree-Law 14/2013 took effect on January 1, 2014. It allows Spanish banks to convert some deferred tax assets (DTAs) generated by time differences (arising from non-deductible provisions for loans and foreclosed assets, and by employee pension payments) into tax credits.

Tax credits are valuable assets that do not depend on future profitability, and therefore will no longer be deducted under CRD4 capital rules. According to management guidance, this measure had a positive impact of around 60-70 bps on BBVA's 9.8% fully-phased Common Equity Tier 1 ratio reported at year-end 2013.

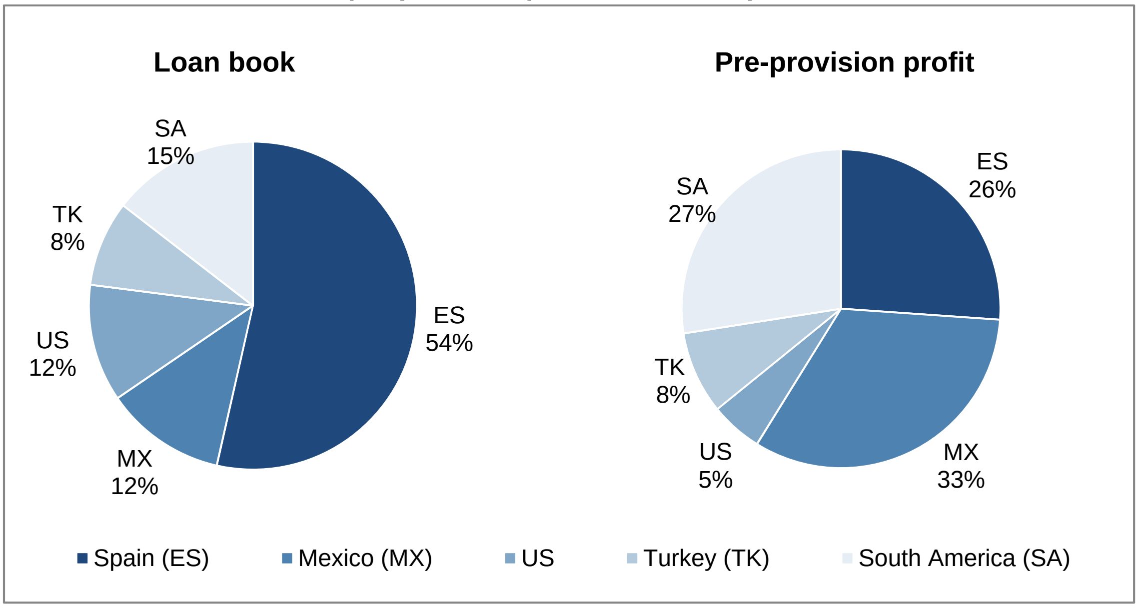
Rating drivers (Details)

1. Retail-focused, globally diversified revenue and earnings streams with strong market positions in several key markets (Spain, US Sunbelt, Mexico, Argentina, Chile, Venezuela, Colombia, Peru and Turkey).

BBVA offers predominantly retail banking services to customers in Europe, Asia and the Americas. In 2013, corporate and investment banking revenues accounted for 15% of the group's total revenues.

While the bulk of the bank's activity remains in Spain (Spanish assets still account for more than 50% of the total for the group), BBVA's emerging markets operations have helped the bank navigate the crisis that has engulfed its home country and still offer a good degree of business diversification. As shown in Chart 1, pre-provision profits from South America and Mexico accounted for 61% of the group's total.

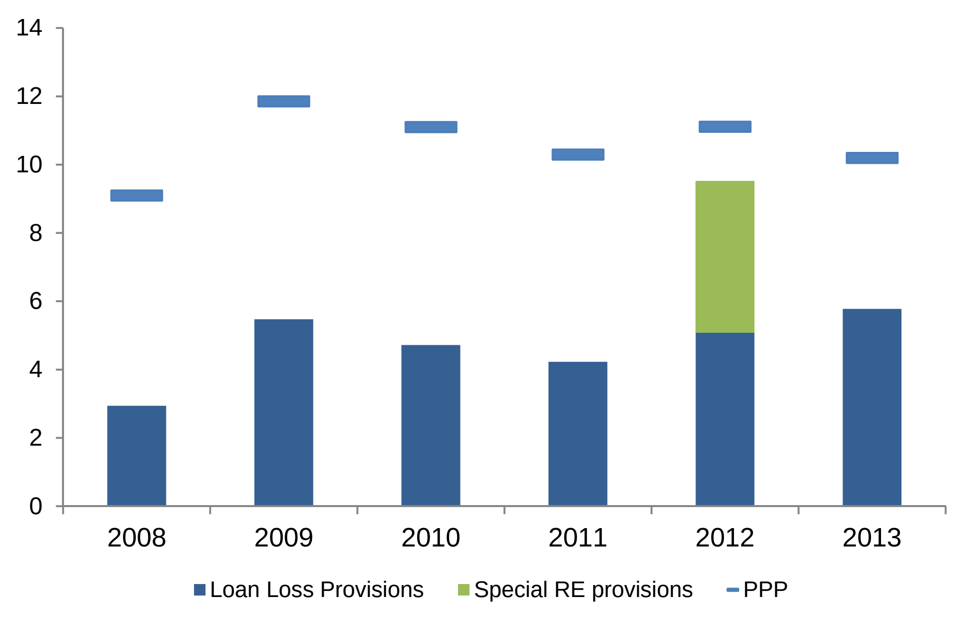
Chart 1: BBVA's loans and pre-provision profit divisional split, 2013



Source: Company data, Scope Ratings
Note: Turkey includes other loans in Europe and Asia. BBVA reports Eurasia as a single business division

During the past few years, the income stream from outside Spain has ensured that BBVA maintained a positive bottom line at a group level in most quarters. The only exception was Q4 2011, when the bank posted net losses driven by a large goodwill write-down in the US.

Chart 2: Pre-provision profit offers a first line of defense against asset quality shocks (EUR bn)



Source: Company data, Scope Ratings

2. Large exposure to Spanish credit and sovereign risk remains a key factor

Out of the group's balance sheet of approximately EUR 600bn, the Spanish segment accounts for EUR 315bn of total assets, not including an additional EUR 20bn in real estate assets, which were recently separated and put in run-off mode.

The Spanish loan book, which comprises approximately EUR 173bn of loans, mainly consists of retail mortgages and business loans. It has experienced sustained asset quality deterioration in recent years, even if we exclude the troubled real estate developer loans. If we stress the Spanish loss assumptions, we note that an increase in the Spanish loan-loss ratio to 400 bps (from 142 bps in 2013) would wipe out group profits for the entire year.

Adding to the large loan book exposure, we note that BBVA had a EUR 53bn exposure to Spanish sovereign risk as of December 2013, or 152% of EBA Core Tier 1 capital (see Table 1), including bonds (EUR 30bn) and loans (EUR 23bn) and excluding exposures in the insurance companies (EUR 11bn). This risk concentration makes BBVA capital ratios sensitive to potential losses on Spanish sovereign debt. Indeed, for every 10% loss on Spanish sovereign debt, BBVA capital ratios would decline by c. 150 bps. In other words, a 30% loss rate in the event of default (or voluntary PSI) would translate into a EUR 16bn loss and leave BBVA with a 5.9% EBA CT1 ratio. That said, such sovereign losses are not our expected scenario, but rather a simplified exercise to assess the group's vulnerability to a tail risk. Our calculations do not include the tax implication of the eventual losses or management actions that could mitigate the capital impacts of such losses in a stressed scenario. A quarter of the exposure has a maturity of less than one year, which means that BBVA could materially reduce its exposure in a relatively short time by not rolling the paper. However, we caution that in periods of real stress and market closure, a large bank can, in fact, be asked to support the bond issuance of its home sovereign.

Table 1: BBVA's exposure to sovereign risk at year-end 2013

BBVA (EUR m)		CT1 Ratio assuming haircut of			
		0%	10%	20%	30%
Spanish sovereign exposure	53,253	10.8%	9.2%	7.5%	5.9%
% of Core Tier 1 capital (EBA)	152%				
Core Tier 1 (EBA)	35,038				
RWAs	323,605				

Source: Company data, Scope Ratings

The Spanish economy is recovering and we believe that the risk of a tail event for the Spanish sovereign has receded further since the ECB effectively backstopped it in the summer of 2012. However, we still see significant weakness due to fragile public finances (government deficit/GDP of 7.2% and public debt/GDP at 94.3% in 2013 - source: European Commission) and the current account deficits accumulated during the past decade, which have left Spain with a net international investment deficit of over 90% of GDP - one of the highest in Europe.

3. Significant improvement in capital and liquidity position in recent years

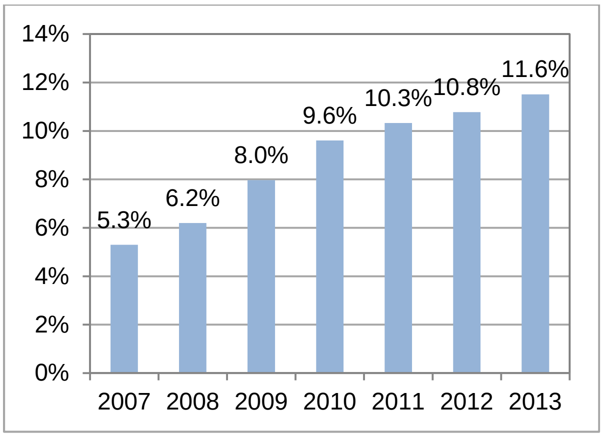
BBVA has significantly improved its capital and liquidity in recent years. On a Basel 2 basis, the group CT1 Ratio has gone from 5.3% in 2007 to 11.5% in 2013 (see Chart 3.a). The increase was driven primarily by profit generation, with limited capital raisings from asset divestments and RWA growth throughout most of the period.

On a CRD4 basis, BBVA reported a 9.8% fully loaded CET1 Ratio as of year-end 2013, including the positive impact from Royal Decree 14/2013 on deferred tax assets, as well as the partial divestment of CITIC.

Moreover, BBVA has already issued approximately EUR 2.6bn in CRD4 compliant AT1 instruments. These securities, equivalent to 0.8% of group RWAs, provide an additional protection buffer to senior bondholders.

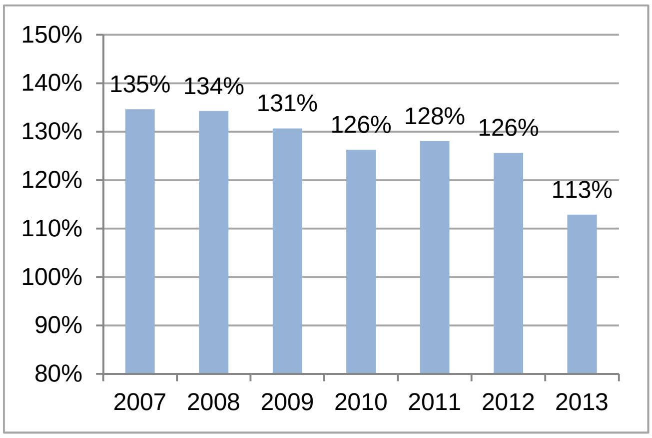
Similarly, BBVA has enhanced its funding profile. Deleveraging in Spain helped reduce the loan/deposit ratio to 113% in 2013 from 135% in 2007. Wholesale funding declined from 44% of total funds in 2007 to 35% in 2013.

Chart 3.a: BBVA Core Tier 1 Capital ratio (Basel 2) evolution - 2007-2013



Source: Company data, Scope Ratings

Chart 3.b: BBVA Gross Loan/Deposit evolution - 2007-2013



Source: Company data, Scope Ratings

While BBVA does not disclose its CRD4 net stable funding ratio and liquidity coverage ratio, the bank has stated that it is compliant with the liquidity regulatory requirements and comfortable with its position in relation to the CRD4 liquidity framework. BBVA has repaid slightly over half of the EUR 30bn in LTRO loans initially taken out (including UNNIM).

4. Intervention by host or home regulators could limit intragroup capital and liquidity flows across geographies at times of stress

The recent financial crisis has shown that, in a period of stress, intragroup capital and liquidity mobility across geographies can significantly diminish, limiting a cross-border banking group's financial flexibility just when it needs it the most. Faced with such restrictions, some banking groups may take steps ranging from the listing of a minority stake to the disposal of the entire business in order to unlock capital from a subsidiary. The extent to which cross-border banking groups have at their disposal such alternatives represents a mitigation to this risk.

Conversely, we acknowledge that BBVA's subsidiarisation limits the risk of contagion between units. Indeed, we look favorably at cross-border banking organizations that display reassuring capital and liquidity metrics not only at the group level, but also at the subsidiary level. As of December 2013, BBVA's parent company had a CET1 ratio of 12.7% (calculated according to Bank of Spain rules).

Peer comparison

At Scope Ratings, we compare banks within peer groups at domestic and cross border levels.

BBVA's national peer group mainly comprises Santander, Bankia and Caixabank, although it also includes mid-sized banks such as Sabadell, Popular and Bankinter. While Santander and BBVA pursued an international expansion with the result that Spain now represents about one-quarter and one-half of their respective loan portfolios, the rest of their peers are largely domestic lenders.

At the cross border level, we compare BBVA with large and diversified retail banks, including Unicredit, KBC, Erste Bank, RBS, ING, Nordea, Danske Bank, Commerzbank and Raiffeisen, as well as Santander. The group is heterogeneous, but it shares a predominant weight of retail in the banks' business model and exposure to several developed and emerging markets. Several of the above names fall under the definition of systemically-important financial institutions and as such are required to carry additional capital buffers (1% in the case of BBVA).

In Spain, BBVA compares favorably with peers in terms of impaired loans ratio, due to its international diversification. BBVA's asset quality is in line with international peers in 2013.

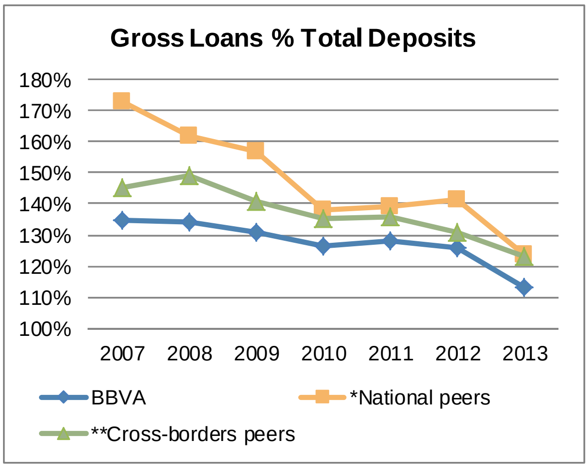
BBVA's profitability is amongst the highest in both peer groups. The difference with domestic peers is largely explained by the high provisions in Spain, which impact on group earnings is diluted in the case of BBVA. Compared with international peers, BBVA benefits from very high profitability in Mexico, which accounts for 29% of group revenues and 85% of group profits.

From a funding and liquidity perspective, BBVA has a lower loan-to-deposit ratio than both domestic and international peers.

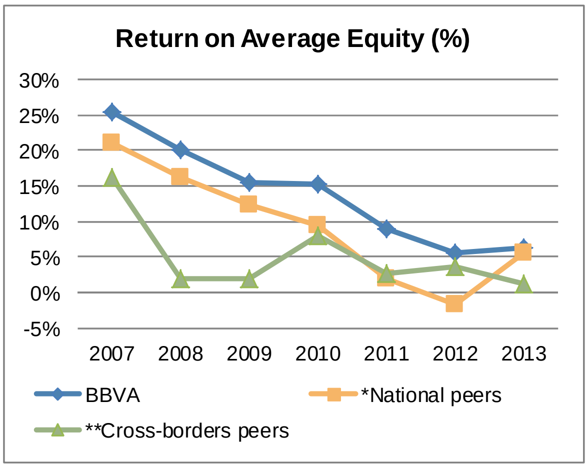
The strong and resilient group profitability has contributed to the strengthening of capital, although the Core Equity Tier 1 ratio under CRD4 (fully phased) remains below 10%, partly because of the very high risk intensity of BBVA's balance sheet (RWA/Assets of 54% in 2013). The bank leverage ratio is significantly better than those of its peers.

In time, BBVA's capital position could benefit from a convergence towards a more level playing field in Europe, especially in the area of RWA harmonization, where Spanish practices are particularly conservative.

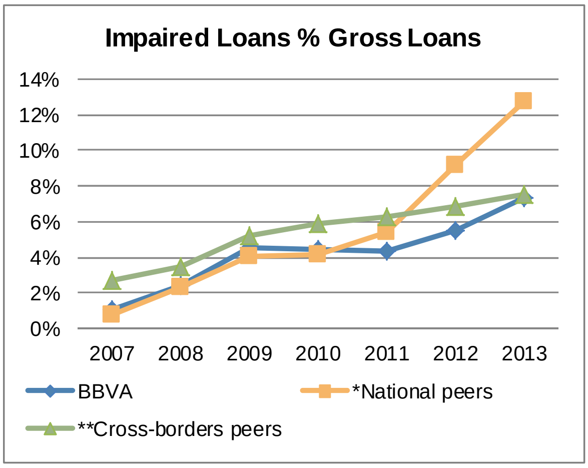
Peer Comparison - BBVA group



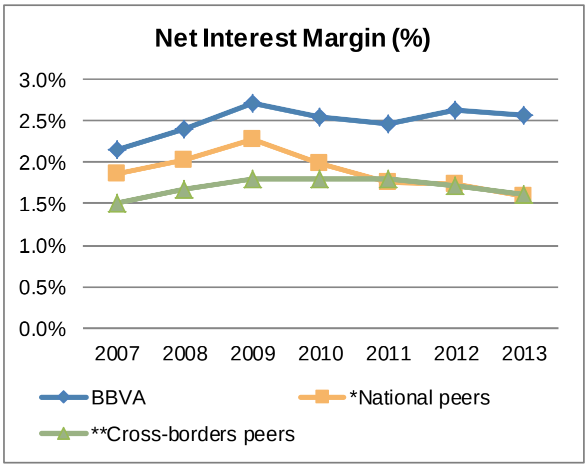
Source: SNL Financial, Scope Ratings



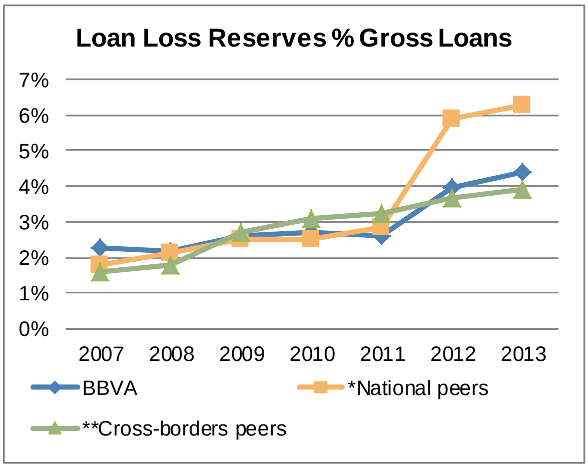
Source: SNL Financial, Scope Ratings



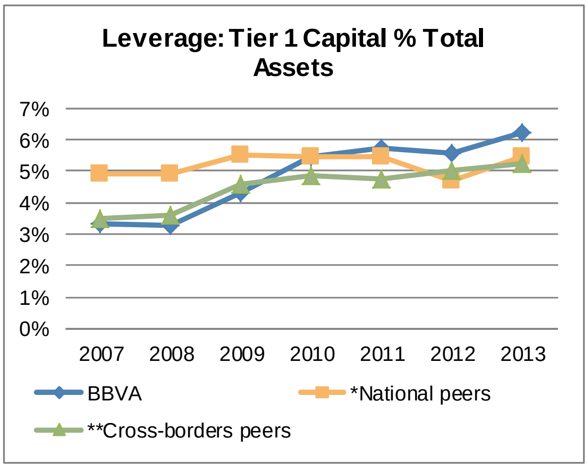
Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings

*National peers : Santander, BBVA, Caixabank, Bankia, Sabadell, Popular, Bankinter.
**Cross-border peers based on business model : Santander, BBVA, Unicredit, RBS, Erste Bank, RZB AG, Commerzbank, Nordea, KBC, Danske Bank, ING Bank.
Notes: Cross-border peer group averages exclude RZB in 2013

Selected Financial Information - BBVA group

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Balance sheet summary (EUR billion)									
Assets									
Cash and balances with central banks	22.6	14.7	16.3	20.0	30.9	37.4	37.1	28.5	22.3
Interbank assets	21.0	33.9	22.2	23.6	26.1	26.5	24.2	24.9	25.7
Total securities	109.4	87.5	112.2	101.0	98.3	119.4	122.5	124.3	126.2
of which debt instruments	81.8	72.6	98.3	88.1	88.6	110.5	113.6	115.8	118.1
of which equity instruments	21.0	15.0	13.9	12.9	9.7	9.0	9.0	8.5	8.1
Derivatives	15.8	44.8	32.9	37.3	52.1	53.8	38.0	36.1	34.3
Gross customer loans	318.0	342.7	332.2	348.3	361.3	367.7	350.1	355.8	363.9
of which impaired loans	3.2	8.4	15.2	15.4	15.6	20.3	25.8	25.6	25.1
Total funded assets	482.9	501.1	504.8	517.9	548.3	585.5	561.5	562.1	567.7
Total Assets	**502.2**	**542.6**	**535.1**	**552.7**	**597.7**	**637.8**	**599.5**	**598.2**	**602.0**
Liabilities									
Interbank liabilities	88.1	66.8	70.3	68.2	92.5	106.5	87.7	70.2	56.2
Senior debt	83.0	104.2	99.9	85.2	81.9	87.2	65.5	66.8	68.1
Derivatives	19.3	41.5	30.3	34.8	49.4	52.3	38.0	36.1	34.3
Customer deposits	236.2	255.2	254.2	275.8	282.2	292.7	310.2	324.1	339.2
Subordinated debt + hybrid securities	15.7	17.0	17.9	17.4	15.4	11.8	10.6	10.6	10.6
Total Liabilities	**474.3**	**515.9**	**504.3**	**515.3**	**557.6**	**594.0**	**554.7**	**551.3**	**552.7**
Ordinary equity	27.1	25.7	29.3	35.9	38.2	41.4	42.4	44.5	46.9
Minority interests	0.9	1.0	1.5	1.6	1.9	2.4	2.4	2.4	2.4
Total Liabilities and Equity	**502.2**	**542.6**	**535.1**	**552.7**	**597.7**	**637.8**	**599.5**	**598.2**	**602.0**
Core Tier 1 Capital [1]	*16.1*	*17.6*	*23.2*	*30.1*	*34.2*	*35.5*	*37.5*	*39.6*	*42.0*
Income Statement summary (EUR billion)									
Net interest income	9.4	11.7	13.9	13.3	13.2	15.1	14.6	14.6	15.5
Net fee & commission income	4.7	4.5	4.4	4.0	4.0	4.4	4.4	4.4	4.7
Net trading income	2.7	1.6	1.5	1.8	1.5	1.8	2.5	2.5	1.8
Operating Income	**18.2**	**19.0**	**20.7**	**20.3**	**20.0**	**21.9**	**21.4**	**22.6**	**24.0**
Operating expenses	7.8	9.9	8.8	9.2	10.2	11.4	11.8	12.1	12.8
Loan loss provision charges	1.9	2.9	5.5	4.7	4.2	8.0	5.8	5.6	5.6
Non-recurring items	0.1	0.8	-0.6	0.0	-1.9	-0.4	-0.2	0.0	0.1
Pre-Tax Profit	**8.5**	**6.9**	**5.7**	**6.3**	**3.7**	**2.1**	**3.6**	**4.9**	**5.7**
Income tax	2.1	1.5	1.1	1.3	0.2	-0.3	0.6	1.2	1.4
Net profit attributable to minority interests	0.3	0.4	0.4	0.4	0.5	0.7	0.8	0.9	1.1
Net Income Attributable to Parent	**6.1**	**5.0**	**4.2**	**4.6**	**3.0**	**1.7**	**2.2**	**2.8**	**3.2**

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] Basel 2 basis

Ratios - BBVA group

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Funding/Liquidity									
Gross loans % Total deposits	134.6%	134.3%	130.7%	126.3%	128.0%	125.6%	112.9%	109.8%	107.3%
Total deposits % Total funds	55.8%	57.6%	57.5%	61.8%	59.8%	58.7%	65.4%	68.7%	71.5%
Wholesale funds % Total funds	44.2%	42.4%	42.5%	38.2%	40.2%	41.3%	34.6%	31.3%	28.5%
Asset Mix, Quality and Growth									
Total loans % Funded assets	65.9%	68.4%	65.8%	67.2%	65.9%	62.8%	62.4%	63.3%	64.1%
Impaired loans % Gross loans	1.0%	2.4%	4.6%	4.4%	4.3%	5.5%	7.4%	7.2%	6.9%
Loan loss reserves % Impaired loans	220.2%	88.7%	57.4%	61.2%	60.1%	71.4%	59.5%	59.5%	59.5%
Gross loan growth (%)	20.9%	7.8%	-3.1%	4.8%	3.7%	1.8%	-4.8%	1.6%	2.3%
Impaired loan growth (%)	30.1%	157.8%	81.8%	1.1%	1.9%	29.7%	27.3%	-1.0%	-2.0%
Funded assets growth (%)	21.8%	3.8%	0.7%	2.6%	5.9%	6.8%	-4.1%	0.1%	1.0%
Earnings									
Net interest income % Revenues	51.8%	61.6%	67.2%	65.5%	65.7%	69.1%	68.3%	64.8%	64.6%
Fees & commissions % Revenues	26.0%	23.9%	21.4%	19.8%	20.1%	19.9%	20.7%	19.6%	19.7%
Trading income % Revenues	14.7%	8.2%	7.5%	9.0%	7.4%	8.1%	11.8%	11.2%	7.5%
Other income % Revenues	7.5%	6.4%	3.9%	5.7%	6.8%	3.0%	-0.8%	4.4%	8.2%
Net interest margin (%)	2.4%	2.6%	3.0%	2.9%	2.7%	3.0%	2.8%	2.9%	3.0%
Pre-provision Income % Risk-weighted assets (RWAs)	3.4%	3.2%	4.1%	3.5%	3.0%	3.2%	2.9%	3.2%	3.4%
Loan loss provision charges % Pre-provision income	18.4%	32.3%	46.2%	42.5%	43.2%	76.3%	60.4%	53.5%	49.6%
Loan loss provision charges % Gross loans (cost of risk)	0.7%	0.9%	1.7%	1.4%	1.2%	2.3%	1.7%	1.6%	1.6%
Cost income ratio (%)	43.1%	52.1%	42.7%	45.4%	51.2%	52.2%	55.3%	53.9%	53.2%
Net Interest Income / Loan loss charges (x)	5.0	4.0	2.5	2.8	3.1	1.9	2.5	2.6	2.8
Return on average equity (ROAE) (%)	25.2%	19.0%	15.3%	14.1%	8.1%	4.2%	5.3%	6.3%	7.0%
Return on average funded assets (%)	0.9%	0.7%	0.6%	0.6%	0.4%	0.2%	0.3%	0.3%	0.4%
Retained earnings % Prior year's book equity	16.2%	9.9%	10.0%	11.6%	5.4%	1.1%	4.0%	4.9%	5.4%
Pre-tax return on core tier 1 capital	52.7%	39.5%	24.7%	21.1%	10.8%	5.8%	9.5%	12.4%	13.6%
Capital and Risk Protection [1]									
Common equity tier 1 ratio (common equity tier 1 capital % RWAs)	5.3%	6.2%	8.0%	9.6%	10.3%	10.8%	11.6%	12.2%	12.8%
Tier 1 leverage ratio (%)	4.1%	4.1%	5.1%	6.0%	5.7%	5.6%	6.6%		
Median of tier 1 leverage ratio and core tier 1 ratio (%)	4.7%	5.2%	6.5%	7.8%	8.0%	8.2%	9.1%		
Total loss coverage (core tier 1 capital + loan loss provisions) % RWAs	7.6%	8.8%	11.0%	12.6%	13.2%	15.2%	16.2%	16.9%	17.4%
Non-senior bailinable debt cushion (as % of total liabilities)	3.3%	3.3%	3.5%	3.4%	2.8%	2.0%	1.9%		
Asset risk intensity (RWAs % total assets)	60.6%	52.2%	54.4%	56.7%	55.3%	51.6%	54.3%	54.3%	54.3%

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] Basel 2 basis

METHODOLOGIES USED FOR THIS REPORT

For the rating and analysis contents of this report, Scope has used the following methodologies which were published on www.scoperatings.com:

"Bank Rating Methodology" (February 2014)

"Forecasting Bank Financials Methodology" (February 2014)

Forecasting bank financials: Forward-looking estimates are an important analytical tool underpinning Scope's bank ratings. These forecasts cover the current financial year (before final year-end figures are published by the bank) plus the forthcoming two years. Depending on the complexity of the bank being assessed, different forecasting tools will be used. For a majority of banks operating primarily commercial and retail banking franchises (loans and deposits) the analysis is underpinned by an **accounting** forecast of the balance sheet and profit and loss account. For more complex groups with multiple ranges of activities – notably those with material wholesale and investment banking operations – Scope uses an **analytical** forecast, relying on the bank's business-line reporting to come up with plausible estimates. For all banks Scope also includes a **regulatory metrics** forecast, considering the growing importance of this aspect in bank analysis.

For complex banks, divisional data is used to forecast profit and loss accounts and basic divisional balance sheet metrics. For less complex banks, a line-by-line forecasting of major P&L elements is forecast.

For balance sheet forecasts, Scope estimates of all major balance sheet lines, using the P&L estimates to complete the forecast of the capital/shareholders' equity line. This comprehensive methodology for estimating the balance sheet is used for all the banks in our universe, irrespective of size and complexity.

Lastly, our forecasts include assessments of the major regulatory metrics: Tier 1 and CET 1 (historically CT1), Leverage, Liquidity Coverage Ratio, and Net Stable Funding Ratio (the latter two when and if sufficient public information to compute them is available).

Scope will not aim to forecast financials when it considers the public disclosure of the bank as insufficient for a transparent and credible outcome.

All Scope's bank financial forecasts are based on public information. For its forecasts Scope will not use any non-public information or data, even if such information or data were provided by rated banks. Scope's forecasting process is transparent, with a detailed roadmap provided in its *"Forecasting bank financials"* methodology.

BNP Paribas SA
Issuer Rating Report

AA- STABLE OUTLOOK
Financial Institutions

Overview

Scope Ratings assigns an Issuer Credit-Strength Rating (ICSR) of AA- to BNP Paribas S.A. (BNPP), with a stable outlook. This rating reflects the diversified franchise of BNP Paribas by business and geographically, resulting in a very stable earnings base and a high ability to absorb shocks.

The rating applies to senior unsecured debt issued by BNP Paribas S.A. However, the rating is not applicable to unguaranteed debt issued by subsidiaries of BNP Paribas S.A.

Ratings (assigned on April 2, 2014)

Issuer Credit-Strength Rating	**AA-**
Outlook	Stable
Senior Unsecured Debt	AA-

Unsolicited ratings with issuer participation.

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Rating drivers (Summary)

The ratings drivers, in decreasing order of importance in the rating assignment, are:

- (+) A well-diversified business and geographic mix, with exposure to different economies and businesses.
- (+) A proven ability to absorb shocks (low event risk).
- (+) Extensive balance sheet restructuring that has reinforced capital (BNP Paribas's Basel 3 capital position is strong).
- (+) Ongoing efforts to reduce costs and increase efficiency; BNPP constantly endeavors to optimize its organization.
- (−) Average risk-weighted asset intensity (level of group RWAs as a percentage of total assets) compared with peers, although the gap is largely due to accounting differences.

Rating change drivers

Given BNPP's strong focus on the European banking market, a large acquisition in Europe would be a rating change driver, and not necessarily negative in the long term. We note that BNPP has thrived from acquisitions in countries such as Italy or Belgium, and that the ensuing diversification process has secured the stability of earnings.

The ability of BNP Paribas to squeeze more costs out of its "Simple and Efficient" program by 2016 would be a positive rating driver. The bank has successfully reduced its cost-income ratio over the decades from 62.7% in 2001, after the BNP and Paribas merger, to a low of 60.2% in 2007. The group recently revised the BNP Paribas "Simple & Efficient" program upwards, with cumulative recurring cost savings of EUR 2.8bn by 2016 versus EUR 2bn in the initial plan. This should reduce the group's underlying cost-income ratio from

2013 levels of 66% to 63% by 2016. Assuming RWA growth of 3% per annum on full-year 2013 estimates and a cash dividend payout rising to its 45% target by 2016, supplementary post-tax earnings could thus rise by about EUR 1bn, or around 10bps of fully-phased Basel 3 CET1 ratio. The upward revision of the "Simple & Efficient" cost savings target is a tribute to the success of the program, even if the majority of the gains yet to be booked (EUR 2bn by 2016) will be invested in the business, i.e. up to EUR 1.4bn.

Only a sharp deterioration in the economic and political situation in France could significantly impact BNP Paribas's credit standing, in our opinion. Although unlikely, this merits mention considering the current poor economic environment in France. In our opinion, renewed problems in the euro area should remain manageable given the bank's ability to withstand the 2010-2012 crisis.

Recent events

On top of its Q4 results, BNP Paribas recently reported two medium-sized acquisitions, showing that the bank has achieved the financial stability necessary to allow it to grow again in its selected markets.

First, BNP Paribas announced on November 13 that it would purchase the remaining 25% stake in Fortis from the Belgian government for a consideration of EUR 3.25bn, thus bringing its total holding to 100%. Scope believes that this strategic move makes sense as it enables the bank to benefit from the entire earnings flow of the company without significantly impacting its Basel 3 CET1 ratio (-50bps impact).

A couple of weeks later, on December 5, BNPP announced it had bought 98.5% of the Polish bank Gospdarki Zywnosciowei (Bank BGZ) from Rabobank for EUR 1bn. The association of Polska with BGZ should make BNPP the seventh largest player in Poland.

BNP Paribas's Q4 2013 results were reassuringly uneventful, except for a EUR 798m provision related to the "retrospective review of US dollar payments involving parties subject to US economic sanctions". This provision was a surprise, but we note it was constituted following years of due diligence and after the bank presented the conclusion of its enquiries to the relevant authorities in the US. This case is the only major litigation risk reported by BNP Paribas, and we believe that the bank has handled it with its usual thoroughness, even if it is demonstrating its customary caution regarding the actual fine that might be imposed versus the provision.

2014-2016 Business Development Plan

On March 24, BNP Paribas presented its 2014-2016 Business Development Plan. In the course of the day, the group re-iterated the major principles underpinning its strategic vision and quantified its likely progress over the next three years. In our opinion, the three main takeaways are as follows.

- The 2014-2016 plan demonstrates the ability of BNP Paribas to encompass change while remaining consistent with its long-term strategy. The group's strategy remains that of a European-based universal bank with four domestic markets (France, Belgium, Italy, Luxembourg) complemented by businesses well diversified by product (corporate and investment bank, asset and wealth management, securities services, insurance) and geographically (US retail banking, Turkey, Asia-Pacific). Another "stable" aspect of the strategy is the relentless search to maximize cross-selling between the different divisions and geographies of the bank, making BNP Paribas one of the very few institutions to lead a successful "one bank" strategy. The most recent development in this respect is the introduction of the successful private banking platform in the US and in Turkey, or the rollout of the "One Bank for Corporates" initiative throughout Europe. At the same time, the bank is open to change and innovation. BNP Paribas is currently reshuffling its various retail networks to change the branch format and turn the banking experience into a mix of advisory and digital capabilities. At the same time, BNP Paribas has launched Hellobank!, the first 100% digital mobile bank in Europe. The initiative was launched in

2013 in Germany, Belgium, France and Italy and has attracted 177,000 clients so far. The aim is for Hellobank! to reach 1.4m clients by 2017.

- The bank is pursuing convincing growth initiatives. In the course of its history, BNP Paribas has achieved growth either through external acquisitions or organically. Currently, considering all the regulatory changes undergone by the sector, as well as BNPP's G-SIFI status, it seems that the organic route is preferred– even if this does not prevent BNP Paribas from seizing acquisition opportunities when they arise (BGZ in Poland being one of the most recent examples). In this context, some of BNP Paribas's initiatives look extremely promising. In particular, the development plan of Asia Pacific has come off to a good start: in just one year the bank delivered close to 50% of the revenue growth target it had planned for the next four years. In Germany, BNP Paribas realized it was worth building a bank out of the twelve separate platforms previously in existence in the country. With the successful launch of Hellobank! In Germany, BNPP can now tap the retail deposit market as well. Turkey and Poland are also two countries where the bank is relying on increased cross-selling and market share gains in the future.
- BNP Paribas will not hesitate to use its balance sheet to secure growth. In the context of a Basel 3 CET1 target of 10%, and a long-term payout ratio of 45%, we estimate that the annual capital generation of the bank (i.e. its retained earnings) could come to between EUR 3bn and EUR 4.5bn over 2014-2016. Of this, around EUR 1.3bn-2bn will finance organic growth (securing 3% RWA growth while maintaining the CET1 ratio at 10%); while around EUR 1.7bn-2.5bn will qualify as "free cash flow" and will act as a "security buffer" or finance additional growth, either external or organic. Assuming a CET1 ratio of 10%, BNP Paribas can, in theory, increase its RWAs by about EUR 30bn to EUR 45bn per annum without denting its capital base. Although the bank is highly unlikely to do so, we find encouraging that it can put to use its strong balance sheet in its traditionally very stable and low-risk corporate banking business. This would allow the bank to regain some of the market share lost during the deleveraging of 2011-2012 and secure quality business in a market from which many international banks have withdrawn. So even if BNP Paribas still uses the "Originate to Distribute" model, its ability to put its balance sheet to good use is also quite reassuring. BNP Paribas' 8%+ funded asset growth CAGR target in Corporate Banking would lead the bank to report, in 2016, broadly the same level of assets as in 2011 before the deleveraging – not exactly an aggressive target.

BNP Paribas also gave interesting disclosure on liquidity and capital planning. On the former, it stated that its Liquidity Coverage Ratio (LCR) at year-end 2013 was "above regulatory threshold" – meaning that the bank is already around 100%. On capital planning, BNPP is now gradually re-issuing Tier 2 instruments; it made its first issue since 2007, a EUR 1.5bn Tier 2 note due March 2026, on March 18.

Rating drivers (Details)

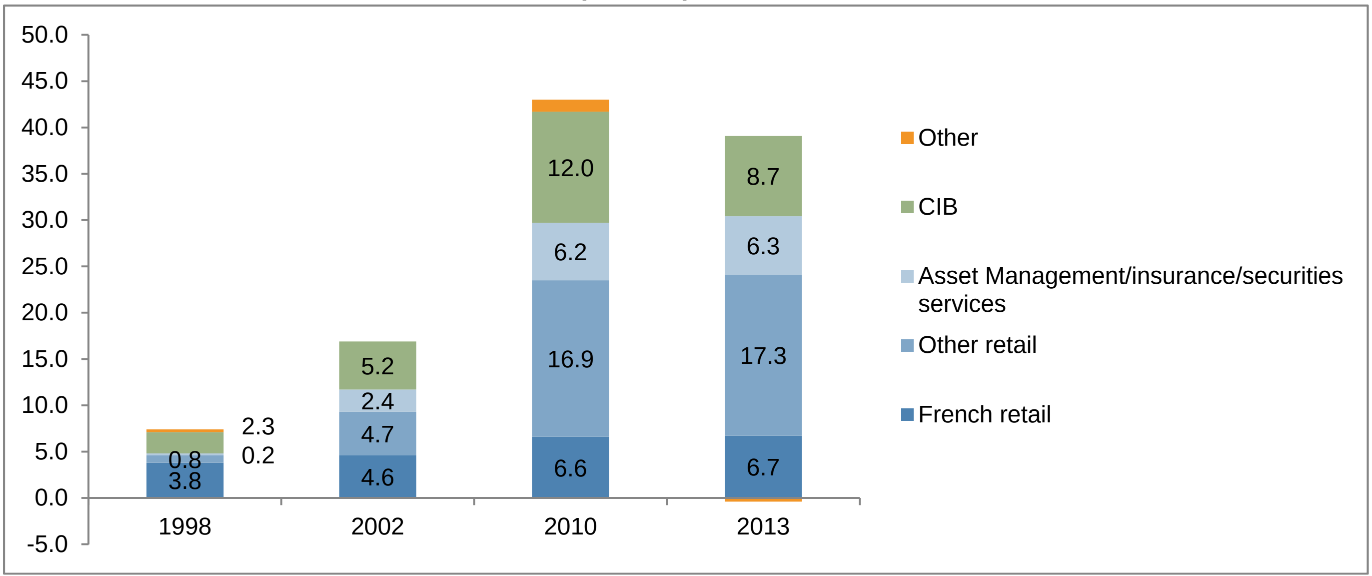
1. A well-diversified business and geographic mix

BNP Paribas's strength as a bank has always been its diversification, visible first and foremost at the **business line** level. Prior to its privatization in the 1990s, the old Banque Nationale de Paris (BNP) was essentially a French domestic retail business with traditional commercial banking operations and one subsidiary in the US: Bank of the West. Its merger with Paribas contributed multiple expertise in corporate and investment banking, as well as great franchises in personal finance, asset management, and securities services. Chart 1 below examines these trends by looking at the pre-tax earnings mix of the company in 1997, 2002 (post BNP Paribas merger), 2010 (post BNL and Fortis acquisitions) and 2013.

As seen in Chart 1, the different retail businesses of BNP Paribas experienced a quantum leap in 2002, with the addition of Paribas' old Compagnie Bancaire business, and in 2006 and 2009 with the addition of the BNL and

Fortis networks. Together, all retail banking operations represent between 55% and 62% of BNPP's revenue mix over the cycle, while the weight of Corporate & Investment Banking (CIB) has traditionally been limited to 25-30%.

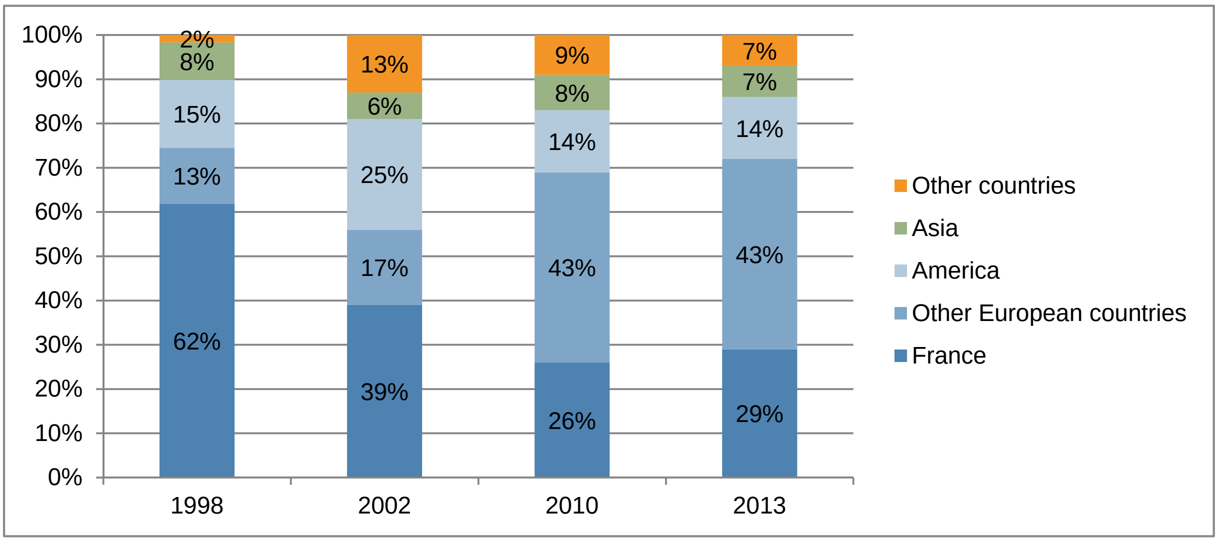
Chart 1: BNP Paribas revenue mix 1998-2013 (EUR bn)



Source: Company data, Scope ratings estimates

BNP Paribas's business mix is also well-diversified at **geographic** level**.** In our view, this priority given to diversification comes from the fact that during the 1994-1995 French recession, the old BNP managed to maintain acceptable financial fundamentals thanks to the earnings contribution of its subsidiary Bank of the West in the United States. This positive experience with diversification probably shaped the resolutely European strategy launched by BNP Paribas in the 2000 decade, when the bank purchased BNL (2006) and Fortis (2009), thus gaining leadership positions in three other European countries (Italy, Belgium and Luxembourg). Looking at the geographic breakdown of the loan book for the same period as for Chart 1, we can see that the company's risk base is extremely well-diversified geographically.

Chart 2: Geographic breakdown of loan book at BNP Paribas, 1998-2013



Source: Company data, Scope ratings estimates

While the weight of France has declined over the years from more than 60% of the loan book to about 30% today, Western Europe has become the main contributor to the loan book. Of the 43% coming from Western Europe, the main contributors are Italy (12%) and Belgium & Luxembourg (14%).

2. A proven ability to absorb shocks (low event risk)

Ever since Banque Nationale de Paris (and then BNP Paribas) has reported quarterly earnings (i.e. since Q1 1999), it has reported only one loss, in Q4 2008. Even the provisioning of Greek sovereign bonds in Q3 2011 did not lead it to report a loss despite some EUR 2.6bn in one-off charges. The Q4 2008 pre-tax loss of EUR -2bn was triggered by the dislocation of markets following on the Lehman collapse and the resulting lack of liquidity. This did not prevent the bank from reporting a EUR 3bn profit for the full year or from having the financial and strategic acumen to buy Fortis on the back of the crisis.

3. Strong capital build-up

Of the European banks, BNP Paribas was among the most exposed to the new, tighter capital regime of Basel 3 as the bank had just purchased Fortis (2009) and had one of the largest balance sheets in the world at EUR 2trn. Since then, though, BNP Paribas has significantly reduced its RWAs and significantly increased its capital base. After one year during which the bank assessed the impact of the new capital rules, it decided to launch an aggressive adaptation plan in 2011 that significantly improved both its leverage and Basel 3 metrics (as shown in the table below).

Table 1: Leverage and capital metrics BNP Paribas (EUR bn except otherwise noted)

	2005	2006	2007	2008	2009	2010	2011	2012	2013
Tier 1 capital	28.8	34.4	39.2	41.8	62.9	68.5	71.0	75.2	66.6
Total Assets	1,258.0	1,440.0	1,694.0	2,076.0	2,058.0	1,998.0	1,965.0	1,907.0	1,800.1
Leverage ratio (%)	2.3%	2.4%	2.3%	2.0%	3.1%	3.4%	3.61%	3.94%	3.70%
RWAs (Basel 2, then Basel 2.5 from 2011 onwards)	378	463	533	535	621	601	614	552	560
CET1 ratio (%) (Basel 2, then Basel 2.5 from 2011 onwards)				5.4%	8.0%	9.2%	9.6%	11.7%	11.7%
RWA Basel 3 estimated							642	580	627
Published Basel 3 CET1 ratio (%)							7.4%	9.9%	10.3%
Implied Basel 3 CET1 (€bn)							47.5	57.4	64.9

Source: Company data, Scope ratings estimates

The adaptation plan meant selling a 28.7% stake in Klépierre, a property company initially in the Paribas dowry, deleveraging the corporate and investment banking business on around EUR 50bn of assets between September 2011 and December 2012, running-down EUR 8.5bn of non-core leasing outstanding since 2010, and running down the mortgage loan book of the Personal Finance division, now reclassified in the corporate center. Some of the revenue sluggishness experienced by the bank between 2011 and 2013 can be explained by this intense deleveraging effort.

But with a fully-phased Basel 3 CET1 ratio of 10.3% as of December 31, 2013 and a leverage ratio consistently above 3.5%, BNP Paribas can now run its business on a fully normalized basis.

4. Ongoing efforts to reduce costs and increase efficiency

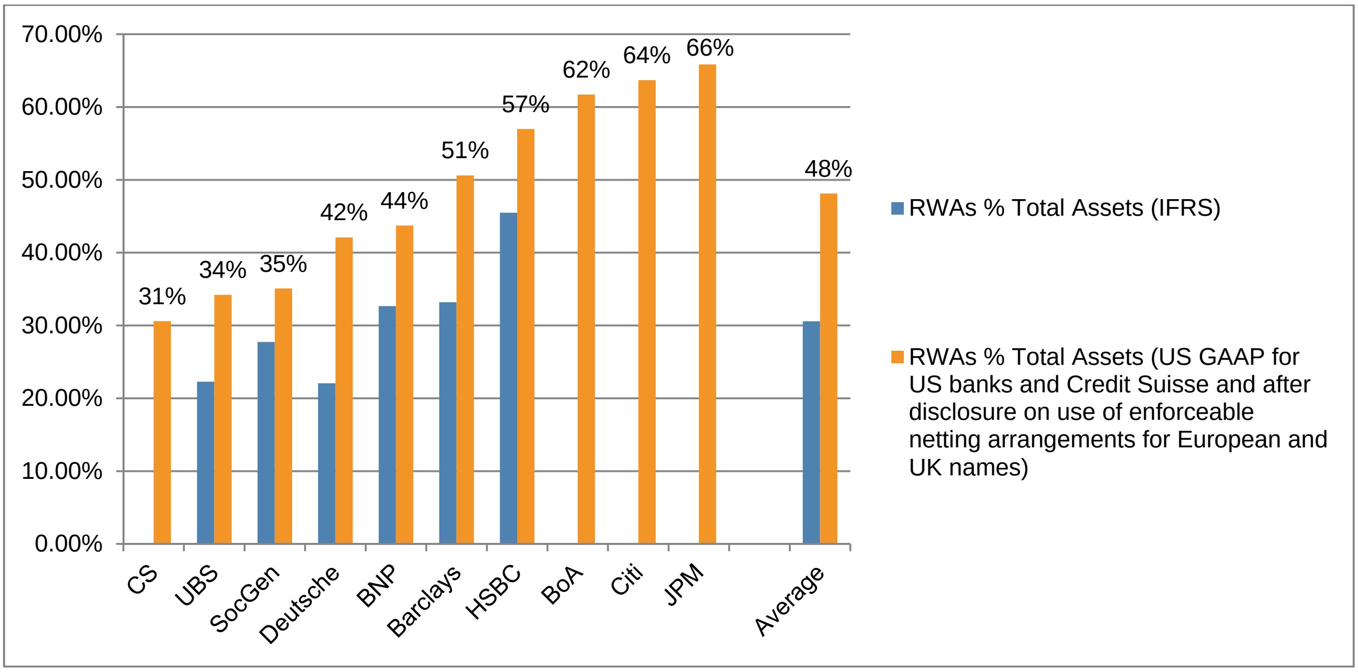
Optimization has always been at the forefront of BNP Paribas's priorities, ever since Banque Nationale de Paris was privatized in 1993 and started to improve the efficiency and the profitability of its loss-making French retail network. These efforts were pursued with the BNP-Paribas merger, leading the newly merged company to realize EUR 700m in costs synergies by September 2001, more than a year ahead of plan. The bank continued with a EUR 240m cost savings program in 2004 representing 2% of the cost base at that point, and EUR 250m in cost savings following the merger with BNL in February 2006, which was raised to EUR 270m later in the year. The acquisition of Fortis led to additional cost synergies, initially estimated at EUR 900m (mostly costs) in 2009 and then raised to EUR 1.2bn in December 2010 and EUR 1.5bn in December 2011. In December 2012, BNP Paribas announced the "Simple & Efficient" plan aimed at generating EUR 2bn in cost savings by 2015. As mentioned above, the success of this program prompted the bank to increase its cost savings targets from EUR 2bn to EUR 2.8bn.

5. Average risk-weighted assets intensity

French banks post among the lowest risk-weighted intensity of banks worldwide. In other words, the proportion of risk-weighted assets to assets remains low versus international peers.

However, the well-known accounting differences between IFRS and US GAAP tend to give a material advantage to US peers. To facilitate comparisons, IFRS 7 has requested banks reporting under IFRS to disclose both gross and net amounts of recognized financial assets and liabilities associated with master netting agreements and similar arrangements. Using the restatements provided by IFRS 7 enables a closer comparison between banks reporting under US GAAP and banks reporting under IFRS.

Chart 3: "Harmonized" Risk-Weighted Assets Intensity for selected European, UK and US banks – YE 2013



Source: Scope Ratings estimates, Company data

As we can see, the IFRS 7 restatements bring BNP Paribas much closer to the global peer group average of 48% (BNP Paribas reports an estimated "harmonized" IFRS 7-compliant, risk-weighted asset intensity of 44%, to be compared with a "reported" IFRS RWA intensity of 33%). BNPP's ratio does not stand among the best in the peer group but the bank's business mix is different from that of Bank of America or JP Morgan.

Assuming BNP Paribas moves its asset intensity to the peer group average of 48%, it would have to generate around EUR 4bn of extra capital, on our estimates, to maintain its Basel 3 CET1 target of 10%, from what would then be a level of 9.4%. We estimate BNP Paribas could reach this level in about a year of retained earnings.

Peer comparison

At Scope Ratings, we compare banks within peer groups at domestic and cross-border level.

Domestically, BNP Paribas is comparable to Société Générale, Crédit Agricole Group, BPCE and Crédit Mutuel Group.

Looking at the performance of BNP Paribas versus domestic peers, it is interesting to note that, on many metrics, the five rated banks show very similar rankings. This is particularly the case for liquidity metrics, since the loan-to-deposits ratio of all French banks is comprised between 110% and 130%, with BNPP ranking roughly in the middle of the pack.

In asset quality terms, French banks are clearly divided between domestically-biased and internationally-biased banks. The internationally-biased banks (BNPP and SocGen) post higher impaired loans-to-total loans ratios, but the coverage ratios are homogenous.

In profitability terms, BNP Paribas benefits from very good pre-provision profitability. As a result, its ROE remains acceptable within the French peer group despite considerably higher levels of capital (although it has gone down in 2013 due to provisions for litigation).

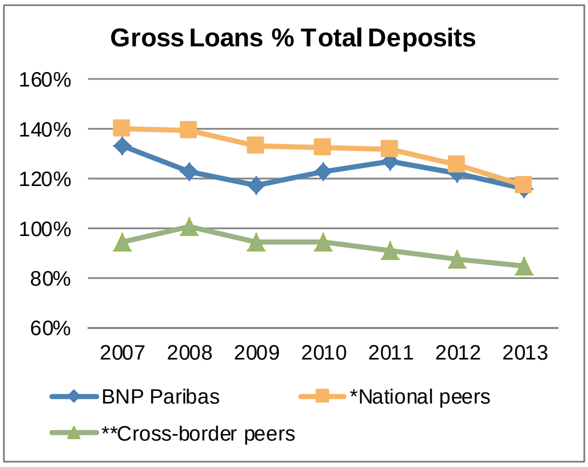
The story is a bit different at cross-border level. Outside France, we have positioned BNP Paribas in the bucket of large universal banks operating in varied markets in varied geographies. This peer group includes Société Générale, HSBC, Barclays, Deutsche, UBS and Credit Suisse, plus Citigroup, Bank of America and JP Morgan in the United States.

Overall, we find the positioning of BNP Paribas solid versus peers, particularly on the CET1 front where BNPP Paribas has managed to close the gap with global peers.

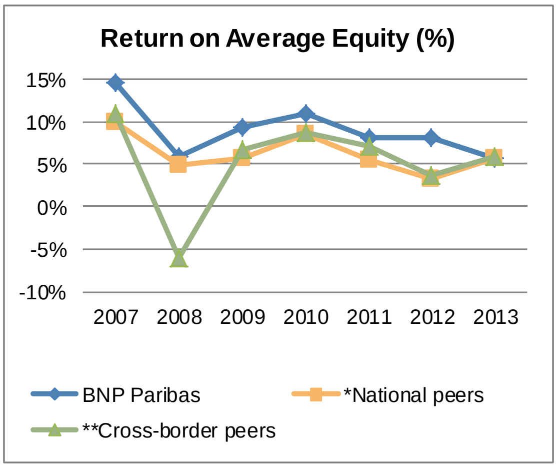
The bank’s profitability is average overall, but with a notably better cost-income ratio than peers.

The only area where BNPP has margin for improvement is on funding and liquidity, where it has a loan-to-deposits ratio of 116% as of year-end 2013 vs. a peer group average of 86%, and where the ratio of wholesale funds to total funds is also higher than peers. However, in this area BNP Paribas has posted the most impressive improvement of its peers since the crisis.

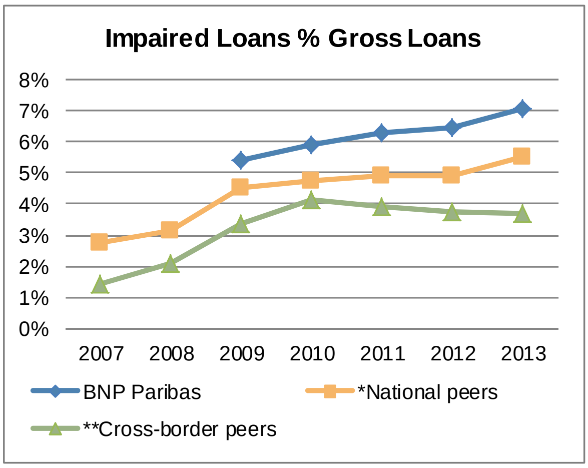
Peer Comparison - BNP Paribas group



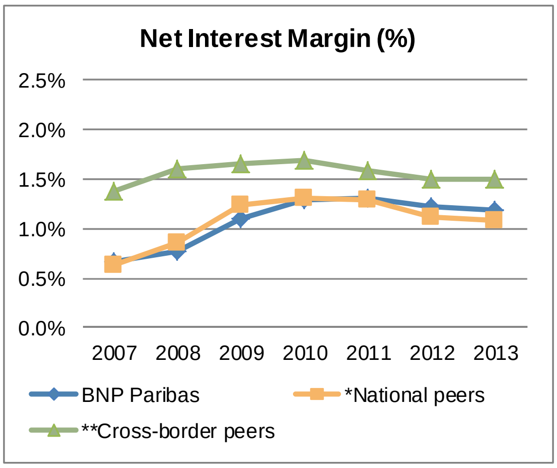
Source: SNL Financial, Scope Ratings



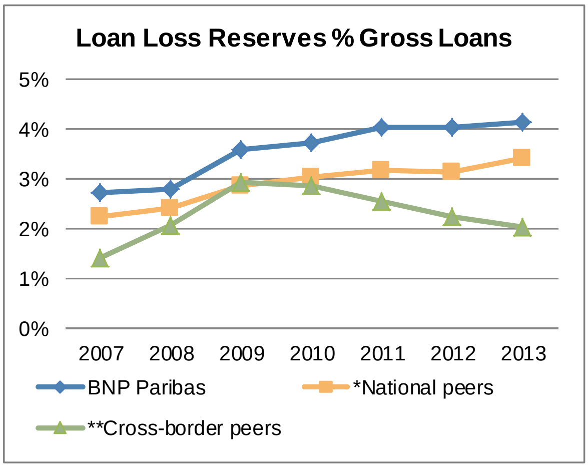
Source: SNL Financial, Scope Ratings



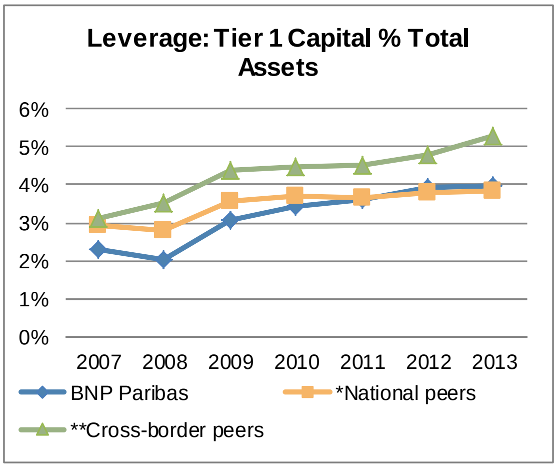
Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings

*National peers: BNP Paribas, Credit Agricole Group, Credit Mutuel Group, Groupe BCPE, Societe Generale
**Cross-border peers: Bank of America Corp, Barclays, BNP Paribas, Citigroup Inc, Credit Suisse, Deutsche Bank, HSBC, JP Morgan Chase, Societe Generale, UBS

Selected Financial Information - BNP Paribas group

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Balance Sheet summary (EUR billion)									
Assets									
Cash and balances with central banks	18.5	39.2	56.1	33.6	58.4	103.2	101.1	105.8	127.6
Interbank assets	73.4	70.6	88.9	62.7	49.4	40.4	50.5	50.5	55.5
Total securities	817.0	768.3	696.3	717.1	571.0	554.7	583.1	601.7	621.2
of which debt instruments	650.5	664.8	579.3	588.5	477.1	432.9	443.8	452.7	461.8
of which equity instruments	166.6		117.0	128.6	93.9	121.8	139.2	149.0	159.4
Derivatives	238.8	574.0	371.1	355.5	465.7	430.7	313.5	321.7	331.8
Gross customer loans	460.5	509.2	702.4	707.9	694.4	658.3	644.3	656.6	675.5
of which impaired loans	14.2	16.4	38.4	42.1	43.7	42.5	45.4	44.5	43.6
Total funded assets	1,448.7	1,524.1	1,693.1	1,643.9	1,503.1	1,483.2	1,489.8	1,525.7	1,590.9
Total Assets	**1,694.5**	**2,075.6**	**2,057.7**	**1,998.2**	**1,965.3**	**1,907.2**	**1,800.1**	**1,844.1**	**1,919.3**
Liabilities									
Interbank liabilities	171.9	187.2	226.2	170.1	150.4	113.3	85.7	77.1	73.3
Senior debt	576.6		477.4	483.1	370.7	418.3	423.2	444.3	488.7
Derivatives	245.8	551.5	364.6	354.3	462.2	424.0	310.3	318.4	328.4
Customer deposits	346.7	414.0	604.9	580.9	546.3	539.5	557.9	569.1	580.4
Subordinated debt + hybrid securities	18.6	18.5	31.8	27.9	22.1	16.7	13.6	12.3	11.0
Total Liabilities	**1,635.1**	**2,016.6**	**1,977.4**	**1,912.5**	**1,879.7**	**1,813.2**	**1,709.0**	**1,749.8**	**1,821.7**
Ordinary equity	47.1	42.7	61.5	66.6	68.1	78.2	81.0	84.1	87.4
Minority interests	5.6	5.7	10.8	11.0	10.3	8.6	3.6	3.6	3.6
Total Liabilities and Equity	**1,694.5**	**2,075.6**	**2,057.7**	**1,998.2**	**1,965.3**	**1,907.2**	**1,800.1**	**1,844.1**	**1,919.3**
Core Tier 1 Capital [1]	*30.3*	*28.9*	*49.5*	*55.4*	*47.5*	*57.4*	*64.8*	*67.0*	*70.3*
Income Statement summary (EUR billion)									
Net interest income	9.7	13.5	21.0	24.1	24.0	21.7	20.6		
Net fee & commission income	6.3	5.9	7.5	8.5	8.4	7.5	7.2		
Net trading income	9.7	2.5	6.0	5.1	3.6	4.4	5.7		
Operating Income	**31.4**	**27.6**	**40.4**	**44.1**	**42.5**	**39.6**	**39.1**	**38.1**	**39.0**
Operating expenses	18.8	18.4	23.3	26.5	26.1	26.5	26.1	25.3	25.6
Loan loss provision charges	1.7	5.8	8.4	4.9	3.6	3.9	4.0	3.6	3.5
Non-recurring items	0.2	0.5	0.9	0.3	-3.0	1.7	-0.5	-0.8	-0.6
Pre-Tax Profit	**11.1**	**3.9**	**9.0**	**13.0**	**9.7**	**10.4**	**8.2**	**8.4**	**9.3**
Income tax	2.7	0.5	2.5	3.9	2.8	3.1	2.8	2.6	2.9
Net profit attributable to minority interests	0.5	0.4	0.6	1.3	0.8	0.8	0.6	0.6	0.7
Net Income Attributable to Parent	**7.8**	**3.0**	**5.8**	**7.8**	**6.1**	**6.6**	**4.8**	**5.2**	**5.7**

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] CRD 4 basis from 2011 onwards

Ratios - BNP Paribas group

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Funding/Liquidity									
Gross loans % Total deposits	132.8%	123.0%	116.1%	121.9%	127.1%	122.0%	115.5%	115.4%	116.4%
BNP Paribas	30.9%	34.1%	44.9%	45.7%	49.8%	49.3%	51.3%	51.3%	50.0%
Wholesale funds % Total funds	69.1%	65.9%	55.1%	54.3%	50.2%	50.7%	48.7%	48.7%	50.0%
Asset Mix, Quality and Growth									
Gross loans % Funded assets	31.8%	33.4%	41.5%	43.1%	46.2%	44.4%	43.2%	43.0%	42.5%
Impaired loans % Gross loans	3.1%	3.2%	5.5%	5.9%	6.3%	6.4%	7.0%	6.8%	6.5%
Loan loss reserves % Impaired loans	88.0%	87.2%	50.5%	50.7%	64.1%	62.5%	58.7%	59.9%	61.1%
BNP Paribas	13.2%	10.6%	38.0%	0.8%	-1.9%	-5.2%	-2.1%	1.9%	2.9%
Impaired loan growth (%)	-9.6%	15.5%	134.0%	9.7%	3.8%	-2.8%	7.0%	-2.0%	-2.0%
Funded assets growth (%)	15.5%	5.2%	11.1%	-2.9%	-8.6%	-1.3%	0.4%	2.4%	4.3%
Earnings									
Net interest income % Revenues	30.9%	48.9%	52.1%	54.5%	56.5%	55.0%	52.6%		
Fees & commissions % Revenues	20.1%	21.2%	18.5%	19.2%	19.8%	19.0%	18.3%		
Trading income % Revenues	30.9%	9.1%	14.9%	11.6%	8.4%	11.2%	14.5%		
BNP Paribas	18.0%	20.7%	14.5%	14.7%	15.3%	14.8%	14.5%		
Net interest margin (%)	0.9%	1.1%	1.6%	1.7%	1.8%	1.8%	1.7%		
Pre-provision Income % Risk-weighted assets (RWAs)	2.4%	1.7%	2.7%	2.9%	2.7%	2.4%	2.3%	2.2%	2.3%
Loan loss provision charges % Pre-provision income	13.2%	62.5%	49.1%	27.7%	21.8%	29.7%	30.9%	28.1%	26.3%
Loan loss provision charges % Gross loans (cost of risk)	0.4%	1.2%	1.4%	0.7%	0.5%	0.6%	0.6%	0.6%	0.6%
Cost income ratio (%)	59.8%	66.6%	57.8%	60.1%	61.5%	67.1%	66.7%	66.4%	65.7%
Net Interest Income / Loan loss charges (x)	5.8	2.3	2.5	4.9	6.7	5.6	5.1		
Return on average equity (ROAE) (%)	17.0%	6.7%	11.2%	12.2%	9.0%	9.0%	6.1%	6.3%	6.7%
Return on average funded assets (%)	0.4%	0.1%	0.2%	0.3%	0.3%	0.3%	0.2%	0.2%	0.2%
Retained earnings % Prior year's book equity	10.6%	4.5%	9.5%	8.7%	6.9%	6.9%	3.8%	3.8%	3.9%
Pre-tax return on common equity tier 1 capital	36.5%	13.6%	18.2%	23.5%	20.3%	18.1%	12.6%	12.6%	13.2%
Capital and Risk Protection [1]									
Common equity tier 1 ratio (common equity tier 1 capital % RWAs)	5.7%	5.4%	8.0%	9.2%	7.4%	9.9%	10.3%	10.4%	10.5%
Tier 1 leverage ratio (%)	2.3%	2.0%	3.1%	3.4%	3.6%	3.9%	3.7%		
Median of tier 1 leverage ratio and common equity tier 1 ratio (%)	4.0%	3.7%	5.5%	6.3%	5.5%	6.9%	7.0%		
Total loss coverage (CET 1 capital + loan loss provisions) % RWAs	8.0%	8.1%	11.1%	12.8%	12.3%	15.2%	16.3%	15.9%	16.8%
Non-senior bailinable debt cushion (as % of total liabilities)	1.5%	1.4%	2.0%	1.9%	1.6%	1.3%	1.2%	1.1%	1.0%
Asset risk intensity (RWAs % total assets)	31.5%	25.8%	30.2%	30.1%	31.2%	28.9%	31.1%	34.8%	34.8%

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] CRD 4 basis from 2011 onwards

METHODOLOGIES USED FOR THIS REPORT

For the rating and analysis contents of this report, Scope has used the following methodologies which were published on www.scoperatings.com:

"Bank Rating Methodology" (February 2014)

"Forecasting Bank Financials Methodology" (February 2014)

Forecasting bank financials: Forward-looking estimates are an important analytical tool underpinning Scope's bank ratings. These forecasts cover the current financial year (before final year-end figures are published by the bank) plus the forthcoming two years. Depending on the complexity of the bank being assessed, different forecasting tools will be used. For a majority of banks operating primarily commercial and retail banking franchises (loans and deposits) the analysis is underpinned by an **accounting** forecast of the balance sheet and profit and loss account. For more complex groups with multiple ranges of activities – notably those with material wholesale and investment banking operations – Scope uses an **analytical** forecast, relying on the bank's business-line reporting to come up with plausible estimates. For all banks Scope also includes a **regulatory metrics** forecast, considering the growing importance of this aspect in bank analysis.

For complex banks, divisional data is used to forecast profit and loss accounts and basic divisional balance sheet metrics. For less complex banks, a line-by-line forecasting of major P&L elements is forecast.

For balance sheet forecasts, Scope estimates of all major balance sheet lines, using the P&L estimates to complete the forecast of the capital/shareholders' equity line. This comprehensive methodology for estimating the balance sheet is used for all the banks in our universe, irrespective of size and complexity.

Lastly, our forecasts include assessments of the major regulatory metrics: Tier 1 and CET 1 (historically CT1), Leverage, Liquidity Coverage Ratio, and Net Stable Funding Ratio (the latter two when and if sufficient public information to compute them is available).

Scope will not aim to forecast financials when it considers the public disclosure of the bank as insufficient for a transparent and credible outcome.

All Scope's bank financial forecasts are based on public information. For its forecasts Scope will not use any non-public information or data, even if such information or data were provided by rated banks. Scope's forecasting process is transparent, with a detailed roadmap provided in its *"Forecasting bank financials"* methodology.

BPCE SA
Issuer Rating Report

A+ STABLE OUTLOOK
Financial Institutions

Overview

Scope Ratings assigns an Issuer Credit-Strength Rating (ICSR) of A+ to BPCE SA with a stable outlook. This rating reflects the strong improvement in the fundamentals of a group that was only put together in 2009 to avoid a full government bail-out of Natixis (NX), the listed subsidiary of Banques Populaires (BP) and Caisses d'Epargne (CE). In four years, the most recently created French banking group managed to create a strong culture and proper business standards out of very disparate components. At the same time, the rating also reflects the somewhat less strong liquidity and funding metrics of the bank, which are in part a direct result of its checkered history.

The ratings on BPCE SA are based on Groupe BPCE's (BPCE) credit fundamentals and support. The A+ rating is not applicable to unguaranteed debt issued by subsidiaries of BPCE SA.

Ratings (assigned on April 2, 2014)

Issuer Credit-Strength Rating	**A+**
Outlook	Stable
Senior Unsecured Debt	A+

Unsolicited ratings without issuer participation.

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Rating drivers (Summary)

The ratings drivers, in decreasing order of importance in the rating assignment, are:

- (+) A strong franchise and a low-risk business model. The combination of two of the largest domestic retail franchises in France together with the powerful and de-risked Natixis product engine guarantee sustainable cash generation, which is strongly supportive of the rating.
- (+) The manner in which BPCE has considerably simplified its dual mutualist-listed structure and aligned the interests of all its components (Banques Populaires, Caisses d'Epargne, BPCE and Natixis) is very beneficial for bondholders: there is little friction between entities and no obstacle to free capital circulation within the group in the unlikely case of a major credit event.
- (−) The liquidity metrics of the company remain slightly less strong than French and international peers.
- (+) Natixis is now much more than just BPCE's corporate & investment banking arm. Its manufacturing capabilities in specialized financial services help raise the number of products per client in the retail networks, while BPCE's listed subsidiary also benefits from a highly profitable asset management division.
- (−) The overall profitability of the two large retail networks of the BPCE group (Banques Populaires and Caisses d'Epargne) is not where it should be versus French peers and considering the bank's large market shares.

Rating change drivers

In its 2014-2017 strategic plan, the bank is very discreet about its acquisition plans, except for EUR 1.5bn that are budgeted for the asset management division of Natixis. Excluding asset management, the objectives of the bank at an international level are less clear ("seize opportunistic developments internationally"). The equity market reach of Natixis as the listed entity of BPCE could pave the way for a large non-domestic acquisition that could prove problematic to integrate.

The restructuring of the BPCE group occurred with no particular change to the geographic spread of the bank. On our estimates, France represented 78% of the total commitments of the group as of year-end 2013. Considering the extent of the bank's exposure to France, any sharp deterioration in the fundamentals of the French economy could negatively impact BPCE.

After four years of restructuring, we expect the capital build-up of the company to gather momentum, and we expect its Basel 3 core Tier 1 ratio to increase by 40bps per annum. The 12% Basel 3 CET1 target by 2017 is realistic and would rank BPCE among the best capitalized banks in Europe.

Recent events

Beyond the good 2013 results reported by the bank last February, the most important recent event was BPCE's presentation of its 2014-2017 strategic plan last November. The new plan capitalizes on the success of the 2009-2013 "Together" plan, which was defended by the company and implemented throughout 2011 and 2012, despite the euro crisis, at a time when several French banks were dropping their strategic plans.

The new 2014-2017 strategic plan (called "Another way to grow") is quite innovative to the extent that priority is given to strengthening capital adequacy and transforming the bank's funding model. Contrary to many plans where funding, liquidity and capital are a means to an end, improving these metrics is the paramount priority at BPCE. Growing for the sake of growing is definitely not part of the plan. Indeed, the overall capital allocation at group level will remain stable with a priority on insurance and asset management (the latter being granted a budget of EUR 1.5bn in the course of the plan for acquisitions). At Natixis, new loan production will be done through the strict criteria of the "Originate to Distribute" (O2D) model, and parts of the loans will be sold to investors – Natixis will keep a portion on-balance sheet to ensure that its own interests and client interests are aligned. Lastly, the entire growth plan of the two retail networks will be based on increasing the number of products per client rather than increasing loan volumes; a goal we do not perceive as being very capital intensive either. BPCE's new plan strikes us as formalizing what it means to run a bank in a post-Basel 3 world.

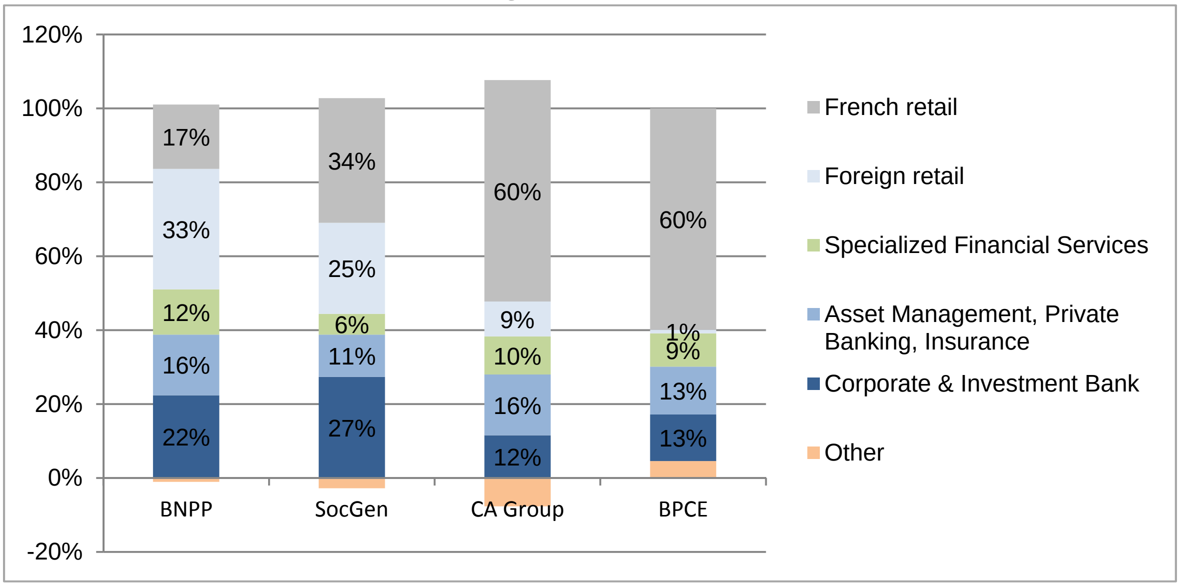
Rating drivers (Details)

1. A strong franchise and a low-risk business model

Over the past decade or so, French bank mergers involving mutualist banks did not result in combined entities that were as low-risk as their predecessor banks. The merger of BP and CE in 2009 was no exception, as the combination was mostly designed to shore up the financially troubled Natixis. But despite unfavorable odds, BPCE's new management was very good at (1) capitalizing on the strong domestic retail franchises of BP and CE, and (2) restructuring and de-risking Natixis, partly through a guarantee from BPCE on the subsidiary's toxic assets. The notional amount of toxic assets under guarantee represented EUR 52.8bn in Natixis' books as of Q1 2009; equivalent to 3.3x the proforma shareholder's equity of BPCE at year-end 2008. By December 2013, the toxic assets had fallen to EUR 7.6bn (less than 17% of BPCE's 2013 estimated tangible equity). The whole toxic assets division (known as GAPC) will be closed down by BPCE mid-2014. As for the quality of the franchises underpinning BPCE, Caisses d'Epargne is a well-established brand in France with a focus on household savings, while Banques Populaires specializes in servicing French small- and medium-sized companies. On top of these two networks, it is important to include Crédit Foncier de France (CFF), a mortgage lending specialist, and Banque Palatine (formerly San Paolo Bank (France), specialized in upper market corporate and retail clients). All of BPCE's networks claimed a market share of 21.4% of the sector's deposits and 20.6% of the loans, second only to Crédit Agricole-LCL (around 25% market share for loans and deposits).

The strength of the franchise combined with the restructuring of Natixis have led BPCE to benefit from a very low-risk business model compared with peers, as demonstrated in Chart 1 below, which looks at the revenue structures of four large French banks as of December 2013.

Chart 1: Revenue breakdown of four large French banks, 2013



Source: Scope Ratings research, Company data

Chart 1 shows that, with 13% of total revenues as of December 2013, the weight of the corporate and investment banking businesses remains very small in BPCE's revenue mix. But Natixis has become much more than a corporate & investment bank. BPCE's listed subsidiary comprises very stable businesses, such as the Specialized Financing entities and the Asset Management division. Natixis is also the product engine of the group. We believe that as CE and BP increase the number of products per client, Natixis will improve its revenues generated by the two networks, partly triggered by the fact that, from 2016 onwards, Natixis will be the exclusive provider of insurance products for the entire BPCE group following the termination of the manufacturing agreement between Caisse Nationale de Prévoyance (CNP) and BPCE. The weight of asset management should also increase on the back of the future acquisitions budgeted in Natixis' 2014-2017 strategic plan. As a result, the weight of the Corporate & Investment Banking (CIB) division could be diluted further and the business model could remain as low-risk as it is now.

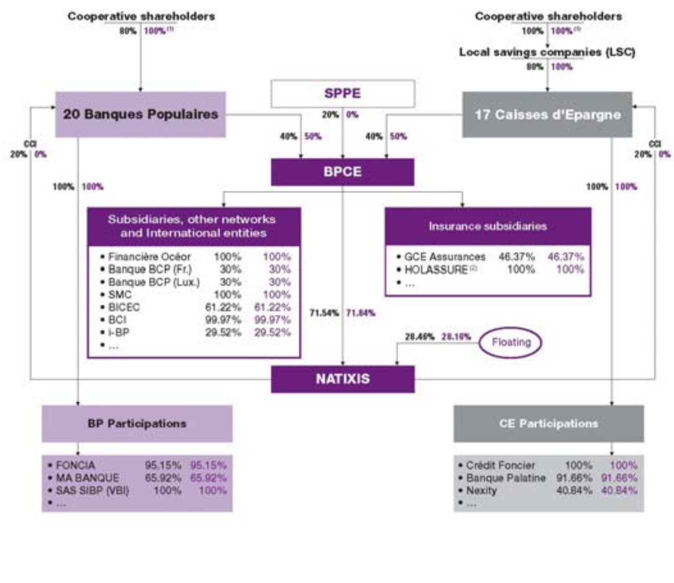
2. BPCE's corporate structure has been considerably simplified since 2009

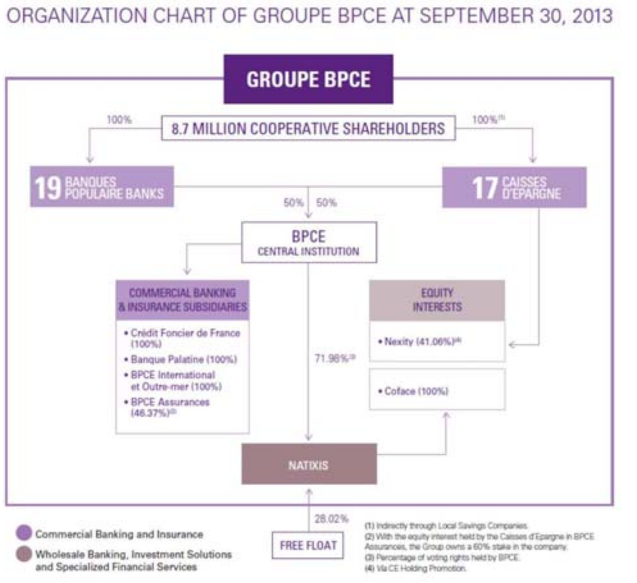
Since the merger that created BPCE in 2009, the company's new management has made every effort to simplify a corporate structure that was too complicated and could be an obstacle to the free circulation of cash flows between different member banks.

The left part of Chart 2 shows the corporate structure as it was in December 2009. Back in 2009, BPCE was a complicated banking group, where the BPs and the CEs held an equal proportion of the capital of BPCE (20% of the company was by the French government at the time held), as well as 100% of two holding companies (BP Participations and CE Participations), to which each network had contributed its financial and other non-network-related equity stakes. In addition, BPCE owned 71% of the listed vehicle Natixis, and to complicate matters further, Natixis owned 20% of the capital of each network (BPs and CEs). The latter ownership enabled Natixis to be exposed to the French retail business.

In the course of the last four years, the group managed to collapse the vast majority of this structure by (1) bringing all the equity stakes up to BPCE – bar Coface (located at Natixis) and the property company Nexity (located at CE) - and closing the intermediary holding companies; (2) selling the majority of the non-strategic holdings (Société Marseillaise de Crédit, Foncia, equity stake in Volksbank International, own-account Private Equity, correlation derivatives portfolio, Eurosic) bar Coface (soon to be IPO'ed) and Nexity; and (3) through a very brave move, ending the BP, CE and Natixis cross-shareholding by having the BPs and the CEs agree to buy back the 20% of their capital held by Natixis. The right side of Chart 2 looks at the current corporate structure of BPCE.

Chart 2: BPCE's corporate structure –then (left) and now (right)





Source: Company data

It is clear that cash flows are now circulating more freely. From the very inception of the group, BPCE has centralized the long-term bond issues of the BPCE Group under its name (and Crédit Foncier's for long-dated bonds funding property projects). While BPs and CEs contribute the bulk of the group's cash generation, Natixis is the product engine of the BPs and the CEs as well as the group representative for businesses that the network cannot engage in (Corporate & Investment Banking, Asset Management). BPCE, as Central Body of the group, seems to be a "trusted intermediary" between the different banking cultures represented by all of the group's components. This is made easier, in our view, by the fact that BPCE is only a Central Body and does not double up as a listed vehicle or full-bodied bank. All the missions are well-defined.

The successful ability of all parties at BPCE to set aside their cultural differences is exemplified by the fact that back in 2009, when the group was created, two distinct share categories were issued: one for CE shareholders and one for BP shareholders in order to guarantee the parity between the two shareholders during the five years of an "incorporation period" that guaranteed that this equality between networks would continue in case of a capital increase, share cancellation, etc. But the company's general shareholders' meeting of December 20, 2012 decided to abolish the incorporation period. Instead, the meeting defined a system whereby shares can be freely transferred (after a pre-emptive right of each relevant network) from August 1, 2019.

3. Group liquidity has room for continued improvement

Considering what have been essentially strong achievements in business and governance standards, the liquidity metrics of Groupe BPCE offer room for improvement. On paper, the liquidity should look strong, since BPCE accumulates two big retail networks, with one in particular (CE) specialized in household savings. However, the loss-leader of CE's deposit offer, the Livret A (the only tax-free savings product in France) is essentially unavailable for liquidity purposes as it is transferred to Caisse des Dépôts (CDC) for social housing purposes. On top of this, Natixis is an amalgamation of wholesale-funded credit institutions, which were known at the time as "Institutions Financières Spécialisées". These companies could not, by law, receive deposits from the public. They were Crédit National, BFCE, Crédit Foncier de France – the addition of CDC's former investment bank (Ixis) to the whole did nothing to improve the situation – as it was also fully wholesale funded (on a balance sheet of around EUR 250bn). It must also be said that the group's communication on liquidity has not been as consistent as in other areas (although BPCE was the only French bank to acknowledge in writing that it had used the ECB's LTRO facilities).

Following a deep dive into the accounts of BPCE between 2009 and 2013, we found that the bank has significantly improved on its liquidity metrics but there is still room for improvement.

In Table 1 we have compiled some liquidity metrics by making the following restatements on the published accounts: (1) 65% of the Livret A deposits is assumed unavailable and transferred to CDC; and (2) the pool of assets of Compagnie de Financement Foncier segregated for covered bonds is also restated from the loan book. Making the second restatement is logical since the assets are "off" the "regular" funding circuit of BPCE and legally secured for covered bond holders. These restatements help explain why some of the metrics disclosed in Table 1 are different from the numbers reported by the bank in the "peer comparison", "selected information" and "ratios" tables below.

Table 1: Main restated liquidity metrics of BPCE

	2009	2010	2011	2012	2013
Loans % deposits	175.35%	142.71%	142.38%	133.42%	125.50%
Liquid assets % short-term funds	108.76%	106.74%	107.57%	134.03%	124.58%
Wholesale funds % total funds	59.23%	57.08%	58.88%	58.14%	53.17%
ST wholesale funds % total funds	36.03%	33.86%	36.37%	32.50%	33.93%
Deposits % total funds	40.74%	42.86%	41.12%	41.86%	46.83%
Loans % total assets	50.30%	43.76%	40.94%	41.31%	43.29%
Repos % ST wholesale funds	24.29%	31.13%	38.62%	53.20%	46.30%

Source: Company data, Scope Ratings estimates

The year 2009 gives a good idea as to what the non-restated loans-to-deposits ratio of BPCE would look like, i.e. prima facie a high dependency of the bank to wholesale funding, much higher than French and international peers.

Excluding the covered pool, the ratio declines to an acceptable but still high 125% in 2013. In the meantime, we note that the proportion of wholesale funds to total funds has remained at a high 53% (despite a mild decrease between 2012 and 2013) and that within this the proportion of repos has increased steadily from 24% in 2009 to 53% in 2012, before receding slightly in 2013. We believe that BPCE is in a transition as far as liquidity and funding are concerned. The bank has yet to complete the second phase of its transformation whereby the bulk of the corporate loans outstanding are repackaged and sold and/or syndicated away, while the long-term loans (property, local authorities) should be extensively refinanced as covered bonds. This is a very ambitious and credible strategy but it may take years before these efforts are plainly visible in the bank's balance sheet structure.

4. Natixis' dual role as product and growth engine

Between 2009 and 2013, Natixis managed to become indispensable to the proper functioning of BPCE Group as a product engine. During this time, its biggest achievement was bringing a close to EUR 900m in revenue synergies with BP and CE (around 4% of BPCE's revenues in 2013), basically increasing the equipment rate of the two networks in consumer finance, payments and, to a lesser extent, insurance. This role should increase in the future as the BP and CE networks still lag behind the rest of the French banking sector in several high-profile products such as insurance, factoring or payment processing. In insurance, the equipment targets should be made easier by the severance of the partnership with CNP, the historical life insurance partner of CE.

But Natixis will also have to be the growth engine of the group, through low-capital intensity businesses such as asset management, where the bank is Top 15 worldwide, and thanks to the O2D model, made credible and real as the bank has already announced two partnerships with insurance companies interested in the potential yield of the lending business (Ageas – 2012 and CNP – 2013).

5. The profitability of the BP and CE networks is not where it should be

Table 2: Comparative profitability of retail divisions in France (Year-end 2013)

	BP+CE	BNPP	SocGen	Reg Bks CA	LCL
Total revenues (EURm)	13,387	6,726	8,235	14,873	3,811
Cost-income ratio (%)	65.5%	65.3%	64.0%	54.0%	66.0%
Cost of risks (%)	0.34%	0.24%	0.66%	0.26%	0.34%
Estimated post-tax ROE (%)	8%	17%	13%	25%	22%
Net profits (EURm)	2,072	1,278	1,164	3,666	599

Source: Company data, Scope Ratings estimates

Table 2 compares the financial performances of BP and CE (combined) with the performances of other retail networks in France. Even if the ROEs are distorted by the different capital allocation methodologies of each network, it is clear that the BP and CE networks are among the least profitable of the peer group. The cost-income ratio remains higher than its peers and the cost of risks is simply average. If we compare the P&L of the BP and CE networks with Crédit Agricole's regional banks, we see that the revenue bases are not that different: EUR 14.9bn for the regional banks of Crédit Agricole and EUR 13.4bn for the combination of BP and CE. Despite a limited 11% difference in revenues, the difference in net profits is closer to 75%, showing that BPCE has a significant margin for improvement.

Peer comparison

At Scope ratings, we compare banks within peer groups at domestic and cross-border levels.

Domestically, BPCE is comparable to BNP Paribas, Société Générale, Crédit Agricole Group and Crédit Mutuel Group.

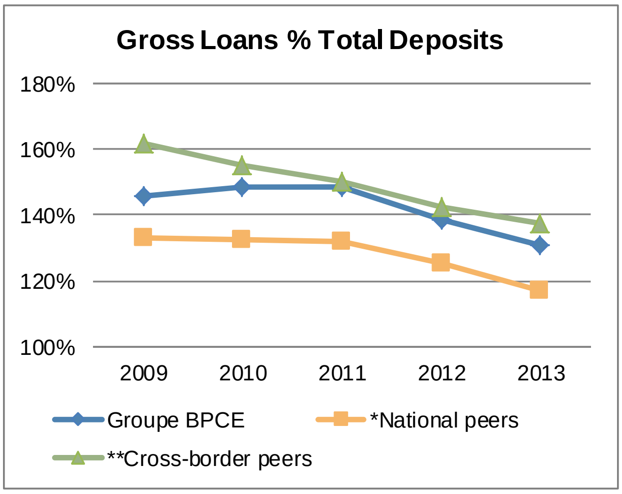
Looking at the performance of Groupe BPCE versus domestic peers, it is interesting to note that on many metrics the five rated banks show very similar rankings. This is particularly the case of liquidity metrics, since the loan-to-deposits ratios of all French banks are between 110% and 130%. BPCE displayed one of the highest loan-to-deposits ratios in 2013 of French banks, despite a major improvement since 2009 and the creation of the bank (the restated LTD ratio stood at 175% then). Other liquidity ratios show that BPCE still has room for improvement in this area, particularly regarding the weight of wholesale funding in total funding.

In asset quality terms, French banks are clearly divided between domestically-biased and internationally-biased banks. Among the former (CA Group, Crédit Mutuel and BPCE), BPCE shows impaired loans metrics which rank well among peers, with a coverage ratio within average levels.

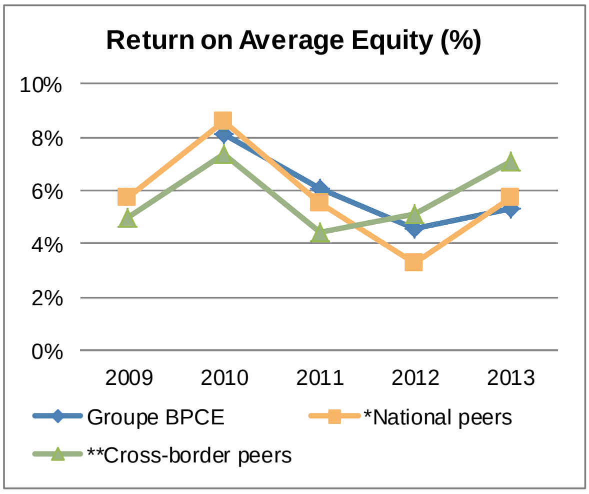
Looking outside France, we have positioned Groupe BPCE as a domestic pure play, together with banks such as Crédit Mutuel, CaixaBank, Lloyds or Rabobank.

Despite some of the problems mentioned above, BPCE’s relative position will look acceptable versus its international peers. The position of the bank appears better than average in terms of a loan-to-deposits ratio, but the weight of wholesale funding to total funding and the proportion of short-term wholesale funding remains higher than those of its peers. The capital position is decent though, and we believe that BPCE’s target of a CET1 ratio of 12% by 2017 is realistic and adequate considering the business model and risk profile of the group.

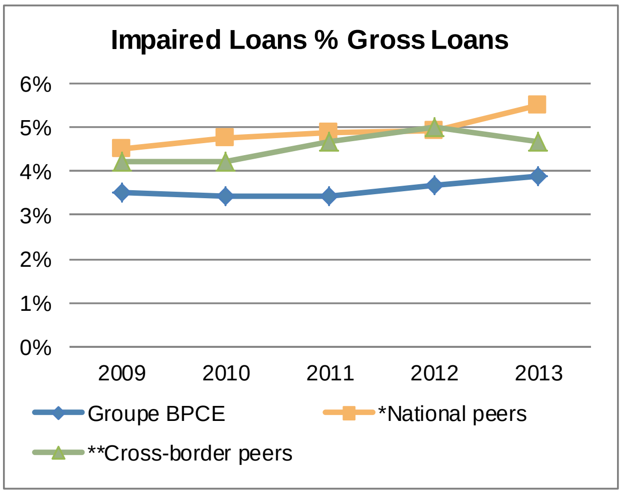
Peer Comparison - Groupe BPCE



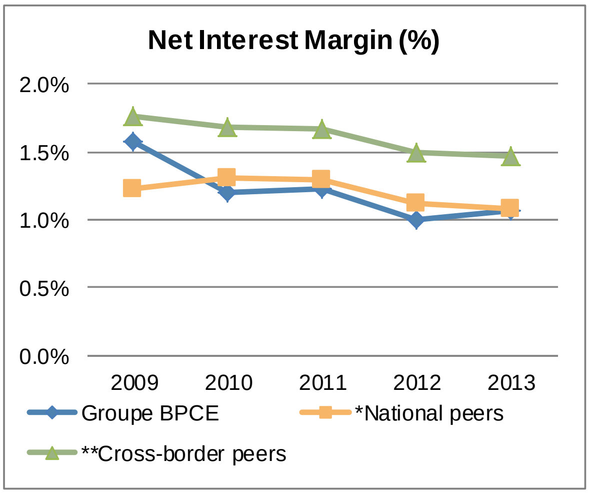
Source: SNL Financial, Scope Ratings



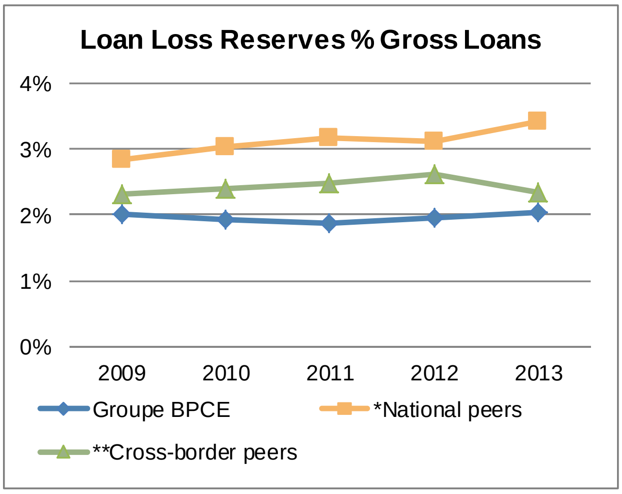
Source: SNL Financial, Scope Ratings



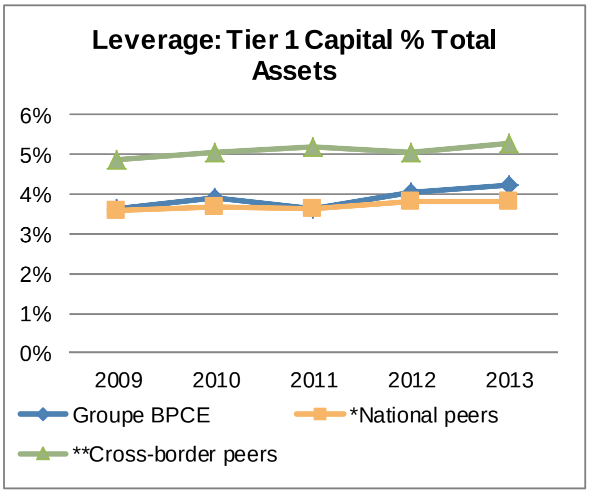
Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings

*National peers: BNP Paribas, Credit Agricole Group, Credit Mutuel Group, Groupe BCPE, Societe Generale
**Cross-border peers: Groupe BPCE, Credit Mutuel Group, Intesa, DNB ASA, Credit Agricole Group, CaixaBank, Swedbank, Lloyds Banking group, Wells Fargo & Co., Rabobank Group

Notes: Cross-border peer group excludes Credit Mutuel Group in 2013 as well as Intesa for the Net Interest Margin and the Return on Average Equity. We use H1 2013 numbers as a 2013 proxy for Intesa on all other ratios

Selected Financial Information - Groupe BPCE

	2009	2010	2011	2012	2013	2014E	2015E
Balance Sheet summary (EUR billion)							
Assets							
Cash and balances with central banks	13.1	24.1	16.0	53.8	60.4	60.4	60.4
Interbank assets	147.7	143.7	141.7	129.5	108.4	110.5	113.9
Total securities	164.3	150.7	198.9	244.9	231.4	234.9	239.7
of which debt instruments	122.5	108.9	163.7	203.7	181.2	181.2	181.2
of which equity instruments	41.8	41.7	35.2	41.2	50.2	53.7	58.5
Derivatives	102.1	90.2	127.5	72.5	67.1	68.2	69.6
Gross customer loans	527.7	573.3	581.2	574.9	588.3	597.1	609.1
of which impaired loans	18.9	20.0	20.3	21.9	23.3	24.0	24.5
Total funded assets	918.6	954.5	1,012.1	1,077.9	1,058.9	1,089.6	1,121.5
Total Assets	**1,028.8**	**1,048.4**	**1,138.4**	**1,147.5**	**1,123.5**	**1,155.3**	**1,188.5**
Liabilities							
Interbank liabilities	116.3	106.5	118.7	111.5	88.9	90.7	93.4
Senior debt	276.8	292.3	332.3	366.9	293.6	293.6	293.6
Derivatives	110.2	94.0	126.3	69.6	64.6	65.6	67.0
Customer deposits	369.8	394.3	399.0	430.5	458.3	485.8	510.1
Subordinated debt + hybrid securities	15.0	13.8	12.0	10.0	10.5	9.4	8.5
Total Liabilities	**981.0**	**997.1**	**1,089.5**	**1,093.2**	**1,065.3**	**1,094.3**	**1,124.4**
Ordinary equity	34.7	41.2	41.9	47.0	47.8	50.6	53.8
Minority interests	3.8	4.0	3.7	3.8	6.8	6.8	6.8
Total Liabilities and Equity	**1,028.8**	**1,048.4**	**1,138.4**	**1,147.5**	**1,123.5**	**1,155.3**	**1,188.5**
Core Tier 1 Capital [1]	*28.5*	*33.1*	*26.0*	*38.7*	*42.5*	*45.3*	*48.4*
Income Statement summary (EUR billion)							
Net interest income	12.8	12.2	12.5	11.0	11.5	11.8	12.4
Net fee & commission income	7.0	7.4	7.4	7.3	7.7	8.2	8.7
Net trading income	0.4	2.0	1.0	2.3	2.1	2.1	2.2
Operating Income	**25.5**	**24.0**	**23.8**	**22.6**	**23.2**	**24.2**	**25.3**
Operating expenses	19.7	16.1	15.9	15.9	16.1	16.7	17.3
Loan loss provision charges	4.8	2.1	2.3	2.6	2.2	2.2	2.2
Non-recurring items	0.0	-0.1	-0.9	0.0	0.0	0.0	0.0
Pre-Tax Profit	**-0.4**	**5.7**	**4.7**	**3.7**	**4.9**	**5.3**	**5.9**
Income tax	-0.3	1.7	1.6	1.4	1.9	2.1	2.3
Net profit attributable to minority interests	-0.6	0.4	0.3	0.2	0.3	0.3	0.4
Net Income Attributable to Parent	**0.5**	**3.6**	**2.7**	**2.1**	**2.7**	**2.8**	**3.1**

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information.
Please refer to "Methodologies Used for this Report" for further details.

[1] CRD 4 basis from 2011 onwards

Ratios - Groupe BPCE

	2009	2010	2011	2012	2013	2014E	2015E
Funding/Liquidity							
Gross loans % Total deposits	146.3%	148.8%	148.9%	136.6%	131.4%	125.8%	122.1%
Total deposits % Total funds	47.0%	48.5%	46.1%	46.7%	53.6%	55.0%	56.1%
Wholesale funds % Total funds	53.0%	51.5%	53.9%	53.3%	46.4%	45.0%	43.9%
Asset Mix, Quality and Growth							
Gross loans % Funded assets	58.9%	61.5%	58.7%	54.6%	56.9%	56.1%	55.5%
Impaired loans % Gross loans	3.5%	3.4%	3.4%	3.7%	3.9%	3.9%	3.9%
Loan loss reserves % Impaired loans	69.8%	66.1%	63.4%	60.5%	59.4%	57.7%	56.6%
Gross loan growth (%)	-	8.9%	1.3%	-1.1%	2.5%	1.5%	2.0%
Impaired loan growth (%)	-	-7.1%	6.1%	10.9%	12.7%	-4.1%	-3.4%
Funded assets growth (%)	-	-74.6%	15.2%	16.6%	42.9%	-43.7%	-24.3%
Earnings							
Net interest income % Revenues	50.0%	50.7%	52.5%	48.7%	49.7%	49.0%	49.1%
Fees & commissions % Revenues	27.4%	30.9%	31.3%	32.4%	33.2%	33.9%	34.3%
Trading income % Revenues	1.5%	8.5%	4.1%	10.1%	9.1%	8.8%	8.6%
Other income % Revenues	21.2%	9.9%	12.1%	8.7%	7.9%	8.3%	8.0%
Net interest margin (%)	1.6%	1.5%	1.4%	1.2%	1.2%	1.3%	1.3%
Pre-provision Income % Risk-weighted assets (RWAs)	1.4%	2.0%	2.0%	1.7%	1.7%	1.8%	1.8%
Loan loss provision charges % Pre-provision income	84.0%	26.4%	29.2%	39.2%	31.3%	29.7%	26.5%
Loan loss provision charges % Gross loans (cost of risk)	0.9%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%
Cost income ratio (%)	77.4%	66.8%	66.7%	70.7%	69.5%	69.0%	68.5%
Net Interest Income / Loan loss charges (x)	2.6	5.8	5.4	4.2	5.2	5.3	5.9
Return on average equity (ROAE) (%)	-	9.6%	6.5%	4.8%	5.6%	5.7%	6.0%
Return on average funded assets (%)	-	0.3%	0.2%	0.1%	0.2%	0.2%	0.2%
Retained earnings % Prior year's book equity	-	10.5%	6.5%	5.1%	5.7%	5.9%	6.2%
Pre-tax return on common equity tier 1 capital	-	17.3%	18.0%	9.7%	11.5%	11.6%	12.1%
Capital and Risk Protection [1]							
Common equity tier 1 ratio (common equity tier 1 capital % RWAs)	6.9%	8.1%	6.6%	8.8%	10.4%	10.8%	11.2%
Tier 1 leverage ratio (%)	3.7%	3.9%	3.6%	4.1%	3.8%		
Median of tier 1 leverage ratio and common equity tier 1 ratio (%)	5.3%	6.0%	5.1%	6.4%	7.1%		
Total loss coverage (CET 1 capital + loan loss provisions) % RWAs	10.1%	11.4%	10.0%	13.6%	13.8%	14.1%	14.4%
Non-senior bailinable debt cushion (as % of total liabilities)	2.4%	2.0%	1.4%	1.2%	1.3%	1.2%	1.1%
Asset risk intensity (RWAs % total assets)	40.0%	38.8%	34.1%	33.2%	32.8%	36.4%	36.4%

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information.
Please refer to "Methodologies Used for this Report" for further details. *[1] CRD 4 basis from 2011 onwards*

METHODOLOGIES USED FOR THIS REPORT

For the rating and analysis contents of this report, Scope has used the following methodologies which were published on www.scoperatings.com:

"Bank Rating Methodology" (February 2014)

"Forecasting Bank Financials Methodology" (February 2014)

Forecasting bank financials: Forward-looking estimates are an important analytical tool underpinning Scope's bank ratings. These forecasts cover the current financial year (before final year-end figures are published by the bank) plus the forthcoming two years. Depending on the complexity of the bank being assessed, different forecasting tools will be used. For a majority of banks operating primarily commercial and retail banking franchises (loans and deposits) the analysis is underpinned by an **accounting** forecast of the balance sheet and profit and loss account. For more complex groups with multiple ranges of activities – notably those with material wholesale and investment banking operations – Scope uses an **analytical** forecast, relying on the bank's business-line reporting to come up with plausible estimates. For all banks Scope also includes a **regulatory metrics** forecast, considering the growing importance of this aspect in bank analysis.

For complex banks, divisional data is used to forecast profit and loss accounts and basic divisional balance sheet metrics. For less complex banks, a line-by-line forecasting of major P&L elements is forecast.

For balance sheet forecasts, Scope estimates of all major balance sheet lines, using the P&L estimates to complete the forecast of the capital/shareholders' equity line. This comprehensive methodology for estimating the balance sheet is used for all the banks in our universe, irrespective of size and complexity.

Lastly, our forecasts include assessments of the major regulatory metrics: Tier 1 and CET 1 (historically CT1), Leverage, Liquidity Coverage Ratio, and Net Stable Funding Ratio (the latter two when and if sufficient public information to compute them is available).

Scope will not aim to forecast financials when it considers the public disclosure of the bank as insufficient for a transparent and credible outcome.

All Scope's bank financial forecasts are based on public information. For its forecasts Scope will not use any non-public information or data, even if such information or data were provided by rated banks. Scope's forecasting process is transparent, with a detailed roadmap provided in its *"Forecasting bank financials"* methodology.

Commerzbank AG

Issuer Rating Report

SCOPE BBB+ POSITIVE OUTLOOK
Financial Institutions

Overview

Scope Ratings assigns an Issuer Credit-Strength Rating (ICSR) of BBB+ to Commerzbank AG (CZ), with a positive outlook. The rating reflects the fact that the bank has now restructured and is running under more normal operating, profitability and prudential metrics. It also reflects the still high risk profile of the bank's non-core portfolio and CZ's problematic financial track record since its merger with Dresdner Bank in 2009. Our positive outlook reflects the fact that the bank is on the right de-risking track and that the continuous run-down of CZ's non-core portfolio at or below the revised EUR 75bn target by 2016 (versus current levels of EUR 116bn) is likely to improve further the bank's credit quality.

The BBB+ rating applies to senior unsecured debt issued by Commerzbank AG. However, the rating does not apply to unguaranteed debt issued by subsidiaries of Commerzbank AG.

Ratings (assigned on April 2, 2014)

Issuer Credit-Strength Rating	**BBB+**
Outlook	Positive
Senior Unsecured Debt	BBB+

Unsolicited ratings with issuer participation.

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Rating drivers (Summary)

The rating drivers, in decreasing order of importance in the rating assignment, are:

- (+) The de-risking of the bank is on track.
- (−) …but the risk profile of the bank's non-core portfolio remains high.
- (+) The business model of the restructured Commerzbank is attractive…
- (−) …but securing revenue growth in German retail banking will take some time.
- (+) The balance sheet metrics of the bank have improved significantly since 2008.
- (−) Commerzbank's track record since its merger with Dresdner Bank in 2008 has been problematic.

Rating change drivers

Any tangible evidence that Commerzbank is successfully pursuing its de-risking through a consistent reduction of its non-core asset portfolio would be a materially positive rating change driver, underpinning our current positive outlook.

Even if the domestic retail activities of Commerzbank in Germany are currently showing signs of recovery and volume improvement, revenue growth levels remain muted. Considering the cost reduction undergone by CZ since 2008, any sign of revenue increase would have a material impact on the bank's operating leverage and therefore on cash generation and the ability to better absorb the negative cash flow of the non-core portfolio.

So far, the improvement in Commerzbank's credit fundamentals is closely linked to improving market conditions and better asset valuations. Any deterioration in market fundamentals could, in our view, have a material impact on CZ's credit metrics and on the value of its non-core assets portfolio. This is particularly true considering that, up to now, CZ's core business has merely covered the costs of the non-core portfolio.

Recent events

The Q4 2013 results of Commerzbank demonstrated that the bank is on the right track to reduce its risk profile, with the non-core assets (NCA) portfolio falling by EUR 8bn quarter-on-quarter (and 23% year-on-year) to EUR 116bn as of December 31, 2013. The higher-than-expected decline triggered Commerzbank's change of guidance vis-à-vis its NCA portfolio: it now anticipates a EUR 15bn acceleration in the decrease of the portfolio to around EUR 75bn by 2016. The recovery in the number of new customers in the retail business (+245,000 year-on-year) and a 6% increase in loan volumes at the Mittelstand division were encouraging signs for Commerzbank. These positive factors are yet to be reflected in revenues.

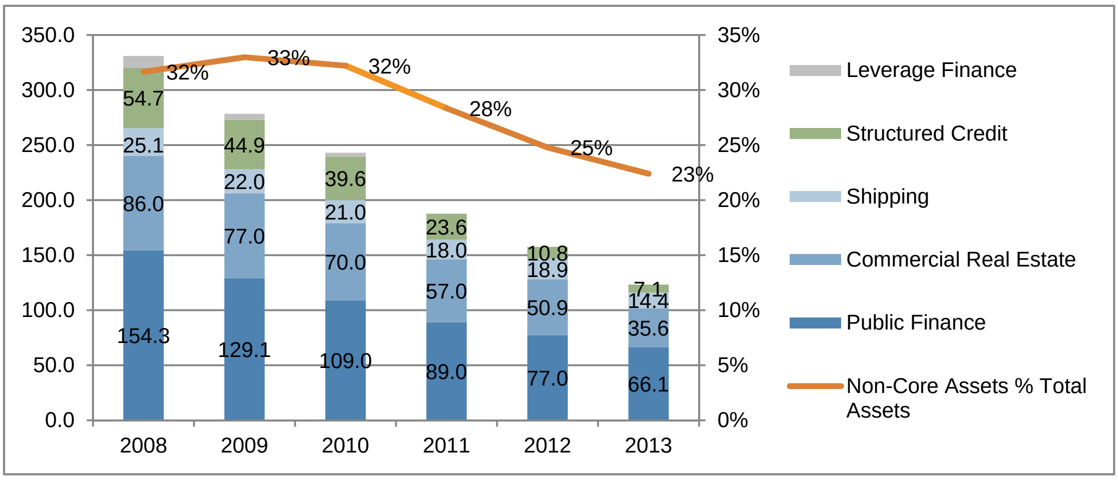
Last February, the bank announced the sale of EUR 710m worth of Spanish non-performing commercial real estate (CRE) assets, representing a RWA reduction of EUR 600m and a 50% decline in total Spanish CRE assets, which were down to EUR 1bn as of year-end 2013. This transaction also reveals the appetite of market participants for Commerzbank's risky assets.

Rating drivers (Details)

1. The de-risking of the bank is on track

In order to compare Commerzbank's Non-Core Assets (NCAs) over a long period of time, we have slightly restated the definition given by CZ of NCAs to add back the nominal value of the structured credit portfolio, which, until 2012 was included in the "Portfolio Restructuring Unit" and was distinct of the then-NCA division. Until 2010, we maintained the conduits and other asset-backed exposures among the non-core assets, but took them out from 2011 onwards as their value did not change and they increasingly represented securitization of German Mittelstand receivables – definitely a core business, in our view. The de-risking of Commerzbank is detailed on Chart 1.

Chart 1: Restated Non-Core Assets portfolio of Commerzbank, 2008-2013 (in EUR bn)



Source: Scope Ratings estimates, Company

As seen, the reduction of Commerzbank's risk profile is not a recent phenomenon: it began the year after the merger announcement with Dresdner Bank. The asset reduction was in response to the state aid-related requirements of the European Commission after the EUR 18.2bn support granted by the German government in November 2008 and January 2009 (note that the 2008 numbers on the chart above are proforma of this merger). At the time and among other generally mild requests, the EC asked Commerzbank to sell Eurohypo before the end of 2014, as the vast majority of the NCAs disclosed above (except for the structured credit portfolio and the leverage finance business) were located at Eurohypo.

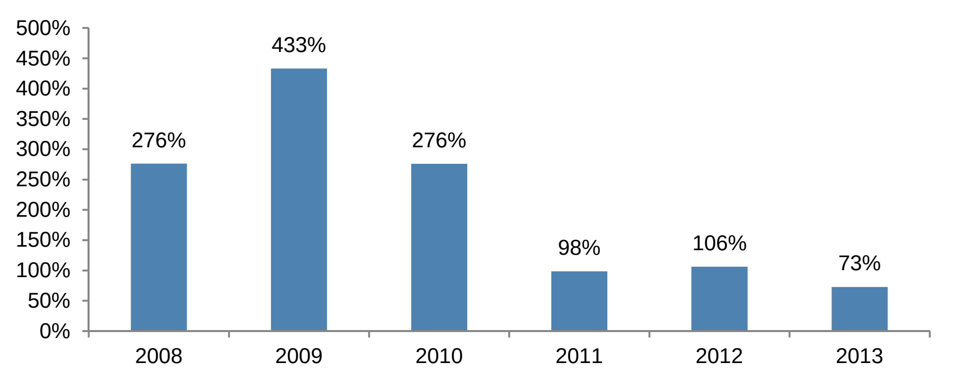
Between 2008 and 2013, the "enlarged" NCA portfolio of Commerzbank declined sharply from EUR 331bn in 2008 to EUR 123bn, including the structured credit portfolio. Each year, Commerzbank has reduced its NCAs by an average of 18%, representing a decline of 63% (or more than EUR 200bn) since 2008. Interestingly enough, as a percentage of the total assets of the group, Chart 1 shows that the reduction became only more pronounced from 2011 onwards. Between 2008 and 2010, NCAs represented around one-third of the total assets of the bank. This number dropped to 25% in 2012 and 23% in 2013. The NCA portfolio has therefore contracted steadily throughout the years, even if the EC requirement has changed somewhat: since Eurohypo eventually proved difficult to sell, the CRE subsidiary of CZ now has to be run down. This does not really change the nature of CZ's de-risking, but slows down the process considerably.

2. The risk profile of the bank's non-core portfolio remains high

We have stress-tested the non-core portfolio of Commerzbank by making the following very severe assumptions, which we clearly do not expect to materialize: (1) we used the defaulted exposure of each sub-portfolio (shipping and CRE), assuming a probability of default of 100% and a loss-given default of 100% – a theoretical worst-case scenario, (2) we have added supplementary losses corresponding to 20% of the remaining exposure to peripheral sovereigns (on the Public Finance Portfolio) and (3) we have added another 20% loss on the total structured credit portfolio.

We compare the sum of (1), (2) and (3) to the CET1 capital of the bank (under Basel 3 standards from 2012 onwards). We are therefore comparing a very severe stress loss with the most conservative definition of capital we can use. Chart 2 gives some revealing answers.

Chart 2: Stress-tested expected loss of Commerzbank from NCAs as a % of CET 1 capital



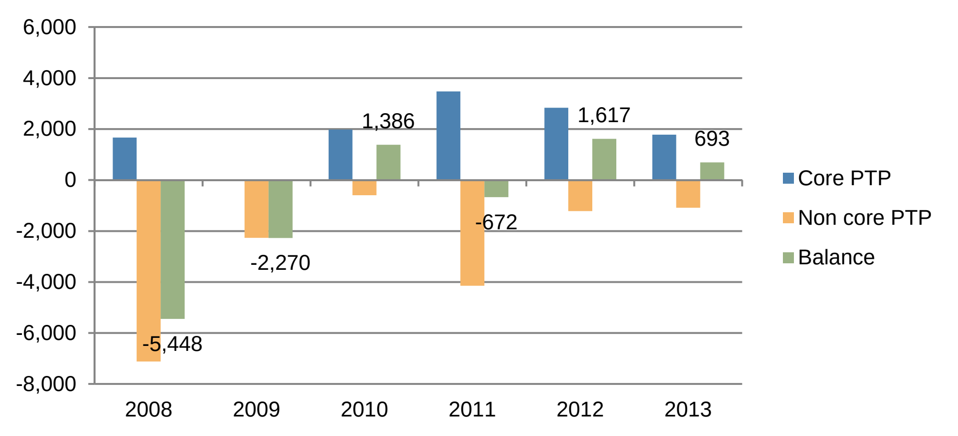
Source: Scope Ratings estimates, Company data

Under this very conservative stress scenario, the gross expected stress losses fall sharply, from a peak of EUR -37bn at year-end 2009 to EUR -14bn at the end of 2013. This compares to CET1 capital which, at its lowest, was EUR 8.5bn in 2009 (excluding silent participations) and is now EUR 19.4bn under fully-phased Basel 3 standards.

This stress test does not include the specific and generic loan loss provisions held by Commerzbank against its default NCA portfolio. If we deduct them from the stress losses, we end up with a maximum net stress loss of EUR 10.5bn, representing 54% of CZ's CET1 capital. Our stress test does not take the collateral received by the bank into account, although it represents a significant portion of the bank's credit protection.

Assuming CZ benefits from the cash generation of its other businesses and has to report the losses in one calendar year, we reckon that the impact of the stress loss on the bank's estimated 2014 fully-phased Basel 3 Core Equity 1 tier capital would stand at 310bps. This would bring the CET1 ratio of Commerzbank down to 6.1%, on our estimates. While this scenario may be quite extreme, a comparison of the cash generation of CZ's core business (German domestic retail banking + Mittelstand banking + Polish retail banking + capital markets + corporate center) with the pre-tax losses generated by the non-core business shows that the pre-tax profits of the core businesses can just about absorb the pre-tax losses of the non-core business (see Chart 3). This, in our view, justifies a cautiously optimistic view of Commerzbank's credit quality. We note that the bank itself forecasts cumulative pre-tax operating losses of EUR 2.9bn on its NCA portfolio between 2013 and 2016.

Chart 3: Pre-tax profit of Commerzbank: core business vs. non core (EUR m)



Source: Company data, Scope Ratings estimates

3. The business model of the restructured Commerzbank is attractive

In many ways, the strategy that Commerzbank presented to the market after its merger with Dresdner in 2009 has not materially changed since. The idea remains as compelling as ever: build a Germany-centered universal bank with a strong focus on the Mittelstand and private clients, supported by a de-risked and scaled down investment bank. Commerzbank can serve its corporate client base internationally through an extensive network of 60 offices in 50 countries (with a strong density in Asia) and a 70% stake in mBank (formerly BRE), the third-largest bank in Poland.

Commerzbank's strategy is clear and well articulated, but its execution has been fundamentally delayed by three major problems:

1. The deterioration of Eurohypo's credit quality from 2008 onwards, which triggered significant losses that have been at the core of the company's problems over the last six years.
2. The European sovereign bond crisis of 2011-2012, which put more pressure on the asset quality of the bank's public finance portfolio.
3. The management of the German government silent participation of EUR 16.4bn, which was only reimbursed almost five years after the government's first intervention in November 2008.

Now that Commerzbank's management team is less distracted by the effects of the crisis than before, the bank can start executing a "One Bank" strategy, which is not dissimilar to the strategy followed by successful European peers. The interactions between the divisions are indeed quite obvious:

- Between the private customer business and the Mittelstand division for the servicing of very small SMEs (with turnover of less than EUR 2.5m).
- Between the Mittelstand division and the capital markets business for the latter to provide "quasi" investment banking services to the mid/ large caps of the Mittelstand division (with turnover of EUR 25m or more).
- Between the Mittelstand division, mBank and the international network of Commerzbank for serving German exporters and importers.

A key challenge for the bank remains regaining market share in its core German retail market and translating this into revenues.

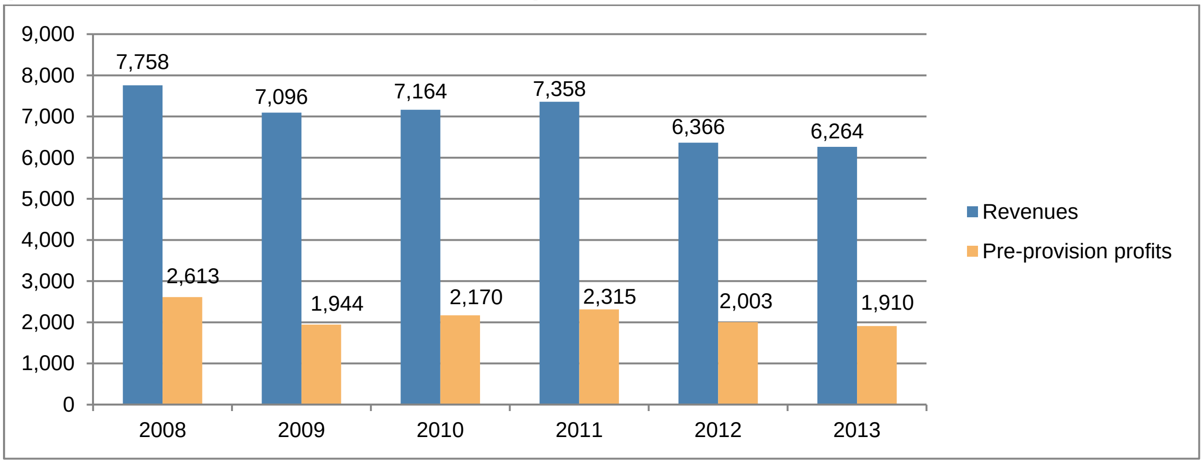
4. Securing revenue growth in German retail banking will take some time

While the business model of Commerzbank provides many competitive advantages, it is hampered by the structure of the German banking system.

The breakdown of the German banking sector in three very different and distinct pillars is already well known. Because a significant portion of the banks are not-for-profit organizations or mutualist structures where share “ownership” does not give any right to the net assets of the bank, profitability has never really been an end-objective for these banks. On the contrary, the priority has always been to fuel the German economic growth under good pricing conditions through the financing of the German Mittelstand. This phenomenon has positively contributed to the strength of the German economy but has also contributed, in our opinion, to the relative financial weakness of German banks versus some European peers. As a result, the larger banks – private and Landesbanken alike – had to look for more substantial revenue growth outside Germany and/or outside the “traditional” retail banking business, which is penalized by very low margins and a high break-even point. Deutsche Bank’s solution was to build a global investment bank. Commerzbank initially pursued the same approach, but following the bank’s withdrawal from investment banking in 2005, it chose the strategy of becoming a large player in global commercial real estate lending and mortgage-backed securities by buying Eurohypo in 2005.

Post-crisis, Commerzbank is refocusing on Germany where its challenge is to develop in a very competitive market. We are encouraged by the increase in new clients in the Private Customer division as well as the loan growth in the Mittelstandbank division; even if in both cases revenue growth has yet to materialize.

Chart 4: Revenues and pre-provision profits of Commerzbank’s German retail business (Private Clients + Mittelstandbank, EUR m)



Source: Company data, Scope Ratings estimates

As Chart 4 demonstrates, since the proforma numbers of the new Commerzbank post merger with Dresdner in 2008, German retail revenues have dropped by a compound annual growth rate (CAGR) of 4% per annum. Pre-provision profits shrank by 6% during the same time period, still an acceptable figure since Commerzbank reduced its German retail costs by about EUR 0.8bn between 2008 and 2013, while revenues were contracting by EUR 1.5bn.

5. The balance sheet metrics of the bank have improved significantly since 2008

As 2008 is the first year for which proforma accounts of the new Commerzbank-Dresdner combination are available, we have traced the balance sheet history of the newly-merged bank as of then.

Table 1 shows the progress of the balance sheet metrics of the new group.

Table 1: Table 1: Commerzbank – key balance sheet metrics

	2008	2009	2010	2011	2012	2013
Loans % deposits	130.08%	133.10%	124.70%	116.15%	104.78%	88.96%
Liquid assets % short-term funds	69.08%	110.79%	125.09%	150.94%	162.26%	207.92%
Wholesale funds % total funds	56.90%	56.70%	53.99%	47.55%	44.65%	37.23%
Short-term wholesale funds % total funds	28.22%	33.87%	32.69%	27.13%	27.40%	23.19%
Deposits % total funds	43.10%	43.30%	46.01%	52.45%	55.35%	62.77%
Loans % total assets	39.80%	41.72%	43.45%	44.82%	43.80%	44.75%
Tangible equity % total assets	1.64%	2.70%	3.28%	3.18%	3.63%	4.14%
Tangible equity (ex-silent participation) % total assets	0.86%	0.67%	1.01%	2.78%	3.26%	4.14%

Source: Company data, Scope Ratings estimates

As we can see, Commerzbank has, over the years, considerably improved its liquidity and funding profile. From a loan-to-deposit ratio of 130% in 2008, this metric has been steadily brought down to 89% in 2013. The proportion of liquid assets to short-term funds has also increased significantly – from a point where the bank was a net short-term borrower (proforma 2008) to a situation where the excess of liquid assets over short-term funds reached about EUR 110bn in 2013 on our estimates – i.e. the equivalent of the entire short-term debt outstanding at year-end 2013.

The capital level of the bank has also improved, pursuant to the capital increases and balance sheet reduction efforts of the bank over the years. In the five years since the trough of 2009, the ratio of tangible equity to total assets has almost been multiplied by five.

To conclude, Table 1 pictures a bank which, after having been in a crisis situation, now looks very good versus European peers.

6. Commerzbank's track record since 2008 has been problematic

A key factor holding our rating at its level is Commerzbank's problematic track record since the merger with Dresdner Bank was announced in 2008. The recent positive three quarters come after 19 very difficult quarters since Q4 2008. The two key stakeholder groups of the bank, investors and clients, had good reason to be disappointed by the bank's performance between 2009 and H1 2013.

- **Investors**: As Commerzbank was poorly capitalized when it was bailed out by the German government in 2008-2009, the bank had to spend the better part of 2009 to 2013 looking to exchange the government's silent participation against fresh common equity capital, which led to a material dilution for shareholders. As for hybrid investors, the intervention of the government meant that several preferred dividends had to be suspended; in particular, Eurohypo Capital Funding Trust I and II. Last November the bank did, in fact, repay the dividends that had been suspended between 2010 and 2013. In addition, during the crisis several issues were called or exchanged for common equity at deep discount to par, the January 2011 exchange in particular.

- **Clients**: Because of the combination of events described above – sub-prime crisis, merger integration, government bail-in and euro sovereign crisis – the bank could not really focus on customer satisfaction until the end of 2012. A combined sustained period of low interest rates and the structural problems of the German banking market led to a decrease in the revenues of the German retail business (see Chart 4 above).

On all these aspects Commerzbank has started to turn the corner. With regard to **Investors**, it could be argued that since the last capital increase was announced in March 2013 the bank has been able to start again with "a clean slate" and its performance with investors should be judged from the moment the silent participation was fully repaid. With regard to **Clients**, Commerzbank has been very clear that it needed to regain trust and modernize the bank as far as the Private Customer division is concerned. Since the bank "rebooted" its offering and services in 2012, it has seen an increase in client accounts, market share (particularly in construction financing) and customer loyalty. At year-end 2013, Commerzbank's Private Customer division registered 245,000 new customers, a trend that accelerated towards the end of the year.

Peer comparison

Of the banks rated by Scope, Commerzbank can be compared with Deutsche Bank in Germany. However, given their different business models, only limited valid conclusions can be drawn from such a comparison.

On a cross-border basis, we have positioned Commerzbank in the bucket of banks with a strong domestic market and a material foothold abroad. This peer group includes Unicredit, BBVA, Santander and selected Nordic banks. Commerzbank's foreign activities are of a more limited scope than those of its large cross-border peers, being to a large extent focused on its successful Polish bank. BRE (recently rebranded mBank), which is the third-largest bank in Poland, contributed around 9% of Commerzbank's revenues in 2013 and 15% of pre-provision profits. It is a very stable cash contributor to Commerzbank's business mix.

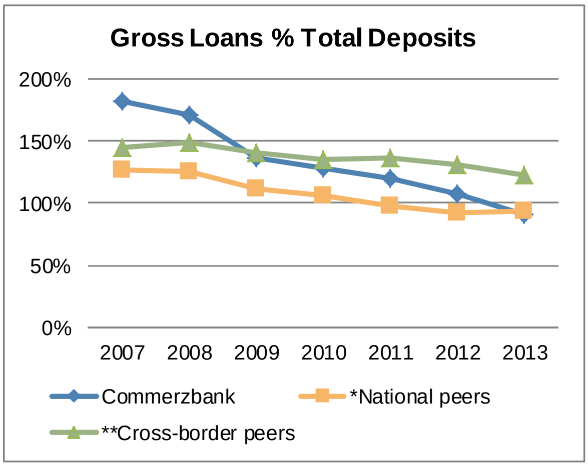
The progress of Commerzbank in terms of liquidity versus cross-border peers has been impressive over the years and the loan-to-deposit ratio of the company is now best-in-class after trailing behind at the start of the crisis. The group has also normalized and lowered its proportion of wholesale funding so that the bank stands particularly well among a rather large peer group.

The bank's capital position is also improving, even if it is not quite at the same level as those of its cross-border peers.

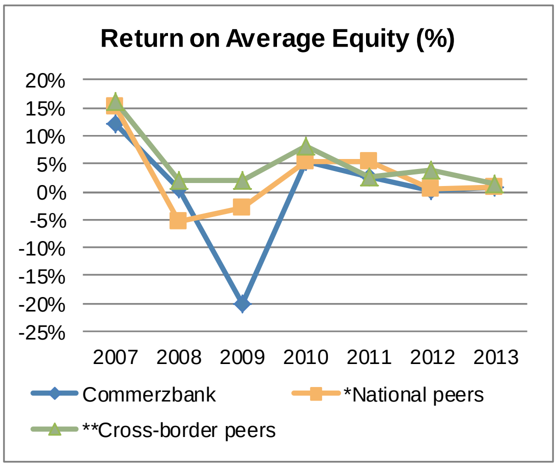
In asset quality terms, the bank has an acceptable level of impaired loans to total loans, but the coverage remains low versus peers. This is due to the mortgage-driven features of CZ's loan book, meaning the bank makes up in collateral what it does not charge in provisions.

The drawback of all the balance sheet restructuring lies in the profitability metrics: the bank has a lower margin and a higher cost-income ratio than its peers.

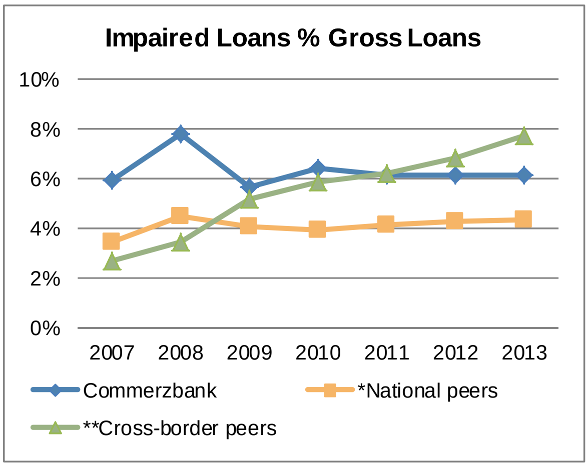
Peer Comparison - Commerzbank group



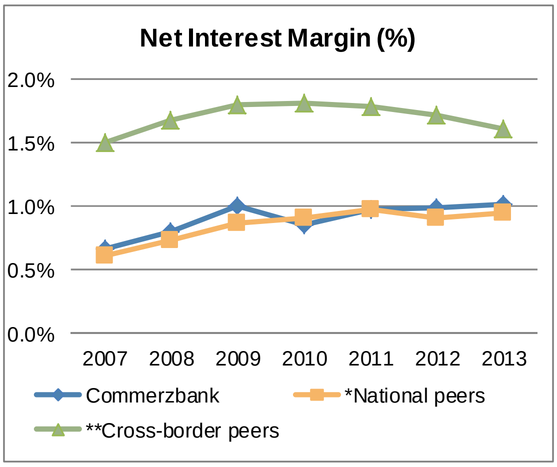
Source: SNL Financial, Scope Ratings



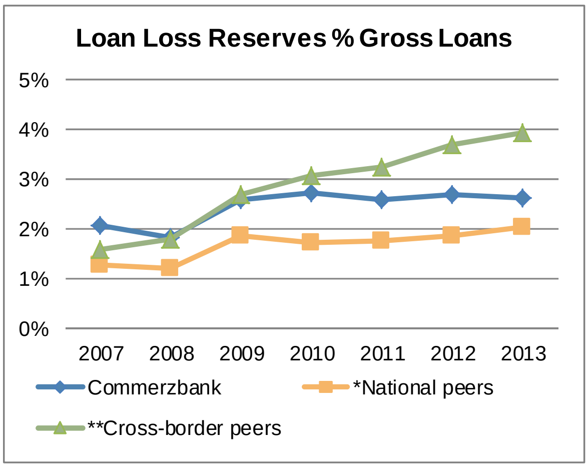
Source: SNL Financial, Scope Ratings



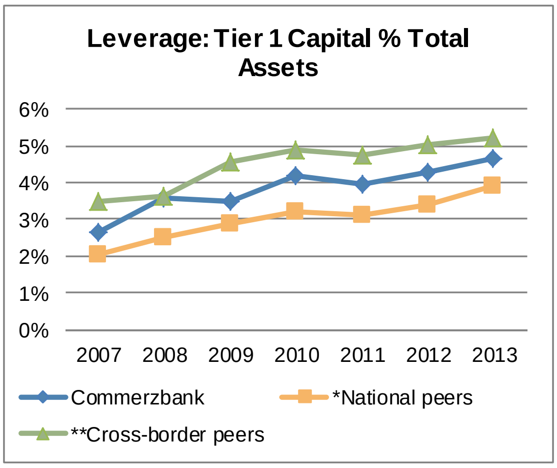
Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings

*National peers: Commerzbank, Deutsche Bank

**Cross-border peers based on business model : Santander, BBVA, Unicredit, RBS, Erste Bank, RZB AG, Commerzbank, Nordea, KBC, Danske Bank, ING Bank

Notes: Cross-border peer group averages exclude RZB in 2013

Selected Financial Information - Commerzbank group

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Balance Sheet summary (EUR billion)									
Assets									
Cash and balances with central banks	5.2	6.6	10.3	8.1	6.1	15.8	12.4	21.0	28.8
Interbank assets	74.0	63.0	106.7	110.6	87.8	88.0	87.5	87.5	89.3
Total securities	166.4	153.6	173.1	160.5	127.5	127.6	120.1	120.8	123.9
of which debt instruments	150.4	144.1	157.8	145.6	114.5	107.3	97.7	97.7	99.7
of which equity instruments	15.0	8.7	11.9	13.9	11.7	19.4	21.5	22.1	23.2
Derivatives	73.0	103.5	183.6	128.8	128.9	112.7	69.5	68.3	68.0
Gross customer loans	291.6	290.4	362.0	337.2	304.4	286.0	253.0	245.6	240.6
of which impaired loans	17.1	22.7	20.5	21.6	18.7	17.6	15.6	14.8	14.0
Total funded assets	536.1	512.0	654.4	614.7	523.5	517.7	478.2	479.9	487.6
Total Assets	**616.5**	**625.2**	**844.1**	**754.3**	**661.8**	**636.0**	**549.7**	**550.1**	**557.5**
Liabilities									
Interbank liabilities	125.1	128.5	140.6	137.6	98.5	110.2	77.7	77.7	79.2
Senior debt	205.6	165.8	171.4	140.4	111.5	84.5	69.7	62.7	59.6
Derivatives	80.4	113.3	189.7	139.6	138.3	118.3	71.5	70.2	69.9
Customer deposits	159.2	170.2	264.6	262.8	255.3	265.8	276.5	284.8	293.3
Subordinated debt + hybrid securities	14.5	15.0	19.9	17.1	15.5	13.9	13.7	13.7	13.7
Total Liabilities	**600.3**	**605.4**	**817.5**	**725.6**	**637.0**	**609.7**	**522.7**	**522.8**	**529.4**
Ordinary equity	15.1	11.0	8.8	10.7	21.4	23.1	26.0	26.4	27.1
Minority interests	1.0	0.7	0.6	0.8	0.7	0.9	1.0	1.0	1.0
Total Liabilities and Equity	**616.5**	**625.2**	**844.1**	**754.3**	**661.8**	**636.0**	**549.7**	**550.1**	**557.5**
Core Tier 1 Capital [1]	*13.3*	*11.2*	*7.3*	*9.6*	*20.8*	*17.7*	*19.4*	*19.8*	*20.5*
Income Statement summary (EUR billion)									
Net interest income	4.0	4.7	7.2	7.1	6.7	6.5	6.1	0.0	0.0
Net fee & commission income	3.2	2.8	3.8	3.6	3.5	3.2	3.2	0.0	0.0
Net trading income	1.0	-1.1	-0.6	2.1	-1.7	0.1	0.0	0.0	0.0
Operating Income	**8.5**	**6.6**	**10.6**	**12.6**	**9.8**	**9.9**	**9.5**	**9.2**	**9.4**
Operating expenses	5.5	5.2	9.3	8.7	7.9	7.1	6.9	6.8	6.8
Loan loss provision charges	0.5	1.8	4.2	2.5	1.4	1.6	1.8	1.6	1.4
Non-recurring items	0.0	0.0	-1.0	0.0	0.0	-0.3	-0.5	0.0	0.0
Pre-Tax Profit	**2.5**	**-0.4**	**-4.7**	**1.4**	**0.5**	**0.9**	**0.2**	**0.7**	**1.2**
Income tax	0.6	-0.5	0.0	-0.1	-0.2	0.8	0.1	0.3	0.4
Net profit attributable to minority interests	0.0	0.1	-0.1	0.1	0.1	0.1	0.1	0.1	0.1
Net Income Attributable to Parent	**1.9**	**0.0**	**-4.5**	**1.4**	**0.6**	**0.0**	**0.1**	**0.4**	**0.7**

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] CRD 4 basis from 2012 onwards

Ratios - Commerzbank group

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Funding/Liquidity									
Gross loans % Total deposits	183.2%	170.6%	136.8%	128.3%	119.2%	107.6%	91.5%	86.2%	82.0%
Total deposits % Total funds	31.6%	34.9%	43.1%	45.7%	52.8%	55.7%	63.2%	64.9%	65.8%
Wholesale funds % Total funds	68.4%	65.1%	56.9%	54.3%	47.2%	44.3%	36.8%	35.1%	34.2%
Asset Mix, Quality and Growth									
Gross loans % Funded assets	54.4%	56.7%	55.3%	54.8%	58.2%	55.3%	52.9%	51.2%	49.4%
Impaired loans % Gross loans	5.9%	7.8%	5.7%	6.4%	6.2%	6.1%	6.2%	6.0%	5.8%
Loan loss reserves % Impaired loans	47.2%	24.6%	47.6%	43.6%	41.7%	42.6%	45.2%	47.1%	48.6%
Gross loan growth (%)	-1.2%	-0.4%	24.6%	-6.9%	-9.7%	-6.0%	-11.5%	-2.9%	-2.0%
Impaired loan growth (%)	34.7%	32.2%	-9.4%	5.2%	-13.1%	-6.2%	-11.5%	-5.0%	-5.0%
Funded assets growth (%)	-0.5%	-4.5%	27.8%	-6.1%	-14.8%	-1.1%	-7.6%	0.4%	1.6%
Earnings									
Net interest income % Revenues	47.1%	71.4%	67.5%	55.8%	68.9%	65.4%	64.9%		
Fees & commissions % Revenues	37.0%	43.0%	35.5%	28.8%	35.8%	32.7%	33.9%		
Trading income % Revenues	11.8%	-17.3%	-5.8%	16.3%	-17.1%	1.1%	0.2%		
Other income % Revenues	4.1%	2.8%	2.8%	-1.0%	12.4%	0.8%	1.0%		
Net interest margin (%)	0.8%	0.9%	1.3%	1.2%	1.2%	1.3%	1.3%		
Pre-provision Income % Risk-weighted assets (RWAs)	1.3%	0.4%	0.5%	1.5%	0.8%	1.3%	1.3%	1.1%	1.2%
Loan loss provision charges % Pre-provision income	16.0%	128.8%	311.2%	63.4%	71.7%	57.6%	71.2%	68.7%	52.0%
Loan loss provision charges % Gross loans (cost of risk)	0.2%	0.6%	1.3%	0.7%	0.4%	0.6%	0.7%	0.7%	0.6%
Cost income ratio (%)	64.9%	78.5%	87.3%	68.8%	80.7%	72.0%	72.8%	74.2%	72.4%
Net Interest Income / Loan loss charges (x)	8.4	2.6	1.7	2.8	5.0	4.0	3.4		
Return on average equity (ROAE) (%)	13.1%	0.0%	-45.8%	14.6%	4.0%	-0.2%	0.3%	1.5%	2.7%
Return on average funded assets (%)	0.2%	0.0%	-0.5%	0.2%	0.1%	0.0%	0.0%	0.1%	0.1%
Retained earnings % Prior year's book equity	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	1.5%	2.7%
Pre-tax return on common equity tier 1 capital	18.9%	-3.6%	-63.4%	14.2%	2.4%	4.9%	1.2%	3.7%	6.1%
Capital and Risk Protection [1]									
Common equity tier 1 ratio (common equity tier 1 capital % RWAs)	5.6%	3.3%	2.6%	3.6%	8.8%	7.6%	9.0%	9.2%	9.4%
Tier 1 leverage ratio (%)	2.6%	3.6%	3.5%	4.2%	4.0%	4.3%			
Median of tier 1 leverage ratio and common equity tier 1 ratio (%)	4.1%	3.5%	3.1%	3.9%	6.4%	5.9%			
Total loss coverage (CET 1 capital + loan loss provisions) % RWAs	9.0%	5.0%	6.1%	7.1%	12.1%	12.1%	13.8%	12.4%	12.5%
Non-senior bailinable debt cushion (as % of total liabilities)	2.4%	3.8%	4.4%	4.6%	2.8%	2.7%	2.6%	2.6%	2.6%
Asset risk intensity (RWAs % total assets)	38.4%	54.1%	33.2%	35.5%	35.8%	32.7%	34.7%	39.3%	39.3%

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] CRD 4 basis from 2012 onwards

METHODOLOGIES USED FOR THIS REPORT

For the rating and analysis contents of this report, Scope has used the following methodologies which were published on www.scoperatings.com:

"Bank Rating Methodology" (February 2014)

"Forecasting Bank Financials Methodology" (February 2014)

Forecasting bank financials: Forward-looking estimates are an important analytical tool underpinning Scope's bank ratings. These forecasts cover the current financial year (before final year-end figures are published by the bank) plus the forthcoming two years. Depending on the complexity of the bank being assessed, different forecasting tools will be used. For a majority of banks operating primarily commercial and retail banking franchises (loans and deposits) the analysis is underpinned by an **accounting** forecast of the balance sheet and profit and loss account. For more complex groups with multiple ranges of activities – notably those with material wholesale and investment banking operations – Scope uses an **analytical** forecast, relying on the bank's business-line reporting to come up with plausible estimates. For all banks Scope also includes a **regulatory metrics** forecast, considering the growing importance of this aspect in bank analysis.

For complex banks, divisional data is used to forecast profit and loss accounts and basic divisional balance sheet metrics. For less complex banks, a line-by-line forecasting of major P&L elements is forecast.

For balance sheet forecasts, Scope estimates of all major balance sheet lines, using the P&L estimates to complete the forecast of the capital/shareholders' equity line. This comprehensive methodology for estimating the balance sheet is used for all the banks in our universe, irrespective of size and complexity.

Lastly, our forecasts include assessments of the major regulatory metrics: Tier 1 and CET 1 (historically CT1), Leverage, Liquidity Coverage Ratio, and Net Stable Funding Ratio (the latter two when and if sufficient public information to compute them is available).

Scope will not aim to forecast financials when it considers the public disclosure of the bank as insufficient for a transparent and credible outcome.

All Scope's bank financial forecasts are based on public information. For its forecasts Scope will not use any non-public information or data, even if such information or data were provided by rated banks. Scope's forecasting process is transparent, with a detailed roadmap provided in its *"Forecasting bank financials"* methodology.

Crédit Agricole SA
Issuer Rating Report

A POSITIVE OUTLOOK
Financial Institutions

Overview

Scope Ratings assigns an Issuer Credit-Strength Rating (ICSR) of A to Crédit Agricole SA (CASA) with a positive outlook. The ratings on Crédit Agricole SA are based on Crédit Agricole Group's (CA Group) credit fundamentals and support. The A rating is not applicable to unguaranteed debt issued by subsidiaries of Crédit Agricole SA.

This rating reflects the benefits of the banking group's de-risking and return to its domestic retail roots, while leveraging on its size and expertise in savings products businesses (asset management and insurance). It also reflects the difficulty related to the status of the Organe Central (Central Body) Crédit Agricole SA, which is at the same time network head and listed holding company. As a result, the communication channels between the regional banks and CASA were tested during the European crisis. Our positive outlook reflects the possible change in relationship between CASA and the regional banks, which, if clear and properly executed, could materially improve the governance of the group.

Ratings (assigned on April 2, 2014)

Issuer Credit-Strength Rating	**A**
Outlook	Positive
Senior Unsecured Debt	A

Unsolicited ratings with issuer participation.

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Team Leader

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Rating drivers (Summary)

The rating drivers, in decreasing order of importance in the rating assignment, are:

- (+) After the 11 difficult years that followed on the IPO of CASA, CA Group has now de-risked and returned to its domestic retail roots.
- (+) CA Group can benefit from the ample cash generation of its very strong franchises in retail banking and bancassurance in France, where its number one market position seems very secure, and in asset management in Europe (through Amundi).
- (−) We believe that the governance structure of the group has shown its limits, with constant push-pull pressures between CASA (Central Body) and the regional banks. This tension peaked during the crisis and in our view raised questions about the ability of the group to react effectively in an adverse situation.
- (+) After years of restructuring and deleveraging, the group is now in a position to build strong capital levels over the next two to three years.

Rating change drivers

In our view, the biggest hurdle to a higher rating for CA Group remains its current structure, in which the group's Central Body is also a listed vehicle with its own market-driven priorities. We believe that the recent crisis and its consequences have led the group to re-assess its modus operandi. Our outlook reflects our belief that the group is aware of this problem and is currently working towards a clearer group structure with well-defined responsibilities. A higher level of clarity and proper execution could lead to a higher rating.

As the group has reverted to its French roots (Italy and to a lesser extent Poland remaining the only material foreign markets), any further sharp deterioration in the fundamentals of the French economy could negatively impact the revenues and the credit quality of CA Group, considering its entrenchment in its core market.

Recent events

2013 results

CA Group reported very solid Q4 2013 results. In particular, the domestic retail banking activities of the regional banks and LCL (the former Crédit Lyonnais) showed very good resilience in what remain difficult operating conditions in France, while the savings business continued to be extremely cash generative. At the same time, the asset quality is under control and is improving in some areas that had long been difficult, in particular the Italian consumer credit business where CA Group sold EUR 1.4bn of non-performing loans in the course of the quarter. Since CA Group has considerably reduced its risk profile in investment banking, the results of the division appear to be less volatile (restated from own credit, DVAs, CVAs and the impact of the sale of Newedge to Société Générale).

The publication by CASA last November of a detailed capital planning roadmap giving very detailed fully-phased Basel 3 CET1 targets for CA Group and CASA until 2015 and updated by the Strategic Plan until 2016 provided important information.

Strategic Plan 2014-2016

On March 20, Crédit Agricole presented its 2014-2016 strategic plan, which strikes us as being very detailed and significantly more focused than the previous plan. It is also interesting to note that the group gives balance sheet metrics targets, which we find paradoxically more demanding than the profitability targets, all very reasonable. Scope's 2015 earnings forecasts for CA Group follow the overall trajectory of the group's own estimates. CA Group targets net profits of more than EUR 6.5bn in 2016 – Scope expects EUR 5.9bn in 2015.

For 2016, CA Group intends to focus on four pillars of development:

- Innovate and transform the retail business in France to better serve customers and strengthen the bank's leadership in France. Since CA Group has the largest retail network in France, it is easy to understand why the bank will try to develop both the brick-and-mortar branches and the online/digital channels. Considering the geographic spread of the bank, however, an overly aggressive reduction of the branch network would be risky. We believe that the bank has fully appreciated this challenge in its development plan.
- Step up the revenue synergies across the group. This strategic pillar, which consists in generating EUR 850m in additional group synergies by 2016, is quite demanding. Credit Agricole is known for its ability to exploit cross-divisional synergies, in particular between life insurance and retail; in 2013 CA Group generated a total of EUR 7.2bn in total synergies, more than 20% of Group revenues. However the targets rely on increasing the weight of non-life insurance sales in the networks and boosting the weight of specialized financial services product engines in the network's offering – both of which are less developed than life insurance.
- Achieve focused growth in Europe. The objective of CA Group is to increase its revenues generated in Europe (excluding France) by a combined 12% to EUR 7.6bn by 2016. This aspect of the plan may prove somewhat optimistic, considering that the group expects the revenues generated by its Italian subsidiary Cariparma (CA Group's largest exposure abroad) to grow by a CAGR of 5% per annum. This growth rate would be

underpinned by market share gains linked to the withdrawal of some local players, as well as the fact that, according to CA Group management, Cariparma uses no carry trade whatsoever, which may benefit the bank when interest rates increase.

- Invest in human resources, strengthen group efficiency and mitigate risks. Between now and 2016, CA Group intends to invest EUR 3.7bn to support business development and improve operational efficiency; generate EUR 950m of costs savings enabling a 2% fall in the group's cost-income ratio by 2016; and maintain strong risk metrics in asset quality, liquidity and funding, and market risks.

CA Group also disclosed interesting information on liquidity and on capital planning. On the former, it reported a Liquidity Coverage Ratio (LCR) of 80%+ at YE 2013, and is targeting a level above 100% at year-end 2014. With regard to the Net Stable Funding Ratio (NSFR), the group acknowledged the penalizing impact of repos in the ratio's calculation and announced a target of 100% by year-end 2016.

On the latter, the group confirmed that it would issue more than EUR 4bn of AT1 products between 2014 and 2016, so as to offset the regulatory grandfathering of older Tier 1 notes by 10% a year (EUR 0.9bn per annum, EUR 3.6bn in total over 2013-2016). The bank intends to capitalize on market opportunities to strengthen the financial structure and prepay hybrid Basel 2.5 instruments. It added that it does not plan to issue Tier 2 between 2014 and 2016.

Rating drivers (Details)

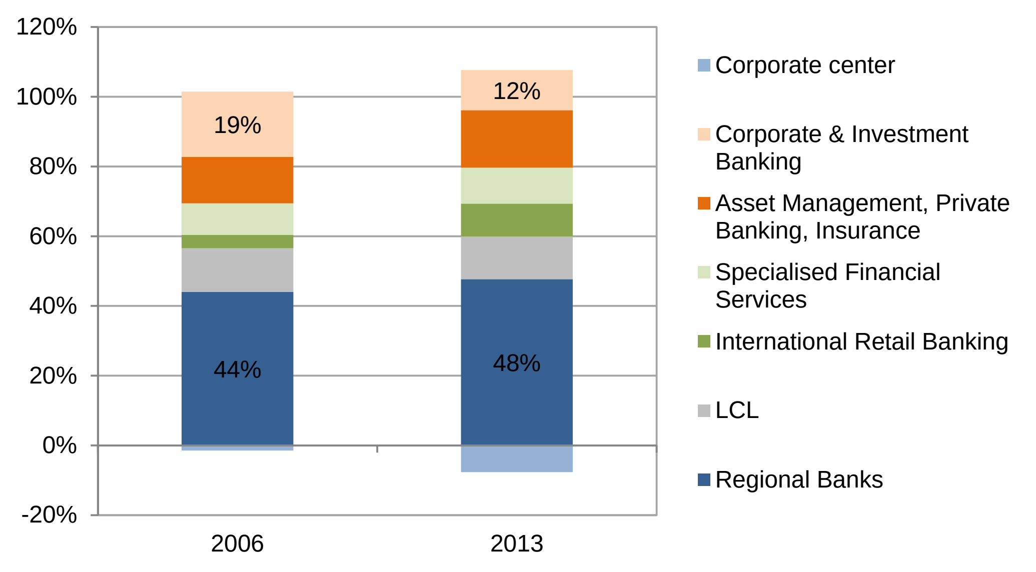
1. Back to domestic retail roots

The history of Crédit Agricole Group can be divided into in three different periods. Between the creation of the first local banks in 1894 and the creation of the Fédération Nationale de Crédit Agricole in 1945, CA Group built its business alongside its mutualist structure. Between 1959 and 1991, CA Group's lending restrictions were progressively lifted. Lastly, in 2001, the Central Body CNCA (renamed CASA) became listed, enabling CASA to launch a very ambitious growth strategy. Initially, the objective of CASA's listing was to enable the group to take part in French domestic consolidation and have an opportunity to buy Crédit Lyonnais (the acquisition was effective in 2003). But between 2005 and 2009, CA Group diversified aggressively into investment banking (essentially through organic growth from 2005 onwards); retail banking in Italy (acquisition of Cariparma and Friuladria in 2007, of Carispe and 96 branches from Intesa in 2010); Greece (acquisition of Emporiki in 2006) and Spain (20% of Bankinter acquired in 2007-2008); brokerage (Newedge, 2008); consumer credit (Agos Ducato, 2008); and asset management (SGAM in 2009).

The combination of the 2007-2009 financial crisis and the 2011-2012 EU sovereign crisis led Crédit Agricole to disengage and retrench. This move proved very costly, raising questions about the strategy of the past six to seven years. It generated losses of around EUR 8.3bn between 2007 and 2012 on the toxic assets stemming from the financial crisis, in addition to a EUR 5.5bn loss in 2011-2012 on Emporiki; EUR 1.1bn representing the cost of the "Private Sector Initiative" in Greece; as well as a combined EUR 6.6bn of goodwill impairment on various assets and on disposals – including Emporiki and investment banking assets.

Things have changed though, and at year-end 2013 the revenue breakdown of CA Group was much sounder than in 2006, at the peak of the bank's development in investment banking.

Chart 1: Revenue breakdown of CA Group, 2006-2013



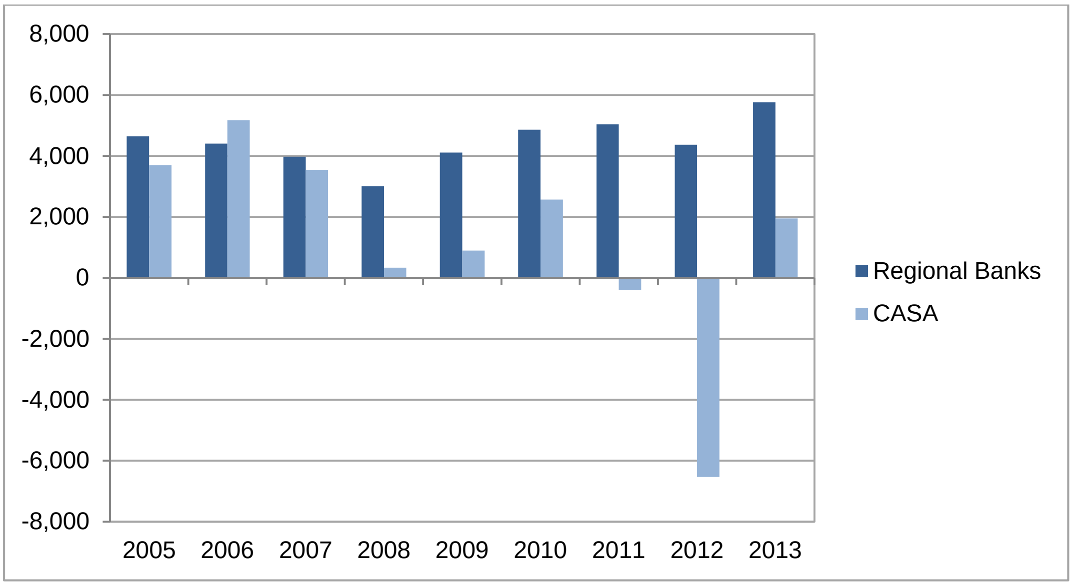
Source: Scope estimates, company data

As a group consolidating the regional banks and CASA, and therefore netting out all the intra-group entries, CA Group was never as dependent on Corporate & Investment Banking (CIB) as CASA alone was. Indeed, CA Group fully integrates 100% of the results of the regional banks, representing around EUR 14-15bn of revenues, instead of the 25% equity-accounted income consolidated by CASA, representing around EUR 1bn in an associates line. However, notwithstanding the enlarged perimeter of CA Group, the weight of French retail banking increased from 44% to 48% of group revenues between 2006 and 2013, while that of CIB fell by 7% to 12%. The weight of all retail businesses stood at 80% in 2013 versus 69% in 2006. When asset management, insurance and private banking are added, it could be argued that “lower-risk” revenues make up more than 95% of CA Group’s revenues. This is a good sign indicating that CA Group is back to its domestic retail roots.

2. A strong franchise in domestic retail and in savings management

CA Group’s regional banks network is the largest in France. Fed by the business of 2,483 local banks spread throughout more than 7,000 branches servicing 21 million clients (about a third of the total French population), the regional banks represent a loan market share of around 19% (21% for individuals). Deposit market shares are very similar. If we add the contribution of LCL, the market share of CA Group in French retail is close to 25%. Chart 2 compares the pre-tax profits of the regional banks’ network with the pre-tax profits of CASA, both just excluding taxes and income from associates. As Chart 2 shows, between 2005 and 2007, CASA managed to match the profitability of the regional banks. But the financial crisis cut into the profits of CASA, and in 2012 the profits of the group’s regional banks, large as they were, proved insufficient to offset the losses of CASA. This phenomenon led to CA Group posting its first-ever loss.

Chart 2: Regional banks vs. CASA pre-tax profits (excluding associates), 2005-2013 (EUR m)



Source: Company data, Scope estimates

The Savings Management and Insurance division is the second-largest contributor to CA Group's net profit. Within it, life insurance is a natural product engine for the regional banks, manufacturing life insurance products for the retail network. Outside the network, Amundi, the asset management arm of the CA Group, has gained a global critical mass following the merger of CAAM with SGAM in 2009 and is very successful. We believe that Amundi may, in fact, be the only lasting success of the 2005-2009 development years. CA Group refers to it as the ninth-largest asset manager in the world and the largest in Europe (source: IPE "Top 400 global asset managers active in the European marketplace") with assets under management of EUR 777bn as of year-end 2013. On top of external distribution, Amundi also acts as a product engine for the regional banks, LCL and Société Générale, which currently owns 25% of Amundi.

3. Limits of the current governance structure

Because of the hybrid nature of Credit Agricole SA (both listed vehicle and Central Body as defined by the French Monetary and Financial Code, articles l511-30 and l511-31), we believe that the relationships between the different stakeholders of the group are perfectible. We base this on the following considerations:

- The regional banks and CASA have a vertical parent-daughter relationship, but also a horizontal cross-guarantee/guarantor relationship.
- Due to its Central Body status, CASA has a supervisory function for the regional bank network, while at the same time being majority-owned by the regional banks through SAS Rue La Boétie.

These first two points are common to every other mutualist group in France. In addition, CA Group presents some specific features:

- The internal funding mechanisms within Crédit Agricole Group are complex.
  - Each regional bank holds a current account with CASA, which records the financial movements resulting from internal financial transactions within the group.

- Funds held in special savings accounts (like the Livret A passbook savings account) are collected by the regional banks on behalf of CASA. These funds are required to be transferred to the latter.
- The regional banks also collect savings funds on behalf of CASA. Special savings accounts and term deposits are transferred back to the regional banks through “advances” (loans) to the regional banks, with a view to funding their medium and long-term loans. Currently CASA transfers back to the regional banks 50% of the funds collected in the form of advances. These “mirror advances” have maturity and interest rates precisely matching those of the savings funds received, and regional banks are free to use them at their discretion. Margins from deposits that have not been retroceded are split equally between CASA and the regional banks (since January 1, 2004). Also, since January 1, 2004, 50% of the new loans distributed by the regional banks and falling within the field of application of financial relations between CASA and the regional banks may be refinanced by advances from CASA negotiated at market rates.
- As a listed company, CASA also needs to meet the needs of institutional and retail equity investors (in minority but historically above 40% of CASA’s capital), which do not necessarily have the same priorities as the regional banks (majority shareholders).
- At the time of its IPO, CASA bought a 25% stake in the regional banks in the form of non-voting shares (*certificats coopératifs d’investissement*). This technique gave CASA exposure to the earnings of the regional banks, but did little to simplify the complexity of the relationship between CASA and the regional banks.

These factors inherently create a raft of different prerogatives and responsibilities, which can create difficulties in the channels of communication.

In our opinion, the worsening of the euro crisis from the summer 2011 together with the withdrawal of US money market funds from the short-term funding of European banks put pressure on CASA’s liquidity. In fact, CA Group put together an “adaptation plan” revealed on 28 September 2011 that seemed somewhat one-sided. As a result of this strategic change, CASA ended up disposing of a significant chunk of its investment bank, reducing its corporate loan book, writing off a large portion of the goodwill accumulated during the expansion years and, finally, selling the Greek bank Emporiki after considerable losses. Prima facie, the “adaptation plan” was announced at group level and included liquidity measures taken group-wide but, in reality, the vast majority of the efforts were made at CASA level. Specifically, if we assume that about half of the EUR 22bn funding reduction achieved by the domestic retail networks was due to the decline in the loan-to-deposits ratio of LCL, this would mean that 83% of the reduction in group funding needs and 100% of the group RWA reductions were attributable to CASA and CASA affiliates.

CA Group’s corporate governance issues are also illustrated by the way the group communicates on capital. Despite the fact that the regulator looks at CA Group, and not CASA, to analyze the capital and the liquidity of Crédit Agricole, a lot of details are devoted to the regulatory capital of CASA, the group’s listed entity. We are also surprised by the time and effort spent by the group on a complex intra-group capital enhancement operation (Switch), which then disappears at the consolidated group level, just for the purpose of boosting CASA’s capital ratios.

Overall, the rejuvenated business model of Crédit Agricole Group as revealed at the presentation of the Strategic Plan 2014-2016 would be helped by clarifying responsibilities between the group’s different participants, provided this clarification is convincing and properly executed. The multiplication of intra-group financial flows and intra-group corporate responsibilities could be simplified, so that the group can fully deliver on its very convincing strategy.

4. Capital build-up of CA Group expected to gain momentum

As a result of the de-risking of CA Group and its return to its domestic retail roots, we expect the bank to build a strong capital base over the next two to three years. The group's principal cash generators are the regional banks. As these are not managed via ROE targets or dividend yield, Scope expects a significant accumulation of capital at group level. In its capital planning exercise, CASA's CFO detailed the major Basel 3 estimates, most recently when presenting the 2014-2016 strategic plan. CA Group is targeting a fully-phased Core Equity Tier 1 ratio of 11% at the end of 2013 (achieved), 12% at the end of 2014, 13% at the end of 2015 and 14% at the end of 2016. The group claims that this will be reached through earnings generation and asset sales/identified balance sheet management. We cannot estimate the type of assets that CA Group will sell, especially since CASA has already disposed of numerous assets, but we can estimate the level of the CET1 ratio under conservative retained earnings and asset growth estimates. This is the aim of Table 1, together with an estimate of the "lowest possible" leverage ratio, i.e. assuming Total Tier 1 capital divided by all-grossed-up IFRS total assets. Therefore, the ratio cannot possibly be calculated in a more conservative manner.

Under these circumstances, we are comfortable with CA Group's capital levels. In fact, CA Group should post the highest capital levels of French banks in 2015E, at 12.5% CET1, roughly 200bps ahead of BNP Paribas. Our forecasts assume that CA Group will fall about 50bps short of its 2015 CET1 targets, but this could be explained by the fact that our forecasts include no further disposals and gives the bank no credit for any management action as detailed in the 2014-2016 strategic plan. We note that, on a pure organic basis, our CET1 estimates are roughly in line with the bank's targets.

As for the leverage ratio, the five large French banks are already materially above the 3% CRD 4-defined minimum in 2013.

In addition, the regulator looks at Crédit Agricole's regulatory capital from a group perspective and not at CASA level. The advantage is that this presents the regulatory capital in a more favorable light as all intra-group deductions and associated RWAs are not included in the calculation of the ratio at group level.

Table 1: Relative capital build-up of the five rated French banks

	2011		2012		2013		2014E		2015E	
	CET1 (%)	T1 LR (%)	CET1 (%)	T1 LR (%)	CET1 (%)	T1 LR (%)	CET1 (%)	T1 LR (%)	CET1 (%)	T1 LR (%)
Crédit Mutuel	12.0%	4.6%	12.0%	4.4%	14.2%	5.6%	NA	NA	NA	NA
BPCE	6.6%	3.6%	8.8%	4.1%	10.4%	3.6%	10.8%	NA	11.2%	NA
BNP Paribas	7.4%	3.6%	9.9%	3.9%	10.3%	3.7%	10.4%	NA	10.5%	NA
Crédit Agricole Group	7.2%	3.3%	9.3%	3.1%	11.2%	3.8%	11.8%	NA	12.5%	NA
Société Générale	6.1%	3.2%	8.1%	3.2%	10.0%	3.5%	10.3%	NA	10.4%	NA

Source: Scope estimates, company data

Peer comparison

At Scope Ratings, we compare banks within peer groups at domestic and cross-border level.

In France, Crédit Agricole Group is comparable to BNP Paribas, Société Générale, BPCE and Crédit Mutuel Group.

Looking at the performance of CA Group versus domestic peers, we note that, on many metrics, the five rated banks show similar rankings. This is particularly the case of liquidity metrics, since the loan-to-deposits ratio of all French banks falls between 110% and 130%. CA Group has significantly improved this metric over the years and is now well-positioned among its domestic peers.

In asset quality terms, French banks are clearly divided between domestically-biased and internationally-biased banks. Among the former (CA Group, Crédit Mutuel and BPCE), Crédit Agricole shows impaired loans metrics that rank among the best of its peers. The loan loss coverage ratio of CA Group is also the best among rated French banks.

The capital metrics of the group have improved as a result of the 60% reduction in the gross present value of derivatives reported on balance sheet thanks to the application of IAS 32, which increases the possibility of derivatives netting.

Outside France, we have positioned CA Group in the bucket of mostly domestic institutions. This peer group includes Lloyds, Rabobank, Intesa and Swedbank among others.

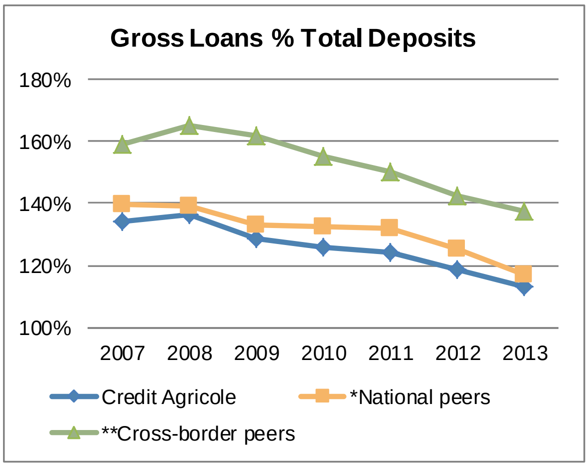
CA Group's position among peers can be said to evolve rapidly. Ten years ago, CA Group would have been considered a pure retail bank. Five years ago, the expansion into investment banking and the positions reached by CASA could have warranted a place among the large universal banks. Today, CA Group is back among the mostly domestic European retail banks.

Overall, CA Group looks well compared with peers. At 113% in 2013, its loan-deposit ratio compares well with its peers. The other liquid indicators look good and are improving, which is not surprising considering the significant efforts made by the group in 2011-2012.

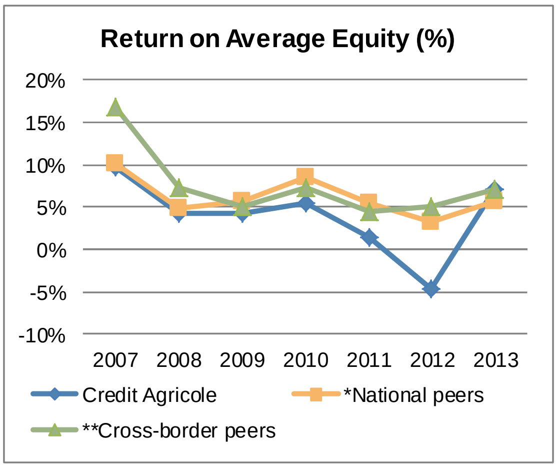
In asset quality terms, CA Group also shows metrics consistent with its leading position in the French market: much better than most internationally, but slightly lower than the metrics of Nordic banks. The coverage ratio of CA Group at the international level ranks among the best. On average, Crédit Agricole's profitability metrics are in line compared with peers, as demonstrated by the ROE comparative in our peer group charts.

Regarding leverage, the ratio of CA Group is still at the lower-end of international peers despite the bank's progress in 2013, and the risk-asset intensity remains low (only one Nordic banks shows lower ratios). This is a problem common to all French banks but, in the case of CA Group, it causes us less concern considering the group's low risk profile.

Peer Comparison - Credit Agricole Group



Source: SNL Financial, Scope Ratings



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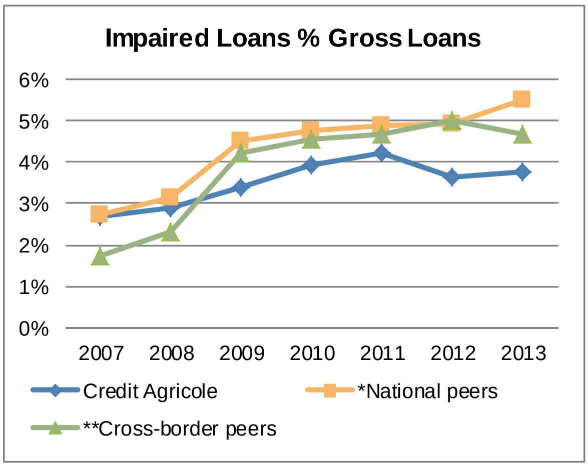

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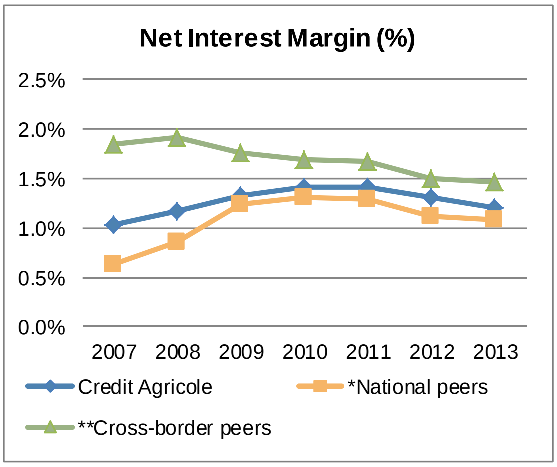

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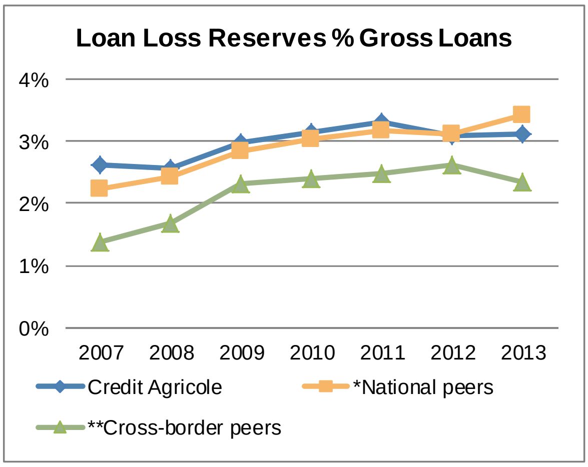

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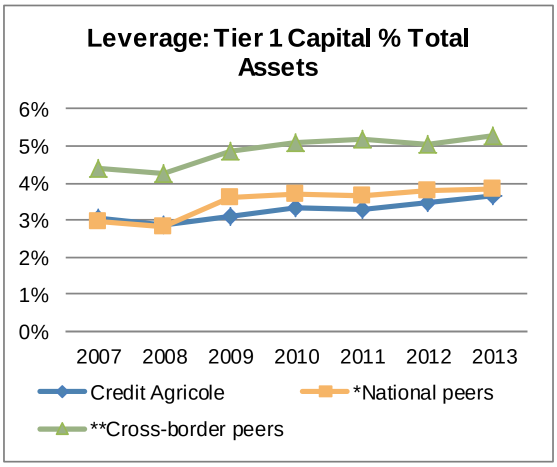

Source: SNL Financial, Scope Ratings

*National peers: BNP Paribas, Credit Agricole Group, Credit Mutuel Group, Groupe BCPE, Societe Generale
**Cross-border peers: Groupe BPCE, Credit Mutuel Group, Intesa, DNB ASA, Credit Agricole Group, CaixaBank, Sw edbank, Lloyds Banking group, Wells Fargo & Co., Rabobank Group

Notes: Cross-border peer group excludes Credit Mutuel Group in 2013 as w ell as Intesa for the Net Interest Margin and the Return on Average Equity. We use H1 2013 numbers as a 2013 proxy for Intesa on all other ratios.

Selected Financial Information - Credit Agricole Group

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Balance Sheet summary (EUR billion)									
Assets									
Cash and balances with central banks	21.8	52.5	37.5	31.7	31.4	46.1	71.6	94.5	132.8
Interbank assets	86.3	78.7	90.2	101.8	102.8	117.3	93.7	94.6	96.5
Total securities	499.5	410.1	433.4	447.2	407.8	501.6	485.6	489.2	476.9
of which debt instruments	399.5	351.0	336.4	349.7	325.6	429.7	360.9	360.9	342.8
of which equity instruments	70.9	31.3	58.4	56.0	41.8	38.5	37.9	39.8	43.8
Derivatives	187.6	401.0	282.4	266.3	392.8	477.0	190.7	191.3	190.7
Gross customer loans	645.0	717.4	747.7	776.6	827.1	758.8	731.3	731.3	738.2
of which impaired loans	17.5	20.8	25.2	30.9	34.9	27.7	27.7	27.7	27.4
Total funded assets	1,356.0	1,391.6	1,415.1	1,470.3	1,491.5	1,531.0	1,516.9	1,544.1	1,578.8
Total Assets	**1,540.9**	**1,784.0**	**1,693.8**	**1,730.8**	**1,879.5**	**2,008.0**	**1,706.3**	**1,734.1**	**1,768.1**
Liabilities									
Interbank liabilities	151.9	150.8	113.9	124.2	126.8	110.0	104.6	104.6	104.6
Senior debt	328.8	300.0	282.9	273.9	233.3	294.5	310.9	314.0	317.1
Derivatives	184.9	392.4	278.7	260.6	388.0	477.0	189.4	190.0	189.4
Customer deposits	485.7	527.9	577.9	623.3	666.7	639.0	648.0	654.5	667.6
Subordinated debt + hybrid securities	22.5	31.6	34.1	33.0	33.1	28.1	26.6	26.6	26.6
Total Liabilities	**1,470.9**	**1,715.0**	**1,619.1**	**1,653.4**	**1,802.8**	**1,931.9**	**1,624.7**	**1,647.7**	**1,676.8**
Ordinary equity	64.8	63.7	68.8	71.5	70.7	70.8	76.3	81.0	86.0
Minority interests	5.2	5.3	5.9	6.0	6.1	5.3	5.4	5.4	5.4
Total Liabilities and Equity	**1,540.9**	**1,784.0**	**1,693.8**	**1,730.8**	**1,879.5**	**2,008.0**	**1,706.3**	**1,734.1**	**1,768.1**
Core Tier 1 Capital [1]	*42.4*	*42.2*	*45.8*	*49.6*	*40.0*	*47.8*	*60.7*	*65.4*	*70.4*
Income Statement summary (EUR billion)									
Net interest income	13.9	18.0	21.3	22.4	23.0	23.1	21.5		
Net fee & commission income	9.5	9.3	10.8	10.8	10.7	9.0	8.9		
Net trading income	8.5	-8.5	5.0	4.7	0.2	5.4	4.6		
Operating Income	**30.3**	**29.6**	**31.8**	**33.4**	**39.4**	**31.9**	**31.2**	**31.7**	**32.7**
Operating expenses	20.3	20.4	19.7	20.9	21.9	21.0	19.7	19.9	19.9
Loan loss provision charges	3.2	5.5	7.0	5.2	10.1	5.0	4.0	3.6	3.6
Non-recurring items	1.5	0.5	0.2	-0.1	-1.3	0.2	0.2	0.0	0.0
Pre-Tax Profit	**8.2**	**3.9**	**4.8**	**6.6**	**4.0**	**-1.4**	**7.7**	**8.2**	**9.2**
Income tax	1.7	1.0	1.8	2.5	2.9	2.3	2.2	2.6	2.9
Net profit attributable to minority interests	0.5	0.5	0.3	0.5	0.3	0.1	0.4	0.4	0.4
Net Income Attributable to Parent	**6.0**	**2.5**	**2.7**	**3.6**	**0.8**	**-3.7**	**5.1**	**5.3**	**5.9**

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] CRD 4 basis from 2011 onwards

Ratios - Credit Agricole Group

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Funding/Liquidity									
Gross loans % Total deposits	132.8%	135.9%	129.4%	124.6%	124.0%	118.7%	112.8%	111.7%	110.6%
Total deposits % Total funds	49.1%	52.3%	57.3%	59.1%	62.9%	59.6%	59.4%	59.5%	59.8%
Wholesale funds % Total funds	50.9%	47.7%	42.7%	40.9%	37.1%	40.4%	40.6%	40.5%	40.2%
Asset Mix, Quality and Growth									
Gross loans % Funded assets	47.6%	51.6%	52.8%	52.8%	55.5%	49.6%	48.2%	47.4%	46.8%
Impaired loans % Gross loans	2.7%	2.9%	3.4%	4.0%	4.2%	3.7%	3.8%	3.8%	3.7%
Loan loss reserves % Impaired loans	62.6%	81.9%	108.5%	53.8%	78.7%	84.5%	82.5%	82.5%	82.5%
Gross loan growth (%)	20.7%	15.1%	9.4%	12.1%	11.2%	-1.7%	2.7%	6.7%	7.7%
Impaired loan growth (%)	7.6%	18.9%	21.3%	22.3%	13.1%	-20.6%	0.0%	0.0%	-1.0%
Funded assets growth (%)	8.0%	2.6%	1.7%	3.9%	1.4%	2.6%	-0.9%	1.8%	2.2%
Earnings									
Net interest income % Revenues	46.0%	60.9%	66.9%	67.0%	58.3%	72.5%	68.9%		
Fees & commissions % Revenues	31.5%	31.4%	33.8%	32.3%	27.2%	28.2%	28.5%		
Trading income % Revenues	28.0%	-28.8%	15.7%	14.1%	0.4%	17.1%	14.7%		
Other income % Revenues	-5.4%	36.5%	-16.3%	-13.4%	14.1%	-17.8%	-12.1%		
Net interest margin (%)	1.3%	1.5%	1.8%	1.8%	1.8%	1.8%	1.7%		
Pre-provision Income % Risk-weighted assets (RWAs)	1.6%	1.5%	2.2%	2.1%	3.4%	2.3%	2.4%	2.2%	2.3%
Loan loss provision charges % Pre-provision income	31.8%	59.9%	58.0%	41.6%	57.6%	45.7%	34.8%	30.7%	28.1%
Loan loss provision charges % Gross loans (cost of risk)	0.5%	0.8%	1.0%	0.7%	1.3%	0.6%	0.6%	0.5%	0.5%
Cost income ratio (%)	67.2%	69.1%	62.0%	62.6%	55.6%	65.8%	63.1%	62.5%	60.9%
Net Interest Income / Loan loss charges (x)	4.4	3.3	3.0	4.3	2.3	4.6			
Return on average equity (ROAE) (%)	9.7%	3.8%	4.1%	5.1%	1.1%	-5.3%	7.0%	6.7%	7.0%
Return on average funded assets (%)	0.3%	0.1%	0.1%	0.2%	0.0%	-0.2%	0.2%	0.2%	0.2%
Retained earnings % Prior year's book equity	n/a	n/a	n/a	n/a	n/a	n/a	7.0%	6.2%	6.1%
Pre-tax return on common equity tier 1 capital	19.4%	9.2%	10.6%	13.4%	9.9%	-2.9%	12.7%	12.6%	13.1%
Capital and Risk Protection [1]									
Common equity tier 1 ratio (common equity tier 1 capital % RWAs)	6.7%	6.9%	8.5%	8.4%	7.2%	9.3%	11.2%	11.8%	12.5%
Tier 1 leverage ratio (%)	3.0%	2.9%	3.1%	3.3%	3.3%	3.1%	4.4%		
Median of tier 1 leverage ratio and common equity tier 1 ratio (%)	4.9%	4.9%	5.8%	5.9%	5.3%	6.2%	7.8%		
Total loss coverage (CET 1 capital + loan loss provisions) % RWAs	8.5%	9.6%	13.6%	11.2%	12.9%	14.8%	17.5%	16.0%	16.5%
Non-senior bailinable debt cushion (as % of total liabilities)	1.5%	1.8%	2.1%	2.0%	1.8%	1.5%	1.6%	1.6%	1.6%
Asset risk intensity (RWAs % total assets)	40.9%	34.5%	31.8%	34.2%	27.8%	23.9%	28.0%	31.9%	31.9%

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] CRD 4 basis from 2011 onwards

METHODOLOGIES USED FOR THIS REPORT

For the rating and analysis contents of this report Scope has used the following methodologies which were published on www.scoperatings.com:

"Bank Rating Methodology" (February 2014)

"Forecasting Bank Financials Methodology" (February 2014)

Forecasting bank financials: Forward-looking estimates are an important analytical tool underpinning Scope's bank ratings. These forecasts cover the current financial year (before final year-end figures are published by the bank) plus the forthcoming two years. Depending on the complexity of the bank being assessed, different forecasting tools will be used. For a majority of banks operating primarily commercial and retail banking franchises (loans and deposits) the analysis is underpinned by an **accounting** forecast of the balance sheet and profit and loss account. For more complex groups with multiple ranges of activities – notably those with material wholesale and investment banking operations – Scope uses an **analytical** forecast, relying on the bank's business-line reporting to come up with plausible estimates. For all banks Scope also include a **regulatory metrics** forecast, considering the growing importance of this aspect in bank analysis.

For complex banks, divisional data is used to forecast profit and loss accounts and basic divisional balance sheet metrics. For less complex banks, a line-by-line forecasting of major P&L elements is forecast.

For balance-sheet forecasts, Scope estimates of all major balance sheet lines, using the P&L estimates to complete the forecast of the capital/shareholders' equity line. This comprehensive methodology for estimating the balance sheet is used for all the banks in our universe, irrespective of size and complexity.

Lastly, our forecasts include assessments of the major regulatory metrics: Tier 1 and CET 1 (historically CT1), Leverage, Liquidity Coverage Ratio, and Net Stable Funding Ratio (the latter two when and if sufficient public information to compute them is available).

Scope will not aim to forecast financials when it considers the public disclosure of the bank as insufficient for a transparent and credible outcome.

All Scope's bank financial forecasts are based on public information. For its forecasts Scope will not use any non-public information or data, even if such information or data were provided by rated banks. Scope's forecasting process is transparent, with a detailed roadmap provided in its *"Forecasting bank financials"* methodology.

Credit Suisse AG
Issuer Rating Report

SCOPE | A+ STABLE OUTLOOK
Financial Institutions

Overview

Scope Ratings assigns an Issuer Credit-Strength Rating (ICSR) of A+ to Credit Suisse AG, with a stable outlook. This rating reflects the bank's successful business restructuring as well as the acceleration of its capital build-up. The rating also reflects the fact that leverage remains slightly too high versus domestic and international peers, while Credit Suisse's proposed new legal structure in the context of recovery and resolution planning could further dissociate the company's operating cash flow from the bondholders at holding company level. The A+ rating applies to senior unsecured debt issued by Credit Suisse AG. However, the rating is not applicable to unguaranteed debt issued by subsidiaries of Credit Suisse AG nor to debt issued by its parent Credit Suisse Group AG.

Ratings (assigned on April 2, 2014)

Issuer Credit-Strength Rating	**A+**
Outlook	Stable
Senior Unsecured Debt	A+

Unsolicited ratings with issuer participation.

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Rating drivers (Summary)

The rating drivers, in decreasing order of importance in the rating assignment, are:

- (+) The very resilient private banking and wealth management division is proving to be a highly efficient cash cow throughout the cycle.
- (+) The successful redeployment of the investment bank has reduced risk and volatility.
- (−) The bank's Tier 1 leverage ratio remains decidedly lower than peers, despite a strong improvement in risk-weighted metrics.
- (−) The proposed new legal structure of Credit Suisse in the context of resolution planning could have a negative impact for creditors at the holding company level.
- (+) A strong management team, which has helped the bank weather the crisis and has been successfully renewed over the years.
- (+) The weight of two very thorough and proactive public authorities (SNB and FINMA) in the field of financial stability and bank supervision in Switzerland.

Rating change drivers

Beware too much restructuring. To date, Credit Suisse has successfully managed to reduce the absolute size of its investment bank without harming its franchise or profitability. However, the recently announced build-up of two non-strategic units (one in the Private Banking & Wealth Management division (PBWM), the other in the Investment Bank (IB)) could at some point begin to damage the franchise of Credit Suisse. So far, we believe that the restructuring of the Rates business away from non-Basel 3 compliant and capital intensive positions, together with the decision of CS Group to exit 83 countries to rationalize its private banking setup, has proven successful. Nevertheless, further pressure from shareholders for supplementary cuts could, in our view, harm the bank and the proper functioning of its integrated model.

The recent success of CS Group's Private Banking business is associated more with the efficiency gains made by combining the asset management and the private bank and integrating Clariden Leu than with significant asset and revenue growth. For too long, CS Group's strategy in Wealth Management has been limited to waiting for interest rates to increase and for the Swiss franc to weaken. We believe that between H2 2009 and 2011, the bank lost much of the momentum it had gained during the crisis years. In our view, any initiative enabling CS Group to reposition the Private Bank towards higher growth clients and geographies would be positive for the stability of the bank's cash generation.

Recent events

Credit Suisse reported its Q4 2013 earnings at the beginning of February. Overall, it was a reasonably dependable set of numbers, not dissimilar to Q3 in its trends: Private Banking margins are stabilizing at a low 104bps, compared with 109bps in Q4 2012 and 105bps in Q3 2013, while investment banking revenues are proving much less volatile. On a yearly basis, Credit Suisse's profitability has improved markedly with net reported earnings multiplied by 2.5x year-on-year. At the same time, it has seen its capital position strengthened significantly with the CET1 ratio rising from 6.7% to 10.3% year-on-year.

Towards the end of 2013, Credit Suisse announced a new Basel 3-compliant legal structure aimed at aligning the group's organization with current and developing regulatory requirements. We comment on this announcement in the "Rating drivers" section below.

On March 21, Credit Suisse settled its largest mortgage-related investor litigation by announcing a settlement of USD 885m to resolve all claims pertaining to two lawsuits filed by the Federal Housing Finance Agency (FHFA) against Credit Suisse. As a result of this settlement, Credit Suisse incurred an after-tax charge in respect of its 4Q 13 and full-year 2013 results of CHF 275m. Restated 2013 financial statements including the impact of this charge will be released by the company as part of the Annual Report on April 3.

Rating drivers (Details)

1. The very resilient private banking and wealth management division is proving to be a highly efficient cash cow throughout the cycle

Over the years, Credit Suisse has benefitted from the reliability of a very solid private banking division, which has on average represented about 33%-35% of CS Group's pretax profit. Table 1 shows the main metrics of the division.

Table 1: Private Banking metrics – Credit Suisse

	2007	2008	2009	2010	2011	2012	2013
Wealth management PTP (CHF m)	3,865	2,509	2,898	2,528	1,446	2,021	2,059
Net new money (CHF bn)	50.2	42.2	35.3	45.3	37.4	19.0	18.9
Gross margin (bps)	115	115	131	120	122	114	107

Source: Company data

The apparent volatility of the results is deceptive.

Despite a sharp fall in net profits, the division had to reposition the business in the context of:

1. Pronounced de-risking of the client base (around 28-30% of client assets have been invested in cash since 2010).

2. Retreat from Swiss-neighboring offshore markets (Germany, France, Italy) leading to pronounced outflows from these countries in 2012-2013.
3. Persistently low interest rates weighing on gross margins and a strong Swiss franc that penalized the P&L (as a large portion of revenues is labelled in USD while the bulk of the cost base is CHF-denominated).
4. Re-orientation of the business towards Ultra-High Net Worth Individuals (UHNWIs) and Asia-Pacific, which feature higher growth but lower margins than other sections of the franchise.
5. Restructuring of the international network leading to the closure of 83 offices in countries where Credit Suisse did not believe it had enough critical mass to service HNWIs profitably. This included the sale of the onshore German business to ABN AMRO.

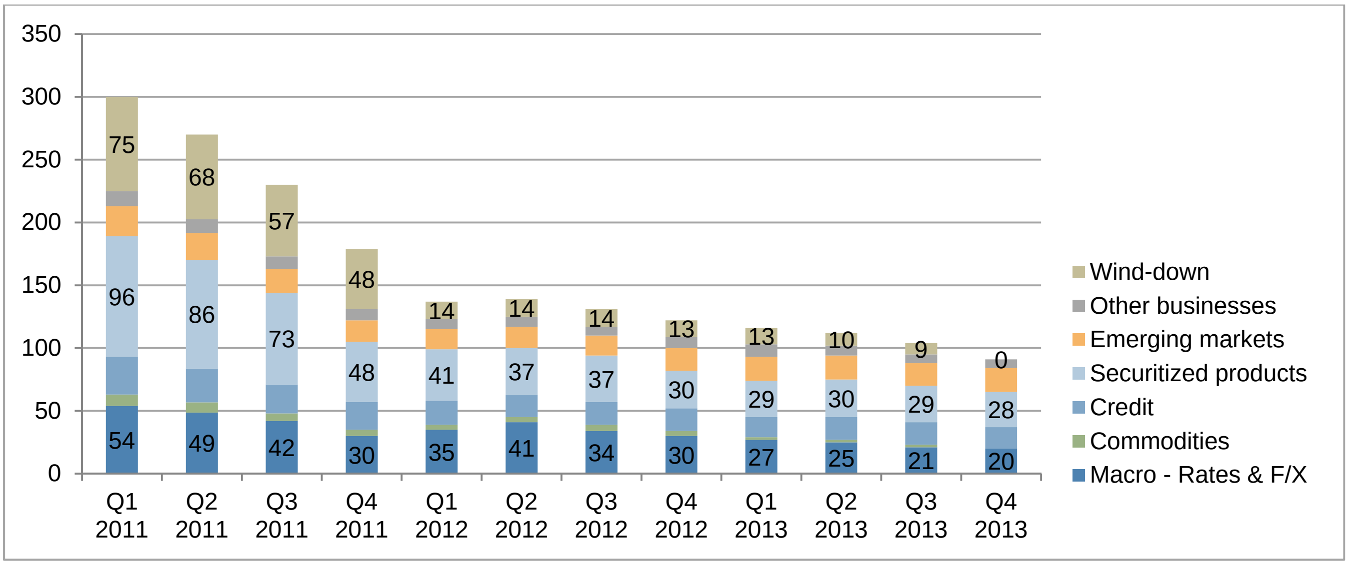
As a result of the points above, the division's profitability reached a trough in 2011; even if it still accounted for one-third of the group's profits. However, the restructuring of the division – recently combined with the Asset Management IT platform – and the re-orientation of the franchise should soon bear fruit. Indeed, the profitability of Wealth Management improved again in 2012 and stabilized in 2013.

2. The investment bank has been successfully redeployed without damage to the franchise

While some of its peers have deliberately taken an aggressive stance on reducing investment banking exposure, Credit Suisse has, in our view, been more cautious. Indeed, it is very difficult to assess the impact of too aggressive a reduction in a given business considering the hazards of such de-risking for integrated banks. CS has therefore taken a decisive, but measured approach to reducing its investment banking (IB) exposure, and we believe that so far it has been successful.

In pure capital generation terms, Chart 1 shows the magnitude of CS Group's efforts.

Chart 1: RWA reduction in the FICC business (USD bn)



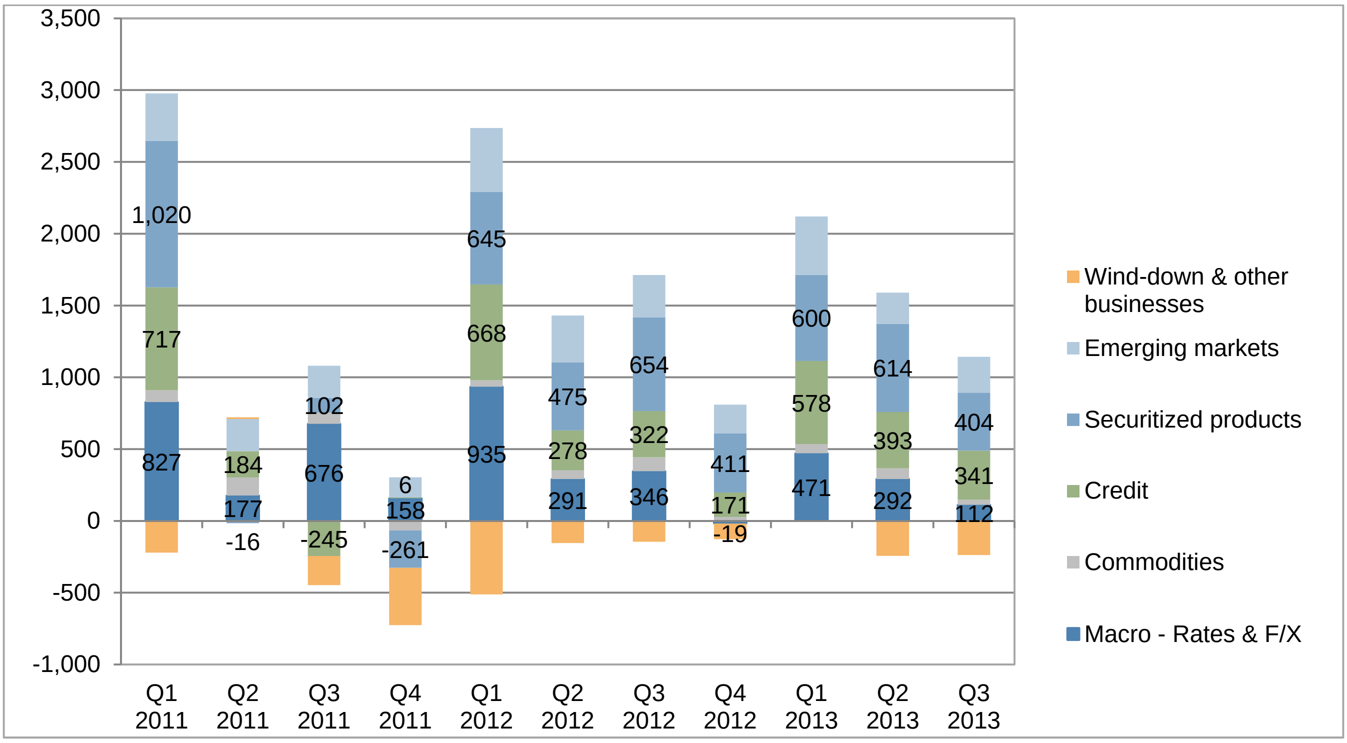
Source: Company data, Scope Ratings estimates

Based on our estimates, the RWAs of the investment bank's Fixed Income, Currency & Commodities (FICC) division dropped from USD 300bn in Q1 2011 to USD 91bn at the end of 2013. This is a fall of more than two-thirds in two and a half years. As seen on the chart, the bank has been extremely efficient in getting rid of its "wind-down" businesses, essentially consisting of long-dated, unsecured trades representing a reduction of USD 64bn until Q3

2013. The USD 68bn decline in securitized products' RWAs is also quite impressive, reflecting the bank's full exit from CMBS origination and a major reduction in RMBS inventories. Looking at this chart, it seems intuitively natural to think that the profitability of the FICC business would in fact fall. However, if anything, the revenue trends of the IB seem now less volatile than they used to be (Chart 2).

Looking at Chart 2, even a high-level examination shows that from Q2 2012 onwards the volatility of Credit Suisse's FICC results has abated significantly. Unsurprisingly, wind-down businesses report consistently negative revenues, but it is encouraging to see macro revenues (composed of global rates and forex) come under control. Over the six quarters between Q2 2012 and Q3 2013, macro revenues did not peak above USD 471m (in Q1 2013) – even if they still experienced one quarter of negative revenues in Q4 2012. Despite a very aggressive reduction in inventories, securitized products have demonstrated remarkably resilient revenues since Q1 2012, as has the credit business, much more under control. In this context, Credit Suisse's Q3 (and Q4) results made further progress on stabilizing the IB franchise and reducing its volatility. This adds another layer of security in a rapidly de-risking business.

Chart 2: Revenue volatility of the Investment Bank (USD m)



Source: Company data, Scope Ratings estimates

Unfortunately, it is not possible to update the series on Chart 2 as the break-up of Credit Suisse between "strategic" and "non-strategic" businesses has rendered Q4 2013 comparisons with the above impossible. However, we believe that Chart 2 is a very good and recent example of the de-risking trends at Credit Suisse, which should be amplified by the transfer of the previous "wind-down" businesses to the non-strategic division of the investment bank.

3. The leverage ratio remains lower than peers

Since June 2012 and the announcement of its capital measures, Credit Suisse has accelerated the build-up of its capital base under Basel 3. As Table 2 demonstrates, the progress on the risk-weighted asset side has been spectacular.

Table 2: Swiss CET1 Basel 3 and leverage ratio of Credit Suisse (%)

	2011	2012	2013
Common equity Tier 1 (%)	3.51%	6.69%	10.30%
Tier 1 leverage ratio (%)	-	2.39%	3.03%

Source: Scope Ratings estimates, Company data

Indeed, in less than two years the CET1 ratio of the bank has trebled, from 3.5% to 10.3%.

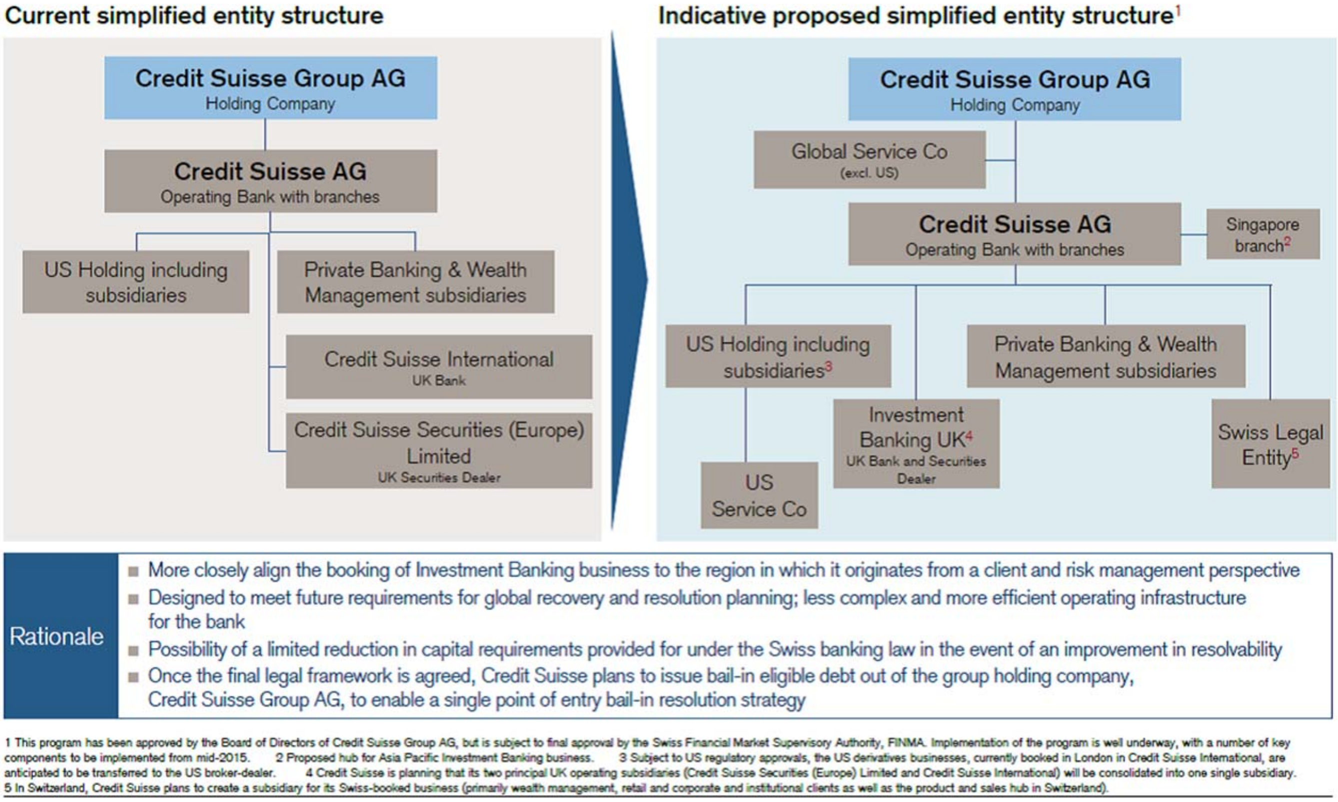
However, the Tier 1 leverage ratio (comprising all loss-absorbing capital) has remained somewhat weak at slightly above 3%, despite a 25% improvement on 2012. The bank cannot be criticized for not shedding assets in absolute terms. A quick look at the balance sheet and its pre-crisis levels shows that total US GAAP assets fell from a peak of CHF 1,360bn in 2007 to CHF 1,031bn in 2009 and CHF 873bn in 2013. However, the problem is that since CS reports under US GAAP and therefore uses netted positions for its derivatives, it has to account for considerable add-ons in its asset base when reporting its "exposure" (the denominator of the leverage ratio in Switzerland). Since the beginning of 2013, the total exposure number of Credit Suisse has decreased by less than 10%, at CHF 1,154bn (versus CHF 1,280bn as of Q1 2013). The fact that the exposure is calculated on the basis of a three-month average does not help, either. We reckon that retained earnings will help CS add 33bps to its leverage ratio by 2015. Taking into account CS's objective to bring the total exposure to CHF 1,070bn in the long-term could add another cumulative 26bps and raise the bank above a Tier 1 leverage ratio of 3.5%. However, this is likely to happen after 2015.

The leverage problem also raises the issue of the risk asset intensity of the bank. Under Basel 3, the ratio of RWAs to assets of CS Group stands at about 31% as of year-end 2013, which is considerably lower than international peers (using IFRS 7 to harmonize total assets definition between banks reporting under different accounting standards). This raises the issue of the bank's internal modelling and the appropriate calibration of risk by RWAs.

4. The credit impact of CS Group's proposed new legal entity structure is potentially negative

Last November, Credit Suisse announced a new legal structure prepared to "address developing and future regulatory requirements" to be ready by mid-2015. The bank discussed the new structure with the FINMA and ensured that it would be compliant with Swiss, US and UK regulation. Chart 3 compares the new structure with the existing one.

Chart 3: Proposed changes to Credit Suisse legal entity structure



Source: Company data

We will not add to the rationale, which is clearly explained by the company in the box below the structures on Chart 3, but we note the importance of aligning the booking of investment banking to the region in which it originates from a client and risk management perspective. The Singapore branch will serve this purpose for Asia Pacific (APAC) investment banking, while the US holding company and subsidiaries will take care of the US business. There will be two shared-services companies; one for the US and another for the rest of the world. Lastly, in order to respect FINMA's preferred resolution technique (the SPE, or Single Point of Entry), it is the parent holding company (in blue in the graph above), Credit Suisse Group AG, which will issue bailinable debt on behalf of the group.

Overall, we find that this structure makes sense and combines the simplicity of business alignment with the necessary complexity of running a large business in the US. At the same time, we are concerned about the growing remoteness between the cash flows and the holding company, particularly versus the old structure (as demonstrated in Chart 3). Indeed, there will be one supplementary layer between the Private banking business and the holding company in the form of a Swiss legal entity. In the US, we believe it will be difficult to free the cash flow, as US regulators have expressed their willingness to compensate US creditors before participating in a foreign-driven Single Point of Entry (SPE) resolution. The US cash flows will also become more important as all the derivatives businesses (currently booked in London) will be booked in the US.

5. CS Group's management has successfully resisted the impact of the 2007-2008 financial crisis and has promoted a talented new generation of bankers

On the whole, CS Group's management team has remained stable over the last decade. This can be attributed to the fact that the bank did not have recourse to public money during the crisis, and was able to fund itself externally without too much difficulty. This in turn stems from the fact that between 2002 and 2005, CS Group faced its own crisis linked to the insurance company Winterthur, purchased by Credit Suisse in 1997. The disposal of the company in 2006 as well as an insightful de-risking of the investment bank prior to the 2007-2008 crisis protected the bank against a surfeit of financial woes and gave it the enviable status of "crisis winner" until the end of H1 2009. The bank's financial performance then sagged a bit until Q3 2011, at which point CS Group announced the redeployment of its strategy, shifting the Private Bank strategy towards UHNWIs and platform sharing with asset management. At the same time, CS Group started to exit capital-intensive and high-risk positions in its investment bank, particularly in Fixed Income.

The repositioning of the bank continued with the capital initiatives announced in July 2012. Even if these measures were directed by the Swiss National Bank (SNB, see below), they were very diligently executed and CS Group was able to exponentially increase its capital level in less than 18 months.

In the new phase of its restructuring disclosed in Q3 2013, CS announced the creation of two non-strategic units, one for the PBWM division and one for the IB. These units are purportedly not redirected to the corporate center, so as to secure the "experience and focus" of the divisional managers. The perimeter of these units does not strike us as too aggressive.

6. The weight of two very thorough and proactive public authorities (SNB and FINMA) in the field of financial stability and bank supervision in Switzerland

Following the financial crisis that brought another large bank to the brink of collapse, the Swiss financial authorities took steps to enhance the supervision of banks, in particular of the two large institutions that are critical in Switzerland as their banking assets represent five times the country's GDP. The respective prerogatives (and joint work) of the Swiss National Bank (SNB) and FINMA (Financial Regulator) are defined in the February 23, 2010 Memorandum of Understanding in the field of financial stability.

The following steps have been successfully taken since the crisis:

1. SNB and FINMA have managed to speedily insert Too Big To Fail (TBTF) and systematically-relevant specific legislation into the 1934 Banking Act and the 1972 Ordinance on banks. The most important conclusions of Basel 3 rules and their Swiss interpretation on minimum capital levels and liquidity as well as the recommendations of the Financial Stability Board (FSB) on TBTF have all been incorporated in the domestic regulation. For capital and liquidity, the Swiss Federal Council has written two specific ordinances (on June 1 and November 30, 2012) following and sometimes going beyond Basel 3 recommendations. All key measures have been in force since January 2013.
2. On top of this extensive legislative effort, both SNB and FINMA have maintained a very close monitoring of the two large systemically-relevant banks and have taken action when they perceived that they needed to strengthen some aspects of their financial fundamentals.

In the case of Credit Suisse, the SNB had been very public and very vocal in its June 2012 stability report. In a rather unusual move that started in the executive summary of the report, the SNB recommended that "Credit Suisse significantly expand its loss-absorbing capital during the current year". This recommendation was repeated five more times in the course of a 24-page report. This proved effective as less than a month later Credit Suisse announced its CHF 15.3bn capital restructuring plan.

Peer comparison

At Scope ratings, we compare banks within peer groups at domestic and cross-border levels.

Of the banks rated by Scope, Credit Suisse can only be compared to UBS in Switzerland. Since both banks are part of the same global peer group of large universal banks operating in varied markets, we do not feel we have to focus specifically on the domestic comparison.

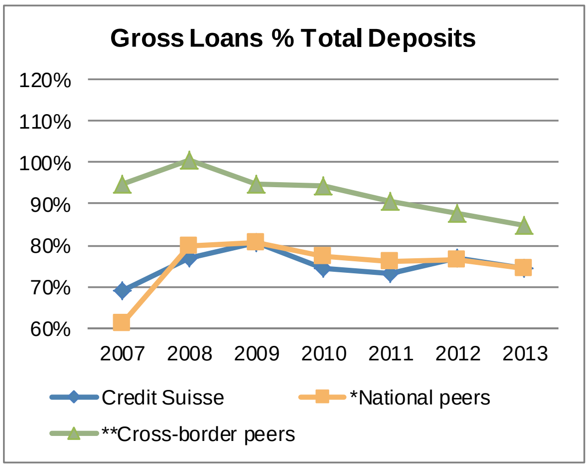
We will therefore focus on the global peer group including BNP Paribas, Société Générale, HSBC, Barclays, Deutsche and UBS plus Citigroup, Bank of America and JP Morgan in the United States.

Overall, we find Credit Suisse’s positioning solid, starting with a much fitter balance sheet than several years ago, particularly in light of the changes the bank underwent over the years. First, the bank reduced its total assets by 36% between 2007 and 2013 in one of the very best performances of its peers, even if the US GAAP total assets do not include the add-ons requested by the FINMA for the calculation of the leverage ratio.

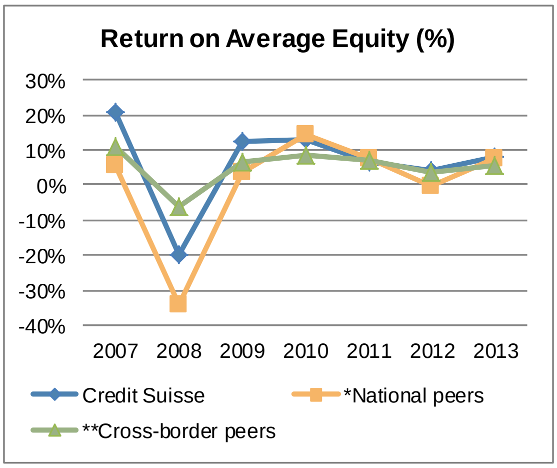
The liquidity of the bank also remains very satisfactory versus peers, with lower wholesale funding, increased deposits and still comfortable excess deposits versus loans. The asset quality metrics of CS are also sound and its performance is below par only with regards to cost metrics. But this is a phenomenon shared by the two large Swiss banks.

Lastly, even if prima facie the leverage ratio and the asset risk intensity of the bank look good, they are both flattered by the netting of derivatives. On a comparable basis and versus peers, Credit Suisse posts a weak leverage ratio and a low level of RWAs to assets. These metrics are the only serious concerns marring an otherwise satisfactory credit picture.

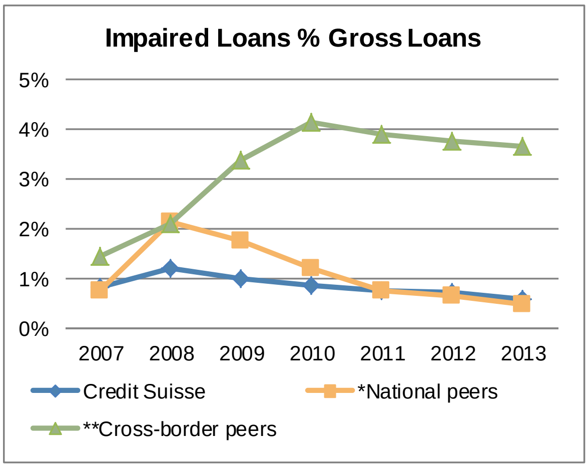
Peer Comparison - Credit Suisse Group



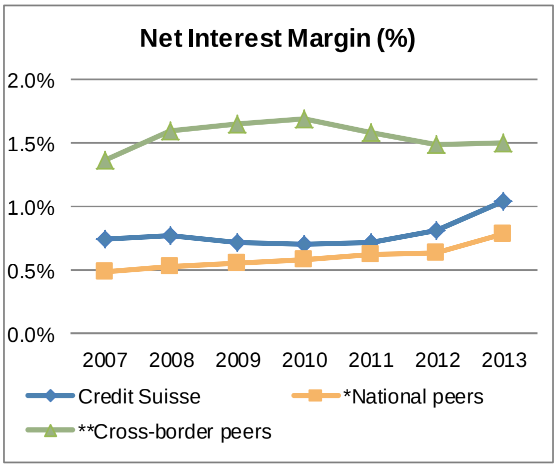
Source: SNL Financial, Scope Ratings



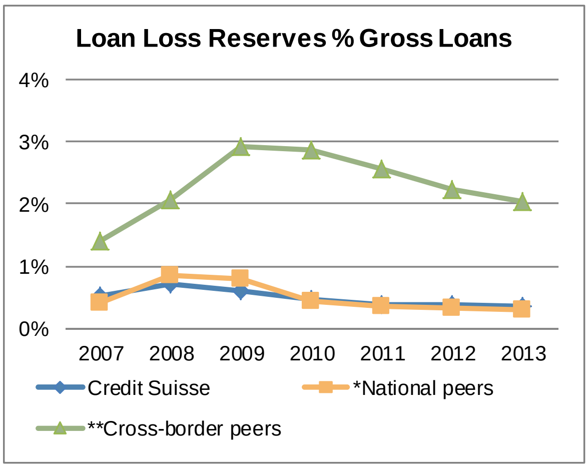
Source: SNL Financial, Scope Ratings



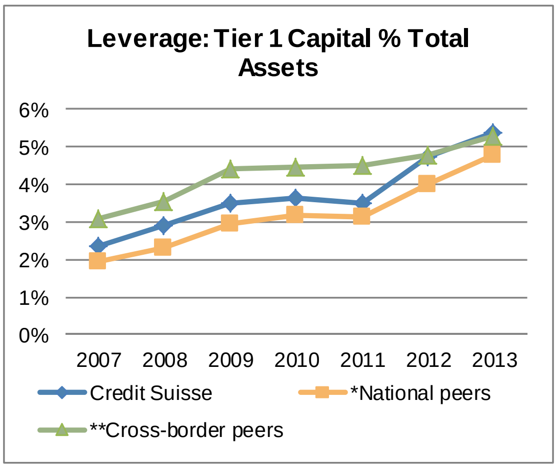
Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings

*National peers: Credit Suisse, UBS

**Cross-border peers: Bank of America Corp, Barclays, BNP Paribas, Citigroup Inc, Credit Suisse, Deutsche Bank, HSBC, JP Morgan Chase, Societe Generale, UBS

Selected Financial Information - Credit Suisse Group

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Balance Sheet summary (CHF billion)									
Assets									
Cash and balances with central banks	38.5	90.0	51.9	65.5	110.6	61.8	68.7	82.4	102.2
Interbank assets	13.4	10.3	9.1	7.0	7.6	7.5	1.5	1.5	1.5
Total securities	799.5	574.8	556.5	561.4	509.1	449.2	391.2	384.7	392.5
of which debt instruments	521.4	436.2	384.7	389.5	391.2	323.2	275.0	261.3	261.3
of which equity instruments	248.8	127.5	152.6	150.5	100.9	111.8	103.6	110.8	118.6
Derivatives	99.6	108.6	57.2	50.5	56.3	37.1	33.7	33.4	33.9
Gross customer loans	232.1	229.0	230.6	214.3	229.0	237.6	247.9	247.9	250.4
of which impaired loans	1.9	2.7	2.3	1.9	1.7	1.7	1.5	1.5	1.5
Total funded assets	1,281.5	1,075.5	973.7	972.9	987.0	883.6	835.7	841.8	870.8
Total Assets	**1,360.7**	**1,170.4**	**1,031.4**	**1,032.0**	**1,049.2**	**924.3**	**872.6**	**878.4**	**908.0**
Liabilities									
Interbank liabilities	90.9	58.2	36.2	37.5	40.1	31.0	23.1	23.1	23.1
Senior debt	461.4	379.4	334.1	340.6	341.2	281.8	223.3	223.3	245.6
Derivatives	79.2	94.8	57.7	59.1	62.1	40.7	36.9	36.5	37.2
Customer deposits	335.5	297.0	286.7	287.6	313.4	308.3	333.1	339.8	346.5
Subordinated debt + hybrid securities	18.5	25.6	24.6	23.2	24.2	17.7	21.0	18.9	17.0
Total Liabilities	**1,300.8**	**1,123.1**	**983.1**	**989.0**	**1,008.1**	**882.0**	**824.7**	**828.7**	**856.3**
Ordinary equity	43.2	32.3	37.5	33.3	33.7	35.5	42.9	44.7	46.7
Minority interests	16.6	14.9	10.8	9.7	7.4	6.8	5.0	5.0	5.0
Total Liabilities and Equity	**1,360.7**	**1,170.4**	**1,031.4**	**1,032.0**	**1,049.2**	**924.3**	**872.6**	**878.4**	**908.0**
Core Tier 1 Capital [1]	*30.1*	*22.5*	*24.0*	*26.6*	*13.0*	*19.0*	*27.5*	*29.3*	*31.3*
Income Statement summary (CHF billion)									
Net interest income	8.4	8.5	6.9	6.5	6.4	7.2	8.1		
Net fee & commission income	16.5	12.5	11.8	11.9	11.0	11.3	11.5		
Net trading income	6.1	-9.9	12.2	9.3	5.0	1.2	2.8		
Operating Income	**36.9**	**7.0**	**31.3**	**29.2**	**24.2**	**22.2**	**24.2**	**26.8**	**28.0**
Operating expenses	22.9	20.8	22.7	21.8	20.5	19.8	19.0	20.8	21.3
Loan loss provision charges	0.2	0.8	0.5	-0.1	0.2	0.2	0.2	0.0	0.0
Non-recurring items	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.9	-0.9
Pre-Tax Profit	**13.7**	**-15.4**	**8.2**	**7.5**	**3.5**	**2.2**	**5.2**	**5.1**	**5.7**
Income tax	1.2	-4.6	1.8	1.5	0.7	0.5	1.5	1.5	1.7
Net profit attributable to minority interests	4.7	-2.6	-0.3	0.8	0.8	0.3	0.6	0.6	0.7
Net Income Attributable to Parent	**7.8**	**-8.2**	**6.7**	**5.1**	**2.0**	**1.3**	**1.0**	**3.0**	**3.3**

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] Basel 3 basis from 2011 onwards

Ratios - Credit Suisse Group

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Funding/Liquidity									
Gross loans % Total deposits	69.2%	77.1%	80.4%	74.5%	73.1%	77.1%	74.4%	73.0%	72.3%
Total deposits % Total funds	37.0%	39.1%	42.1%	41.7%	43.6%	48.3%	55.5%	56.2%	54.8%
Wholesale funds % Total funds	63.0%	60.9%	57.9%	58.3%	56.4%	51.7%	44.5%	43.8%	45.2%
Asset Mix, Quality and Growth									
Gross loans % Funded assets	18.1%	21.3%	23.7%	22.0%	23.2%	26.9%	29.7%	29.5%	28.8%
Impaired loans % Gross loans	0.8%	1.2%	1.0%	0.9%	0.8%	0.7%	0.6%	0.6%	0.6%
Loan loss reserves % Impaired loans	63.4%	60.1%	60.7%	54.6%	53.0%	53.3%	58.7%	58.7%	58.7%
Gross loan growth (%)	15.7%	-1.4%	0.7%	-7.1%	6.8%	3.8%	4.3%	0.0%	1.0%
Impaired loan growth (%)	-8.7%	40.0%	-15.7%	-18.9%	-7.8%	0.6%	-15.5%	0.0%	0.0%
Funded assets growth (%)	7.1%	-16.1%	-9.5%	-0.1%	1.5%	-10.5%	-5.4%	0.7%	3.4%
Earnings									
Net interest income % Revenues	22.9%	122.4%	22.0%	22.4%	26.5%	32.2%	33.6%		
Fees & commissions % Revenues	44.8%	179.5%	37.6%	40.8%	45.2%	50.9%	47.5%		
Trading income % Revenues	16.7%	-141.7%	38.8%	31.9%	20.7%	5.4%	11.6%		
Other income % Revenues	15.7%	-60.2%	1.6%	4.9%	7.5%	11.5%	7.3%		
Net interest margin (%)	1.1%	1.1%	1.0%	1.0%	0.9%	1.0%	1.3%		
Pre-provision Income % Risk-weighted assets (RWAs)	4.5%	-5.4%	3.9%	3.4%	1.5%	1.1%	2.0%	2.2%	2.4%
Loan loss provision charges % Pre-provision income	1.7%	-5.9%	5.9%	-1.1%	5.0%	7.2%	3.0%	0.0%	0.0%
Loan loss provision charges % Gross loans (cost of risk)	0.1%	0.4%	0.2%	0.0%	0.1%	0.1%	0.1%	0.0%	0.0%
Cost income ratio (%)	62.1%	298.6%	72.4%	74.6%	84.6%	89.3%	78.4%	77.5%	76.3%
Net Interest Income / Loan loss charges (x)	35.2	10.5	13.6	-82.8	34.4	42.1	52.4		
Return on average equity (ROAE) (%)	17.9%	-21.8%	19.3%	14.4%	5.8%	3.9%	7.8%	6.8%	7.2%
Return on average funded assets (%)	0.4%	-0.5%	0.4%	0.3%	0.1%	0.1%	0.2%	0.2%	0.3%
Retained earnings % Prior year's book equity	11.3%	-19.3%	13.6%	9.5%	2.1%	3.4%	5.5%	4.1%	4.4%
Pre-tax return on common equity tier 1 capital	45.6%	-68.4%	34.3%	28.0%	26.6%	11.5%	18.9%	17.5%	18.3%
Capital and Risk Protection [1]									
Common equity tier 1 ratio (common equity tier 1 capital % RWAs)	9.7%	8.8%	10.8%	12.2%	3.5%	6.7%	10.3%	10.9%	11.3%
Tier 1 leverage ratio (%)	2.5%	2.8%	3.1%	3.4%	3.7%	4.8%	5.4%		
Median of tier 1 leverage ratio and common equity tier 1 ratio (%)	6.1%	5.8%	7.0%	7.8%	3.6%	5.7%	7.8%		
Total loss coverage (CET 1 capital + loan loss provisions) % RWAs	10.0%	9.4%	11.5%	12.6%	5.8%	8.9%	10.6%	11.2%	11.6%
Non-senior bailinable debt cushion (as % of total liabilities)	1.4%	2.3%	2.5%	2.3%	2.4%	2.0%	2.5%	2.3%	2.0%
Asset risk intensity (RWAs % total assets)	22.9%	22.0%	21.5%	21.2%	23.0%	24.3%	30.6%	30.6%	30.6%

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] Basel 3 basis from 2011 onwards

METHODOLOGIES USED FOR THIS REPORT

For the rating and analysis contents of this report Scope, has used the following methodologies which were published on www.scoperatings.com:

"Bank Rating Methodology" (February 2014)

"Forecasting Bank Financials Methodology" (February 2014)

Forecasting bank financials: Forward-looking estimates are an important analytical tool underpinning Scope's bank ratings. These forecasts cover the current financial year (before final year-end figures are published by the bank) plus the forthcoming two years. Depending on the complexity of the bank being assessed, different forecasting tools will be used. For a majority of banks operating primarily commercial and retail banking franchises (loans and deposits) the analysis is underpinned by an **accounting** forecast of the balance sheet and profit and loss account. For more complex groups with multiple ranges of activities – notably those with material wholesale and investment banking operations – Scope uses an **analytical** forecast, relying on the bank's business-line reporting to come up with plausible estimates. For all banks Scope also includes a **regulatory metrics** forecast, considering the growing importance of this aspect in bank analysis.

For complex banks, divisional data is used to forecast profit and loss accounts and basic divisional balance sheet metrics. For less complex banks, a line-by-line forecasting of major P&L elements is forecast.

For balance sheet forecasts, Scope estimates of all major balance sheet lines, using the P&L estimates to complete the forecast of the capital/shareholders' equity line. This comprehensive methodology for estimating the balance sheet is used for all the banks in our universe, irrespective of size and complexity.

Lastly, our forecasts include assessments of the major regulatory metrics: Tier 1 and CET 1 (historically CT1), Leverage, Liquidity Coverage Ratio and Net Stable Funding Ratio (the latter two when and if sufficient public information to compute them is available).

Scope will not aim to forecast financials when it considers the public disclosure of the bank as insufficient for a transparent and credible outcome.

All Scope's bank financial forecasts are based on public information. For its forecasts Scope will not use any non-public information or data, even if such information or data were provided by rated banks. Scope's forecasting process is transparent, with a detailed roadmap provided in its *"Forecasting bank financials"* methodology.

Deutsche Bank AG
Issuer Rating Report

A- STABLE OUTLOOK
Financial Institutions

Overview

Scope Ratings assigns an Issuer Credit-Strength Rating (ICSR) of A- to Deutsche Bank AG (Deutsche), with a stable outlook. This rating reflects the somewhat challenged business model of the company at a time when increased capital constraints and the US regulatory overhaul make it very costly for a “global universal bank” to operate as efficiently as before the crisis. To mitigate this factor, we acknowledge the improvement of the bank’s earnings mix through the acquisition of Postbank between 2008 and 2010, as well as the cross-cycle resilience of the investment bank’s revenue streams despite very difficult current operating conditions.

The A- rating applies to senior unsecured debt issued by Deutsche Bank AG. However, the rating is not applicable to unguaranteed debt issued by subsidiaries of Deutsche Bank AG.

Ratings (assigned on April 2, 2014)

Issuer Credit-Strength Rating	**A-**
Outlook	Stable
Senior Unsecured Debt	A-

Unsolicited ratings with issuer participation.

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Rating drivers (Summary)

The rating drivers, in decreasing order of importance in the rating assignment, are:

- A somewhat challenged business model.
- Despite recent market share erosion in a limited number of areas, the resilience of Deutsche’s debt sales & trading revenues has been impressive.
- The acquisition of Postbank has boosted the domestic retail component of Deutsche’s earnings.

Rating change drivers

Any strategic initiative aimed at strengthening the link between the investment bank and the other areas of the group would, in our view, increase the cohesion of the bank and therefore strengthen its business model.

The high capital intensity of Deutsche’s business model, as well as high litigation costs and the fact that the US Foreign Banking Organizations (FBO) rules request foreign banks to strengthen their capital at local US domestic level, mean that Deutsche Bank is working hard to strengthen its capital base, including its leverage ratio metrics. Any sustained improvement on that front from now on would be positive for the credit rating of the company.

Deutsche Bank has yet to reduce its balance sheet by EUR 164bn in assets by 2015, i.e. 10% of group total IFRS assets as of year-end 2013. It is therefore difficult to predict the level at which the bank will be able to stabilize its fixed income margin (defined as Fixed Income, Currency & Commodities (FICC) revenues as a % total estimated FICC assets). Considering that fixed income revenues account for about 25% of

Deutsche's group revenues, the bank's ability (or lack thereof) to maintain its fixed income margin on a sharply declining asset base could have a significant impact on the credit rating of the bank.

Recent events

Deutsche Bank pre-announced its 2013 FY results on January 20 but these were restated when Deutsche released its annual report on March 20. On the back of a somewhat weak quarter in fixed income sales & trading, roughly EUR -1.1bn of litigation charges, and a combination of one-off charges and restructuring expenses, the bank reported a quarterly post-tax loss attributable to shareholders of around EUR -1.4bn. For the full year, Deutsche Bank reported net profits of EUR 0.7bn, a 2.5x increase versus the EUR 0.3bn profits reported in 2012, but still a weak showing in profitability terms. Despite the quarterly net losses, Deutsche managed to maintain its fully-phased Basel 3 CET1 ratio flat at 9.7%, in particular thanks to a reduction in RWA of EUR 15bn quarter on quarter. The fully loaded pro-forma Tier 1 leverage ratio (under current CRD4 definitions) stood at 3.1%.
Apart from results, Deutsche has featured materially in the sector's news flow since the end of 2013 with the following:

- Two significant legal settlements were announced in December: one with the European Commission on the LIBOR issue (for EUR 725m in total) and another one with the Federal Housing Finance Agency (FHFA) regarding the residential mortgage-backed securities litigation (EUR 1.4bn). Both settlements were covered by existing litigation reserves.
- On December 5, Deutsche announced that it was refocusing its commodities business by exiting its dedicated trading desks for energy, agriculture, base metals and dry bulk. The new commodities business will focus on financial derivatives and precious metals.
- In February, Deutsche announced it had reached an agreement with Kirch Group to conclude all legal disputes between the two parties. The settlement provides for a payment of EUR 775m, plus interest, and a lump-sum settlement of costs. Due to existing provisions, this settlement resulted in a decrease in net profits of about EUR 350m after tax. The charge was reflected in the fourth quarter 2013 results.
- Lastly, on March 27, Deutsche Bank announced it had closed the sale of BHF-Bank to Kleinwort Benson Group and RHJ International. Deutsche will receive consideration subject to closing purchase price adjustments of EUR 340m, comprised of EUR 309m in cash and EUR 31m in RHJ International shares issued at par value. The sale will result in a CRD4 exposure reduction of approximately EUR 6bn and will have net positive impact on the bank's CRD4 pro-forma fully-loaded common equity tier 1 ratio of around 5bps in Q1 2014.

Rating drivers (Details)

1. A somewhat challenged business model

Deutsche has acknowledged the fact that its chosen business model is facing challenges going forward, particularly in the next 12 to 15 months. Deutsche's co-CEO stated publicly in the recent past that "the most challenging business model is the one that Deutsche has adopted". Indubitably, being a global universal bank with a strong investment banking bias in a post-crisis world entails a lot of hurdles, commercial, financial and regulatory alike.

The challenges are expressed at three levels:

- Geographically: Speaking in pure investment banking terms, "being global" means being strong in the US. Indeed, the US investment banking fee pool remains the largest in the world: out of a global fee pool of close to USD 82.7bn as of December 31, 2013 (source: Thomson Reuters), the US represents 57% of the total, more than twice the total of Europe. As it happens, Deutsche has built a significant market position in US investment banking over the years, with a joint No. 1 position in US fixed income trading and a corresponding US market share of 10.9% as of September 30, 2013, down from 12.2% at year-end 2012 (source Greenwich Associates). Protecting this US market share proved challenging as in February 2013 the Federal Reserve Board published final rules to strengthen the oversight of US operations of foreign banks. According to the Board, a foreign banking organization with USD 50bn or more in US non-branch assets will be required to organize its US subsidiaries under a single US intermediate holding company (IHC). These IHCs will be submitted to the same risk-based and leverage capital standards applicable to US bank holding companies. They will also have to meet enhanced liquidity requirements, conduct stress tests and hold a buffer of highly liquid assets.

In 2011, Deutsche's bank holding company in the US reported assets of USD 355bn as of December 31, 2011, shareholders' equity of USD 4.8bn and tangible equity of USD -0.6bn. The bank therefore needed to strengthen its capital base in the US, but it also had plenty of time to alter its US structure and make it compliant with regulation. According to the bank's CFO, Deutsche plans to reduce its balance sheet in the US from USD 400bn (as of year-end 2013) to USD 300bn, partly by reallocating some businesses away from the US, and partly by reducing the size of some operations. This is the case when part of the client base is not using the bank's other, more profitable offerings.

- By product: the second big challenge faced by Deutsche Bank with regard to its global model is the fact that the bank has built up and nurtured a dominant position in fixed income. The bank is number 1 in fixed income trading worldwide with a market share of 10% as of year-end 2013, down from 10.7% at year-end 2012 (source: Greenwich Associates). This is a commendable performance but we believe that two recent trends have challenged the sustainability of fixed income revenues. First, on the capital front: the capital necessary to sustain banks' securitization activities has increased with Basel 3. Combined with the capital necessary to maintain high inventory levels of fixed income products on-balance sheet, this has challenged the returns of FICC businesses globally. Second, the shift of OTC derivatives towards standardized clearing platforms is bound to negatively impact FICC margins. These market trends are obviously not specific to Deutsche Bank but they are critical for Deutsche considering its size in this business. We note that between 2012 and 2013, the market share of the largest two fixed income players globally (Deutsche and Barclays) has fallen from a combined 20.5% to 19.2% (source: Greenwich Associates).

- In integration terms: we also note that, unlike some other global universal banks, Deutsche has been late in launching a systematic "one bank" program as its Swiss or French peers have done. To be sure, the bank has taken note of these problems and announced in its Q3 financial report an aligned and integrated commercial banking coverage for "Mittelstand" companies in Germany, through a joint-venture between the Global Transaction Banking (GTB) and the PCB (Private & Commercial Banking) divisions. The coverage of 11,500 German SMEs is to be transferred to this new joint venture. More needs to be done though and we believe that Deutsche can be even more specific with regard to the quantification of its cross-divisional synergies.

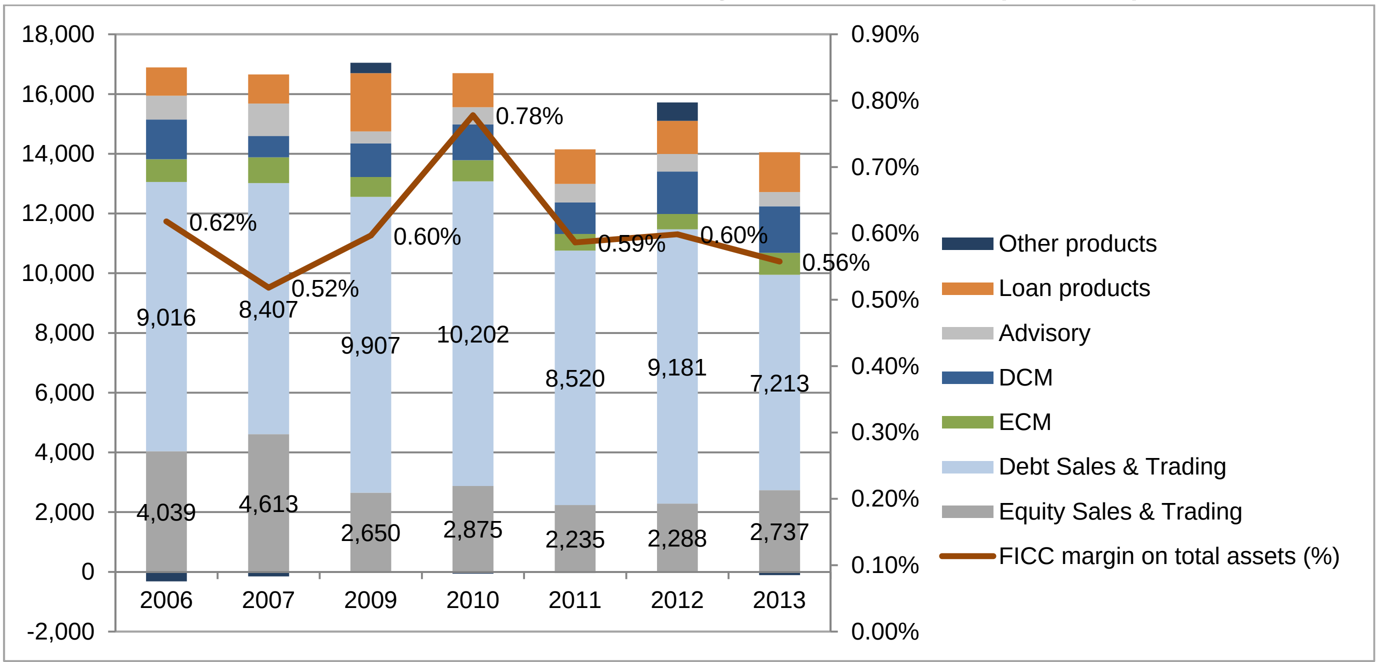
The uncertainty surrounding some divisions is also a concern. The AWM (Asset & Wealth Management) division has been a structural underperformer for years, to the point that Deutsche considered disposing of all the non-German parts of its Asset Management division in a thorough business review that lasted between November 2011 and June 2012. It seems that the inability of Deutsche to dispose of these businesses led the bank to rethink its strategy in order to reduce the number of low-margin mandates and focusing on Ultra High Net Worth Individuals (UHNWIs) – the latter being an extremely competitive market, in our view. Achieving lasting success in this division will be difficult: although 2013 was a record year based on pre-tax profits, this is partly due to the reallocation of the Corporate Banking & Securities (CB&S) passive third-party business to the AWM division back in 2012.

The last doubtful aspect about the business model lies in the fact that Deutsche seems to have taken some questionable decisions under pressure. To many market participants, Deutsche appeared to be a “crisis winner”. The bank showed resilience and composure during the 2007-2008 financial crisis, it didn’t tap government money, it gained market share and proved a very efficient consolidator through the purchase of Postbank between 2008 and 2010 to reinforce its stable cash generation. While initially Deutsche used this hard-earned status to expand its market share, the group changed strategy towards the beginning of Q2 2013. Deutsche announced (1) a EUR 3bn capital raising in April; and (2) an extensive EUR 250bn deleveraging exercise two months later. In its Q3 2013 results presentation the company communicated hat this deleveraging would generate a negative recurring pre-tax profit impact of EUR 450-500m per annum, and one-off costs of EUR 600m. However, we believe that to support a further EUR 164bn decline in assets while maintaining its gross fixed-income margin, the annual loss of FICC revenues could stand at another EUR 1bn from year-end 2013 levels, considering that between 2012 and 2013, a EUR 325bn fall in total CB&S assets corresponded to a drop in underlying FICC revenues of around EUR 2bn.

2. The investment banking earnings of Deutsche Bank have been remarkably resilient

Chart 1 demonstrates the resilience of Deutsche’s investment banking revenues by sub-segment at two levels. We excluded 2008 in order to keep the scale of the chart readable, and we also excluded GTB from the picture to show only the theoretically most volatile parts of the investment bank.

Chart 1: The resilience of Deutsche’s investment banking revenues 2006-2013 (excl. 2008) in EUR m and %



Source: Company data, Scope Ratings estimates

First, looking at the left axis, we note that between 2006 and 2013, there has been only an 18% difference between peak and trough Corporate Banking & Securities (CB&S) underlying revenues, despite quite volatile market conditions. Looking at the average revenues during the period, the peak (recorded in 2009) was only 8% higher than the average, while the 2013 trough was less than 12% below that average. Clearly the debt sales & trading business has been the main contributor to the bank’s CB&S revenues and has helped the bank weather a structural decline in its equity trading revenues, triggered in part by the closure of Deutsche’s equity prop desk at the end of 2008. This therefore raises the question of the sustainability of Deutsche’s debt sales & trading revenues. The line graph scaled on the right side of the chart gives a mitigating answer: compared with total assets (including the gross present value of derivatives), Deutsche has mostly managed to maintain its gross FICC margin in a tight range comprised between 56bps and 62bps. 2007 and 2010 were the only trough and peak exceptions in what seems to have been a very resilient business. This was achieved while Deutsche's investment banking assets fell from EUR 1.79trn in 2007 to EUR 1.11trn in 2013 and is encouraging in light of the further planned balance sheet reduction. However, the mitigating part of the line graph on Chart 2 is that the 2013 FICC revenues have shown for the first time a clear correlation between balance sheet reduction and margin erosion, which was not the case between 2011 and 2012, when CB&S assets fell by EUR 117bn but FICC revenues increased by almost EUR 700m.

3. The Postbank acquisition has partially rebalanced Deutsche's earnings profile

Deutsche's acquisition of a majority stake in Postbank in 2010 was actually one of the last steps taken by the company to boost the stability of its earnings, although we have seen that the CB&S earnings were hardly in need of stabilization. It followed on the acquisition of norisbank and Berliner Bank in 2006, and the purchase in 2010 of a further 2.8% stake in Hua Xia, the 13th largest bank in continental China, bringing Deutsche's equity stake in the company to 19.9% (Deutsche had taken an initial 14% stake in 2005). In 2008, Deutsche Post sold 29.75% of its subsidiary Postbank to Deutsche Bank, and at the end of 2010 Deutsche Bank could fully consolidate Postbank with a stake of about 51%. Deutsche declared an ownership of 94.1% as of September 5, 2012. The acquisition enabled the Deutsche Bank-Postbank combination to become the undisputable Number 1 retail institution among private banks in Germany with a client base of 24 million, way above runner-up Commerzbank (11 million), but significantly below the leaders Sparkassen (combined client base of 50 million) and the cooperative banks (30 million).

Table 1 shows that while the acquisition of Postbank was a commercial success, it was not a total game changer for Deutsche's business mix.

Table 1: Deutsche Bank's revenue and pre-tax earnings mix 2006-2013

	2006	2007	2009	2010	2011	2012	2013
Retail revenues % Total	18%	19%	20%	19%	32%	28%	29%
Retail PTP % Total (ex CC and NCOU) [1]	13%	16%	11%	13%	30%	28%	29%
CB&S + GTB Revenues % total group revenues	67%	64%	71%	64%	52%	58%	55%
CB&S + GTB PTP % Group (ex CC and NCOU)	76%	71%	91%	79%	59%	69%	60%

[1] 2012 and 2013 numbers are restated from CtAs and PPAs.
Source: Company data, Scope Ratings estimates

To be clear, the table ignores the weight of the non core unit (NCOU) and of the corporate center (CC), to focus on the combined pre-tax profits and revenues of the four operating divisions: CB&S, GTB, AWM and PBC (Private & Business Clients, the divisional name of the retail business).

We have combined GTB and CB&S to be able to duplicate a typical "Corporate & Investment Bank" division at another bank. Indeed, around 74% of GTB's revenues as of December 31, 2011 are composed of trade finance and cash management, which would typically be part of the responsibilities of a corporate bank at another institution.

Keeping this in mind, the weight of the retail bank experienced a quantum leap between 2010 and 2011, with retail revenues jumping from 19% to 32% of group revenues, while the weight of pre-tax profits would rise from 13% to

30% (while the PTP of the investment bank declined in the same period from 79% to 59%). The retail bank has broadly maintained this level of relative profitability since then, versus 60% for the combination of GTB and CB&S.

Peer comparison

At Scope ratings, we compare banks within peer groups at domestic and cross-border level.

Of the banks rated by Scope, Deutsche Bank can only be compared to Commerzbank in Germany and only limited valid conclusions can be drawn from the comparison of these two institutions, considering their different business models. However, the performance of their domestic retail businesses (if we include Commerzbank's Mittelstandbank division in its Private Customers division) is broadly similar in profitability terms.

On a cross-border basis, we have included Deutsche in a peer group comprising BNP Paribas, Société Générale, HSBC, Barclays, UBS and Credit Suisse plus Citigroup, Bank of America and JP Morgan in the United States.

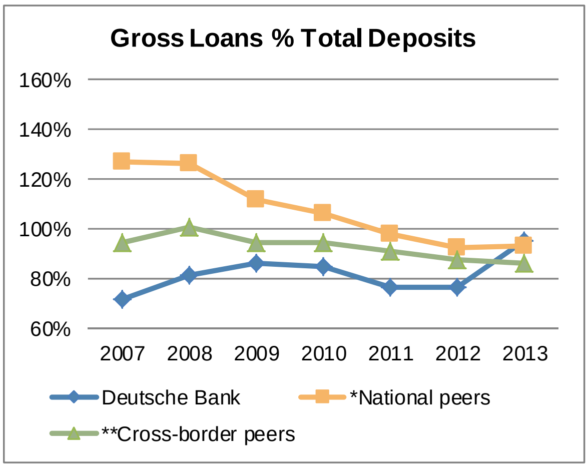
Traditionally, Deutsche Bank has compared itself with US peers rather than European peers. This reflected the importance of the investment bank in the bank's mix as well as the willingness to succeed in US investment banking. Deutsche has been among the most successful European banks in this respect.

To a large extent, Deutsche has driven its own strategy by comparing itself with the US benchmark "crisis winner" of the peer group, JP Morgan. There is a point to make that the retail-driven acquisitions of 2006-2010 were intended to shift Deutsche's earnings mix towards more stable businesses and to achieve a 40/60 earnings mix (60 representing CIB) similar to JP Morgan. This is also what drove the EUR 3bn capital increase last year, so that Deutsche could reach the benchmark CET1 ratio of 10%.

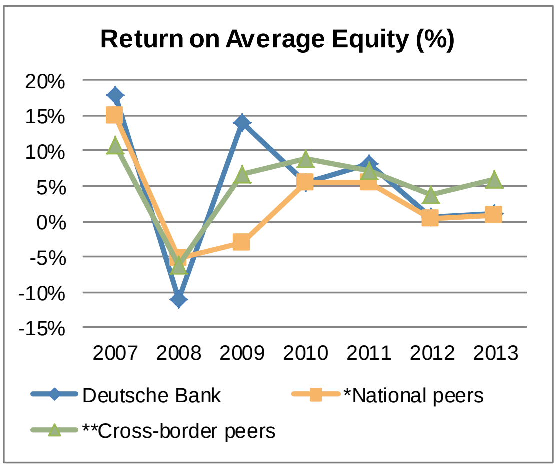
However, Deutsche cannot really rival its benchmark yet in terms of profitability, for example on ROE or the cost-income ratio. Deutsche also remains sub-standard in leverage terms. Much of this has to do with the fact that the JP Morgan's US domestic commercial and retail business is far more profitable than the equivalent business of Deutsche, reflecting the structurally different nature of retail banking in Germany vs. the US.

Within Europe, competitors in France, Switzerland and the UK show better leverage metrics and – at the margin – better CET1 metrics. The bank's profitability versus European peers is low and its cost-income ratio is also at the bottom quintile.

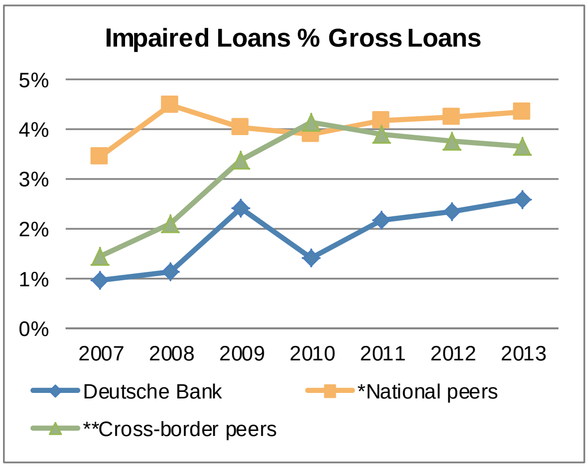
Peer Comparison - Deutsche Bank group



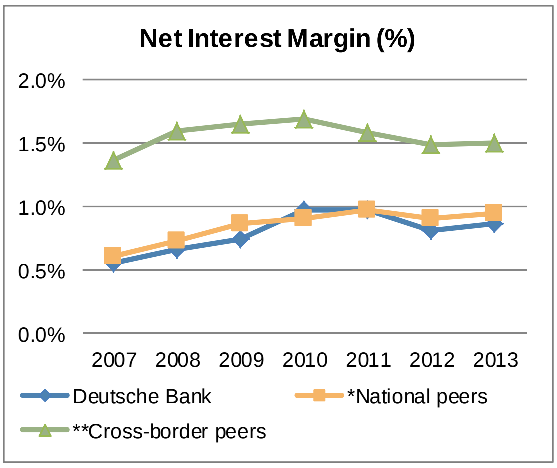
Source: SNL Financial, Scope Ratings



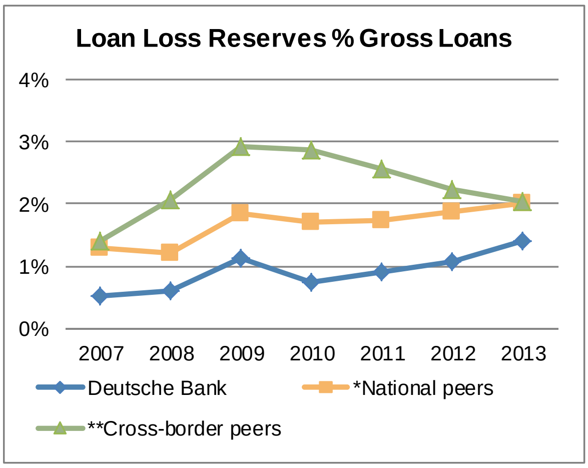
Source: SNL Financial, Scope Ratings



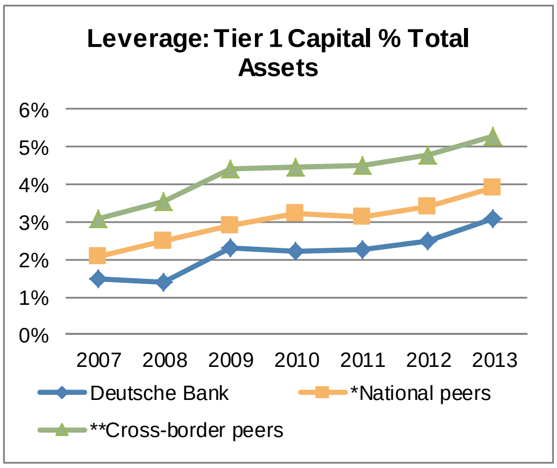
Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings

*National peers: Commerzbank, Deutsche Bank
**Cross-border peers: Bank of America Corp, Barclays, BNP Paribas, Citigroup Inc, Credit Suisse, Deutsche Bank, HSBC, JP Morgan Chase, Societe Generale, UBS

Selected Financial Information - Deutsche Bank group

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Balance Sheet summary (EUR billion)									
Assets									
Cash and balances with central banks	8.6	9.8	9.3	17.2	15.9	27.9	17.2	430.4	413.6
Interbank assets	21.6	64.7	47.2	100.4	162.0	120.6	101.4	96.4	91.5
Total securities	1,181.8	417.1	402.2	498.1	478.4	512.6	455.7	23.3	22.1
of which debt instruments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
of which equity instruments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Derivatives	184.5	1,234.0	603.2	666.3	867.1	776.7	508.6	483.1	459.0
Gross customer loans	327.4	323.6	298.6	453.4	464.0	443.3	396.6	377.2	358.7
of which impaired loans	3.1	3.7	7.2	6.3	10.1	10.3	10.1	9.9	9.7
Total funded assets	1,411.5	1,016.1	919.9	1,251.8	1,320.5	1,265.9	1,127.4	1,075.5	1,026.4
Total Assets	**1,925.0**	**2,202.4**	**1,500.7**	**1,905.6**	**2,164.1**	**2,022.3**	**1,611.4**	**1,535.3**	**1,463.2**
Liabilities									
Interbank liabilities	0.0	0.0	0.0	0.0	0.0	0.0	114.2	108.5	103.0
Senior debt	704.3	385.5	349.2	442.5	433.4	376.6	317.0	301.2	286.1
Derivatives	513.5	1,186.3	580.8	653.8	843.6	756.3	484.0	459.8	436.8
Customer deposits	457.9	395.6	344.2	534.0	601.7	577.2	413.6	392.9	373.3
Subordinated debt + hybrid securities	14.5	17.9	18.2	24.6	19.8	20.9	19.5	18.5	17.6
Total Liabilities	**1,885.7**	**2,170.5**	**1,462.7**	**1,855.3**	**2,109.4**	**1,968.0**	**1,556.4**	**1,478.6**	**1,404.7**
Ordinary equity	37.9	30.7	36.6	48.8	53.4	54.0	54.7	56.5	58.3
Minority interests	1.4	1.2	1.3	1.5	1.3	0.2	0.2	0.2	0.2
Total Liabilities and Equity	**1,925.0**	**2,202.4**	**1,500.7**	**1,905.6**	**2,164.1**	**2,022.3**	**1,611.4**	**1,535.3**	**1,463.2**
Core Tier 1 Capital [1]	*22.7*	*21.5*	*23.8*	*30.0*	*36.3*	*31.3*	*34.0*	*35.8*	*37.6*
Income Statement summary (EUR billion)									
Net interest income	8.8	12.5	12.5	15.6	17.4	16.0	14.8		
Net fee & commission income	12.3	9.7	8.9	10.7	11.5	11.4	12.3		
Net trading income	8.2	-8.5	7.7	3.7	3.8	6.3	4.2		
Operating Income	**30.9**	**15.2**	**29.1**	**30.7**	**34.2**	**33.3**	**31.5**	**30.2**	**29.8**
Operating expenses	21.2	17.9	19.7	22.8	25.6	28.5	27.0	25.0	23.4
Loan loss provision charges	0.9	2.0	3.6	1.4	1.9	1.7	2.1	0.9	0.8
Non-recurring items	0.0	0.0	0.0	0.0	-0.5	-0.4	-0.4	0.0	0.0
Pre-Tax Profit	**8.7**	**-5.7**	**5.2**	**4.0**	**5.4**	**0.8**	**1.5**	**4.2**	**5.6**
Income tax	2.2	-1.8	0.2	1.6	1.1	0.5	0.8	1.5	2.0
Net profit attributable to minority interests	0.0	-0.1	0.0	0.0	0.2	0.1	0.0	0.0	0.1
Net Income Attributable to Parent	**6.5**	**-3.8**	**5.0**	**2.3**	**4.1**	**0.3**	**0.7**	**2.7**	**3.6**

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] CRD 4 basis from 2012 onwards

Ratios - Deutsche Bank group

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Funding/Liquidity									
Gross loans % Total deposits	71.5%	81.8%	86.7%	84.9%	77.1%	76.8%	95.9%	96.0%	96.1%
Total deposits % Total funds	38.9%	49.5%	48.4%	53.3%	57.0%	59.2%	47.9%	47.9%	47.9%
Wholesale funds % Total funds	61.1%	50.5%	51.6%	46.7%	43.0%	40.8%	52.1%	52.1%	52.1%
Asset Mix, Quality and Growth									
Gross loans % Funded assets	23.2%	31.8%	32.5%	36.2%	35.1%	35.0%	35.2%	35.1%	34.9%
Impaired loans % Gross loans	1.0%	1.1%	2.4%	1.4%	2.2%	2.3%	2.6%	2.6%	2.7%
Loan loss reserves % Impaired loans	78.9%	78.7%	64.7%	78.4%	62.7%	68.9%	78.0%	79.6%	81.2%
Gross loan growth (%)	26.5%	0.3%	-6.0%	56.7%	4.6%	-1.8%	-7.6%	-0.9%	-0.7%
Impaired loan growth (%)	-2.2%	17.1%	95.6%	-12.3%	59.5%	2.6%	-1.9%	-2.0%	-2.0%
Funded assets growth (%)	18.6%	-28.0%	-9.5%	36.1%	5.5%	-4.1%	-10.9%	-4.6%	-4.6%
Earnings									
Net interest income % Revenues	28.6%	82.2%	42.8%	50.8%	51.1%	47.9%	47.2%		
Fees & commissions % Revenues	39.7%	64.3%	30.6%	34.8%	33.8%	34.2%	39.1%		
Trading income % Revenues	26.6%	-55.8%	26.4%	12.0%	11.1%	19.0%	13.4%		
Other income % Revenues	5.0%	9.3%	0.2%	2.4%	4.0%	-1.1%	0.3%		
Net interest margin (%)	2.8%	3.3%	3.3%	3.4%	2.9%	2.6%	2.7%		
Pre-provision Income % Risk-weighted assets (RWAs)	3.0%	-0.9%	3.4%	2.3%	2.2%	1.4%	1.3%	1.5%	1.8%
Loan loss provision charges % Pre-provision income	9.0%	-69.8%	38.3%	17.6%	22.8%	35.7%	47.9%	18.0%	12.6%
Loan loss provision charges % Gross loans (cost of risk)	0.3%	0.6%	1.2%	0.4%	0.4%	0.4%	0.5%	0.2%	0.2%
Cost income ratio (%)	68.4%	118.4%	67.7%	74.4%	75.1%	85.6%	85.9%	82.9%	78.4%
Net Interest Income / Loan loss charges (x)	10.0	6.4	3.5	11.2	9.0	9.3	7.0		
Return on average equity (ROAE) (%)	18.3%	-11.2%	14.8%	5.4%	8.1%	0.5%	1.2%	4.9%	6.3%
Return on average funded assets (%)	0.3%	-0.2%	0.3%	0.1%	0.2%	0.0%	0.0%	0.2%	0.2%
Retained earnings % Prior year's book equity	12.8%	-10.9%	14.7%	4.4%	7.0%	-1.0%	-0.2%	3.2%	3.2%
Pre-tax return on common equity tier 1 capital	38.5%	-26.7%	21.9%	13.3%	14.8%	2.6%	4.3%	11.9%	15.0%
Capital and Risk Protection [1]									
Common equity tier 1 ratio (common equity tier 1 capital % RWAs)	6.9%	7.0%	8.7%	8.7%	9.5%	7.8%	9.7%	10.2%	10.7%
Tier 1 leverage ratio (%)	1.5%	1.4%	2.3%	2.2%	2.3%	1.5%	2.1%		
Median of tier 1 leverage ratio and common equity tier 1 ratio (%)	4.2%	4.2%	5.5%	5.4%	5.9%	4.7%	5.9%		
Total loss coverage (CET 1 capital + loan loss provisions) % RWAs	7.7%	7.9%	10.4%	10.1%	11.2%	9.6%	12.0%	12.5%	13.0%
Non-senior bailinable debt cushion (as % of total liabilities)	0.8%	0.8%	1.2%	1.3%	0.9%	1.1%	1.3%	1.3%	1.3%
Asset risk intensity (RWAs % total assets)	17.1%	14.0%	18.2%	18.2%	17.6%	16.5%	21.7%	22.8%	23.9%

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] CRD 4 basis from 2012 onwards

METHODOLOGIES USED FOR THIS REPORT

For the rating and analysis contents of this report Scope has used the following methodologies which were published on www.scoperatings.com:

“Bank Rating Methodology” (February 2014)

“Forecasting Bank Financials Methodology” (February 2014)

Forecasting bank financials: Forward-looking estimates are an important analytical tool underpinning Scope’s bank ratings. These forecasts cover the current financial year (before final year-end figures are published by the bank) plus the forthcoming two years. Depending on the complexity of the bank being assessed, different forecasting tools will be used. For a majority of banks operating primarily commercial and retail banking franchises (loans and deposits) the analysis is underpinned by an **accounting** forecast of the balance sheet and profit and loss account. For more complex groups with multiple ranges of activities – notably those with material wholesale and investment banking operations – Scope uses an **analytical** forecast, relying on the bank’s business-line reporting to come up with plausible estimates. For all banks Scope also include a **regulatory metrics** forecast, considering the growing importance of this aspect in bank analysis.

For complex banks, divisional data is used to forecast profit and loss accounts and basic divisional balance sheet metrics. For less complex banks, a line-by-line forecasting of major P&L elements is forecast.

For balance-sheet forecasts, Scope estimates of all major balance sheet lines, using the P&L estimates to complete the forecast of the capital/shareholders’ equity line. This comprehensive methodology for estimating the balance sheet is used for all the banks in our universe, irrespective of size and complexity.

Lastly, our forecasts include assessments of the major regulatory metrics: Tier 1 and CET 1 (historically CT1), Leverage, Liquidity Coverage Ratio, and Net Stable Funding Ratio (the latter two when and if sufficient public information to compute them is available).

Scope will not aim to forecast financials when it considers the public disclosure of the bank as insufficient for a transparent and credible outcome.

All Scope’s bank financial forecasts are based on public information. For its forecasts Scope will not use any non-public information or data, even if such information or data were provided by rated banks. Scope’s forecasting process is transparent, with a detailed roadmap provided in its *“Forecasting bank financials”* methodology.

HSBC Holdings plc
Issuer Rating Report

SCOPE AA- STABLE OUTLOOK
Financial Institutions

Overview

The AA- Issuer Credit Strength Rating (ICSR) on HSBC Holdings plc is based on the Group's very diverse and unique business franchise, which generates robust earnings. This has enabled HSBC to maintain strong liquidity and capital positions during the financial crisis despite having to deal with large losses in its US consumer finance business. Nonetheless, the Group's size and complexity means that it is more vulnerable to operational, governance and internal control risks. With its broad-based focus on emerging markets, HSBC is also more exposed to the potential volatility inherent in these markets.

The AA- rating also applies to senior unsecured debt issued by HSBC Bank plc but not to unguaranteed debt issued by any other direct or indirect subsidiaries of HSBC Holdings plc.

Ratings (assigned on April 2, 2014)

Issuer Credit-Strength Rating	**AA-**
Outlook	Stable
Senior Unsecured Debt	AA-

Unsolicited ratings without issuer participation.

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Team Leader

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Rating drivers (Summary)

The rating drivers, in decreasing order of importance in the rating assignment, are:

- (+) A highly diversified business in terms of activity and geography, supporting a unique market position.
- (+) Ability to generate robust and sustainable earnings even in difficult markets.
- (+) Strong liquidity and capital positions.
- (−) Vulnerable to regulatory, governance and internal control risks due to the Group's size and complexity.
- (−) Exposed to material pockets of emerging market risks.

Rating change drivers

Failure to address compliance and conduct issues. In December 2012, HSBC entered into agreements with US and UK authorities regarding past inadequate compliance with anti-money laundering and sanctions laws. According to these agreements, the Group must take remedial measures within various specified time periods. Failure to comply could lead to further prosecution or a divestiture of US operations.

Continued progress in simplifying the business and increasing global standards across the Group. Since 2011, HSBC's strategy has been focused on implementing global standards and streamlining processes and procedures. Progress has been made but there is more to do, particularly in the areas of risk, compliance and business de-risking. These goals remain a part of the Group's strategy through 2016.

Change in the risk appetite of the Group. With the large exception of the acquisition of Household Finance, a US sub-prime and credit card company, in 2003, the Group has a reputation for being relatively conservative in its management style. The Group itself characterizes its risk culture as being "conservative and control-based." We would view negatively a change in management ethos that would increase the risk profile of the Group (e.g. a material reduction in the Group's liquidity position or a significant increase in riskier capital markets activities).

Ability to successfully manage evolving regulatory requirements. In particular, the Group may be impacted by evolving UK regulations regarding the ring-fencing of personal and small business activities, as well as where capital should sit within the banking group (e.g. subsidiary vs. holding company).

Recent events

2013 results

For 2013, HSBC reported USD 17.8bn in profit, up from USD 15.3bn in the prior year. Drivers of the increase included lower loan impairment charges of USD 5.8bn (2012: USD 8.3bn), lower customer redress costs in the UK of USD 1.2bn (2012: USD 2.3bn) and the absence of fines and penalties related to anti-money laundering in its US operations (2012: USD 1.9bn). Underlying profit before tax was higher in three of the four global businesses and in all regions except for Latin America. Within the Global Private Banking business, the Group continues to address legacy issues and to reposition its business model. Management stated that it did not meet all of its targets – generating a return on equity of 9.2% vs. a target of 12-15% and a cost efficiency ratio of 59.6% vs. a target in the mid 50s.

The Group significantly bolstered its capital position, with the CRD 4 CET1 ratio increasing to 10.9% from 9.5% at year-end 2012. As there continues to be uncertainty about final regulatory capital requirements, management has disclosed that it may not achieve its return on equity target but that it is confident that it would earn above its cost of equity. The Group reiterated its strategic priorities for 2014-2016, each of equal importance: (1) further grow the business and dividends, (2) continue to implement its Global Standards program, and (3) streamline processes and procedures to deliver a further USD 2-3bn in savings.

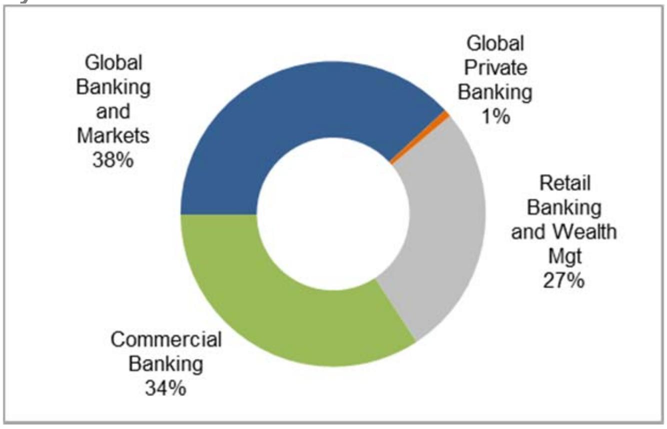
Rating drivers (Details)

1. A highly diversified business in terms of activity and geography, supporting a unique market position

The Group's stated objective is to become the world's leading international bank. Its home markets, the UK and Hong Kong, together with 20 other priority growth markets, account for over 90% of profit before tax. In addition, HSBC operates in network markets which serve to complement the international network. The Group states that its combined presence in home, priority growth and network markets covers around 85-90% of all international trade and financial flows. The Group aims to serve clients as they grow from small enterprises into large and international corporates. Further, HSBC targets opportunities in retail banking arising from social mobility and wealth creation in faster growing markets.

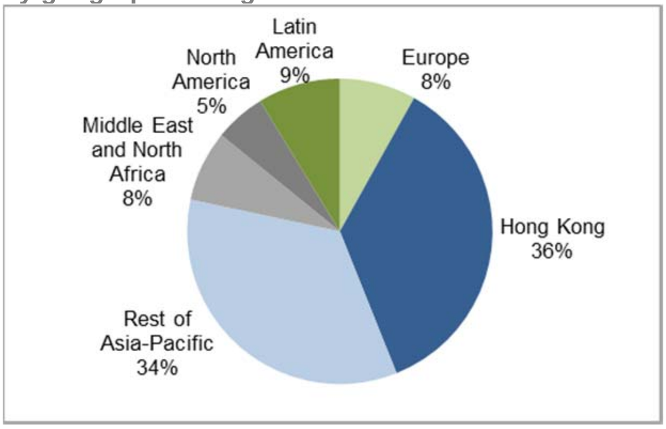
The Group has a matrix management structure, which includes global businesses, geographic regions and global functions. Over half of earnings are derived from more stable retail and commercial banking activities. Within Global Banking and Markets, the Group derives a significant portion of earnings from less volatile and client related businesses such as forex, cash management and securities services. Included in this division is the Group's Treasury portfolio, called Balance Sheet Management.

Chart 1: 2013 profit before tax (USD 22.6bn) by business



Source: Company data, Scope Ratings

Chart 2: 2013 profit before tax (USD 22.6bn) by geographical region



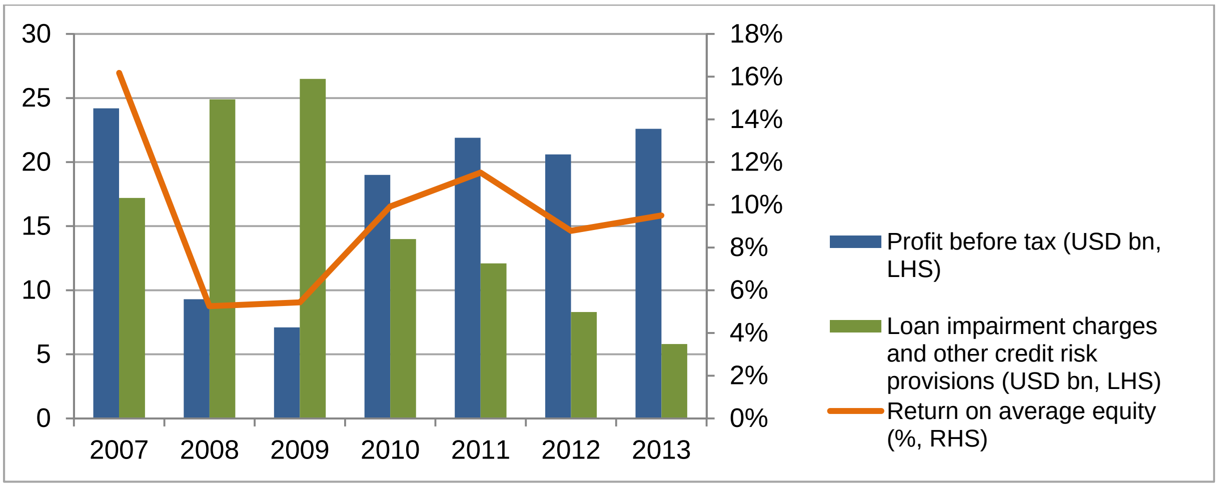
Source: Company data, Scope Ratings

2. Ability to generate sustainable and robust earnings even during difficult markets

The Group's extremely diverse business continues to generate strong earnings, which have enabled it to weather the financial crisis well, and positions it favourably in a changed banking environment. HSBC has not been immune to costs related to UK customer redress, restructuring and US consumer and real estate problems, but earnings have been sufficiently robust to absorb these costs.

HSBC remained profitable in 2008/2009 despite absorbing large impairments and losses in its US businesses. In 2009, management admitted that it had been a mistake to acquire Household Finance and placed most of the US consumer lending business into run-off. The US real estate related legacy portfolio is expected to decline to USD 20bn in 2016, from USD 30bn at year-end 2013 (2012: USD 39bn). At year-end 2013, the Global Banking and Markets business also had a legacy credit portfolio of USD 26bn RWAs (mortgage-backed securities and other asset-backed securities). While not a large component of total assets, these legacy assets remain a drag on Group performance.

Chart 3: Historical earnings (LHS) and profitability (RHS), 2007-2013



Source: Company data, Scope Ratings

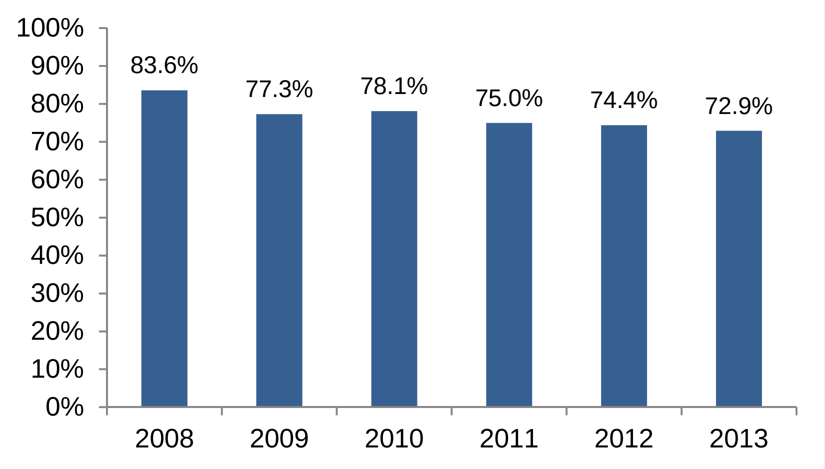
3. Strong liquidity and capital positions

HSBC Holdings plc, the holding company of the Group, does not provide core funding to any subsidiary, nor does it act as a lender of last resort. Further, HSBC has a legal-entity based Group structure, with subsidiaries operating under their own boards of directors as separately capitalized entities. This type of structure is particularly pertinent in times of stress as national regulators may prevent the free movement of liquidity and capital.

The Group's liquidity and funding risk management framework requires liquidity to be managed by operating entities on a stand-alone basis with no implicit reliance on the Group or central banks. Two key measures are used to monitor and control liquidity and funding risks. The advances-to-core funding ratio (i.e. loan-to-deposit ratio) is used to monitor the structural long-term funding position and the stressed coverage ratio, based on Group-defined stress scenarios, is used to monitor resilience to severe liquidity stresses. Each operating entity is expected to comply with its respective limit for the advances-to-core funding ratio and to maintain a positive stressed cash flow position out to three months.

The three principal entities of the Group, HSBC UK, The Hong Kong and Shanghai Banking Corporation and HSBC USA, account for 66% of the Group's customer accounts. The reported advances-to-core funding ratios for these entities were 100%, 72% and 85%, respectively, at year-end 013. And the reported stressed three-month coverage ratios were 109%, 114% and 110%, respectively. At Group level, the reported advances-to-core funding ratio was 72.9%.

Chart 4: Customer advances-to-core funding ratio 2008-2013 (%)



Source: Company data, Scope Ratings

HSBC currently manages its capital position to meet an internal target of CRD 4 CET1 ratio greater than 10%. The Group continues to generate capital and is well positioned compared with peers on both a capital and a leverage basis. At year-end 2013, the estimated CET1 ratio under CRD 4 was 10.9%, up from 9.5% at year-end 2012. Further, the estimated leverage ratio was 4.4% excluding instruments that will be ineligible for inclusion after the Basel 3 transitional period.

4. Vulnerable to regulatory, governance and internal control risks due to the Group's size and complexity

As part of its 2011 strategic objectives, the Group has simplified its structure by focusing on 22 home and priority markets, created four global businesses, established 11 global functions and implemented the 8x8 programme. Nonetheless, HSBC remains large and complex and requires skilled management. The Group's priorities for the next phase of its 2014-2016 strategic plan are to continue implementing global standards (particularly in risk and compliance) and streamlining processes and procedures to generate cost savings.

HSBC faces regulatory sanctions and fines related to business conduct and financial crime. In December 2012, the Group entered into agreements with US and UK authorities regarding inadequate compliance with anti-money laundering and sanctions laws. According to the US Justice Department, HSBC failed to monitor significant volumes of wire transfers and purchases of US dollars from HSBC Mexico. Among other agreements, the Group entered into two- and five-year deferred prosecution agreements and made payments totalling USD 1.9bn. Further, various entities of the Group no longer meet the requirements for financial holding company status and must obtain prior approval from US authorities before engaging in new activities or acquiring control of any new financial subsidiary. If remedial measures, including the establishment of an effective compliance risk management program, are not taken in a timely manner, the Group may be subject to further prosecution or may be required to divest its US businesses.

Like other UK banks, HSBC has incurred costs for customer redress programmes related to payment protection insurance, interest rate derivatives and wealth management (2013: USD 1.2bn, 2012: USD 2.3bn). In addition, it is the subject of ongoing investigations into the setting of LIBOR and other benchmark interest and foreign-exchange rates. Other ongoing legal proceedings concern Household International, Madoff and US residential mortgage foreclosure practices.

Another regulatory risk is that, in periods of extreme stress, the mobility of capital and liquidity across geographies within a group can significantly diminish, limiting a cross-border banking group's financial flexibility at a time when it needs it most. Mitigating factors to this would be the extent to which cross-border banking groups incorporate this risk in their business and financial strategies and can take management actions to increase financial flexibility at short notice. In this context, we look favourably on cross-border banking organizations that display reassuring capital and liquidity metrics not only at group level, but also at subsidiary level. We believe that HSBC has been aware of this potential risk for some time and that its financial management would be able to address this.

5. Exposed to material pockets of emerging market risks

For the last few years, HSBC has focused its investments in "faster growing priority markets", of which more than half can be considered as emerging markets. These include Indonesia, Mainland China, Vietnam, India, Malaysia, Argentina, Mexico, Brazil and Egypt. While these operations are significant contributors to the Group's geographic diversity and earnings, they also expose HSBC to emerging market risks. Compared with other large and diversified banking groups focused on more developed and stable markets, HSBC would be more at risk to potential shocks (e.g., a slowdown in China, political instability in the Middle East or a currency crisis) and changes in investor sentiment regarding emerging markets. In its outlook, management stated that it "anticipates greater volatility in 2014 and choppy markets as adjustments are made to changing economic circumstances and sentiment."

Peer comparison

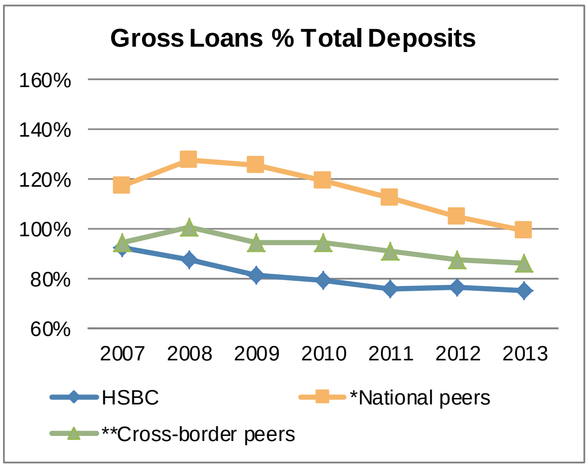
Within the UK, HSBC is among the top four players that dominate the market. However, the Group cannot be easily compared to the other UK banks due to the breadth and scale of its operations. Lloyds and RBS are primarily UK focused retail and commercial banks and continue to be partly owned by the UK government.

Internationally, we compare HSBC to other large universal banks with both retail/commercial and wholesale/investment banking activities. That said, HSBC is somewhat different from its international peers as well, in the sense that it has extensive activities in numerous retail markets across geographies and investment banking activities on a global scale. In that, perhaps its closest peers are Citigroup and BNP Paribas.

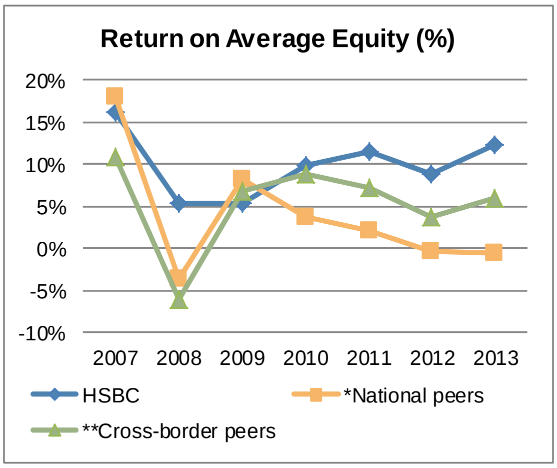
HSBC compares well among both domestic and international peers with respect to liquidity and leverage. 2013 year-end metrics included a leverage ratio of 4.4%% on an end-point PRA-adjusted basis and a CRD 4 CET1 ratio of 10.9%. There is low reliance on wholesale funding, liquid assets are of high quality and the loan-deposit ratio is well below 100%. Profitability (ROAE and ROARWA) has improved since 2009 and is consistently above peer averages, supported by one of the lowest cost-income ratios.

With regard to asset quality, HSBC is generally in line with cross-border peers but much better than national peers. The impaired loan ratio was 3.2% at year-end 2013. Impairments are relatively low in the Group's Asian businesses but are higher for the Latin American, European and North American businesses. The impaired loan ratio has continued to decline as the legacy US portfolio is run-off and the US housing market improves.

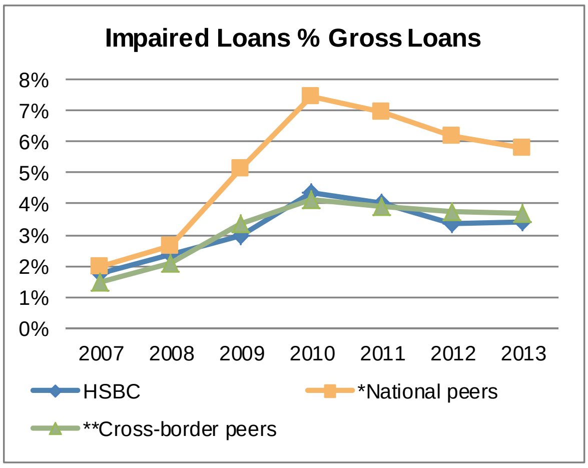
Peer Comparison - HSBC Holdings plc



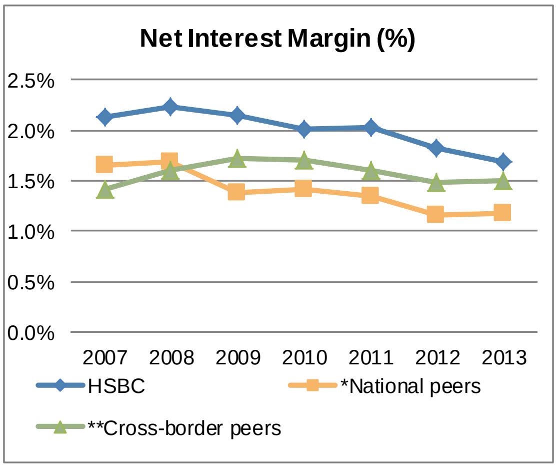
Source: SNL Financial, Scope Ratings



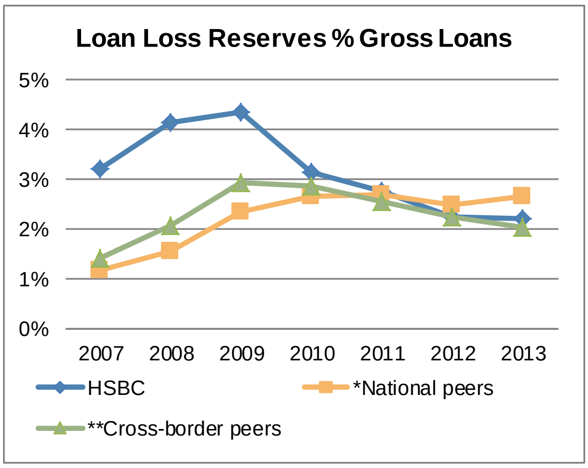
Source: SNL Financial, Scope Ratings



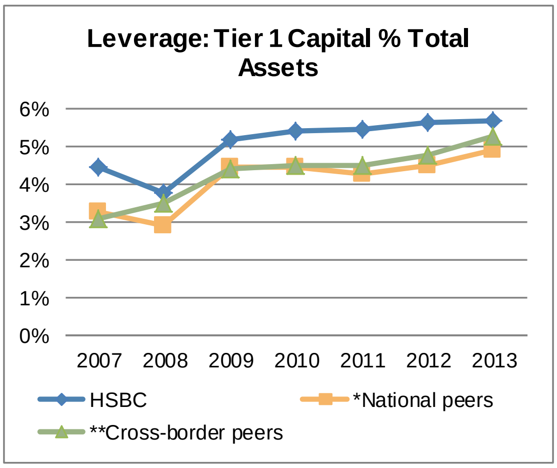
Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings

*National peers: HSBC, Barclays, Lloyds, RBS

**Cross-border peers: Bank of America Corp, Barclays, BNP Paribas, Citigroup Inc, Credit Suisse, Deutsche Bank, HSBC, JP Morgan Chase, Societe Generale, UBS

Selected Financial Information - HSBC Holdings plc

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Balance Sheet summary (USD billion)									
Assets									
Cash and balances with central banks	21.8	52.4	60.7	57.4	129.9	141.5	166.6	191.7	238.2
Interbank assets	347.8	233.1	264.7	285.1	264.8	238.2	245.5	250.4	257.9
Total securities	594.3	603.2	695.6	709.1	656.5	716.4	739.5	734.2	722.9
of which debt instruments	500.9	557.0	622.4	624.1	590.5	621.6	617.9	611.7	599.5
of which equity instruments	84.1	40.1	59.4	66.5	46.1	68.3	98.7	100.7	102.7
Derivatives	187.9	494.9	250.9	260.8	346.4	357.5	282.3	283.2	283.3
Gross customer loans	1,116.0	1,078.4	1,025.7	1,072.6	1,038.9	1,141.3	1,151.7	1,163.0	1,174.4
of which impaired loans	19.6	25.4	30.6	46.9	41.6	38.7	36.4	37.2	36.8
Total funded assets	2,170.9	2,040.4	2,116.8	2,196.0	2,210.2	2,333.7	2,397.0	2,432.1	2,486.0
Total Assets	**2,354.3**	**2,527.5**	**2,364.5**	**2,454.7**	**2,555.6**	**2,692.5**	**2,671.3**	**2,707.3**	**2,761.3**
Liabilities									
Interbank liabilities	199.8	173.9	171.8	155.9	169.1	176.3	179.3	181.0	182.9
Senior debt	343.7	261.3	240.2	244.3	234.1	226.6	214.8	204.1	193.9
Derivatives	183.4	487.1	247.6	258.7	345.4	358.9	274.3	275.2	275.3
Customer deposits	1,206.6	1,235.0	1,264.9	1,359.9	1,377.8	1,491.2	1,540.8	1,571.6	1,618.8
Subordinated debt + hybrid securities	52.4	53.2	54.9	57.2	52.2	51.0	50.9	51.4	52.4
Total Liabilities	**2,218.9**	**2,427.2**	**2,228.8**	**2,299.8**	**2,389.5**	**2,509.4**	**2,480.9**	**2,507.7**	**2,551.4**
Ordinary equity	128.2	90.1	124.8	140.4	151.5	168.0	174.6	183.0	191.7
Minority interests	7.3	6.6	7.4	7.2	7.4	7.9	8.6	8.6	8.6
Total Liabilities and Equity	**2,354.3**	**2,527.5**	**2,364.5**	**2,454.7**	**2,555.6**	**2,692.5**	**2,671.3**	**2,707.3**	**2,761.3**
Core Tier 1 Capital [1]	*90.9*	*80.3*	*106.3*	*116.1*	*122.5*	*122.5*	*132.5*	*140.9*	*149.6*
Income Statement summary (USD billion)									
Net interest income	37.8	42.6	40.7	39.4	40.7	37.7	35.5		
Net fee & commission income	22.0	20.0	17.7	17.4	17.2	16.4	16.4		
Net trading income	17.0	11.7	7.2	9.5	11.0	6.5	11.6		
Operating Income	**80.5**	**84.4**	**68.3**	**70.9**	**75.7**	**65.3**	**66.0**	**65.9**	**67.0**
Operating expenses	39.0	38.5	34.3	37.6	41.1	42.8	38.5	36.8	37.0
Loan loss provision charges	17.3	26.0	26.8	14.1	12.3	8.7	6.0	6.5	6.6
Non-recurring items	0.0	0.0	0.0	0.0	0.0	7.0	1.1	0.0	0.0
Pre-Tax Profit	**24.2**	**9.3**	**7.1**	**19.0**	**21.9**	**20.6**	**22.6**	**22.5**	**23.3**
Income tax	3.8	2.8	0.4	4.8	3.9	5.3	4.8	5.6	5.8
Net profit attributable to minority interests	1.3	0.8	0.9	1.0	1.1	1.3	1.6	1.6	1.7
Net Income Attributable to Parent	**19.1**	**5.7**	**5.8**	**13.2**	**16.8**	**14.0**	**16.2**	**15.3**	**15.9**

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] CRD 4 basis from 2012 onwards

Ratios - HSBC Holdings plc

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Funding/Liquidity									
Gross loans % Total deposits	92.5%	87.3%	81.1%	78.9%	75.4%	76.5%	74.7%	74.0%	72.5%
Total deposits % Total funds	66.9%	71.5%	72.9%	74.5%	74.9%	76.4%	77.3%	78.0%	78.7%
Wholesale funds % Total funds	33.1%	28.5%	27.1%	25.5%	25.1%	23.6%	22.7%	22.0%	21.3%
Asset Mix, Quality and Growth									
Gross loans % Funded assets	51.4%	52.9%	48.5%	48.8%	47.0%	48.9%	48.0%	47.8%	47.2%
Impaired loans % Gross loans	1.8%	2.4%	3.0%	4.4%	4.0%	3.4%	3.2%	3.2%	3.1%
Loan loss reserves % Impaired loans	182.4%	175.7%	145.7%	71.9%	68.5%	66.3%	63.7%	62.5%	63.1%
Gross loan growth (%)	15.7%	-3.4%	-4.9%	4.6%	-3.1%	9.9%	5.7%	5.2%	5.2%
Impaired loan growth (%)	42.1%	29.5%	20.7%	53.1%	-11.3%	-7.0%	-5.8%	2.0%	-1.0%
Funded assets growth (%)	23.4%	-6.0%	3.7%	3.7%	0.6%	5.6%	2.7%	1.5%	2.2%
Earnings									
Net interest income % Revenues	46.9%	50.4%	59.6%	55.7%	53.7%	57.7%	53.8%		
Fees & commissions % Revenues	27.3%	23.7%	25.9%	24.5%	22.7%	25.2%	24.9%		
Trading income % Revenues	21.1%	13.8%	10.6%	13.4%	14.6%	9.9%	17.6%		
Other income % Revenues	4.6%	12.0%	4.0%	6.4%	9.1%	7.2%	3.7%		
Net interest margin (%)	2.1%	2.2%	2.1%	2.0%	2.0%	1.8%	1.7%		
Pre-provision Income % Risk-weighted assets (RWAs)	3.7%	4.0%	3.0%	3.0%	2.9%	2.0%	2.3%	2.4%	2.4%
Loan loss provision charges % Pre-provision income	41.6%	56.6%	78.9%	42.6%	35.5%	38.8%	21.9%	22.5%	22.2%
Loan loss provision charges % Gross loans (cost of risk)	1.7%	2.5%	2.7%	1.4%	1.2%	0.8%	0.5%	0.6%	0.6%
Cost income ratio (%)	48.4%	45.6%	50.2%	53.1%	54.3%	65.5%	58.3%	55.9%	55.2%
Net Interest Income / Loan loss charges (x)	2.2	1.6	1.5	2.8	3.3	4.3	5.9		
Return on average equity (ROAE) (%)	16.2%	5.2%	5.4%	9.9%	11.5%	8.8%	9.5%	8.6%	8.5%
Return on average funded assets (%)	0.6%	0.2%	0.2%	0.4%	0.5%	0.4%	0.5%	0.4%	0.4%
Retained earnings % Prior year's book equity	7.2%	0.1%	-0.6%	4.5%	6.2%	4.6%	5.8%	4.8%	4.8%
Pre-tax return on common equity tier 1 capital	26.6%	11.6%	6.7%	16.4%	17.9%	16.9%	17.0%	16.0%	15.6%
Capital and Risk Protection [1]									
Common equity tier 1 ratio (common equity tier 1 capital % RWAs)	8.1%	7.0%	9.4%	10.5%	10.1%	9.5%	10.9%	11.4%	11.9%
Tier 1 leverage ratio (%)	4.5%	3.8%	5.2%	5.4%	5.5%	5.6%	5.9%		
Median of tier 1 leverage ratio and common equity tier 1 ratio (%)	6.3%	5.4%	7.3%	8.0%	7.8%	7.6%	8.4%		
Total loss coverage (CET 1 capital + loan loss provisions) % RWAs	11.3%	10.9%	13.3%	13.6%	12.5%	13.2%	12.8%	13.3%	13.8%
Non-senior bailinable debt cushion (as % of total liabilities)	2.4%	2.3%	2.6%	2.8%	2.5%	2.3%	2.3%	2.4%	2.4%
Asset risk intensity (RWAs % total assets)	47.7%	45.4%	47.9%	44.9%	47.3%	41.7%	40.9%	45.5%	45.5%

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] CRD 4 basis from 2012 onwards

METHODOLOGIES USED FOR THIS REPORT

For the rating and analysis contents of this report Scope has used the following methodologies which were published on www.scoperatings.com:

"Bank Rating Methodology" (February 2014)

"Forecasting Bank Financials Methodology" (February 2014)

Forecasting bank financials: Forward-looking estimates are an important analytical tool underpinning Scope's bank ratings. These forecasts cover the current financial year (before final year-end figures are published by the bank) plus the forthcoming two years. Depending on the complexity of the bank being assessed, different forecasting tools will be used. For a majority of banks operating primarily commercial and retail banking franchises (loans and deposits) the analysis is underpinned by an **accounting** forecast of the balance sheet and profit and loss account. For more complex groups with multiple ranges of activities – notably those with material wholesale and investment banking operations – Scope uses an **analytical** forecast, relying on the bank's business-line reporting to come up with plausible estimates. For all banks Scope also include a **regulatory metrics** forecast, considering the growing importance of this aspect in bank analysis.

For complex banks, divisional data is used to forecast profit and loss accounts and basic divisional balance sheet metrics. For less complex banks, a line-by-line forecasting of major P&L elements is forecast.

For balance-sheet forecasts, Scope estimates of all major balance sheet lines, using the P&L estimates to complete the forecast of the capital/shareholders' equity line. This comprehensive methodology for estimating the balance sheet is used for all the banks in our universe, irrespective of size and complexity.

Lastly, our forecasts include assessments of the major regulatory metrics: Tier 1 and CET 1 (historically CT1), Leverage, Liquidity Coverage Ratio, and Net Stable Funding Ratio (the latter two when and if sufficient public information to compute them is available).

Scope will not aim to forecast financials when it considers the public disclosure of the bank as insufficient for a transparent and credible outcome.

All Scope's bank financial forecasts are based on public information. For its forecasts Scope will not use any non-public information or data, even if such information or data were provided by rated banks. Scope's forecasting process is transparent, with a detailed roadmap provided in its *"Forecasting bank financials"* methodology.

ING Bank NV
Issuer Rating Report

A STABLE OUTLOOK
Financial Institutions

Overview

The A Issuer Credit-Strength Rating (ICSR) on ING Bank NV is driven by its relatively strong and resilient retail and commercial banking franchise in the Benelux region. The Bank has continued to be profitable despite restructuring, impairments on financial assets and elevated credit costs. Notably, ING Bank remains part of ING Groep NV and will continue to be impacted by restructuring at the group level. The Group is in a period of transition as it is divesting all of its insurance and investment management businesses (nearly half of assets). If implemented as agreed with the European Commission, the Group will be comprised primarily of banking operations from 2015/2016 onwards.

We highlight that the A rating is not applicable to unguaranteed debt issued by subsidiaries of ING Bank NV as well as debt issued by ING Groep NV.

Ratings (assigned on April 2, 2014)

Issuer Credit-Strength Rating	**A**
Outlook	Stable
Senior Unsecured Debt	A

Unsolicited ratings without issuer participation.

Lead Analyst

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Team Leader

Sam Theodore
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Rating drivers (Summary)

The rating drivers, in decreasing order of importance in the rating assignment, are:

- (+) Strong retail and commercial banking franchise in the Benelux.
- (+) Funding and capital have improved to satisfactory levels.
- (+) Good progress made on restructuring plan and “Back to Basics” program.
- (–) Performance likely to be hampered by costs related to further restructuring.

Rating change drivers

Completion of required restructuring. The Group is in the process of fully separating its banking and insurance operations (including investment management) as part of the restructuring required by the European Commission in order to gain approval for the aid it received from the Dutch State in 2008/2009. The remaining insurance operations account for about 15% of Group assets. In November 2012, the Group amended the terms of the restructuring plan, extending the deadline for completion to end-2018 from end-2013. The ability to do so will depend on market conditions and evolving regulatory requirements. The Group also needs to repay EUR 683m in principal plus EUR 342m in interest and premiums to the Dutch State. Successful completion would lend further credibility to management and allow it to focus fully on managing its banking operations.

- Change in business strategy leading to an increase in riskier investment banking activities. Since 2009, ING Bank has refocused its financial markets activities in areas where it has the strongest franchises and where it can support its clients as a universal bank. We would view negatively a change in strategy and business model that increases the risk profile of the Bank.

- Sustained earnings generation that enables ING Bank to meet its capital and leverage targets (fully loaded CRD 4 CET1 ratio above 10% and leverage ratio about 4%). Retained earnings have been negatively impacted by restructuring costs, impairments on financial assets and repayments to the Dutch State. We would view positively a reduction in these costs so that earnings can be retained to further bolster the capital position.

- Meaningful deterioration in asset quality. About 40% of the loan portfolio is exposed to the relatively weak economic environment in the Netherlands. Credit costs are currently elevated but adequately covered by earnings. For 2013, the reported non-performing loan ratio was 2.8%, while credit costs accounted for approximately one-third of pre-provision income. We would view negatively a meaningful increase in credit costs or a poor outcome in the upcoming asset quality review.

Recent events

2013 results

For 2013, ING Group reported a net result of EUR 3.2bn, with the bulk of earnings being generated from the banking business. Banking operations produced a net result of EUR 3.0bn, down slightly from EUR 3.1bn in the prior year. However, the 2012 net result included EUR 1.4bn in gains from divestments. Performance was supported by a higher net interest margin as well as by flat costs. Meanwhile, risk costs remained elevated due to the weak macroeconomic environment. Consequently, risk weighted assets also increased to EUR 301bn in Q4 2013 from EUR 285bn in Q3 2013. The Group disclosed that its risk costs already incorporate the recent review of its commercial real estate portfolio by the Dutch National Bank. The non-performing loan ratio rose to 2.8% in Q4 2013 from 2.5% in Q4 2012. Meanwhile, the reported non-performing loan coverage ratio increased to 39% from 37%.

Strategy update

On March 31, 2014, the Group provided a strategy update for ING Bank. With Group restructuring at an end stage and repayment to the Dutch State nearly complete, management said that they are now “in a position to look ahead to the future of ING Bank – to Think Forward.” The strategy entails becoming the primary bank for more customers by increasing the share of payment accounts in Retail Banking and with anchor products such as lending and transaction services in Commercial Banking. The Bank also detailed how it plans to proceed based on its current market positioning in various geographic markets – classified as Market Leaders, Challengers and Growth Markets.

Financial targets were also updated under Ambition 2017. The Bank intends to grow the loan book by approximately 4% per year and the balance sheet by approximately 3%, funded primarily through customer deposits. In addition, with new lending focused on SMEs and consumer lending, the resulting more diversified lending mix is expected to lead to a higher net interest margin of 150-155 bps by 2017. Management maintained a ROE target of 10% to 13% from 2015. After full repayment to the Dutch State, ING also intends to resume dividend payments in 2015, with an eventual target payout ratio above 40%. Further, the Bank confirmed a fully-loaded CRD 4 CET1 ratio target above 10% and introduced a leverage ratio target of about 4%, subject to final regulations.

Rating drivers (Details)

1. Strong retail and commercial banking franchise in the Benelux

ING Bank has stated that it intends to be predominantly a European bank with leading positions in stable home markets, as well as a leading commercial bank in the Benelux with a strong position in Central and Eastern Europe. The units of ING Direct will also be developed into more full-service banking models.

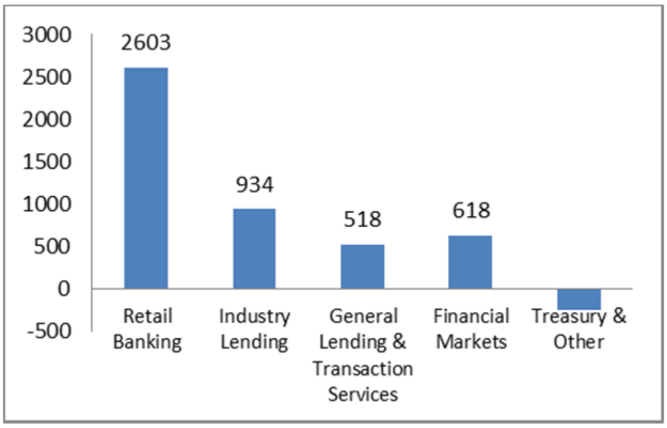
ING Bank operates as a universal bank in the Netherlands and Belgium, where it is the number two and three bank, respectively. In the Netherlands, ING Bank's market shares include 22% in mortgages, 19% in savings, 28% in payments and 30% in SMEs. Further, through ING Direct, the Bank is a leading direct player with operations in Germany, Australia, France, Italy, and Spain. In Germany, it is the third largest private retail bank by number of retail customers, after Deutsche Bank/Postbank and Commerzbank. These operations are generally low cost and have been a good source of customer deposits.

Operations are split between Retail Banking and Commercial Banking, accounting for approximately 60% and 40% of earnings, respectively. Within Retail Banking, over 70% of the loan portfolio is comprised of residential mortgages.

Within Commercial Banking, Industry Lending, which comprises structured finance and real estate finance, is the largest contributor to income. ING Bank is among the top ten players in structured finance globally, with a particular focus on industries such as oil and gas, metals and mining, power and infrastructure and trasportation. Financial Markets comprises trading and sales businesses. Over the last few years, this business has been refocused in light of regulatory changes, with the income contribution declining by more than half. For example, in 2012, the Strategic Trading Platform was discontinued and the international cash equities business outside the Benelux was closed.

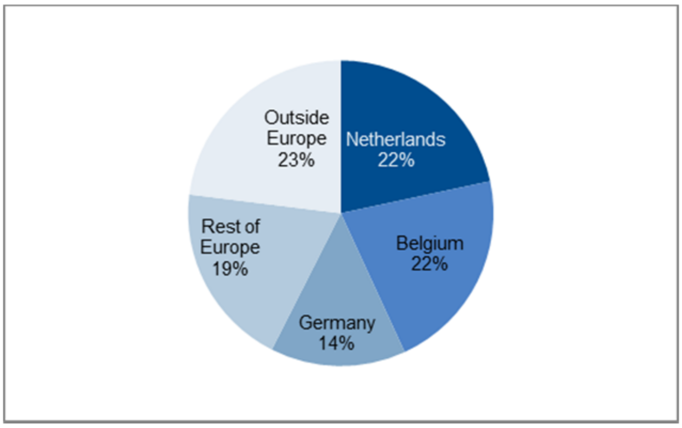
ING Bank has consistently generated profits, even in 2008 and 2009 when net profit was EUR 772m and EUR 684m, respectively. For 2013, ING Bank reported net profit of EUR 3bn.

Chart 1:2013 underlying result before tax by business (EUR 4300 m)



Source: Company data, Scope Ratings

Chart 2: 2013 underlying result before tax by geography



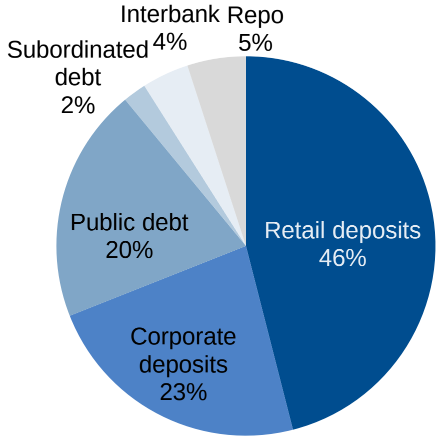
Source: Company data, Scope Ratings

2. Funding and capital have improved to satisfactory levels

Over the last few years, ING Bank has worked to reduce risks and optimize its balance sheet. Its funding profile has improved and capital has been strengthened. Customer deposits are the largest component of funding, supported by continued deposit gathering. The reported loan-to-deposit ratio has steadily declined since 2011 and was 111% at year-end 2013 (2011: 121%). From 2010 to 2011, there was an increase in the loan-to-deposit ratio as the deposits of ING Direct USA were transferred to assets/liabilities held for sale.

The maturity profile of debt has been extended and the reliance on short-term funding from banks has been reduced. Since 2009, interbank funding has declined from EUR 84bn to EUR 27bn at year-end 2013. At the same time, long-term funding has increased from EUR 65bn to EUR 101bn. ING Bank aims for LCR and NSFR ratios above 100% in 2015. At year-end 2013, ING Bank reported that its LCR was above 100% (Sep 2011: 90%) and that its eligible asset buffer stood at EUR 180bn.

Chart 3: 2013 funding mix



Source: Company data, Scope Ratings

Further, ING Bank has reduced investments, trading, repo and interbank positions while increasing the proportion of assets derived from lending. In particular, the balance sheet of the banking operations have been combined with that of ING Direct and deposits from ING Direct are now better matched by own originated assets. From 2008 to 2012, gross loans as a percentage of funded assets increased from 70% to over 75%.

In Q4 2012, the planned de-risking of the investment portfolio was completed. The Bank incurred EUR 601m in losses on its bond holdings with positions in covered bonds, ABS securities and real estate investments being reduced. The investment portfolio is now maintained for liquidity purposes. At year-end 2013, the breakdown of the EUR 97bn investment portfolio was as follows: 58% government bonds, 19% covered bonds, 15% financial and corporate bonds and 8% asset-backed securities. Only 4% of government bond holdings are related to higher risk sovereigns.

At year-end 2013, ING Bank reported a pro-forma fully loaded CRD 4 CET1 ratio of 10% and a leverage ratio of 3.9%. The capital position has steadily improved due to lower RWAs and retained earnings. This improvement has come about even as ING Bank has upstreamed dividends to the Group to repay the Dutch State and to unwind the guarantee facility covering 80% of the Group's Alt-A mortgage securities portfolio.

3. Good progress made on restructuring plan and "Back to Basics" program

In April 2009, the Group announced its "Back to Basics" program with the goals of strengthening financials to navigate through the crisis, simplifying the Group and reinforcing franchises in focus markets. Over the last four years, the Group has made good progress in achieving these objectives. Banking and insurance have been operating separately since 2011, various divestments have been made and insurance businesses have been strengthened to operate as standalone businesses. Group double leverage continues to decline and was EUR 3.9bn in Q1 2014 (2012: EUR 7bn). The Group estimates that the remainder is largely covered by the expected sale of the remaining stakes in ING USA (43% stake) and SulAmerica (10% stake) as well as the intended IPO of NN Group.

The Group has also reduced its reliance on State support, repaying in instalments the EUR 10bn capital injection (via core Tier 1 securities) it received from the Dutch State in 2008. Sources of repayment have come from a rights issue as well as earnings. In March 2014, the Group repaid another EUR 1.2bn to the Dutch State. The Group intends to repay the fourth and last payment of EUR 1.0bn in May 2015. In addition, in December 2013, the Group and the Dutch State unwound the back-up facility on Alt-A mortgage securities, reducing RWA by EUR 2bn.

As regards to divestments required by the European Commission, the second tranche of ING US was sold in October 2013, reducing the stake to 57%. In March 2014, the Group further reduced its stake in ING US to approximately 43%. The retained minority stake will now be accounted for as an associate under equity accounting. This will have an estimated negative after-tax P&L impact of EUR 2bn in the Group's Q1 2014 results but no impact on the capital position of ING Bank. ING Insurance, including ING Life Japan are preparing for a base case IPO in 2014. And following the sale of ING Life Korea completed in December 2013, Asian insurance divestments are effectively completed.

4. Performance likely to be hampered by costs related to further restructuring

While the bulk of the remaining restructuring relates to the insurance operations, the banking operations will not be unaffected. In February 2014, the Group reached an agreement to make its Defined Benefits Pension Fund financially independent. This will facilitate the IPO of ING Insurance and the Group will be released from future financial obligations arising out of the fund. The removal of the pension asset on the Group's balance sheet will result in an after-tax P&L charge of approximately EUR 1.1bn in 1Q 2014 (EUR 0.7bn attributed to ING Bank and EUR 0.4bn to ING Insurance). The expected negative impact on ING Bank's pro-forma fully loaded CRD 4 CET1 ratio is about 20bp.

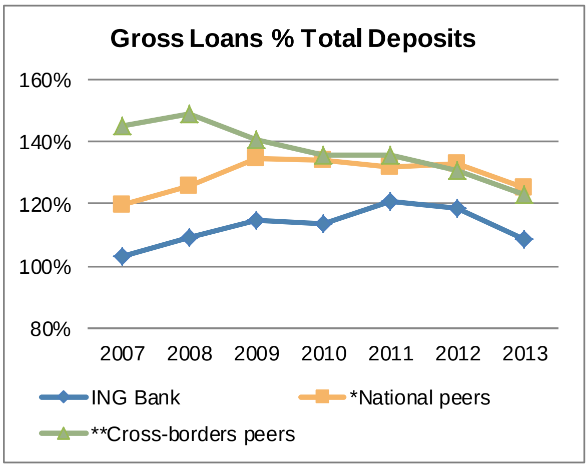
Further, the profitability of the insurance operations has been weaker than the banking operations, generating net losses between 2008 and 2010. In 2013, the insurance operations generated a net result of EUR 201m. Consequently, it is earnings from ING Bank which are upstreamed to the Group in order to repay State aid. The repayment to the Dutch State in March 2014 was funded by a dividend from ING Bank and was estimated to lead to a 40bp reduction in the Bank's CET1 ratio. Moreover, dividends from ING Bank have been used to reduce the Group's double leverage. During the period from 2011 to 2013, ING Bank has upstreamed approximately EUR 8bn of capital to the Group.

Peer comparison

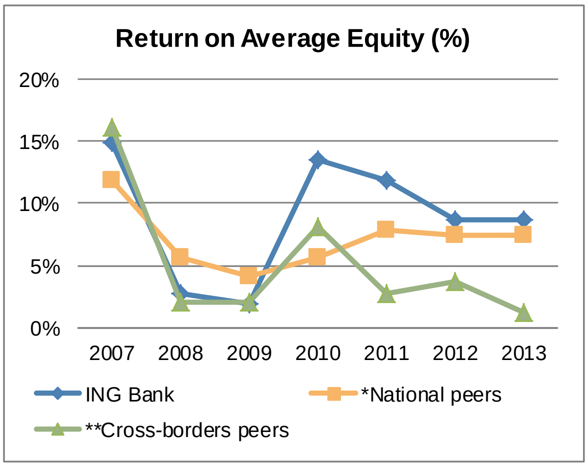
In light of ING Bank's number two position in the Netherlands, it makes sense to compare it to the other major domestic players such as Rabobank and ABN Amro. Unlike these two, ING Bank benefits from greater regional geographic diversification due to its significant operations in Belgium, Luxembourg and Germany. About 40% of the loan portfolio is domestic while international operations further contribute to ING Bank's funding mix via customer deposits. While ING Bank has nearly repaid the Dutch State, ABN Amro remains state-owned. Meanwhile, Rabobank did not require any State aid and maintains a stronger capital position.

At Scope Ratings, ING Bank is included within the peer group of international retail banks. This peer group includes banks such as KBC, Unicredit, Santander, BBVA, Nordea and Commerzbank. Overall, ING Bank compares relatively well to peers in terms of its liquidity and funding profile, asset quality and profitability. We do note that the level of provisions as a percentage of loans is low compared to peers at around 1%. This is somewhat offset by the high level of collateralization. Approximately 80% of the portfolio consists of secured lending such as mortgages, leasing and structured finance. The one area where ING Bank has historically been weaker is in terms of capital and leverage although this has improved and is now in line in with peers. At year-end 2013, ING Bank reported a pro-forma fully loaded CRD 4 CET1 ratio of 10%, with a leverage ratio of 3.9%.

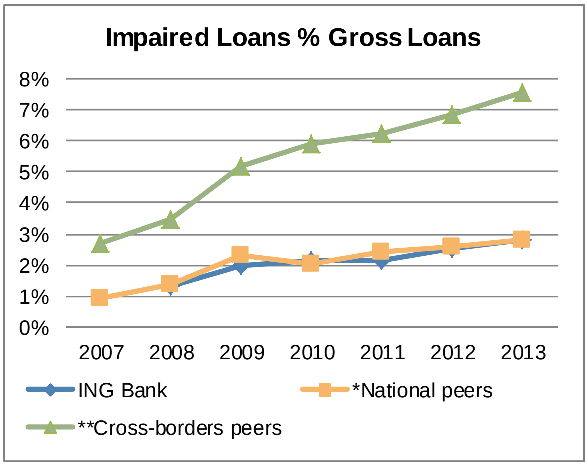
Peer Comparison - ING Bank NV



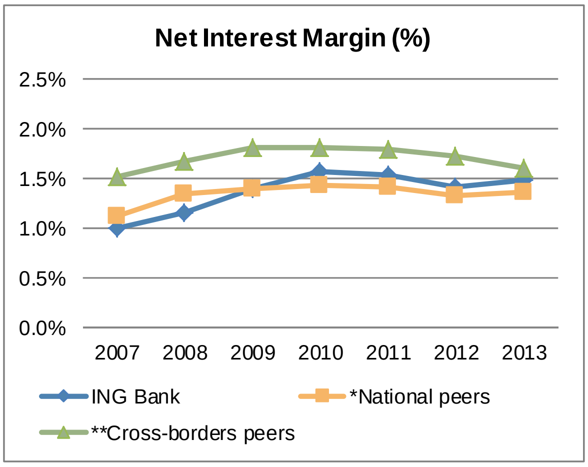
Source: SNL Financial, Scope Ratings



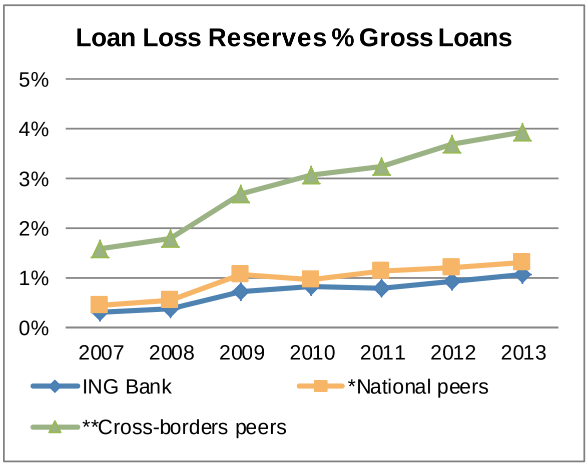
Source: SNL Financial, Scope Ratings



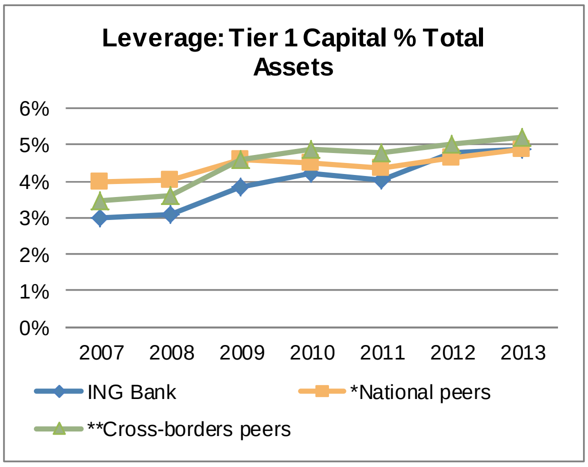
Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings

*National Peers : ING Bank, ABN AMRO, Rabobank.

**Cross-border peers: Groupe BPCE, Credit Mutuel Group, Intesa, DNB ASA, Credit Agricole Group, CaixaBank, Swedbank, Lloyds Banking group, Wells Fargo & Co., Rabobank Group

Notes: Cross-border peer group averages exclude RZB in 2013

Selected Financial Information - ING Bank NV

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Balance Sheet summary (EUR billion)									
Assets									
Cash and balances with central banks	9.8	18.2	12.6	9.5	28.1	15.4	11.9	4.9	-1.2
Interbank assets	48.9	48.4	43.4	51.8	45.3	39.1	43.0	43.9	44.7
Total securities	216.1	181.2	136.8	146.6	107.1	104.6	113.0	114.3	115.6
of which debt instruments	201.0	177.2	130.6	138.4	101.4	97.2	98.5	99.4	100.4
of which equity instruments	15.1	4.0	6.2	8.2	5.8	7.4	14.6	14.9	15.2
Derivatives	35.8	82.5	50.1	51.4	69.2	64.2	37.2	37.9	38.9
Gross customer loans	642.9	661.0	598.7	642.7	626.7	585.2	565.8	577.0	594.2
of which impaired loans	0.0	8.6	12.0	13.8	13.4	14.9	15.9	15.9	15.6
Total funded assets	960.0	945.3	825.1	875.5	887.0	768.0	748.5	754.4	767.3
Total Assets	**994.1**	**1,034.7**	**882.1**	**933.1**	**961.2**	**836.1**	**787.6**	**794.3**	**808.3**
Liabilities									
Interbank liabilities	167.0	152.3	84.2	72.9	72.2	38.7	27.3	25.9	24.6
Senior debt	77.2	106.7	131.2	152.3	151.8	154.1	142.1	139.3	136.5
Derivatives	34.1	89.4	57.0	57.6	74.2	68.1	39.2	39.9	41.0
Customer deposits	626.8	604.1	520.7	565.0	518.7	481.5	508.2	518.4	533.9
Subordinated debt + hybrid securities	18.8	23.4	22.7	22.3	19.5	17.5	15.7	14.1	13.4
Total Liabilities	**966.9**	**1,010.6**	**850.9**	**898.0**	**926.1**	**798.6**	**753.9**	**758.9**	**770.6**
Ordinary equity	25.5	22.9	30.2	34.5	34.4	36.7	32.8	34.5	36.7
Minority interests	1.7	1.2	1.0	0.6	0.7	0.8	1.0	1.0	1.0
Total Liabilities and Equity	**994.1**	**1,034.7**	**882.1**	**933.1**	**961.2**	**836.1**	**787.6**	**794.3**	**808.3**
Core Tier 1 Capital [1]	*23.4*	*24.9*	*26.0*	*30.9*	*31.7*	*31.7*	*30.1*	*31.8*	*34.0*
Income Statement summary (EUR billion)									
Net interest income	9.0	11.3	12.8	13.6	13.6	12.2	12.0		
Net fee & commission income	2.9	2.9	2.7	2.6	2.5	2.1	2.2		
Net trading income	1.3	0.0	0.1	1.0	0.6	0.7	1.0		
Operating Income	**14.5**	**14.4**	**15.2**	**17.8**	**17.1**	**14.7**	**15.3**	**15.2**	**15.5**
Operating expenses	10.0	10.3	9.7	9.7	9.4	9.7	8.7	8.5	8.5
Loan loss provision charges	0.2	3.7	4.5	1.9	2.4	2.2	2.3	2.3	2.0
Non-recurring items	0.1	0.2	0.0	0.3	0.2	1.6	0.0	-2.1	-1.0
Pre-Tax Profit	**4.5**	**0.5**	**0.5**	**6.0**	**5.3**	**4.3**	**4.2**	**2.3**	**3.9**
Income tax	0.8	-0.2	0.0	1.4	1.2	1.1	1.1	0.6	1.0
Net profit attributable to minority interests	0.1	-0.1	-0.1	0.1	0.1	0.1	0.1	0.0	0.1
Net Income Attributable to Parent	**3.6**	**0.8**	**0.7**	**4.5**	**4.0**	**3.1**	**3.1**	**1.7**	**2.8**

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] CRD 4 basis from 2012 onwards

Ratios - ING Bank NV

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Funding/Liquidity									
Gross loans % Total deposits	100.0%	111.7%	116.4%	114.1%	121.5%	118.8%	111.3%	n/a	n/a
Total deposits % Total funds	70.4%	68.1%	68.6%	69.5%	68.0%	69.6%	73.3%	74.3%	75.4%
Wholesale funds % Total funds	29.6%	31.9%	31.4%	30.5%	32.0%	30.4%	26.7%	25.7%	24.6%
Asset Mix, Quality and Growth									
Gross loans % Funded assets	67.0%	69.9%	72.6%	73.4%	70.7%	76.2%	75.6%	76.5%	77.4%
Impaired loans % Gross loans	0.0%	1.3%	2.0%	2.1%	2.1%	2.6%	2.8%	2.8%	2.6%
Loan loss reserves % Impaired loans	0.0%	30.4%	36.7%	37.7%	41.3%	36.9%	38.6%	38.6%	39.4%
Gross loan growth (%)	15.5%	2.8%	-9.4%	7.3%	-2.5%	-6.6%	-3.3%	2.0%	3.0%
Impaired loan growth (%)	0.0%	0.0%	39.5%	15.0%	-2.9%	11.6%	6.7%	0.0%	-2.0%
Funded assets growth (%)	10.4%	-1.5%	-12.7%	6.1%	1.3%	-13.4%	-2.5%	0.8%	1.7%
Earnings									
Net interest income % Revenues	62.2%	78.4%	83.9%	76.5%	79.4%	83.1%	78.2%		
Fees & commissions % Revenues	20.1%	20.1%	17.6%	14.8%	14.6%	14.5%	14.6%		
Trading income % Revenues	9.2%	0.0%	0.6%	5.4%	3.5%	4.9%	6.2%		
Other income % Revenues	8.5%	1.5%	-2.1%	3.3%	2.5%	-2.5%	0.9%		
Net interest margin (%)	1.0%	1.3%	1.5%	1.7%	1.7%	1.6%	1.7%		
Pre-provision Income % Risk-weighted assets (RWAs)	1.1%	1.2%	1.6%	2.5%	2.3%	1.7%	2.2%	2.2%	2.2%
Loan loss provision charges % Pre-provision income	4.4%	88.6%	82.5%	24.0%	30.9%	42.7%	34.7%	34.4%	28.9%
Loan loss provision charges % Gross loans (cost of risk)	0.0%	0.6%	0.7%	0.3%	0.4%	0.4%	0.4%	0.4%	0.3%
Cost income ratio (%)	69.0%	71.3%	64.0%	54.7%	54.7%	65.6%	56.8%	55.4%	55.3%
Net Interest Income / Loan loss charges (x)	45.4	3.1	2.8	7.0	5.7	5.7	5.2		
Return on average equity (ROAE) (%)	15.3%	3.2%	2.6%	13.9%	11.6%	8.8%	8.8%	5.0%	7.9%
Return on average funded assets (%)	0.3%	0.1%	0.1%	0.3%	0.3%	0.3%	0.3%	0.1%	0.2%
Retained earnings % Prior year's book equity	-3.1%	3.0%	2.1%	4.9%	5.5%	0.5%	8.4%	5.1%	6.5%
Pre-tax return on common equity tier 1 capital	19.1%	2.1%	1.9%	19.4%	16.7%	13.6%	14.1%	7.3%	11.4%
Capital and Risk Protection [1]									
Common equity tier 1 ratio (common equity tier 1 capital % RWAs)	5.8%	7.3%	7.8%	9.6%	9.6%	10.4%	10.0%	10.5%	11.0%
Tier 1 leverage ratio (%)	3.0%	3.1%	3.9%	4.2%	4.0%	4.8%	4.9%		
Median of tier 1 leverage ratio and common equity tier 1 ratio (%)	4.4%	5.2%	5.8%	6.9%	6.8%	7.6%	7.4%		
Total loss coverage (CET 1 capital + loan loss provisions) % RWAs	5.8%	8.0%	9.1%	11.2%	11.3%	12.2%	12.0%	12.5%	13.0%
Non-senior bailinable debt cushion (as % of total liabilities)	1.9%	2.3%	2.7%	2.5%	2.1%	2.2%	2.1%	1.9%	1.7%
Asset risk intensity (RWAs % total assets)	40.5%	33.2%	37.7%	34.4%	34.4%	33.3%	35.9%	38.2%	38.2%

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] CRD 4 basis from 2012 onwards

METHODOLOGIES USED FOR THIS REPORT

For the rating and analysis contents of this report Scope has used the following methodologies which were published on www.scoperatings.com:

"Bank Rating Methodology" (February 2014)

"Forecasting Bank Financials Methodology" (February 2014)

Forecasting bank financials: Forward-looking estimates are an important analytical tool underpinning Scope's bank ratings. These forecasts cover the current financial year (before final year-end figures are published by the bank) plus the forthcoming two years. Depending on the complexity of the bank being assessed, different forecasting tools will be used. For a majority of banks operating primarily commercial and retail banking franchises (loans and deposits) the analysis is underpinned by an **accounting** forecast of the balance sheet and profit and loss account. For more complex groups with multiple ranges of activities – notably those with material wholesale and investment banking operations – Scope uses an **analytical** forecast, relying on the bank's business-line reporting to come up with plausible estimates. For all banks Scope also include a **regulatory metrics** forecast, considering the growing importance of this aspect in bank analysis.

For complex banks, divisional data is used to forecast profit and loss accounts and basic divisional balance sheet metrics. For less complex banks, a line-by-line forecasting of major P&L elements is forecast.

For balance-sheet forecasts, Scope estimates of all major balance sheet lines, using the P&L estimates to complete the forecast of the capital/shareholders' equity line. This comprehensive methodology for estimating the balance sheet is used for all the banks in our universe, irrespective of size and complexity.

Lastly, our forecasts include assessments of the major regulatory metrics: Tier 1 and CET 1 (historically CT1), Leverage, Liquidity Coverage Ratio, and Net Stable Funding Ratio (the latter two when and if sufficient public information to compute them is available).

Scope will not aim to forecast financials when it considers the public disclosure of the bank as insufficient for a transparent and credible outcome.

All Scope's bank financial forecasts are based on public information. For its forecasts Scope will not use any non-public information or data, even if such information or data were provided by rated banks. Scope's forecasting process is transparent, with a detailed roadmap provided in its *"Forecasting bank financials"* methodology.

KBC Group NV
Issuer Rating Report

A- STABLE OUTLOOK
Financial Institutions

Overview

The A- Issuer Credit-Strength Rating (ICSR) with a stable outlook on KBC Group NV is driven by its focused and solid franchise as a leading bancassurer in Belgium and the Czech Republic as well as the meaningful progress made in recovering from the financial crisis. The Irish operations remain the exception and continue to drag on KBC's performance. Solvency has improved to satisfactory levels and liquidity is sound.

In assigning our rating, we have focused on KBC Group, rather than the standalone banking operations, as KBC remains committed to its integrated bank and insurance strategy. At year-end 2013, banking assets accounted for over 85% of group assets with insurance assets accounting for the remainder.

The A- rating applies also to senior unsecured debt issued by KBC Bank NV but not to unguaranteed debt issued by its subsidiaries. Further, the rating is not applicable to debt issued by KBC Insurance NV.

Ratings (assigned on April 2, 2014)

Issuer Credit-Strength Rating	**A-**
Outlook	Stable
Senior Unsecured Debt	A-

Unsolicited ratings with issuer participation.

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Team Leader

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Rating drivers (Summary)

The ratings drivers, in decreasing order of importance in the rating assignment, are:

- (+) Solid franchise as a leading bancassurer in Belgium and the Czech Republic.
- (+) Improving solvency and solid liquidity position.
- (–) Relatively weak asset quality driven by operations in Ireland.
- (+) Focused strategy facilitated by the near completion of restructuring agreed with the European Commission.

Rating change drivers

- Failure to repay aid received from the Flemish Regional Government. During the financial crisis, KBC received EUR 7bn in State aid (EUR 3.5bn from the Belgian Government and EUR 3.5bn from the Flemish Regional Government). To date, there remains EUR 2bn outstanding to the Flemish Regional Government – to be repaid in equal installments from 2014 to 2020. The expected source of repayment is earnings.

- Change in business strategy which increases the risk profile of the Group. As KBC is nearly at the end of the restructuring prompted by the financial crisis, it has become more focused and lower risk. We would view negatively a change in strategy which increases risk – such as pursuing acquisitions in non-core markets, investing in higher risk assets or developing wholesale banking activities.

Maintaining a CRD 4 fully loaded CET1 ratio of at least 10%. Management targets a CET1 ratio above 10% which exceeds the 9.25% requested by supervisory authorities. While KBC's capital ratio is currently above this target, future levels will be negatively impacted by expected impairments on the Irish loan portfolio as well as the repayment of State aid.

Improvement in Irish operations. The Irish operations continue to be loss making due to the high level of impairments. KBC has guided to a return to profitability in 2016 for this business. We would view positively an improvement in the Irish business as this is weakest part of the Group and continues to be a drag on performance.

Material deterioration in asset quality. The asset quality of the loan portfolio, driven by loans in Ireland, is relatively low compared with peers. After last year's review of the loan portfolio and the subsequent impairments in Ireland and Hungary, management has indicated that it does not expect any further material impairments. While significantly reduced, the Group still also has about EUR 4.3bn of exposure to structured credit products.

Recent events

2013 results

For 2013, KBC reported a net profit of EUR 1.0bn, compared with EUR 621m in the prior year. Banking activities accounted for about 70% of group net profit while insurance activities accounted for the remainder. Excluding the impact of legacy items (gains on CDOs and losses on divestments) and the valuation of own credit risk, adjusted net profit was EUR 960m, compared with EUR 1.5bn in 2012. Results were negatively impacted by EUR 773m of additional impairments in Q4 due to a review of the Irish loan portfolio.

Within banking, net interest margins were stable while fee and commission income increased due to higher management fees on mutual funds. The reported cost income ratio was 54%, in line with the Group's target. Within insurance, sales of life insurance products declined by nearly 60%, primarily due to a change in the tax treatment of unit-linked life insurance contracts in Belgium. For the non-life insurance business, the combined ratio was a solid 94% for the year. Insurance results overall were negatively impacted by lower investment income due to lower reinvestment yields.

Management has stated that it does not intend to pay dividends in 2013 and 2015. In this way, the Group will not have to pay coupons on the outstanding securities subscribed to by the Flemish Regional Government in 2013 and 2015. However, as the terms of these securities do not allow coupon payments to be skipped for two consecutive years, KBC has announced that it intends to pay the coupon and a dividend in 2014. The dividend may be up to EUR 2 per share, depending on earnings. It is KBC's intention to resume regular dividend payments from 2016 onwards.

Repayment of State aid

In January 2014, KBC repaid a second installment to the Flemish Regional Government of EUR 500m (EUR 330m principal plus a 50% premium), leaving a balance of EUR 2bn. This repayment is ahead of the schedule agreed with the European Commission. While repayments may be accelerated with the approval of the Belgian National Bank, management has indicated that this is unlikely to happen until there is further clarity regarding the ECB's upcoming asset quality review.

Rating drivers (Details)

1. Solid franchise as a leading bancassurer in Belgium and the Czech Republic

KBC is a leading financial institution in its home market of Belgium, as well as in the Czech Republic, serving mainly retail, SME and mid-cap customers. In both of these markets, the Group holds significant market share: 20% in loans and deposits and around 30% in investment funds. In addition, market shares in insurance are relatively solid.

Since the financial crisis, KBC has re-focused its business to concentrate on these two markets as well as on Slovakia, Hungary, Bulgaria and Ireland. In all markets except Ireland, where it provides only banking services, KBC offers both banking and insurance services. Unlike other financial groups, KBC remains committed to its integrated bancassurance model as it believes that it leads to higher cross-selling rates and “good operational results through the cycle.”

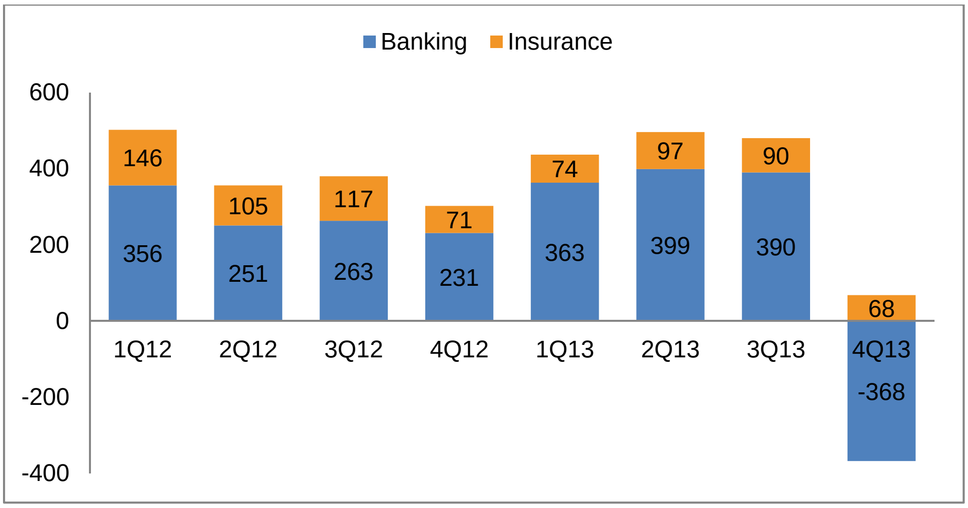
Table 1: Market shares, year-end 2013

	Belgium	Czech	Slovakia	Hungary	Bulgaria
Loans and deposits	20%	20%	10%	9%	2%
Investment funds	35%	29%	7%	17%	
Life insurance	17%	6%	5%	3%	10%
Non-life insurance	9%	6%	3%	5%	10%

Source: Company data, Scope Ratings

After significant losses in 2008 and 2009, KBC has since consistently generated profits. Earnings, however, continue to be negatively impacted by impairments and divestments. 2011 was a particularly poor year as there were also EUR 0.4bn in impairments related to Greek government bonds. And in 2013, earnings suffered from a significant increase in loan impairments, primarily for the Irish and Hungarian businesses (2013: EUR 1.6bn, 2012: EUR 1.1bn).

Chart 1: Underlying net result from banking and insurance (EUR m)



Note: Underlying result excludes changes in fair value of own debt and legacy businesses (CDOs, structured derivatives, divestments).
Source: Company data, Scope Ratings

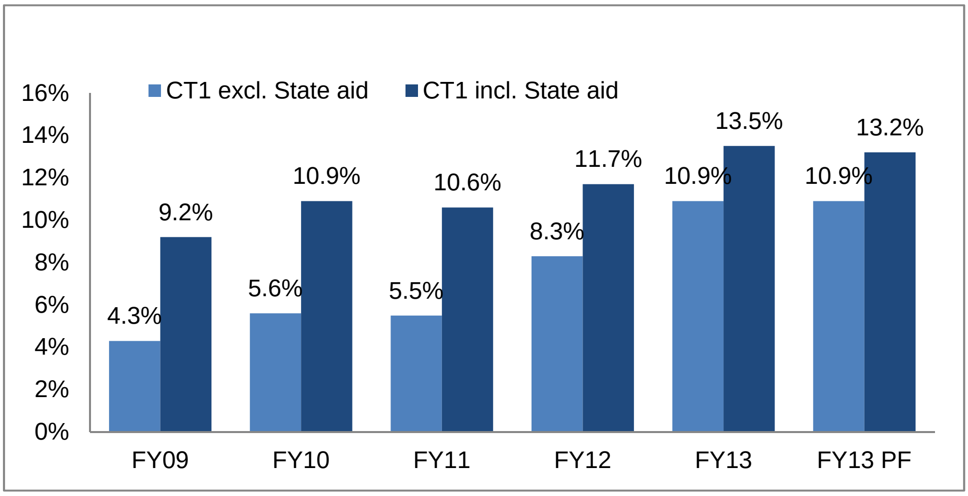
2. Improving solvency and sound liquidity position

KBC's capital position has strengthened considerably since 2009 (even excluding state aid) through a combination of retained earnings, a EUR 1.25bn rights issue in 2012, a reduction in risk-weighted assets and active capital management. The remaining EUR 2bn of aid from the Flemish Regional Government is grandfathered as common equity under CRD 4 until January 2018.

At year-end 2013, on a pro-forma CRD 4 fully-loaded basis, the Group's reported CET1 ratio was 12.5% and the Bank's leverage ratio was 4.4%. The 12.5% CET1 ratio is based on the Danish compromise, which assigns a 370% risk weighting to the holdings of own funds instruments of the insurance company. The figure is also pro-forma the EUR 500m payment made to the Flemish Regional Government in January 2014 and the impact of the signed divestments of KBC Bank Deutschland and Antwerp Diamond Bank.

Excluding the EUR 2bn in State aid, we estimate that KBC's fully loaded CET1 ratio would be about 10.3%. If the EUR 2bn in aid as well as the associated EUR 1bn premium were deducted, we estimate that the CET1 ratio would be about 9.2%. KBC's internal minimum target for the CET1 ratio is 10% on a fully loaded basis, while the National Bank of Belgium has requested that KBC maintain a minimum fully loaded CET1 of 9.25%, excluding latent gains.

Chart 2: Capital development under Basel 2.5



Note: 2013 proforma figures include the EUR 500m repayment of State made in January 2014 and the signed divestments of KBC Bank Deutschland and Antwerp Diamond Bank. Source: Company data, Scope Ratings

KBC Bank maintains a sound liquidity and funding profile. Deposits account for 75% of the funding mix and within this, over 60% is comprised of retail and SME deposits and another 30% of mid-cap deposits. Over the years, the proportion of customer deposits and equity has increased while the proportion of unsecured interbank funding has declined. Deposits are now sufficient to fully fund loans.

At year-end 2013, KBC Bank had EUR 13.1bn in short-term unsecured funding outstanding, compared with EUR 57bn in liquid assets. The reported LCR of 131% and NSFR of 111% were above their 2015 targets of 100% and 105%, respectively. In Q1 2013, the Group repaid EUR 8.3bn in LTRO borrowings, with the remaining EUR 0.37bn outstanding being used in businesses to be disposed of.

The Group has diversified access to capital markets funding. With the introduction in late 2012 of a new framework for Belgian covered bonds, KBC has issued over EUR 4bn in benchmark bonds based solely on a cover pool of Belgian residential mortgages. KBC intends to be a regular issuer of covered bonds as it further diversifies funding.

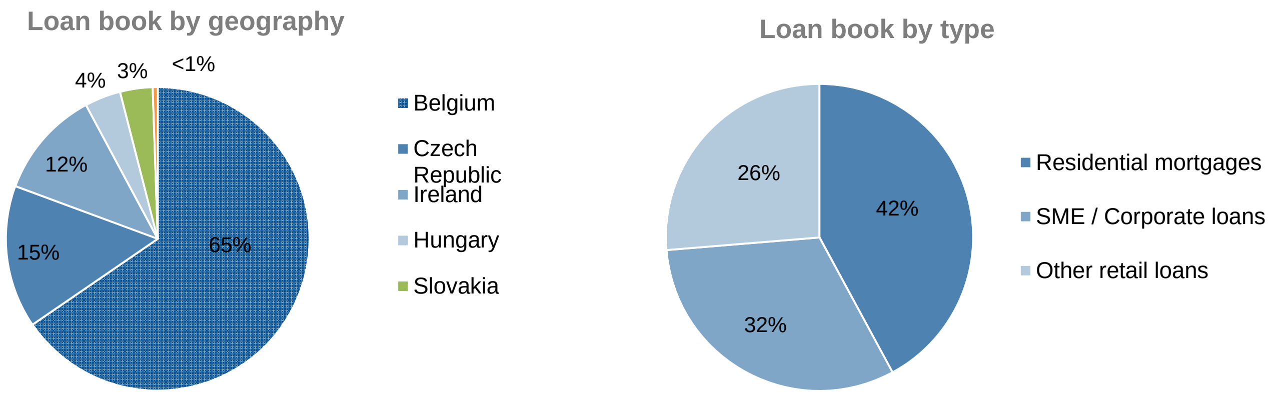
The Group has also issued USD 1bn of capital contingent notes in January 2013 and EUR 1.4bn in CRD 4 compliant Additional Tier 1 capital securities in March 2014.

3. Relatively weak asset quality driven by operations in Ireland

KBC reported a non-performing loan ratio of 5.9% at year-end 2013. However, when adjusted to include restructured loans, over 10% of the loan portfolio is impaired which is relatively high compared to peers. Impairments are not evenly spread throughout the loan portfolio, but are concentrated in Ireland and Hungary.

The largest exposure within the loan portfolio is Belgian-based (over 65%), with the second largest exposure being to the Czech Republic at 15%, followed by Ireland at 12%. Hungary accounts for less than 5% of the loan portfolio.

Chart 3: 2013 loan book by geography and type



Note: Excluding Corporate Centre. Source: Company data, Scope Ratings

In Belgium, mortgages account for about a third of the loan portfolio, with another third being retail lending and the remaining third being SME/corporate lending. The average loan-to-value (LTV) on mortgages is a reasonable 61%. The Belgian economy has been relatively resilient and while home sales have declined, home prices have not. Since late 2007, the 3 month arrears rate for Belgian mortgage loans have been around 1% while for KBC this has been even lower (between 0.2% and 0.4%). Within the Belgian business unit, 2.5% of loans are non-performing. In the Czech Republic, mortgages with an average LTV of 66% account for 45% of the loan portfolio. Within the Czech loan book, 3.0% of loans are non-performing.

In Ireland, nearly 80% of the portfolio is comprised of mortgages. However, the average LTV is a high 117% and nearly half of mortgages have a LTV above 100%. The amount impaired (rather than just non-performing) on the entire Irish loan book is nearly 48%, with provisions providing a relatively modest coverage of 37%. As mentioned above, KBC has recently reassessed this portfolio in light of the EBA's guidelines on non-performing loans and the upcoming asset quality review. In addition to the EUR 773m in loan loss provisions incurred in Q4 2013 due to the reclassification of EUR 2bn of restructured mortgage loans and lower recovery expectations for the SME sector, management has guided to loan loss provisions of EUR 150-200m in 2014 and EUR 50-100m in 2015 and in 2016.

Within Hungary, mortgages with a LTV of 84% account for 35% of the portfolio. About 15% of the entire Hungarian loan book is impaired and provisions provide coverage of 52%. There has been some uncertainty in the Hungarian banking market due to the introduction of a financial transaction levy and the desire by the government to address foreign-currency denominated mortgage loans. KBC has EUR 1.4bn in foreign-currency denominated mortgages outstanding.

4. Focused strategy facilitated by the near completion of restructuring agreed with the European Commission

In 2008/2009, KBC was one of three banks in Belgium that required government support. The Group had a large financial markets business that originated as well as invested in structured credit products. As these products suffered credit rating downgrades leading to losses, investors became increasingly concerned about KBC's exposure. In addition to capital support, KBC secured a guarantee from the Belgian State covering 90% of the default risk on a notional amount of EUR 20bn in structured credit exposure (EUR 5.5bn for super senior CDO investments and EUR 14.5bn of counterparty risk on MBIA, the US monoline insurer). At year-end 2013, the net exposure to structured credit products had reduced to EUR 6.3bn, with EUR 5.3bn of CDO exposure protected by MBIA. In Q1 2014, KBC collapsed another CDO, which is expected to lead to a further EUR 2bn decrease in exposure.

As agreed with the European Commission in 2009, KBC would lower its RWA by 25% through significant reductions in capital markets activities, non-domestic corporate lending, private banking and structured credit exposures. The agreement was renegotiated twice, in 2011 and 2012, but the required divestments are now nearly complete. During the last quarter of 2013, the Group completed the divestment of KBC Banka in Serbia and reached agreements to sell Antwerp Diamond Bank and KBC Bank Deutschland AG. The disposals are expected to have a negligible impact on earnings. Between 2008 and 2013, the Group has actually reduced RWA by over 40%, from EUR 155bn to EUR 90bn.

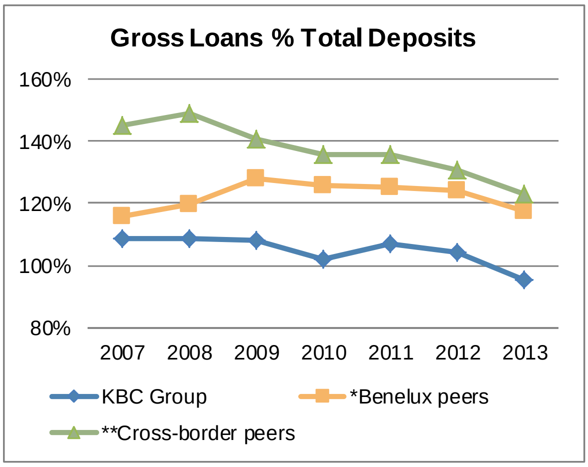
Consequently, KBC has a focused bancassurance strategy in its core markets of Belgium and the Czech Republic, complemented by Slovakia, Hungary and Bulgaria. And in Ireland, KBC intends to turnaround the banking business so that it is profitable in 2016. As a reflection of this focus, effective January 2013, the Group changed its reporting business lines to the following: Belgium, the Czech Republic, International Markets and Group Centre (includes legacy businesses such as CDOs, activities in run-off and divestments).

Peer comparison

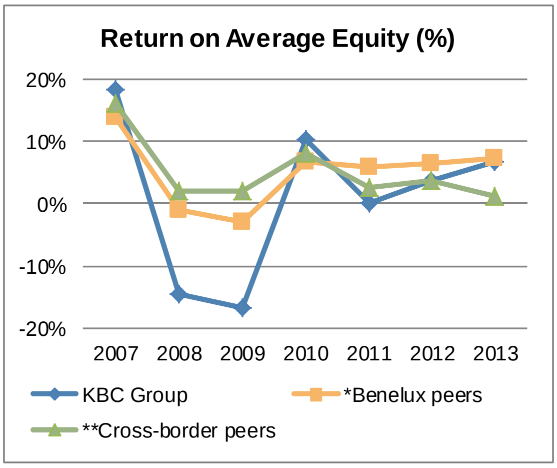
KBC Group is largely a domestic bancassurer with 65% of earnings coming from its home market. However, it also benefits from diversification in selected CEE countries. Within Belgium, KBC competes against ING Belgium and BNP Paribas Fortis, both part of larger financial services groups. It also competes against Belfius Bank and Insurance, which emerged from the dismantling of Dexia Group and is a domestic player that is fully owned by the Belgian State.

At Scope Ratings, we also compare banks within cross-border peer groups and have included KBC Group in the category of international retail banks. This peer group includes banks such as ING Bank, Santander, BBVA, Unicredit, Nordea, Danske and Commerzbank. Compared with peers, KBC has a solid liquidity profile with customer funding accounting for a significant portion of funding and a loan to deposit ratio below 100%. In terms of asset quality, the level of impaired loans is much higher than for peers due to its operations in Ireland. Impairments have so far been adequately covered by pre-provision income. And in regards to solvency, KBC's CET1 and leverage ratios appear somewhat better than peers but we note that KBC's figures include the benefit of State aid, which will need to be repaid over the following six years.

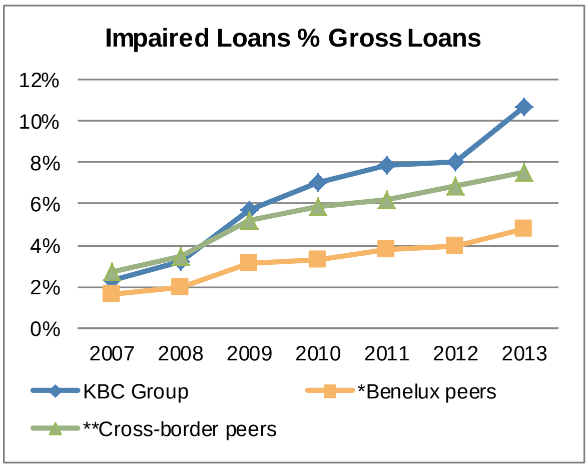
Peer Comparison - KBC Group NV



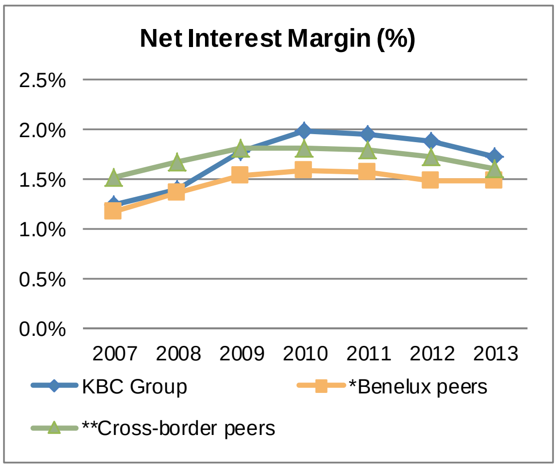
Source: SNL Financial, Scope Ratings



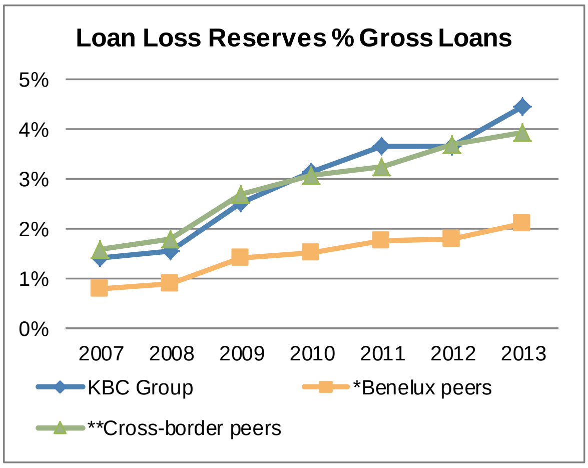
Source: SNL Financial, Scope Ratings



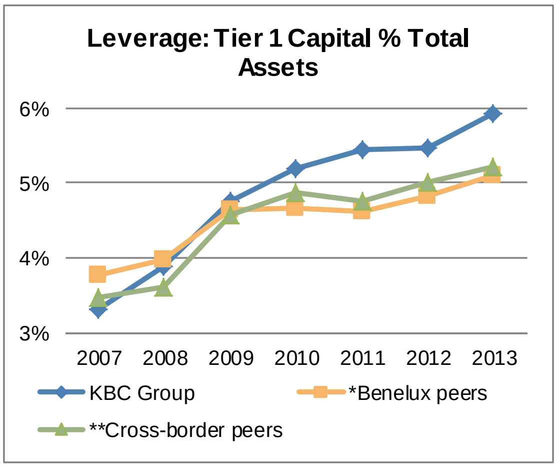
Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings

*Benelux Peers : KBC Group, ABN AMRO, ING Bank, Rabobank.

**Cross-border peers based on business model : Santander, BBVA, Unicredit, RBS, Erste Bank, RZB AG, Commerzbank, Nordea, KBC Group, Danske Bank, ING Bank.

Notes: Cross-border peer group averages exclude RZB in 2013

Selected Financial Information - KBC Group NV

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Balance Sheet summary (EUR billion)									
Assets									
Cash and balances with central banks	4.6	4.5	7.2	15.3	6.2	4.4	4.4	4.4	4.5
Interbank assets	53.8	36.8	21.2	15.5	19.2	16.1	16.3	16.4	16.6
Total securities	108.1	97.3	100.5	91.7	66.8	79.1	77.9	75.4	73.1
of which debt instruments	83.1	86.0	93.1	85.9	62.9	64.9	63.3	60.1	57.1
of which equity instruments	22.2	9.1	5.4	3.8	2.5	2.4	1.9	1.9	2.0
Derivatives	22.2	39.0	21.5	16.3	17.7	13.4	8.7	8.5	8.4
Gross customer loans	149.3	160.4	157.4	155.7	143.5	133.4	128.5	126.1	124.9
of which impaired loans	3.4	5.1	9.0	11.0	11.2	10.8	13.7	13.0	12.8
Total funded assets	329.1	314.6	296.8	297.4	261.8	240.0	231.5	231.8	232.8
Total Assets	**355.6**	**355.3**	**324.2**	**320.8**	**285.4**	**256.9**	**241.3**	**241.4**	**242.3**
Liabilities									
Interbank liabilities	73.1	60.6	45.4	27.9	25.9	22.9	14.3	13.6	12.9
Senior debt	47.2	40.0	38.7	35.8	22.7	24.8	22.9	21.8	20.7
Derivatives	26.5	40.7	27.4	23.4	23.6	16.9	9.8	9.6	9.4
Customer deposits	137.3	147.0	145.3	152.9	134.5	128.3	134.8	137.5	138.8
Subordinated debt + hybrid securities	7.6	9.7	9.4	9.1	8.1	6.6	6.5	5.8	5.2
Total Liabilities	**337.2**	**339.9**	**307.1**	**302.1**	**268.6**	**241.1**	**226.5**	**226.6**	**226.9**
Ordinary equity	17.2	10.7	9.7	11.1	9.8	12.0	12.1	12.4	13.3
Minority interests	1.1	1.2	0.5	0.5	0.5	0.4	0.4	0.4	0.4
Total Liabilities and Equity	**355.7**	**355.3**	**324.2**	**320.8**	**285.4**	**256.9**	**241.3**	**241.4**	**242.3**
Core Tier 1 Capital [1]	*10.0*	*11.1*	*13.2*	*14.4*	*13.4*	*11.6*	*11.2*	*12.0*	*12.9*
Income Statement summary (EUR billion)									
Net interest income	4.1	5.0	5.8	6.2	5.5	4.7	4.1	4.0	3.9
Net fee & commission income	2.0	1.7	1.1	1.2	1.2	1.3	1.5	1.6	1.7
Net trading income	2.3	-3.4	-3.3	0.0	-0.1	0.5	1.3	1.0	0.8
Operating Income	**9.7**	**4.8**	**4.6**	**8.3**	**7.3**	**7.7**	**7.5**	**7.2**	**7.0**
Operating expenses	5.2	5.6	4.8	4.4	4.3	4.2	3.9	3.7	3.7
Loan loss provision charges	0.3	2.2	2.2	1.5	1.5	1.1	1.8	1.2	1.1
Non-recurring items	0.0	0.0	0.0	0.0	-0.3	-0.1	0.0	-0.5	-0.7
Pre-Tax Profit	**4.4**	**-3.0**	**-2.9**	**2.2**	**0.8**	**1.0**	**1.7**	**1.7**	**1.6**
Income tax	1.0	-0.6	-0.3	0.1	0.3	0.4	0.7	0.7	0.6
Net profit attributable to minority interests	0.1	0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Net Income Attributable to Parent	**3.3**	**-2.5**	**-2.5**	**1.9**	**0.0**	**0.6**	**1.0**	**1.0**	**0.9**

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] CRD 4 basis from 2012 onwards

Ratios - KBC Group NV

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Funding/Liquidity									
Gross loans % Total deposits	108.7%	109.1%	108.3%	101.8%	106.7%	104.0%	95.4%	91.7%	89.9%
Total deposits % Total funds	51.7%	56.3%	59.1%	65.7%	68.0%	68.9%	74.6%	76.1%	77.4%
Wholesale funds % Total funds	48.3%	43.7%	40.9%	34.3%	32.0%	31.1%	25.4%	23.9%	22.6%
Asset Mix, Quality and Growth									
Gross loans % Funded assets	45.4%	51.0%	53.0%	52.4%	54.8%	55.6%	55.5%	54.4%	53.6%
Impaired loans % Gross loans	2.3%	3.2%	5.7%	7.0%	7.8%	8.1%	10.7%	10.3%	10.2%
Loan loss reserves % Impaired loans	64.8%	59.7%	46.9%	46.1%	46.7%	45.2%	41.8%	44.0%	44.9%
Gross loan growth (%)	15.4%	7.4%	-1.8%	-1.1%	-7.8%	-7.1%	4.0%	7.7%	6.7%
Impaired loan growth (%)	3.7%	48.5%	75.5%	21.9%	2.6%	-4.2%	27.5%	21.1%	-6.9%
Funded assets growth (%)	9.4%	-4.4%	-5.7%	0.2%	-12.0%	-8.3%	-3.6%	-3.4%	0.6%
Earnings									
Net interest income % Revenues	42.0%	103.4%	126.4%	75.1%	75.6%	60.4%	55.0%	55.7%	55.9%
Fees & commissions % Revenues	20.5%	35.5%	24.6%	14.7%	16.1%	17.0%	19.7%	22.2%	24.2%
Trading income % Revenues	24.1%	-70.2%	-70.7%	0.2%	-0.8%	6.4%	17.2%	13.6%	11.0%
Other income % Revenues	13.4%	31.3%	19.7%	10.0%	9.1%	16.2%	8.1%	8.6%	8.9%
Net interest margin (%)	1.5%	1.7%	2.1%	2.3%	2.2%	2.1%	2.0%	2.0%	2.0%
Pre-provision Income % Risk-weighted assets (RWAs)	3.1%	-0.5%	-0.1%	2.9%	2.3%	3.2%	4.1%	4.1%	3.8%
Loan loss provision charges % Pre-provision income	5.7%	n.m.	n.m.	39.0%	52.0%	32.1%	48.1%	35.4%	33.7%
Loan loss provision charges % Gross loans (cost of risk)	0.2%	1.4%	1.4%	1.0%	1.0%	0.8%	1.4%	1.0%	1.0%
Cost income ratio (%)	53.6%	116.0%	103.8%	53.3%	59.9%	54.9%	51.5%	52.0%	52.0%
Net Interest Income / Loan loss charges (x)	15.8	2.3	2.6	4.1	3.6	4.2	2.4	3.3	3.4
Return on average equity (ROAE) (%)	19.2%	-17.8%	-24.2%	17.9%	0.1%	5.6%	8.4%	8.3%	7.2%
Return on average funded assets (%)	0.7%	-0.5%	-0.5%	0.4%	0.0%	0.2%	0.3%	0.3%	0.3%
Retained earnings % Prior year's book equity	11.7%	-14.5%	-23.0%	10.4%	-5.3%	-3.6%	n/a	2.1%	7.5%
Pre-tax return on common equity tier 1 capital	9.7%	-5.7%	-1.9%	0.6%	2.4%	3.1%	6.1%	5.7%	4.9%
Capital and Risk Protection [1]									
Common equity tier 1 ratio (common equity tier 1 capital % RWAs)	6.8%	7.2%	9.2%	10.9%	10.6%	10.5%	12.5%	13.3%	14.3%
Tier 1 leverage ratio (%)	3.3%	3.9%	4.8%	5.2%	5.4%	5.5%	5.9%		
Median of tier 1 leverage ratio and common equity tier 1 ratio (%)	5.1%	5.5%	7.0%	8.0%	8.0%	8.0%	9.2%		
Total loss coverage (CET 1 capital + loan loss provisions) % RWAs	8.3%	9.1%	12.2%	14.7%	14.8%	14.9%	18.9%	19.7%	20.7%
Non-senior bailinable debt cushion (as % of total liabilities)	2.3%	3.9%	5.2%	5.2%	5.3%	4.1%	3.8%	3.4%	3.0%
Asset risk intensity (RWAs % total assets)	41.5%	43.7%	44.2%	41.2%	44.3%	39.8%	37.1%	37.1%	37.1%

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] CRD 4 basis from 2012 onwards

METHODOLOGIES USED FOR THIS REPORT

For the rating and analysis contents of this report Scope has used the following methodologies which were published on www.scoperatings.com:

"Bank Rating Methodology" (February 2014)

"Forecasting Bank Financials Methodology" (February 2014)

Forecasting bank financials: Forward-looking estimates are an important analytical tool underpinning Scope's bank ratings. These forecasts cover the current financial year (before final year-end figures are published by the bank) plus the forthcoming two years. Depending on the complexity of the bank being assessed, different forecasting tools will be used. For a majority of banks operating primarily commercial and retail banking franchises (loans and deposits) the analysis is underpinned by an **accounting** forecast of the balance sheet and profit and loss account. For more complex groups with multiple ranges of activities – notably those with material wholesale and investment banking operations – Scope uses an **analytical** forecast, relying on the bank's business-line reporting to come up with plausible estimates. For all banks Scope also include a **regulatory metrics** forecast, considering the growing importance of this aspect in bank analysis.

For complex banks, divisional data is used to forecast profit and loss accounts and basic divisional balance sheet metrics. For less complex banks, a line-by-line forecasting of major P&L elements is forecast.

For balance-sheet forecasts, Scope estimates of all major balance sheet lines, using the P&L estimates to complete the forecast of the capital/shareholders' equity line. This comprehensive methodology for estimating the balance sheet is used for all the banks in our universe, irrespective of size and complexity.

Lastly, our forecasts include assessments of the major regulatory metrics: Tier 1 and CET 1 (historically CT1), Leverage, Liquidity Coverage Ratio, and Net Stable Funding Ratio (the latter two when and if sufficient public information to compute them is available).

Scope will not aim to forecast financials when it considers the public disclosure of the bank as insufficient for a transparent and credible outcome.

All Scope's bank financial forecasts are based on public information. For its forecasts Scope will not use any non-public information or data, even if such information or data were provided by rated banks. Scope's forecasting process is transparent, with a detailed roadmap provided in its *"Forecasting bank financials"* methodology.

Lloyds Bank plc
Issuer Rating Report

A STABLE OUTLOOK
Financial Institutions

Overview

The Issuer Credit-Strength Rating (ICSR) of A for Lloyds Bank plc is based on the strength of the Lloyds Banking Group. Formed in January 2009, following the acquisition of HBOS, the Group continues to deal with the consequences of this merger and the repercussions from the financial crisis. Lloyds enjoys a strong domestic franchise as a leading retail and commercial bank in the UK. While progress has clearly been made, Lloyds still needs to generate more sustainable earnings and further clean up its balance sheet to strengthen its financial profile.

The A rating also applies to senior unsecured debt issued by the parent of Lloyds Bank plc, Lloyds Banking Group plc. However, the rating is not applicable to unguaranteed debt issued by subsidiaries of Lloyds Bank plc.

Ratings (assigned on April 2, 2014)

Issuer Credit-Strength Rating	**A**
Outlook	Stable
Senior Unsecured Debt	A

Unsolicited ratings with issuer participation.

Lead Analyst

Pauline Lambert
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Team Leader

Sam Theodore
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Rating drivers (Summary)

The rating drivers, in decreasing order of importance in the rating assignment, are:

- (+) Strong domestic retail and commercial banking franchise in the UK which should generate sustainable earnings.
- (−) Performance continues to be hampered by non-core, restructuring and legacy costs.
- (+) Management has delivered on implementing a focused low risk strategy.
- (−) Significant exposure to the UK housing market.

Rating change drivers

Higher and more stable earnings. Lloyds's earnings remain depressed by impairment, restructuring and legacy costs. We would view positively a reduction in these costs and a continual improvement in margins and volumes for the core business.

Sell-down of government stake. After two successful sales of shares to institutional investors in September 2013 and March 2014, the UK government now holds a 24.9% stake, down from 43.4%. The UK government is expected to continue selling down its stake. Further, in February 2014, Lloyds confirmed that it was preparing documents required for a possible future sale of shares to the public.

Inability to meet the evolving demands of the national regulator, the Prudential Regulatory Authority (PRA). The PRA has set some precedence in being more demanding than other European regulators. For example, the PRA expects banks to meet part of their Pillar 2 capital requirements with common equity tier 1 capital (CET1). Currently, Pillar 2 requirements can be met with any regulatory capital. Going forward, UK banks will also be subject to annual stress testing and the ring-fencing of certain retail activities.

Recent events

2013 results

For 2013, Lloyds reported a statutory loss after tax of GBP 802m compared with a loss of GBP 1.4bn in the prior year. Results were again negatively impacted by GBP 3.5bn in regulatory provisions for legacy issues, primarily PPI (2012: GBP 4.2bn). Underlying profit more than doubled to GBP 6.2bn, from GBP 2.6bn in the prior year, supported by an improved net interest margin and core loan growth as well as lower costs, including a nearly 50% decline in impairment costs.

During the year, the Group's capital position strengthened by 2.2% to 10.3% on a proforma fully loaded CRD 4 CET1 basis. The increase was due to capital generation in the core business, a GBP 35bn reduction in non-core assets which contributed to releasing approximately GBP 2.6bn of capital as well as a GBP 2.2bn dividend from the insurance business to the Group. Going forward, management expects to generate 2.5% of fully loaded CET1 capital over the next two years and then 1.5% to 2% per year, before dividends. Our forecasts incorporate management's expectations to apply to the PRA in the second half of 2014 to restart paying a modest dividend. Over the medium term, the target is a dividend payout ratio of at least 50% of sustainable earnings.

Project Verde

As a condition for receiving state aid, Lloyds was required by the European competition authorities to divest a portion of its retail business by November 2013 (Project Verde). Verde comprises around 630 branches, serving 4.6 million customers and will be the eighth largest bank in the UK. In September 2013, these branches were launched as a new challenger bank under the name of TSB. With the proposed sale to Co-operative Bank falling through, Lloyds plans to divest Verde through an IPO in mid-2014, subject to regulatory and EC approval. The disposal is not expected to materially change the Group's strong domestic retail franchise.

Rating drivers (Details)

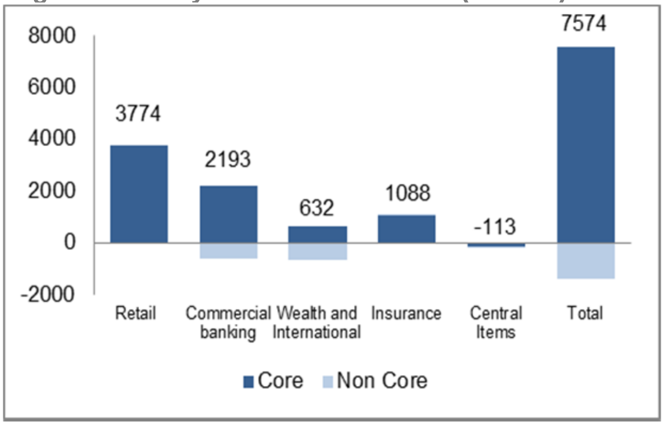
1. Strong domestic retail and commercial franchise in the UK which should generate sustainable earnings

In 2008, as the financial crisis began to take hold, the former Lloyds was in a relatively sound position. It was considered the "most trusted bank" in the UK and had generated GBP 0.8bn in net profit despite market dislocation and a deteriorating UK economy. Meanwhile, investors and customers were increasingly concerned about the creditworthiness of HBOS. For 2008, HBOS recorded a loss of GBP 10.8bn due to losses in its loan portfolio and impairments on its investments. In January 2009 when the two banks merged, assets more than doubled to GBP 1 trillion. The new entity combined the largest and third largest mortgage providers at the time and became the clear market leader in terms of personal current accounts. While integrating HBOS, Lloyds has committed to reducing GBP 200bn of non-core assets by year-end 2014.

Lloyds today remains a leading financial services provider, serving over 30 million customers with the largest branch network in the UK. Unlike other players, Lloyds pursues a multi-brand and multi-channel strategy and remains committed to its bancassurance model. Its well-known brands include Lloyds, Halifax, Bank of Scotland and Scottish Widows. The Group is the UK's leading provider of current accounts, savings, personal loans, credit cards and mortgages. In insurance, the focus is on pensions, protection, annuities and home insurance. Over 15% of FTSE 350 companies use Scottish Widows for their corporate pension arrangements.

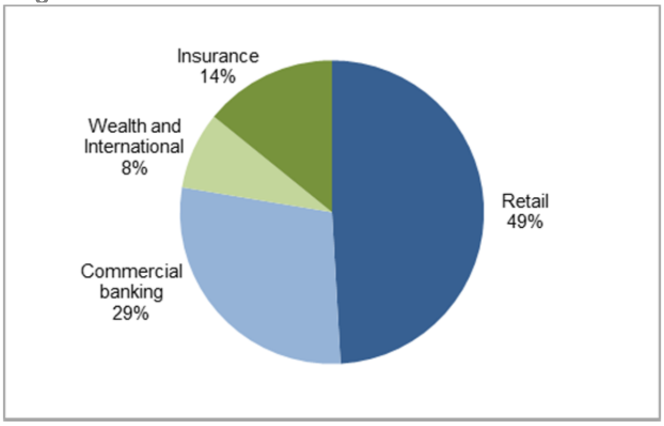
Lloyds enjoys strong market positions and is active in low risk retail and commercial banking activities. In mortgages, Lloyds plans to grow in line with the market, with an emphasis on first time buyers as there are greater cross-selling opportunities. Efforts are focused on areas such as lending to SMEs and mid-sized corporates (low 20% market share) and unsecured personal lending (about 15% market share) where the Group has less than 25% market share. Reflecting this strategy, a new Consumer Finance division was created in January 2014, which comprises the asset finance (primarily auto lease and motor finance) and credit card businesses.

Chart 1: 2013 underlying profit by business segment and by Core and non Core (GBP m)



Source: Company data, Scope Ratings

Chart 2: 2013 underlying profit by business segment for Core business



Source: Company data, Scope Ratings

2. Performance continues to be hampered by non-core, restructuring and legacy costs

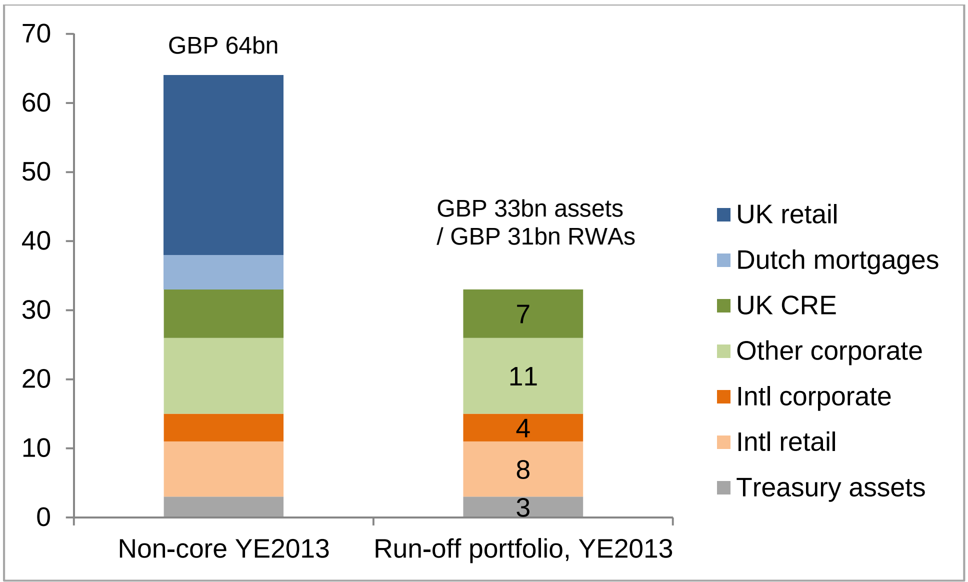
Weak earnings. While Lloyds has made good progress in its business transformation, its earnings remain relatively weak. Furthermore, there is a degree of volatility in reported earnings due to the accounting treatment of its insurance operations. Over GBP 100bn of financial assets backing insurance and investment contracts are accounted for as “other financial assets at fair value through profit or loss” on the balance sheet. Changes in the fair value of these financial assets are consequently reflected in the “trading income” line in the income statement. 2013 results included GBP 668m of positive insurance and policyholder interests volatility, reflecting the rise in equity markets during the year (2012: GBP 312m).

Lloyds is aiming to generate sustainable, predictable returns on equity above the cost of equity. On an underlying basis, the trends are positive but there is much room for improvement. The Group has been loss-making on a statutory basis since 2010. During each quarter in 2013, Lloyds reported an improving banking net interest margin (NIM) (Q4 2013: 2.29%, Q3 2013: 2.17%, Q2 2013: 2.06%, Q1 2013: 1.96%). Going forward, management expects the banking NIM to stabilize but for volumes to increase as they focus on growing the core loan book, particularly via lending to SMEs and first-time home buyers.

Non-core. Lloyds’ non-core assets continue to negatively impact performance. In 2013, the core generated an underlying profit of GBP 7.6bn while the non-core generated an underlying loss of GBP 1.4bn. Although just accounting for 15% of total risk weighted assets, the non-core accounted for half of total impairments. Non-core businesses have below-hurdle returns, are outside of the Group’s risk appetite or are distressed, are sub-scale or have a poor fit with the Group’s customer strategy. More specifically, they include activities in Ireland, retail self-certified mortgages, shipping, aerospace and international.

As of 2014, Lloyds will no longer report its non-core assets separately. The GBP 64bn of non-core assets will be separated into a GBP 33bn run-off portfolio, with the remainder to be re-incorporated into the ongoing Group. The run-off portfolio is comprised of non-core non-retail assets and certain non-core retail assets, including Ireland and Hong Kong. The aim is to reduce the run-off portfolio to approximately GBP 23bn, from GBP 33bn in 2014. The businesses to be re-incorporated into the ongoing Group include Black Horse Asset Finance, UK retail specialist mortgages (closed book) and Dutch mortgages. As non-core assets are being run-off, they are still likely to have a negative although declining impact on Lloyds' earnings.

Chart 3: Non-core / run-off portfolio (GBP bn)



Source: Company data, Scope Ratings

Legacy costs. In addition, Lloyds continues to be impacted by legacy costs related to PPI and interest rate hedging products. The Group has been one of the banks most impacted by PPI charges with provisions from 2011 to 2013 totalling GBP 9.8bn, GBP 2.8bn remaining unutilized. In Q4 2013, a provision of GBP 1.8bn was made to reflect a slower decline in future complaint volumes than previously expected, upward revisions to uphold and response rates and increased estimates for remediation costs. Uncertainties remain in regards to complaint volumes, uphold rates, average redress costs and the outcome of the Financial Conduct Authority Enforcement Team investigation. In the quarter, Lloyds also made a provision of GBP 130m for interest rate hedging products.

Restructuring costs. As part of its 2011 strategic review, Lloyds announced a Simplification program with an expected cost of GBP 2.3bn. To year-end 2013, GBP 1.7bn in costs have been incurred, realizing run-rate cost savings of approximately GBP 1.5bn (target of GBP 2.0bn by year-end 2014). Lloyds will also incur costs related to the EC mandated business disposal of Verde (GBP 1.5bn incurred to year-end 2013). Expected additional costs include GBP 200m for building out the business and GBP 150m of dual running and transaction costs. Assuming a successful IPO, these costs should no longer hamper earnings after 2014.

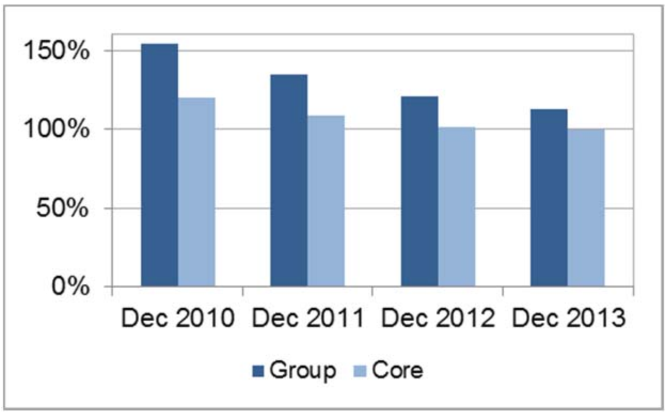
At year-end 2013, Lloyds' reported cost income ratio on an underlying basis was 53% excluding St. James's Place which compares favourably to UK peers. However, if restructuring and legacy costs are included, the cost income ratio remains high and was nearly 80%.

3. Management has delivered on implementing a focused low risk strategy

In June 2011, Lloyds announced a three-to-five year plan to transform itself into a simpler, lower-risk, customer focused UK retail and commercial bank. To date, management has made good progress in delivering on its strategy and is ahead on many targets. In particular,

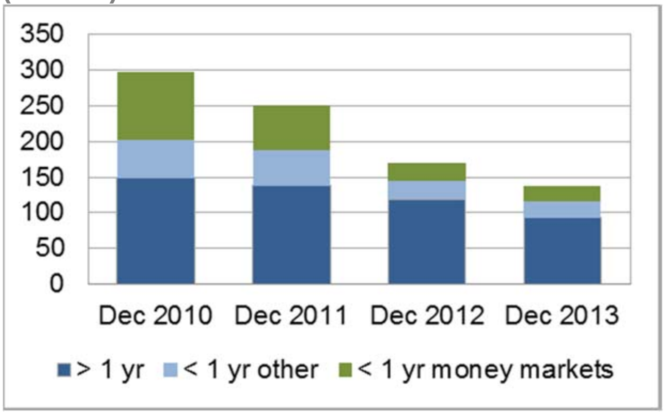
- Reduce non-core assets by at least half (i.e. less than GBP 90bn by YE2014): GBP 64bn at YE2013.
- Fully loaded CRD 4 CET 1 ratio greater than 10% in 2013: 10.0% at YE2013; 10.3% on a proforma basis.
- Group loan-to-deposit ratio less than 130% by YE2014 and 100% for the core business: 113% and 100% respectively, at YE2013.
- Cost income ratio of 42 to 44% by YE2014: 53% at YE2013 excluding St. James's Place.
- Group asset quality ratio (as % of average gross loans) of 50 to 60 bps by YE2014: 57bps in 2013.

Chart 4: Reported loan to deposit ratio for Group and Core business



Source: Company data, Scope Ratings

Chart 5: Decreasing use of wholesale funding (GBP bn)



Source: Company data, Scope Ratings

4. Significant exposure to UK housing market

With the reduction in non-core assets, Lloyds is largely a UK domestic bank with approximately 60% of the loan book being comprised of mortgages. Hence, Lloyds' performance is dependent on the health of the UK economy. While the UK economy has been recovering, there remain concerns about the drivers of economic growth – e.g. consumer spending, manufacturing vs. service output. In particular, increases in housing prices are being scrutinized as prices are historically high compared to wages. According to data from Nationwide, the UK house price to earnings ratio is currently over 5x compared to a long run average of just over 4x (since 1984). As well, the current low interest rate environment enables even financially weaker homeowners to remain current with their mortgage payments. This may change when interest rates rise and could lead to a material increase in arrears.

At year-end 2013, Lloyds' mortgage book was GBP 323bn, with 2.7% being greater than three months in arrears in value terms. Over 75% of the mortgages are considered mainstream while the average loan-to-value (LTV) ratio for the entire portfolio was a reasonable 52.8%. New business mortgages have a somewhat higher LTV of 63.6%. Lloyds has said that approximately 80% of the mortgages it approved during 2013 under the Help-to-Buy program were outside of London and the Southeast, with the average mortgage value being GBP 150,000. Just over 5% of the loan book had LTVs above 100%, down from nearly 12% in the prior year.

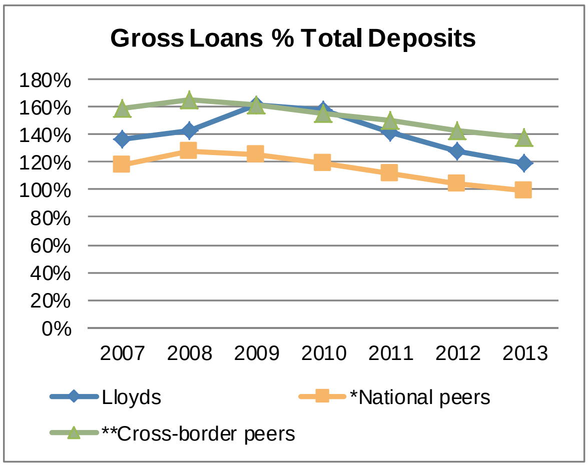
Peer comparison

Within the UK, it is not easy to compare the four major players in the market. Lloyds is largely a domestic retail focused bank. Meanwhile, RBS is implementing a strategic plan to become primarily a domestic retail and commercial bank with limited wholesale banking operations. The two other large players, Barclays and HSBC, each have different business models – being more diversified geographically as well as by business line – although the UK market remains an important home market for both. Barclays and HSBC benefit from having strong income streams in different businesses and geographies.

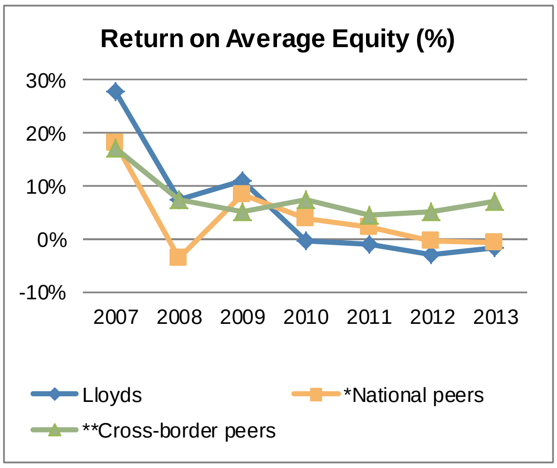
At Scope Ratings, we also compare banks within cross-border peer groups based on business model. We have included Lloyds in the category of primarily domestic retail and commercial banks. This peer group includes Credit Agricole, Credit Mutuel, Intesa, CaixaBank, Rabobank and Swedbank. Over the last few years, Lloyds' financial metrics have improved to levels which are generally consistent with peers. This is the case in regards to liquidity, funding and solvency. At year-end 2013, Lloyds reported a proforma fully loaded CRD 4 CET1 ratio of 10.3%, with a leverage ratio of 3.4% excluding Tier 1 instruments. The proforma figures include the benefits of the announced sales of Heidelberger Leben, Scottish Widows Investment Partnership and Sainsbury's Bank.

The key area of weakness remains profitability as Lloyds continue to incur non-core, restructuring and legacy costs. Non-core assets also lead to a higher impaired loan ratio in comparison to peers but this has been declining steadily. In addition, there is some volatility in earnings due to Lloyds' insurance operations.

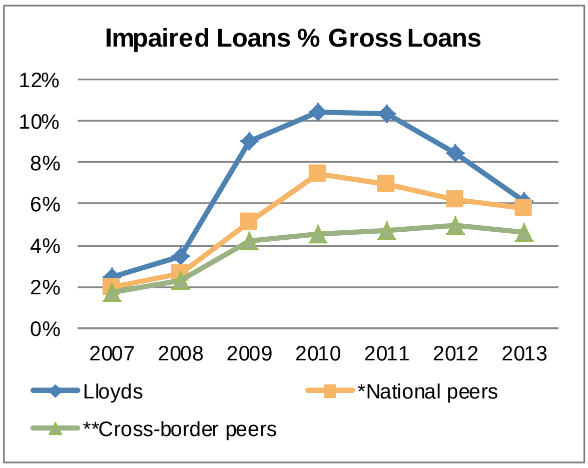
Peer Comparison - Lloyds Banking Group plc



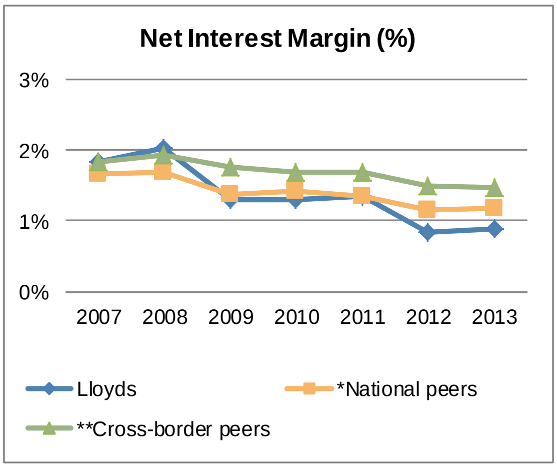
Source: SNL Financial, Scope Ratings



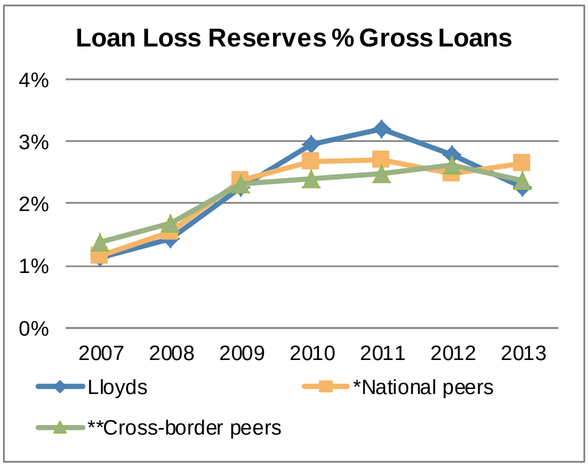
Source: SNL Financial, Scope Ratings



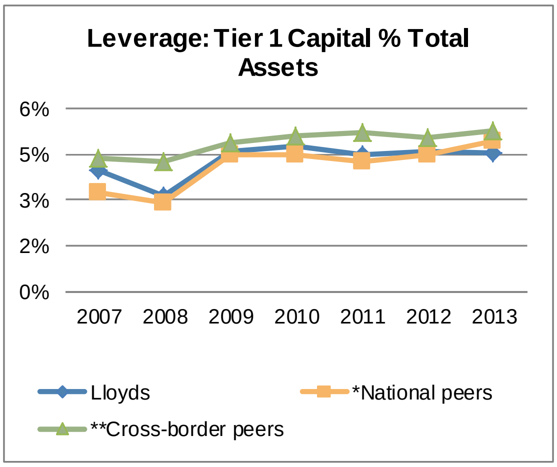
Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings

*National peers: Barclays, HSBC, Lloyds, RBS

**Cross-border peers: Groupe BPCE, Credit Mutuel Group, Intesa, DNB ASA, Credit Agricole Group, CaixaBank, Sw edbank, Lloyds Banking group, Wells Fargo & Co., Rabobank Group

Notes: Cross-border peer group excludes Credit Mutuel Group in 2013 as w ell as Intesa for Net Interest Margin and the Return on Average Equity. We use H1 2013 numbers as a 2013 proxy for Intesa on all other ratios.

Selected Financial Information - Lloyds Banking Group plc

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Balance Sheet summary (GBP billion)									
Assets									
Cash and balances with central banks	4.3	5.0	39.0	38.1	60.7	80.3	49.9	49.9	49.9
Interbank assets	36.1	39.7	42.3	34.4	35.4	34.9	34.7	34.7	34.7
Total securities	76.9	104.6	210.2	220.2	186.4	182.7	158.6	154.3	153.4
of which debt instruments	45.1	81.3	124.0	127.8	108.7	92.7	91.6	90.7	89.8
of which equity instruments	31.8	23.3	86.2	92.5	77.7	90.0	67.0	63.6	63.6
Derivatives	8.7	28.9	49.9	50.8	66.0	56.6	33.1	32.7	33.1
Gross customer loans	211.0	241.0	653.5	618.0	592.4	546.1	528.4	523.2	533.4
of which impaired loans	5.3	8.5	58.8	64.6	60.3	46.3	32.3	29.0	27.6
Total funded assets	345.8	409.1	986.8	949.4	912.3	885.5	816.6	811.1	823.3
Total Assets	**353.3**	**436.0**	**1,027.3**	**991.6**	**970.5**	**934.2**	**847.0**	**841.2**	**853.7**
Liabilities									
Interbank liabilities	39.8	67.0	83.5	51.2	40.7	39.4	14.8	14.0	13.3
Senior debt	54.7	82.5	262.0	250.1	202.8	147.5	121.3	109.2	103.7
Derivatives	7.6	26.9	40.5	42.2	58.2	48.7	30.5	30.0	30.5
Customer deposits	156.6	170.9	406.7	393.6	413.9	426.9	441.3	450.1	463.6
Subordinated debt + hybrid securities	12.0	17.3	34.7	36.2	35.1	34.1	32.3	29.1	26.2
Total Liabilities	**340.9**	**426.3**	**983.1**	**944.7**	**924.0**	**891.6**	**807.7**	**800.0**	**810.4**
Ordinary equity	12.1	9.4	43.3	46.1	45.9	41.9	39.0	40.8	43.0
Minority interests	0.3	0.3	0.8	0.8	0.7	0.7	0.3	0.3	0.3
Total Liabilities and Equity	**353.3**	**436.0**	**1,027.3**	**991.6**	**970.5**	**934.2**	**847.0**	**841.2**	**853.7**
Core Tier 1 Capital [1]	*12.1*	*9.5*	*39.8*	*41.4*	*38.0*	*26.0*	*27.9*	*29.8*	*31.9*
Income Statement summary (GBP billion)									
Net interest income	6.1	7.7	9.0	12.5	12.7	7.7	7.3	7.2	7.4
Net fee & commission income	2.6	2.5	2.7	3.3	3.5	3.2	2.7	2.9	3.0
Net trading income	3.0	-9.2	19.2	16.1	0.0	18.6	17.1	17.1	17.1
Operating Income	**10.7**	**9.9**	**22.5**	**24.9**	**20.8**	**20.5**	**18.5**	**18.9**	**20.4**
Operating expenses	5.6	6.0	15.7	13.0	16.1	16.0	15.3	13.2	13.3
Loan loss provision charges	1.8	3.0	16.7	11.0	8.1	5.1	2.7	2.6	2.5
Non-recurring items	0.7	0.0	11.2	-0.4	0.0	0.0	0.0	0.0	0.0
Pre-Tax Profit	**4.0**	**0.8**	**1.0**	**0.3**	**-3.5**	**-0.6**	**0.4**	**3.1**	**4.7**
Income tax	0.7	0.0	-1.9	0.5	-0.8	0.8	1.2	0.8	1.2
Net profit attributable to minority interests	0.0	0.0	0.1	0.1	0.1	0.1	0.0	0.3	0.4
Net Income Attributable to Parent	**3.3**	**0.8**	**2.8**	**-0.3**	**-2.8**	**-1.5**	**-0.8**	**2.1**	**3.1**

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] CRD 4 basis from 2012 onwards

Ratios - Lloyds Banking Group plc

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Funding/Liquidity									
Gross loans % Total deposits	134.8%	141.0%	160.7%	157.0%	143.1%	127.9%	119.7%	116.2%	115.0%
Total deposits % Total funds	59.5%	50.6%	51.7%	53.8%	59.8%	65.9%	72.4%	74.7%	76.4%
Wholesale funds % Total funds	40.5%	49.4%	48.3%	46.2%	40.2%	34.1%	27.6%	25.3%	23.6%
Asset Mix, Quality and Growth									
Gross loans % Funded assets	61.0%	58.9%	64.9%	63.5%	63.1%	59.9%	63.2%	63.0%	63.3%
Impaired loans % Gross loans	2.5%	3.5%	9.0%	10.5%	10.2%	8.5%	6.1%	5.5%	5.2%
Loan loss reserves % Impaired loans	0.0%	0.0%	21.7%	24.1%	28.2%	32.9%	37.1%	41.2%	43.4%
Gross loan growth (%)	11.6%	14.2%	171.2%	-5.4%	-4.1%	-7.8%	-3.3%	3.7%	6.8%
Impaired loan growth (%)	8.1%	60.8%	588.7%	9.8%	-6.7%	-23.2%	-30.3%	-10.0%	-5.0%
Funded assets growth (%)	2.3%	18.3%	141.2%	-3.8%	-3.9%	-2.9%	-7.8%	-0.7%	1.5%
Earnings									
Net interest income % Revenues	57.0%	78.2%	40.1%	50.5%	61.0%	37.6%	39.7%	38.3%	36.1%
Fees & commissions % Revenues	24.5%	25.7%	12.2%	13.3%	17.0%	15.6%	14.8%	15.2%	14.9%
Trading income % Revenues	28.3%	-92.9%	85.2%	64.8%	-0.1%	90.4%	92.5%	90.6%	83.8%
Other income % Revenues	-9.8%	89.0%	-37.4%	-28.6%	22.0%	-43.7%	-47.0%	-44.1%	-34.8%
Net interest margin (%)	2.1%	2.3%	1.5%	1.5%	1.6%	1.0%	1.0%	1.0%	1.1%
Pre-provision Income % Risk-weighted assets (RWAs)	3.0%	2.3%	1.4%	2.9%	1.3%	1.5%	1.2%	2.1%	2.6%
Loan loss provision charges % Pre-provision income	34.9%	77.8%	243.2%	92.2%	172.4%	113.3%	86.9%	45.4%	34.7%
Loan loss provision charges % Gross loans (cost of risk)	0.9%	1.3%	3.8%	1.8%	1.4%	0.9%	0.5%	0.5%	0.5%
Cost income ratio (%)	52.0%	60.8%	69.6%	52.2%	77.4%	77.9%	82.9%	70.0%	65.0%
Net Interest Income / Loan loss charges (x)	3.4	2.6	0.5	1.1	1.6	1.5	2.7	2.8	3.0
Return on average equity (ROAE) (%)	28.2%	7.2%	10.7%	-0.7%	-6.1%	-3.4%	-2.1%	5.1%	7.4%
Return on average funded assets (%)	0.6%	0.1%	0.2%	0.0%	-0.2%	-0.1%	-0.1%	0.2%	0.3%
Retained earnings % Prior year's book equity	11.2%	6.4%	30.1%	-0.7%	-6.1%	-3.2%	-2.0%	4.7%	5.3%
Pre-tax return on common equity tier 1 capital	33.1%	8.0%	2.6%	0.7%	-9.3%	-2.3%	1.5%	10.4%	14.6%
Capital and Risk Protection [1]									
Common equity tier 1 ratio (common equity tier 1 capital % RWAs)	7.0%	5.6%	8.1%	10.2%	10.8%	8.1%	10.3%	11.1%	11.7%
Tier 1 leverage ratio (%)	3.9%	3.1%	4.6%	4.8%	4.5%	4.6%	4.9%		
Median of tier 1 leverage ratio and common equity tier 1 ratio (%)	5.5%	4.4%	6.3%	7.5%	7.7%	6.3%	7.6%		
Total loss coverage (CET 1 capital + loan loss provisions) % RWAs	7.0%	5.6%	10.7%	14.0%	15.6%	12.8%	14.7%	15.5%	16.1%
Non-senior bailinable debt cushion (as % of total liabilities)	3.5%	4.0%	3.5%	3.8%	3.8%	3.8%	4.0%	3.6%	3.2%
Asset risk intensity (RWAs % total assets)	48.7%	39.1%	48.0%	41.0%	36.3%	33.2%	31.2%	32.0%	32.0%

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] CRD 4 basis from 2012 onwards. Common equity tier 1 figure for 2013 is proforma including announced disposals.

METHODOLOGIES USED FOR THIS REPORT

For the rating and analysis contents of this report Scope has used the following methodologies which were published on www.scoperatings.com:

"Bank Rating Methodology" (February 2014)

"Forecasting Bank Financials Methodology" (February 2014)

Forecasting bank financials: Forward-looking estimates are an important analytical tool underpinning Scope's bank ratings. These forecasts cover the current financial year (before final year-end figures are published by the bank) plus the forthcoming two years. Depending on the complexity of the bank being assessed, different forecasting tools will be used. For a majority of banks operating primarily commercial and retail banking franchises (loans and deposits) the analysis is underpinned by an **accounting** forecast of the balance sheet and profit and loss account. For more complex groups with multiple ranges of activities – notably those with material wholesale and investment banking operations – Scope uses an **analytical** forecast, relying on the bank's business-line reporting to come up with plausible estimates. For all banks Scope also include a **regulatory metrics** forecast, considering the growing importance of this aspect in bank analysis.

For complex banks, divisional data is used to forecast profit and loss accounts and basic divisional balance sheet metrics. For less complex banks, a line-by-line forecasting of major P&L elements is forecast.

For balance-sheet forecasts, Scope estimates of all major balance sheet lines, using the P&L estimates to complete the forecast of the capital/shareholders' equity line. This comprehensive methodology for estimating the balance sheet is used for all the banks in our universe, irrespective of size and complexity.

Lastly, our forecasts include assessments of the major regulatory metrics: Tier 1 and CET 1 (historically CT1), Leverage, Liquidity Coverage Ratio, and Net Stable Funding Ratio (the latter two when and if sufficient public information to compute them is available).

Scope will not aim to forecast financials when it considers the public disclosure of the bank as insufficient for a transparent and credible outcome.

All Scope's bank financial forecasts are based on public information. For its forecasts Scope will not use any non-public information or data, even if such information or data were provided by rated banks. Scope's forecasting process is transparent, with a detailed roadmap provided in its *"Forecasting bank financials"* methodology.

Rabobank Group
Issuer Rating Report

A+ STABLE OUTLOOK
Financial Institutions

Overview

The A+ Issuer Credit-Strength Rating (ICSR) on the Rabobank Group is driven by its leading position in the Netherlands as a low risk cooperative bank. The Group enjoys a reputation for being prudently managed and this is reflected in its robust capital position and resilient performance throughout the financial crisis. More recently, earnings have been negatively impacted by the weak economic environment in the Netherlands. The Group is somewhat dependent on wholesale funding but continues to benefit from regular market access. As credit costs and regulatory capital requirements have increased, Rabobank is aiming to improve profitability to maintain capital levels at a high standard.

We note that the A+ rating does not apply to unguaranteed debt issued by subsidiaries of the Rabobank Group.

Ratings (assigned on April 2, 2014)

Issuer Credit-Strength Rating	**A+**
Outlook	Stable
Senior unsecured debt	A+

Unsolicited ratings with issuer participation.

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Team Leader

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Rating drivers (Summary)

The ratings drivers, in decreasing order of importance in the rating assignment, are:

- (+) The dominant retail and commercial bank in the Netherlands.
- (+) Management's moderate risk approach underpinned by a cooperative ownership structure.
- (+) Robust capital position supported by resilient earnings.
- (−) Regular use of capital markets funding with deposits meeting about half of funding needs.
- (−) Less proactive than some peers in adapting its business to a changing operating environment.

Rating change drivers

↑ The successful implementation of the Vision 2016 restructuring program would lead to a structural improvement in the earnings of the domestic retail banking business. As customers increasingly prefer to handle their banking needs via computers and phones, the Group is focused on the "virtualisation" of its services. This involves a reduction in costs of EUR 1bn as 8,000 jobs are eliminated and the number of local Rabobanks is cut to approximately 100 from the current 129.

↓ A change in management's moderate risk approach. The Group pursues a risk strategy aimed at protecting earnings, maintaining sound balance sheet ratios and protecting its identity and reputation. Rabobank enjoys a reputation for being a safe and conservative bank, despite the unexpected involvement in the recent

LIBOR/EURIBOR investigations. We would view negatively an increase in management's risk appetite or further significant lapses in risk management.

Reduced capital markets access. As Rabobank regularly utilizes capital markets funding, it is vulnerable to financial market shocks and refinancing risks. We would view negatively a significant decline in access or prohibitively expensive access.

Recent events

2013 results

Rabobank reported a net profit of EUR 2.0bn for the year. While the net profit figure was basically unchanged from the prior year, the results in 2013 included two large exceptional items – EUR 774m in fines related to the LIBOR/EURIBOR settlement and EUR 1.7bn in gains related to disposals (primarily the sale of Robeco). Excluding the impact of these two items, pre-tax profit was EUR 1.2bn, down from EUR 2.0bn in 2012. Group credit costs increased to EUR 2.6bn, from EUR 2.4bn in the prior year, primarily due to deterioration in the real estate division. While it appears that the Dutch economy has started to recover, management has said that it expects higher provisions in 2014 and 2015 for their real estate portfolios. Solvency and liquidity remained sound as reflected in a Basel 2.5 Core Tier 1 ratio of 13.5% and a liquidity buffer of EUR 121bn compared with EUR 54bn in short-term debt outstanding.

LIBOR/EURIBOR settlement

In October 2013, Rabobank entered into agreements with authorities in the Netherlands, the UK, the US and Japan regarding its submission processes for LIBOR and EURIBOR between 2005 and 2010. Thirty employees were involved in inappropriate conduct and the Group was found to be insufficiently aware of the risks involved. In addition to paying EUR 744m in charges, Rabobank is investing in strengthening its compliance, risk management and internal audit functions. Consequently, the Chairman of the Executive Board, who was scheduled to retire in 2014, resigned and was succeeded by Rinus Minderhoud (member of the Supervisory Board since 2002) on an interim basis. There remains a risk of reputational damage as this type of behaviour is not in line with the Group's standing.

Rating drivers (Details)

1. The dominant retail and commercial bank in the Netherlands

The Group is the leading domestic bank in the Netherlands providing a broad range of services. The 129 autonomous local Rabobanks have the largest branch network with over 700 branches serving approximately 6.7 million retail customers and approximately 800,000 corporate clients. The Group maintains very strong and leading domestic market positions in mortgages (26% market share), savings (38%), SME lending (44%) and food and agriculture (F&A, 85%).

Rabobank is also active in wholesale banking, international rural and retail banking, leasing and real estate. Wholesale banking activities are focused on serving Dutch corporates with revenues in excess of EUR 250m and customers involved in the international trading of raw materials as well as exports and imports. Stemming from its roots as a collection of small agricultural cooperative banks, Rabobank holds a leading position in the food and agri-sector internationally (accounts for 58% of the wholesale and international retail loan portfolio). As part of its international retail banking activities, the Group also operates direct banks in Germany, Ireland, Belgium, Australia and New Zealand. The RaboDirect business is a meaningful source of funding, accounting for nearly 20% of Group savings deposits.

Table 1: 2013 total income by business (EUR m)

Domestic retail	7,540
Wholesale and international retail	4,047
Leasing	1,570
Real estate	(209)
Other	1,115
Total	**14,063**

Note: Excludes consolidation effects and hedge accounting.
Source: Company data, Scope Ratings

2. Management's moderate risk approach underpinned by a cooperative ownership structure

As a cooperative, the Group's guiding principle is to provide services that are in the interests of its customers. In line with this approach, management aims to be a robust and strong bank by managing risks to ensure "creditworthiness at the highest level."

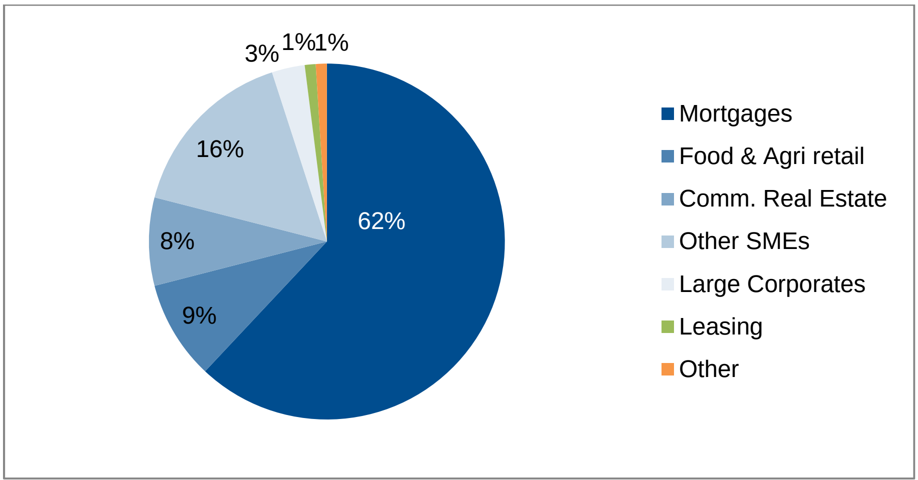
More than 75% of the loan portfolio is domestic, with the exposure being broad and diversified across mortgages, SMEs, food and agribusiness as well as commercial real estate. While non-performing loans have increased due to the weak economic environment, the loan portfolio remains of high quality overall, with 2.8% of loans being impaired at year-end 2013. Commercial real estate lending, accounting for less than 10% of the loan portfolio, is the weakest sector with 15.1% being impaired. The Dutch National Bank recently reviewed the Group's commercial real estate portfolio and determined that sufficient capital was being maintained for this portfolio.

Rabobank reports a 10-year average cost of risk of 28 bps (credit costs % average loans), which is very low. As of year-end 2013, the cost of risk remained elevated at 59 bps, up from 49 bps in the prior year. The coverage of impaired loans by provisions is 34%, relatively modest compared with peers. However, for several years, Rabobank has been writing-off amounts in portfolios which have a very low probability of recovery. Excluding these write-offs of EUR 4.4bn, the coverage ratio would be 51%.

Nearly half of the loan portfolio is comprised of domestic mortgages. At year-end, the average loan-to-value (LTV) of the mortgage book was 81%, which is relatively high compared to European norms. However, Rabobank notes that LTV figures do not take into account the available savings and other assets of the borrower, or the fact that the majority of clients have life insurance pledged to the bank to cover premature death risk. Furthermore, 20% of the mortgage portfolio benefits from a national mortgage guarantee. The proportion of mortgage loans more than 90 days past due remains low at 0.55%. This is also well below the level of the two other large Dutch banks, which have impaired mortgage loan ratios above 1%.

The Dutch housing market is characterized by demand exceeding supply structurally due to an increasing number of households, limited land available for housing and a shortage of housing stock. However, since 2008, the average house price has declined more than 20%. The recovery of the Dutch economy has lagged behind other countries since the financial crisis and after two years of declines, GDP growth is expected to resume in 2014. The European Commission is forecasting GDP growth of 1% in 2014 compared to negative growth of 0.8% in 2013.

Chart 1: Domestic lending portfolio, EUR 338bn at year-end 2013, 77% of total

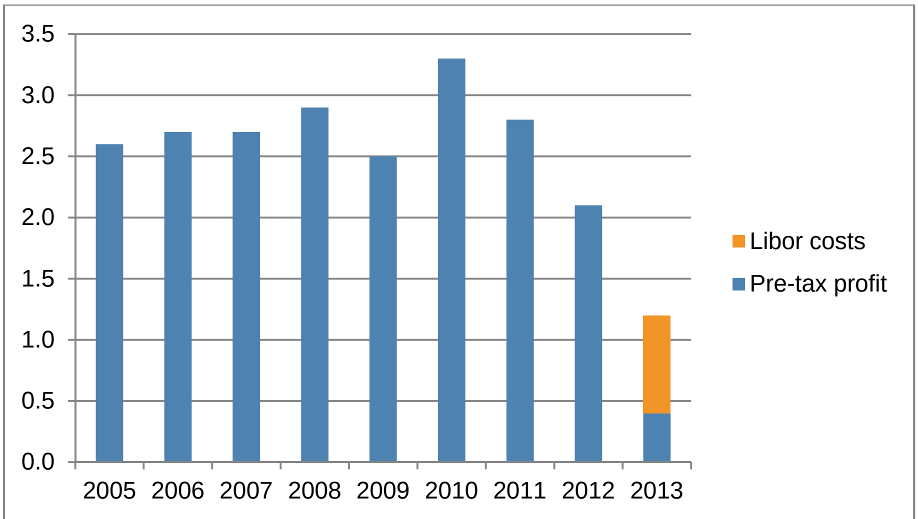


Note: International lending portfolio, EUR 101bn (o/w Large corporates, 49%; Rural and retail, 31%; Leasing, 21%). Source: Company data, Scope Ratings

3. Robust capital position supported by resilient earnings

As evidence of a sustainable core franchise, the Group has generated resilient earnings over a period of many years. Even during the financial crisis, earnings were solid. Unlike many peers, Rabobank did not materially suffer from impairments and revaluations on its assets. In addition, Rabobank was the only large financial institution in the Netherlands that did not require State aid during the financial crisis.

Chart 2: Operating income and Pre-tax profit (EUR bn)



Source: Company data, Scope Ratings

Rabobank has consistently maintained a robust capital position, with a Core Tier 1 ratio well above peers. At year-end 2013, the Basel 2.5 Core Tier 1 ratio was 13.5%, up from 13.2% in the prior year. The Group aims to further increase its capital position with a target Core Tier 1 ratio of at least 14%, and a Total Capital ratio of at least 20% in 2016. This is expected to be achieved by improved earnings and control over the volume of risk-weighted assets. The capital structure will also be enhanced by increasing the proportion of retained earnings and Tier 2 capital while decreasing the proportion of Rabobank Certificates and hybrid capital. On a fully-loaded CRD 4 basis, the reported CET1 and leverage ratios were 11.1% and 4.8%, respectively at year-end 2013.

Rabobank Certificates are an important source of capital as, due to its cooperative structure, Rabobank is unable to issue shares via equity markets. Between 2000 and 2005, the Group had issued certificates to its members and employees, which could only be traded or transferred once a month via an internal market. As part of its capital strategy, the certificates as of January 2014 became available for investment by institutional investors as well and are traded on the Euronext exchange. There are nearly 238 million Rabobank Certificates outstanding, representing EUR 5.9bn of common equity Tier 1 capital.

Proceeds from Rabobank Certificates are available to the Group on a perpetual basis and are subordinated to all liabilities. As the payment of any distributions is fully discretionary, the proceeds from Rabobank Certificates are recognized as equity under IFRS and are considered Tier 1 capital. The intended pay-out distribution is the higher of 6.5% (raised from 5.2% in December 2013), or the effective return on a 10-year Dutch state loan plus 150bps. Rabobank has consistently paid distributions on its certificates. We note that between 2006 and 2013, distributions have been equivalent to about 15-20% of net profit. In 2013, distributions on certificates and other capital securities amounted to EUR 1.0bn.

4. Regular use of capital markets funding with deposits meeting about half of funding needs

Like other Dutch banks, Rabobank is reliant to some extent on capital markets funding. Dutch banks on the whole are unable to match their loan books to local savings as they are held predominantly in pension funds. According to 2012 data from De Nederlandsche Bank, Dutch households held 72% of their assets in pensions compared with 22% in deposits. At year-end 2013, the Group’s reported loan to deposit ratio was a relatively high 135% (2012: 139%). The goal is to reduce this to 130% in 2016.

Rabobank’s funding and liquidity policies focus on funding the long-term loan portfolio with stable sources of funding (i.e. amounts Due to Customers and long-term funding from the capital markets). The retail banking division is expected to largely meet its own funding requirements by raising customer funds. As shown below, the amount Due to Customers plus Long-term Debt exceeds Loans. As well, Short-term Assets are more than double the amount of Short-term Liabilities.

Table 2: Balance sheet structure at year-end 2013 (EUR bn)

Assets		Liabilities and Equity	
Loans	460	Capital	40
		Due to Customers	329
		Long-term debt	165
Short-term Assets	141	Short-term Liabilities	70
Derivatives	40	Derivatives	34
Other	33	Other	36

Source: Company data, Scope Ratings

Benefiting from its reputation as a safe and conservative bank, the Group has been able to consistently tap capital markets for funding, even during the financial crisis. Between 2009 and 2011, Rabobank borrowed more than EUR 40bn annually. Rabobank has also issued hybrid capital securities and senior contingent notes. As part of its strategic plan, Rabobank intends to reduce and diversify its capital markets funding. The use of short-term funding has declined (2013: EUR 54bn outstanding, 2012: EUR 61bn, 2011: EUR 70bn) and the average maturity of the funding portfolio is over 4.5 years.

At year-end 2013, Rabobank maintained a high liquidity buffer of EUR 121bn comprised of cash (32%), government debt (32%) and other central bank assets (36%). This amount is well above the EUR 54bn of short-term debt outstanding. Furthermore, Rabobank reported LCR and NSFR ratios of 126% and 114%, respectively.

5. Less proactive than some peers in adapting its business to a changing operating environment

Having fared relatively well during the financial crisis, Rabobank has faced less pressure than peers to adapt its business to a changing operating environment. However, as business conditions remain challenging, management has acknowledged the need to focus on costs in order to maintain the Group's profitability and capital position at a high standard. This is reflected in the Group's 2013-2016 strategy, which includes strengthening earnings capacity as a key focus as well as the Vision 2016 restructuring program. Actions taken over the last year include reducing the number of local Rabobanks from 136 to 129, reducing the number of branches from over 800 to over 700, modifying wage agreements, selling BGZ Bank in Poland and reducing commercial real estate development activities.

While maximizing profitability is not management's key priority, earnings remain important for bolstering capital and providing protection against credit costs. Management is targeting a return on Tier 1 capital of 8% for year-end 2016 (5.2% in 2013). We note that in recent years credit costs have accounted for an increasing proportion of pre-provision income, up from about one-third in 2010/2011 to over 85% in 2013. With the Dutch economy starting to recover, we would expect credit costs to stabilize.

Other information

Cooperative structure and cross guarantee

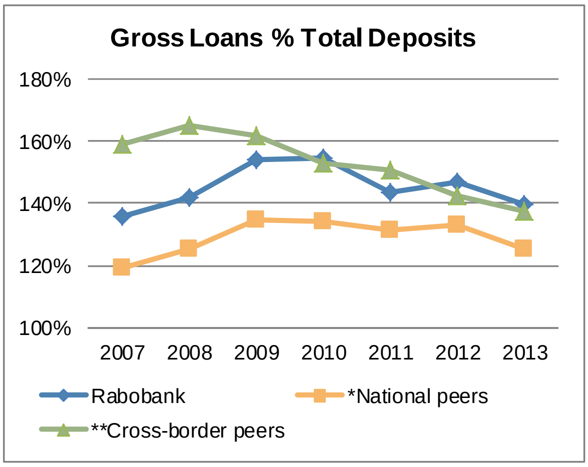
The Rabobank Group consists of the local Rabobanks, their central organization Rabobank Nederland and its subsidiaries and other affiliated entities. Pursuant to the Dutch Financial Supervision Act, Rabobank Nederland is responsible for monitoring the operations, solvency and liquidity of the local Rabobanks. Further, under Article 3:111, there is a formalized internal cross-guarantee system which stipulates that if a participating institution has insufficient funds to meet its obligations towards creditors, the other participants must supplement that institution's funds in order to enable it to fulfil those obligations. For regulatory and financial reporting purposes, the various entities of the Rabobank Group are treated as one consolidated entity.

Peer comparison

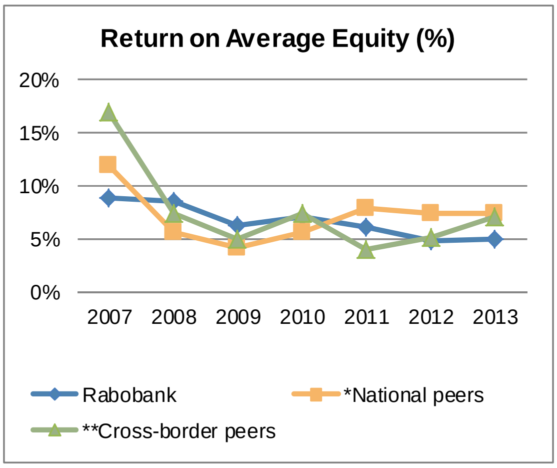
As Rabobank is largely a domestic retail and commercial bank, it is appropriate to compare it with other Dutch banks. Since the financial crisis, the other large Dutch banks, ING Group and ABN Amro, have become more focused, retail and commercial banks. Both of these peers received a significant amount of State aid and continue to deal with the aftereffects. As agreed with the European Commission, ING Group is in the process of disposing its insurance activities and in two years time will be active primarily in banking. Meanwhile, ABN Amro remains completely State-owned.

At Scope Ratings, we also compare banks within peer groups based on business models and have included Rabobank within the category of primarily domestic retail and commercial banks. This peer group includes Lloyds Banking Group, Credit Agricole, Credit Mutuel, BPCE, DNB, CaixaBank and Wells Fargo. Overall, Rabobank's metrics are largely in line with peers. However, we note that asset quality is much better compared to cross-border peers, consistent with the Group's moderate risk approach. At year-end 2013, the impaired loan ratio was 2.8% vs. an average of nearly 5% for cross-border peers. Rabobank's capital position has also historically been stronger than peers, but the gap has narrowed as peers have been bolstering their capital levels in light of the financial crisis and evolving regulatory requirements. As the Group implements its restructuring program, we would expect earnings to improve.

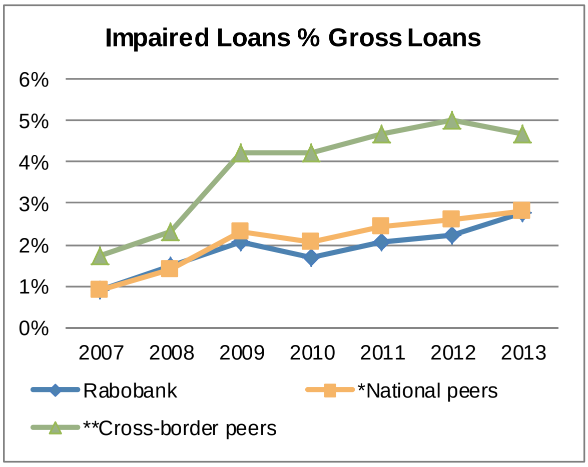
Peer Comparison - Rabobank Group



Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



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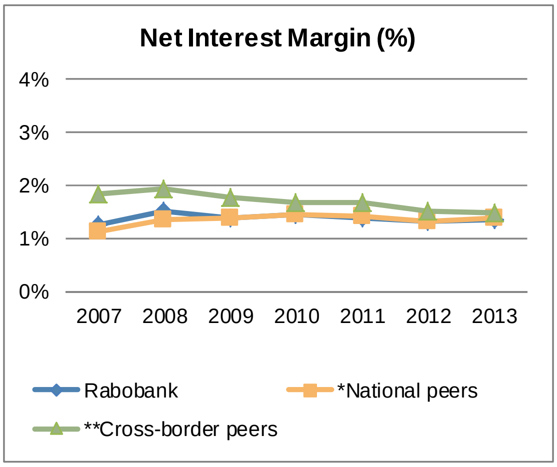
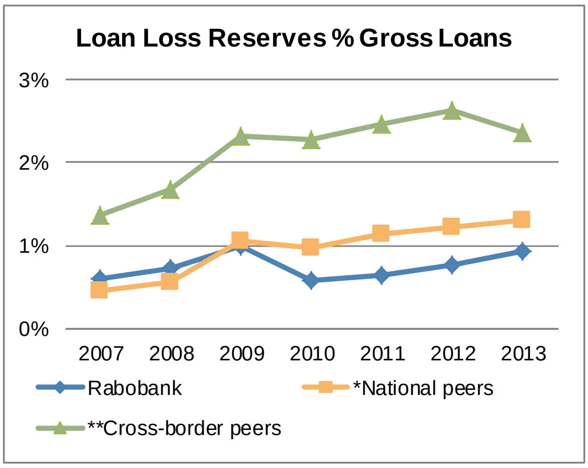
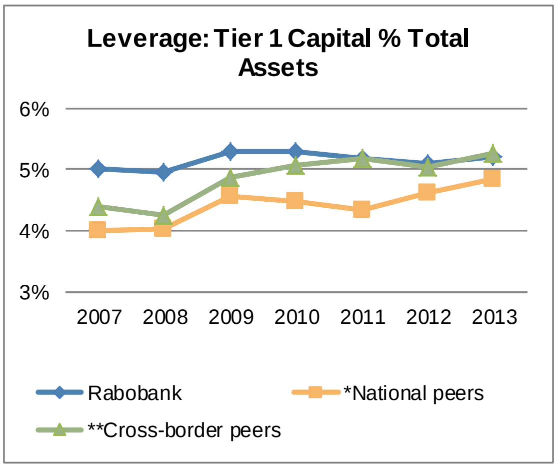


Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings

*National Peers : Rabobank, ABN AMRO, ING Bank

**Cross-Border Peers based on business model : Lloyds, Rabobank, CaixaBank, Swedbank, DNB, Intesa, Wells Fargo, Credit Mutuel Group, BPCE, Credit Agricole

Notes: Cross-border peer group excludes Credit Mutuel Group in 2013 as well as Intesa for Net Interest Margin and Return on Average Equity. We use H1 2013 numbers as a 2013 proxy for Intesa on all other ratios.

Selected Financial Information - Rabobank Group

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Balance Sheet summary (EUR billion)									
Assets									
Cash and balances with central banks	2.1	7.1	16.6	13.5	70.4	68.1	43.0	43.0	45.2
Interbank assets	43.2	33.8	35.6	33.5	25.2	35.4	40.8	42.9	47.2
Total securities	96.2	49.0	52.1	75.4	64.6	60.5	56.7	54.0	53.9
of which debt instruments	78.0	44.9	46.2	70.4	60.7	57.0	53.0	50.3	50.3
of which equity instruments	15.1	4.1	5.8	4.9	3.5	3.0	2.8	2.8	2.7
Derivatives	26.1	66.8	39.1	43.9	59.0	65.4	39.7	39.5	39.1
Gross customer loans	377.0	431.6	441.0	461.1	473.7	491.9	464.5	464.7	460.1
of which impaired loans	3.4	6.5	9.1	7.9	9.7	11.2	12.8	13.7	14.1
Total funded assets	544.4	537.2	561.2	604.6	668.4	677.5	639.9	647.0	654.6
Total Assets	**570.5**	**612.1**	**607.5**	**652.5**	**731.7**	**750.7**	**674.1**	**681.1**	**688.4**
Liabilities									
Interbank liabilities	46.3	23.9	22.4	23.5	26.3	27.1	15.5	15.5	16.3
Senior debt	168.1	159.7	198.4	226.5	239.2	247.4	211.5	211.5	211.5
Derivatives	26.1	75.0	46.3	48.0	63.2	73.2	34.3	34.1	33.8
Customer deposits	277.6	305.1	287.0	298.9	330.0	334.3	332.3	338.9	345.7
Subordinated debt + hybrid securities	2.3	2.2	2.4	2.5	2.4	5.4	7.8	8.2	8.6
Total Liabilities	**539.1**	**578.7**	**569.6**	**611.8**	**686.7**	**708.6**	**634.1**	**641.0**	**648.6**
Ordinary equity	19.7	20.1	22.0	24.7	26.5	25.3	24.6	24.7	25.1
Minority interests	2.7	3.6	3.4	3.1	2.7	1.4	1.0	1.0	1.0
Total Liabilities and Equity	**570.5**	**612.1**	**607.5**	**652.5**	**731.7**	**750.7**	**674.1**	**681.1**	**688.4**
Core Tier 1 Capital	*24.5*	*25.6*	*25.6*	*27.7*	*28.3*	*29.3*	*28.6*	*28.6*	*29.0*
Income Statement summary (EUR billion)									
Net interest income	6.8	8.5	8.1	8.6	9.2	9.2	9.1	9.1	9.3
Net fee & commission income	2.9	2.9	2.6	2.8	2.4	2.2	2.0	2.0	2.1
Net trading income	0.0	-0.6	-0.3	0.4	0.5	1.0	0.3	0.3	0.3
Operating Income	**11.1**	**12.3**	**12.5**	**12.7**	**12.7**	**13.6**	**13.0**	**13.0**	**13.3**
Operating expenses	7.7	7.6	8.0	8.2	8.3	9.2	10.0	9.1	9.1
Loan loss provision charges	0.7	1.8	2.0	1.3	1.6	2.4	2.6	2.6	2.5
Non-recurring items	0.4	0.0	0.0	0.0	0.1	0.1	1.7	0.0	0.0
Pre-Tax Profit	**3.1**	**2.9**	**2.4**	**3.3**	**3.0**	**2.2**	**2.1**	**1.3**	**1.7**
Income tax	0.4	0.1	0.2	0.5	0.4	0.2	0.1	0.1	0.1
Net profit attributable to minority interests	0.7	0.7	0.1	0.1	0.1	0.1	0.1	0.0	0.0
Net Income Attributable to Parent	**2.0**	**2.1**	**2.1**	**2.7**	**2.5**	**2.0**	**2.0**	**1.2**	**1.6**

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.

Ratios - Rabobank Group

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Funding/Liquidity									
Gross loans % Total deposits	135.8%	141.5%	153.7%	154.3%	143.5%	147.1%	139.8%	137.1%	133.1%
Total deposits % Total funds	55.2%	60.9%	54.9%	53.0%	53.8%	53.1%	57.1%	57.6%	58.0%
Wholesale funds % Total funds	44.8%	39.1%	45.1%	47.0%	46.2%	46.9%	42.9%	42.4%	42.0%
Asset Mix, Quality and Growth									
Gross loans % Funded assets	80.3%	78.6%	76.3%	70.9%	72.6%	72.6%	72.6%	71.8%	70.3%
Impaired loans % Gross loans	0.9%	1.5%	2.1%	1.7%	2.1%	2.3%	2.8%	2.9%	3.1%
Loan loss reserves % Impaired loans	48.2%	40.8%	44.1%	27.9%	27.1%	34.3%	33.6%	33.0%	32.0%
Gross loan growth (%)	5.1%	14.5%	2.2%	4.6%	2.7%	3.9%	-5.6%	0.0%	-1.0%
Impaired loan growth (%)	-21.1%	87.9%	40.8%	-13.6%	24.1%	14.9%	14.3%	7.0%	3.0%
Funded assets growth (%)	1.9%	-1.3%	4.5%	7.7%	10.6%	1.4%	-5.6%	1.1%	1.2%
Earnings									
Net interest income % Revenues	60.9%	69.3%	64.8%	67.6%	72.2%	67.4%	69.8%	69.8%	69.8%
Fees & commissions % Revenues	25.7%	23.5%	20.7%	22.2%	18.6%	16.4%	15.4%	15.4%	15.8%
Trading income % Revenues	0.2%	-4.6%	-2.0%	2.8%	3.8%	7.4%	2.2%	2.2%	2.2%
Other income % Revenues	13.2%	11.8%	16.6%	7.3%	5.4%	8.9%	12.6%	12.6%	12.3%
Net interest margin (%)	1.4%	1.7%	1.5%	1.5%	1.5%	1.4%	1.5%	1.5%	1.6%
Pre-provision Income % Risk-weighted assets (RWAs)	1.3%	2.0%	1.9%	2.1%	2.0%	2.0%	1.5%	n/a	n/a
Loan loss provision charges % Pre-provision income	21.5%	39.0%	44.8%	27.6%	36.1%	53.2%	86.4%	67.2%	59.1%
Loan loss provision charges % Gross loans (cost of risk)	0.2%	0.4%	0.5%	0.3%	0.3%	0.5%	0.6%	0.6%	0.6%
Cost income ratio (%)	68.9%	61.9%	64.5%	64.3%	64.9%	67.6%	76.5%	70.0%	68.0%
Net Interest Income / Loan loss charges (x)	9.1	4.7	4.1	6.9	5.7	3.9	3.4	3.5	3.7
Return on average equity (ROAE) (%)	10.6%	10.5%	10.0%	11.5%	9.9%	7.6%	7.8%	4.8%	6.5%
Return on average funded assets (%)	0.2%	0.3%	0.3%	0.3%	0.3%	0.2%	0.2%	0.1%	0.2%
Retained earnings % Prior year's book equity	9.6%	9.0%	8.9%	10.8%	6.6%	3.6%	3.7%	0.2%	1.6%
Pre-tax return on common equity tier 1 capital	12.6%	11.1%	9.5%	11.8%	10.5%	7.6%	7.3%	4.5%	6.0%
Capital and Risk Protection									
Common equity tier 1 ratio (common equity tier 1 capital % RWAs)	9.2%	10.8%	11.0%	12.6%	12.7%	13.2%	13.5%	n/a	n/a
Tier 1 leverage ratio (%)	5.0%	5.0%	5.3%	5.3%	5.2%	5.1%	5.2%		
Median of tier 1 leverage ratio and common equity tier 1 ratio (%)	6.7%	7.5%	7.6%	8.4%	8.3%	8.5%	8.9%		
Total loss coverage (CET 1 capital + loan loss provisions) % RWAs	9.8%	12.1%	12.4%	13.6%	13.8%	14.9%	15.6%	n/a	n/a
Non-senior bailinable debt cushion (as % of total liabilities)	2.1%	2.0%	2.6%	2.5%	2.6%	2.9%	3.4%	3.4%	3.4%
Asset risk intensity (RWAs % total assets)	46.7%	38.1%	39.2%	33.6%	30.6%	29.7%	31.3%	n/a	n/a

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.

METHODOLOGIES USED FOR THIS REPORT

For the rating and analysis contents of this report Scope has used the following methodologies which were published on www.scoperatings.com:

"Bank Rating Methodology" (February 2014)

"Forecasting Bank Financials Methodology" (February 2014)

Forecasting bank financials: Forward-looking estimates are an important analytical tool underpinning Scope's bank ratings. These forecasts cover the current financial year (before final year-end figures are published by the bank) plus the forthcoming two years. Depending on the complexity of the bank being assessed, different forecasting tools will be used. For a majority of banks operating primarily commercial and retail banking franchises (loans and deposits) the analysis is underpinned by an **accounting** forecast of the balance sheet and profit and loss account. For more complex groups with multiple ranges of activities – notably those with material wholesale and investment banking operations – Scope uses an **analytical** forecast, relying on the bank's business-line reporting to come up with plausible estimates. For all banks Scope also include a **regulatory metrics** forecast, considering the growing importance of this aspect in bank analysis.

For complex banks, divisional data is used to forecast profit and loss accounts and basic divisional balance sheet metrics. For less complex banks, a line-by-line forecasting of major P&L elements is forecast.

For balance-sheet forecasts, Scope estimates of all major balance sheet lines, using the P&L estimates to complete the forecast of the capital/shareholders' equity line. This comprehensive methodology for estimating the balance sheet is used for all the banks in our universe, irrespective of size and complexity.

Lastly, our forecasts include assessments of the major regulatory metrics: Tier 1 and CET 1 (historically CT1), Leverage, Liquidity Coverage Ratio, and Net Stable Funding Ratio (the latter two when and if sufficient public information to compute them is available).

Scope will not aim to forecast financials when it considers the public disclosure of the bank as insufficient for a transparent and credible outcome.

All Scope's bank financial forecasts are based on public information. For its forecasts Scope will not use any non-public information or data, even if such information or data were provided by rated banks. Scope's forecasting process is transparent, with a detailed roadmap provided in its *"Forecasting bank financials"* methodology.

Royal Bank of Scotland plc
Issuer Rating Report

SCOPE | BBB+ STABLE OUTLOOK | Financial Institutions

Overview

The BBB+ Issuer Credit-Strength Rating (ICSR) on Royal Bank of Scotland plc is based on the strength of the Royal Bank of Scotland Group plc. RBS's rating is driven by its significant positions in the UK corporate and retail market, which should remain a key strength even after capital markets and foreign activities are wound down considerably. The evolving business model has yet to translate into reliable and sustainable earnings – legacy issues and restructuring continue to be a drag on performance which remains poor.

Majority ownership by the UK government is a supporting element for the BBB+ rating, which incorporates one notch of uplift. We would likely remove the notch of support as RBS's credit profile improves to a point where the UK government could consider reducing its majority ownership stake.

The BBB+ rating also applies to senior unsecured debt issued by RBS's parent, Royal Bank of Scotland Group plc. However, the rating is not applicable to unguaranteed debt issued by subsidiaries of Royal Bank of Scotland plc.

Ratings (assigned on April 2, 2014)

Issuer Credit-Strength Rating:	**BBB+**
Outlook	Stable
Senior Unsecured Debt	BBB+

Unsolicited ratings with issuer participation.

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Rating drivers (Summary)

The rating drivers, in decreasing order of importance in the rating assignment, are:

- (+) Leading UK corporate and retail bank.
- (−) Restructuring is far from complete. Newly formed management team has lots to implement and execute.
- (−) Legacy issues to hamper performance for at least the next two to three years.
- (+) Majority ownership by the UK government on balance is credit positive at this time. Nevertheless, RBS faces additional accountability and needs to manage a politically sensitive relationship.

Rating change drivers

Successful execution of strategy announced in conjunction with the "good bank/bad bank" review. Key milestones include the IPO of Citizens in the US, reducing risk-weighted assets (RWAs), addressing SME lending practices and lowering costs. Success would be credit positive as it would align the business with the goals of the majority shareholder as well as improve RBS's financial profile. With the strategic plan spanning a four-to-six year period, meaningful results will likely materialize over the medium-term.

- **Inability to generate sustainable net profits.** RBS is targeting a return on tangible equity of about 9% to 11% in 2016/2017 to be achieved primarily via the run-down of non-core assets, cost reductions and lower impairments. There will be execution risks as well as significant restructuring costs. In addition, the resizing of certain businesses may also negatively impact earnings.
- **Improvement in capital position to stated targets.** Achieving a fully loaded CRD 4 CET1 ratio of around 11% by end-2015 and 12% by end-2016 would be positive, as it would provide a greater buffer for dealing with further potential conduct-related claims and evolving regulatory requirements. Management intends to reach these targets primarily via the IPO of Citizens and the run-down of legacy assets.
- **Reduction in government ownership and return to private ownership.** Removal of the Dividend Access Share and simplification of the government's holding would be positive initial first steps. Full re-privatisation will likely take a few years to achieve. We are confident that the UK government will not reduce its stake in RBS as long as it is not fully competitive and able to generate value for shareholders.
- **Failure to deal effectively with a changing operating environment.** In particular, RBS will be subject to evolving regulations regarding the ring-fencing of certain activities in the UK. As well, the ongoing debate about Scottish independence may have consequences for RBS's business and strategy.

Recent events

Good bank/bad bank review

In June 2013, the UK government undertook a review of the case for an external "bad bank" to deal with RBS's legacy and poorly performing assets. Subsequently, RBS created an internal "bad bank", RBS Capital Resolution (RCR), comprised of GBP 29bn in assets which are expected to provide poor returns and/or perform badly in a stress scenario. The goal is to remove most of these assets from the balance sheet in three years (target of GBP 6bn or less at year-end 2016). Furthermore, RBS will take measures to restore its financial strength and sharpen its focus on core UK businesses and international corporate capabilities.

2013 results

For the year, RBS reported a loss of GBP 8.6bn, compared to a loss of GBP 5.8bn in 2012. Results were negatively impacted by GBP 3.8bn of regulatory and redress provisions, GBP 4.8bn in impairments related to setting up RCR and GBP 1.4bn for the write-down of goodwill and other intangible assets. Excluding the costs of setting up RCR, income declined 10% primarily due to lower income in the Markets division while expenses declined by 4%. At year-end 2013, the reported CRD 4 fully loaded CET1 and leverage ratios were 8.6% and 3.5%, respectively. In conjunction with the results, management provided further details on its strategic plan.

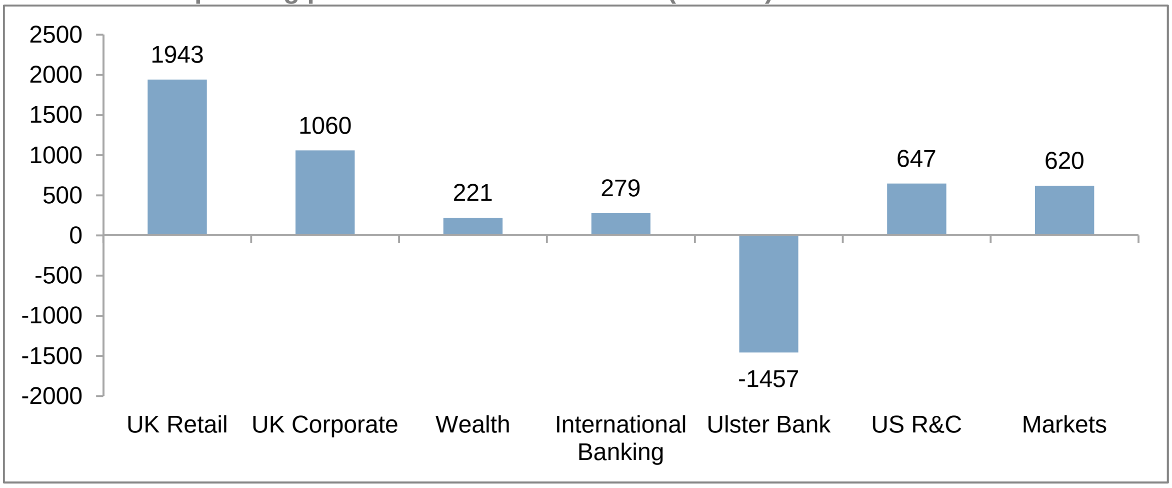
Rating Drivers (Details)

1. Leading UK corporate and retail bank

RBS is the largest corporate bank in the UK, serving SMEs to UK-based multi-national companies. Having lent aggressively in the run-up to the financial crisis, RBS's lending volumes have fallen from an unsustainably high level in 2008 to a level which is more in line with its customer base. However, RBS now faces increasing competition as well as scrutiny from the government who is keen on seeing the Bank support the UK economy. RBS intends to implement the recommendations from the Independent Lending Review which should help it maintain its leading position in corporate banking.

In retail, the Bank has the second largest branch network in the UK and operates primarily through two subsidiaries, NatWest and RBS. The Bank holds market shares of about 18% in retail current accounts and 8% in mortgages[1]. In Ireland, RBS operates via Ulster Bank, which is the number one retail and commercial bank in Northern Ireland and the number three bank in Ireland overall. With the legacy asset reduction in RCR, the size of the Irish franchise will decrease and the aim is to reposition Ulster as a challenger bank to the systemic banks.

Chart 1: 2013 operating profit/loss of Core divisions (GBP m)



Source: Company data, Scope Ratings

Management has stated that RBS's "future is a UK-focused retail and commercial bank with markets and international capabilities" to meet client needs in their UK and Western European operations. Areas of strength include European FX, GBP debt capital markets, international cash management and trade finance. In the next three to five years, RBS intends to have the majority of its business and assets in the UK (2018-2020 target: 80% UK, 20% non-UK; 2013: 60%/40%). As well, the Bank will continue shifting its emphasis from wholesale towards retail and commercial (2018-2020 target: 85% retail and commercial, 15% wholesale; 2013: 80%/20%).

Consequently, RBS is reorganizing from seven divisions to three businesses: Personal and Business Banking, Commercial and Private Banking and Corporate & Institutional Banking. Reporting from Q2 2014 will reflect this new structure, with RCR stated separately. We believe that the streamlined organization and disclosure adds clarity of purpose and provides better visibility of where the Bank is heading.

[1] Source: GfK (6 months ending December 2013)

Table 1: Management's target profile between 2018 and 2020

	RWA	Op profit	ROE
Personal & Business Banking	35%	50%	15%+
Commercial & Private Banking	30%	30%	15%+
Corporate & Institutional Banking	35%	20%	About 10%

Source: Company data, Scope Ratings

2. Restructuring is far from complete. Newly formed management team has lots to implement and execute

During the last five years, RBS has made significant progress in improving its financial soundness. The Bank has achieved its stated medium-term targets in regards to liquidity and capital. In particular, loans as a percentage of deposits at 100% (2013: 94%), short-term wholesale funding less than 10% of third party assets (2013: 4.3%), liquidity portfolio greater than 1.5x short-term wholesale funding (2013: 4.5x) and a Tier 1 leverage ratio less than 18x (2013: 14.4x). Furthermore, RBS has reduced non-core assets to GBP 28bn from GBP 258bn five years ago.

However, the work is far from finished. RBS is embarking on an ambitious restructuring plan to address operational effectiveness so that it can generate sustainable returns. Since 2008, RBS has incurred over GBP 45bn in cumulative net losses. For 2016/2017, the return on tangible equity target is about 9-11% (2013: negative) – to be achieved through the run-down of RCR, cost reductions and lower impairments. Further, management expects 200-300 bps of capital uplift from the IPO of Citizens. Preparations for a partial IPO in 2014 are on track and RBS expects to fully divest the business by year-end 2016. Meanwhile, the cost-income ratio target is about 55% (2013 reported: 73%). Restructuring costs through 2017 are expected to amount to GBP 5.2bn.

The new CEO, Ross McEwan, took over in October 2013, having spent one year as head of the UK retail division and previously as head of retail banking at Commonwealth Bank of Australia. Clearly, the newly formed management team has a lot to implement and execute – aiming to achieve needed improvements in operational effectiveness, costs, asset quality and capital. Progress will take time. Encouragingly, there appears to be support for the strategic plan from the Bank of England and the UK government.

3. Legacy issues to hamper performance for at least the next two to three years

RCR became operational from January 1, 2014 with GBP 29bn in assets, of which approximately 50% comes from the non-core portfolio (excluding Ulster Bank), 17% from Ulster Bank (core and non-core) and the remainder from UK corporate, International Banking and Markets. Commercial real estate and the Irish operations continue to be the key problem areas. Impairments and disposal losses are being brought forward as high-risk loans are being run-down more quickly. Additional loan impairments related to the creation of RCR were GBP 4.5bn in 2013. RBS estimates that lifetime credit costs could be GBP 5bn to 6bn and cash costs of disposals could be GBP 1.5bn to 2bn.

However, over the medium-term, RBS expects to benefit from a meaningful improvement in its capital position as well as a lower risk and simpler organization – steady state RWAs of approximately GBP 300bn in 2018-2020 (2013: GBP 429bn), 40-50% reduction in stress impairments and a non-performing loan ratio of 2.5-3.5% at year-end 2016 from the reported 9.4% in 2013. There will be execution risks as the assets within RCR are expected to be run-off or sold.

Furthermore, RBS remains exposed to further potential costs related to conduct and litigation. In particular, lawsuits and investigations regarding mortgage-backed securities, LIBOR and other trading benchmarks, interest rate hedging products, PPI and technology incidents. Significant provisions were made in 2013 for regulatory and legal actions (GBP 2.4bn), PPI (GBP 900m) and interest rate hedging products (GBP 550m).

The above costs will continue to be a drag on performance and hinder the build-up of retained earnings.

4. Majority ownership by the UK government on balance is credit positive at this time. Nevertheless, RBS faces additional accountability and needs to manage a politically sensitive relationship

During the financial crisis, RBS was one of four UK banks that received direct government support. In 2008, RBS reported a pro-forma attributable loss of more than GBP 24bn due to loan losses, writedowns on credit assets and goodwill impairments related to the acquisition of ABN Amro and Charter One in the US. Consequently, between 2008 and 2009, the UK government acquired ordinary and B shares in RBS, bringing its current economic ownership to 80%.

In November 2013, after completing a review into the case for a bad bank, the government concluded that RBS should focus on its core job of supporting the British economy and lending to British businesses. The government emphasized that measures should be taken to address a “lack of strategic coherence” as well as poorly-performing legacy assets and weak returns in core businesses. Management’s latest strategic plan directly addresses these concerns. If successfully implemented, RBS will become an increasingly UK focused, lower risk corporate and retail bank. However, if not executed in a timely manner, RBS may be subject to further political intervention.

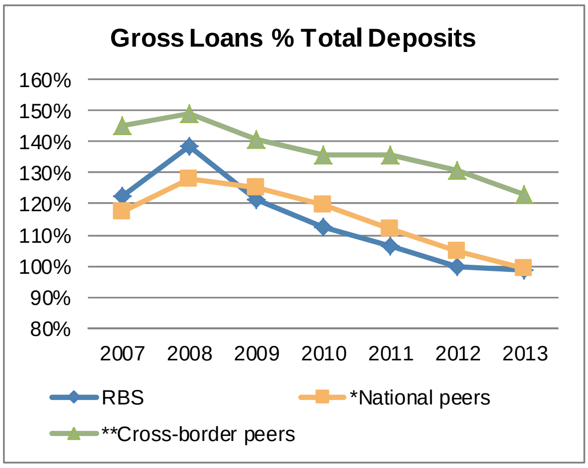
Peer comparison

In addition to national peer analysis, Scope Ratings compares banks within peer groups based on their business models and have included RBS in the category of international retail and commercial banks with limited investment banking activities. This peer group includes banks such as ING Bank, KBC Group, Commerzbank and Nordea. As RBS executes its announced strategy and further reduces its geographic footprint and business scope, we may consider changing its peer group to reflect its more domestic and retail and commercial focus.

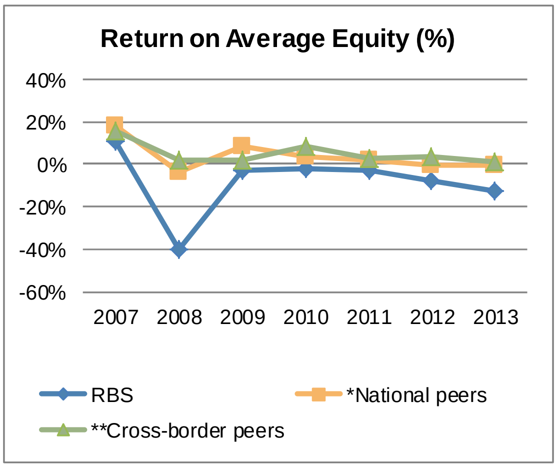
With the strategic focus being on its core UK businesses and international corporate capabilities, RBS is becoming increasingly a UK-focused retail and commercial bank. This means that its business profile will become more comparable to that of Lloyds, having moved away from comparability with Barclays (which was to some extent the case during the pre-crisis years). However, while RBS is particularly strong in the corporate market, Lloyds is more dominant in the retail market. This is evidenced in their loan books – e.g. mortgages comprise over a third of RBS’ loan book while they account for nearly two-thirds of Lloyds’ loan book. RBS also has a more developed capital markets business to support its corporate clients but this will be reduced going forward. Otherwise, there will be a good deal of similarity in their business models. The other large player in the UK market, HSBC, has a different business model, being much more diverse geographically and by business line.

Reflecting the progress made, RBS’ liquidity profile now compares well to peers, with a loan to deposit ratio below 100% and a relatively moderate use of wholesale funding (less than 30% of total funds). Capital and leverage have also improved but remain somewhat below peers. At year-end 2013, RBS’s reported CRD 4 fully loaded CET1 and leverage ratios were 8.6% and 3.5%, respectively. Where RBS continues to compare poorly to peers is in regards to asset quality and profitability. RBS has been loss making since 2008, with earnings being negatively impacted by loan loss charges, impairments on financial assets and conduct and litigation costs.

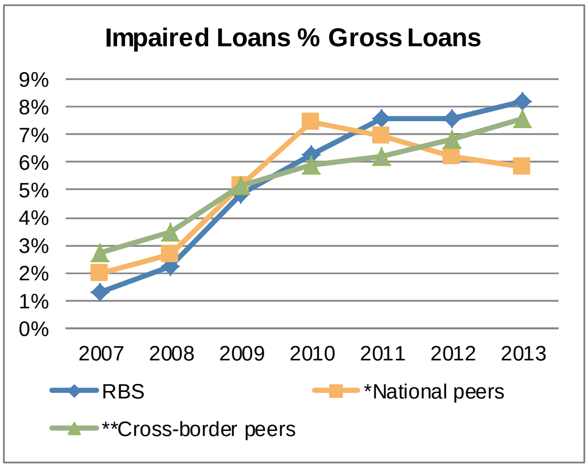
Peer Comparison - RBS Group plc



Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



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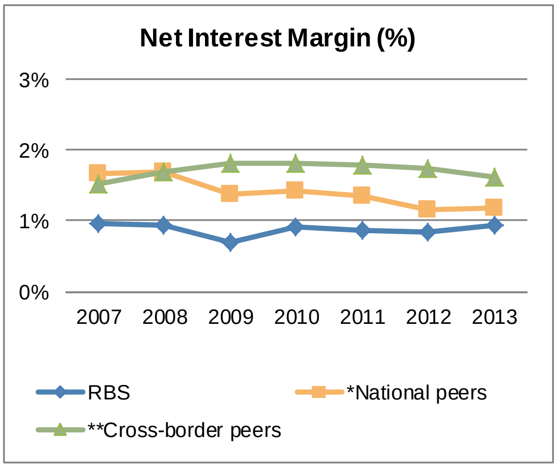

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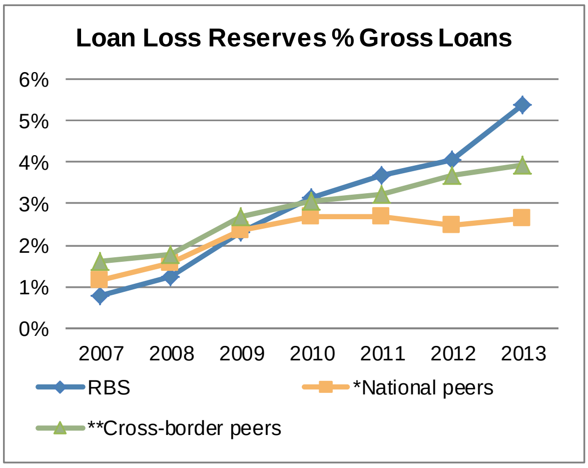

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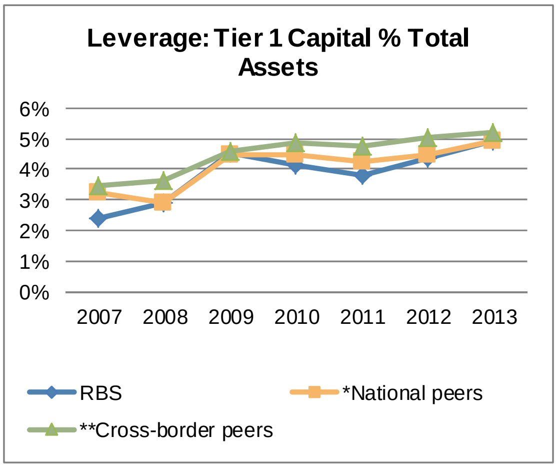

Source: SNL Financial, Scope Ratings

*National peers: Barclays, HSBC, Lloyds, RBS

**Cross-border peers based on business model : Santander, BBVA, Unicredit, RBS, Erste Bank, RZB AG, Commerzbank, Nordea, KBC, Danske Bank, ING Bank.

Notes: Cross-border peer group averages exclude RZB in 2013

Selected Financial Information - RBS Group plc

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Balance Sheet summary (GBP billion)									
Assets									
Cash and balances with central banks	17.9	12.4	52.3	57.0	79.3	79.3	82.7	94.2	115.2
Interbank assets	219.5	138.2	91.8	100.5	83.3	64.0	54.1	48.7	43.8
Total securities	364.3	311.7	300.2	251.3	232.0	178.4	128.0	115.8	110.3
of which debt instruments	294.7	267.5	267.3	217.5	209.1	157.4	113.6	102.2	97.1
of which equity instruments	53.0	26.3	19.5	22.2	15.2	15.2	8.8	7.9	7.5
Derivatives	277.4	992.6	441.5	427.1	529.6	441.9	288.0	270.8	257.4
Gross customer loans	833.4	880.8	736.7	578.6	536.3	521.4	465.9	443.9	423.0
of which impaired loans	11.0	19.6	36.0	36.2	42.4	41.1	39.4	37.4	35.6
Total funded assets	1,568.8	1,430.3	1,272.3	1,029.6	982.9	878.0	742.4	714.0	703.6
Total Assets	**1,840.8**	**2,401.7**	**1,696.5**	**1,453.6**	**1,506.9**	**1,312.3**	**1,027.9**	**982.5**	**958.8**
Liabilities									
Interbank liabilities	312.3	258.0	142.1	98.8	108.8	101.4	64.0	57.6	51.8
Senior debt	274.2	300.3	267.6	218.4	162.6	94.6	67.8	67.8	67.8
Derivatives	272.1	971.4	424.1	424.0	524.0	434.3	285.5	268.5	255.2
Customer deposits	682.4	639.5	614.2	510.7	503.0	521.3	470.9	447.3	442.9
Subordinated debt + hybrid securities	38.0	49.2	37.7	27.1	26.3	26.8	24.0	25.9	25.9
Total Liabilities	**1,749.4**	**2,321.2**	**1,601.9**	**1,376.7**	**1,430.8**	**1,241.8**	**968.7**	**923.6**	**900.1**
Ordinary equity	44.7	45.5	69.9	70.4	70.1	63.4	53.5	53.1	53.0
Minority interests	38.4	21.6	16.9	1.7	0.7	1.8	0.5	0.5	0.5
Total Liabilities and Equity	**1,840.8**	**2,401.7**	**1,696.5**	**1,453.6**	**1,506.9**	**1,312.3**	**1,027.9**	**982.5**	**958.8**
Core Tier 1 Capital [1]	*27.3*	*46.2*	*59.5*	*49.6*	*46.3*	*50.9*	*36.8*	*36.5*	*36.3*
Income Statement summary (GBP billion)									
Net interest income	12.1	18.7	13.4	13.8	12.3	11.4	11.0		
Net fee & commission income	6.1	7.4	5.9	6.3	5.4	4.9	4.5		
Net trading income	3.0	-8.9	7.8	5.0	5.3	0.1	3.3		
Operating Income	**24.9**	**20.3**	**28.8**	**26.0**	**24.4**	**17.4**	**19.4**	**17.6**	**16.6**
Operating expenses	13.9	21.6	17.1	17.5	17.3	17.8	18.2	14.7	13.7
Loan loss provision charges [2]	2.0	8.1	13.9	9.2	7.4	5.3	8.4	3.3	3.0
Non-recurring items	0.7	5.1	-0.2	-0.3	-0.7	0.4	0.5	0.0	0.0
Pre-Tax Profit	**9.8**	**-36.9**	**-2.8**	**-1.0**	**-1.0**	**-5.4**	**-8.1**	**-0.4**	**-0.2**
Income tax	2.0	-2.3	-0.4	0.7	1.1	0.4	0.4	-0.1	0.0
Net profit attributable to minority interests	0.4	-10.2	1.3	-0.5	0.0	-0.1	0.1	0.0	0.0
Net Income Attributable to Parent	**7.3**	**-24.3**	**-3.6**	**-1.1**	**-2.2**	**-5.8**	**-8.6**	**-0.3**	**-0.2**

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] CRD 4 basis from 2013 onwards.
[2] For 2008 and 2009, the figures include GBP 0.9bn and GBP 0.8bn, repsectively of impairments on financial assets.

Ratios - RBS Group plc

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Funding/Liquidity									
Gross loans % Total deposits	122.1%	137.7%	119.9%	113.3%	106.6%	100.0%	99.0%	99.2%	95.5%
Total deposits % Total funds	51.9%	50.7%	57.4%	59.4%	62.4%	69.6%	74.5%	74.1%	74.6%
Wholesale funds % Total funds	48.1%	49.3%	42.6%	40.6%	37.6%	30.4%	25.5%	25.9%	25.4%
Asset Mix, Quality and Growth									
Gross loans % Funded assets	52.8%	61.2%	57.2%	53.9%	52.5%	57.0%	59.4%	58.6%	56.5%
Impaired loans % Gross loans	1.3%	2.2%	4.9%	6.3%	7.9%	7.9%	8.5%	8.4%	8.4%
Loan loss reserves % Impaired loans	44.4%	30.9%	23.1%	64.5%	48.8%	51.7%	64.0%	67.4%	71.0%
Gross loan growth (%)	77.3%	5.7%	-16.4%	-21.5%	-7.3%	-2.8%	-10.6%	-4.7%	-4.7%
Impaired loan growth (%)	75.2%	77.8%	84.1%	0.4%	17.1%	-3.0%	-4.2%	-5.0%	-5.0%
Funded assets growth (%)	108.2%	-8.8%	-11.0%	-19.1%	-4.5%	-10.7%	-15.4%	-3.8%	-1.5%
Earnings									
Net interest income % Revenues	48.4%	91.9%	46.5%	52.9%	50.4%	65.7%	56.7%		
Fees & commissions % Revenues	24.4%	36.6%	20.7%	24.2%	22.2%	28.1%	23.3%		
Trading income % Revenues	11.9%	-43.7%	27.1%	19.3%	21.7%	0.8%	17.2%		
Other income % Revenues	15.3%	15.2%	5.7%	3.6%	5.7%	5.5%	2.8%		
Net interest margin (%)	1.2%	1.4%	1.1%	1.3%	1.4%	1.4%	1.5%		
Pre-provision Income % Risk-weighted assets (RWAs)	1.8%	-0.2%	2.2%	1.8%	1.6%	-0.1%	0.3%	0.7%	0.7%
Loan loss provision charges % Pre-provision income	17.9%	n.m.	118.6%	107.6%	104.1%	n.m.	699.8%	113.2%	106.5%
Loan loss provision charges % Gross loans (cost of risk)	0.3%	0.9%	1.7%	1.4%	1.4%	1.0%	1.8%	0.8%	0.7%
Cost income ratio (%)	55.9%	106.4%	59.3%	67.0%	70.7%	102.6%	93.8%	83.4%	82.8%
Net Interest Income / Loan loss charges (x)	6.1	2.3	1.0	1.5	1.7	2.2	1.3		
Return on average equity (ROAE) (%)	17.2%	-53.9%	-6.3%	-1.6%	-3.1%	-8.6%	-14.7%	-0.6%	-0.3%
Return on average funded assets (%)	0.4%	-1.1%	-0.2%	-0.1%	-0.1%	-0.4%	-0.7%	0.0%	0.0%
Retained earnings % Prior year's book equity	12.4%	-54.4%	-7.9%	-1.6%	-3.1%	-8.2%	-13.6%	-0.6%	-0.3%
Pre-tax return on common equity tier 1 capital	35.7%	-79.8%	-4.6%	-1.9%	-2.3%	-10.7%	-22.0%	-1.1%	-0.5%
Capital and Risk Protection [1]									
Common equity tier 1 ratio (common equity tier 1 capital % RWAs)	4.5%	6.6%	11.0%	10.7%	10.6%	10.3%	8.6%	8.9%	9.1%
Tier 1 leverage ratio (%)	2.4%	2.9%	4.5%	4.1%	3.8%	4.4%	4.9%		
Median of tier 1 leverage ratio and common equity tier 1 ratio (%)	3.5%	4.8%	7.8%	7.4%	7.2%	7.3%	6.8%		
Total loss coverage (CET 1 capital + loan loss provisions) % RWAs	5.3%	7.5%	12.5%	15.7%	15.3%	15.7%	14.5%	15.0%	15.4%
Non-senior bailinable debt cushion (as % of total liabilities)	2.6%	2.7%	2.8%	2.3%	2.2%	2.6%	3.0%	3.4%	3.4%
Asset risk intensity (RWAs % total assets)	33.1%	29.0%	31.9%	32.0%	29.1%	35.0%	37.5%	41.7%	41.7%

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] CRD 4 basis from 2013 onwards

METHODOLOGIES USED FOR THIS REPORT

For the rating and analysis contents of this report Scope has used the following methodologies which were published on www.scoperatings.com:

"Bank Rating Methodology" (February 2014)

"Forecasting Bank Financials Methodology" (February 2014)

Forecasting bank financials: Forward-looking estimates are an important analytical tool underpinning Scope's bank ratings. These forecasts cover the current financial year (before final year-end figures are published by the bank) plus the forthcoming two years. Depending on the complexity of the bank being assessed, different forecasting tools will be used. For a majority of banks operating primarily commercial and retail banking franchises (loans and deposits) the analysis is underpinned by an **accounting** forecast of the balance sheet and profit and loss account. For more complex groups with multiple ranges of activities – notably those with material wholesale and investment banking operations – Scope uses an **analytical** forecast, relying on the bank's business-line reporting to come up with plausible estimates. For all banks Scope also include a **regulatory metrics** forecast, considering the growing importance of this aspect in bank analysis.

For complex banks, divisional data is used to forecast profit and loss accounts and basic divisional balance sheet metrics. For less complex banks, a line-by-line forecasting of major P&L elements is forecast.

For balance-sheet forecasts, Scope estimates of all major balance sheet lines, using the P&L estimates to complete the forecast of the capital/shareholders' equity line. This comprehensive methodology for estimating the balance sheet is used for all the banks in our universe, irrespective of size and complexity.

Lastly, our forecasts include assessments of the major regulatory metrics: Tier 1 and CET 1 (historically CT1), Leverage, Liquidity Coverage Ratio, and Net Stable Funding Ratio (the latter two when and if sufficient public information to compute them is available).

Scope will not aim to forecast financials when it considers the public disclosure of the bank as insufficient for a transparent and credible outcome.

All Scope's bank financial forecasts are based on public information. For its forecasts Scope will not use any non-public information or data, even if such information or data were provided by rated banks. Scope's forecasting process is transparent, with a detailed roadmap provided in its *"Forecasting bank financials"* methodology.

Société Générale SA
Issuer Rating Report

A STABLE OUTLOOK
Financial Institutions

Overview

Scope Ratings assigns an Issuer Credit-Strength Rating (ICSR) of A to Société Générale SA (SocGen), with a stable outlook. This rating reflects the considerable efforts undertaken by the bank to comply with the Basel 3 capital regulations, considering that SocGen's pre-crisis capitalization levels had been lower than its peers. It also reflects the strong retail franchises of Société Générale, both in France and in Central & Eastern Europe (CEE), and its solid position in the global equity derivatives business. However, the rating also incorporates what we perceive as a dent in the bank's revenue base resulting from the recent deleveraging.

The A rating applies to senior unsecured debt issued by Société Générale SA. However, the rating does not apply to unguaranteed debt issued by subsidiaries of Société Générale SA.

Ratings (assigned on April 2, 2014)

Issuer Credit-Strength Rating	**A**
Outlook	Stable
Senior Unsecured Debt	A

Unsolicited ratings with issuer participation.

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Rating drivers (Summary)

The rating drivers, in decreasing order of importance in the rating assignment, are:

- (+) A reliable management team, which proved its mettle during the crisis but had already shown its efficiency in developing high-growth businesses. This dual ability to perform well in favorable as well as unfavorable markets is a competitive advantage in the European banking sector.
- (+) A very substantial de-risking and capital build-up effort.
- (−) The ongoing crisis has challenged SocGen's traditional business model based on leadership positions in high-growth markets such as Central and Eastern Europe, supported by a very stable domestic retail business in France. The performance of some of the bank's franchises has disappointed and, in our view, it will be some time before SocGen can rebuild its revenue base to its full potential.
- (+) The bank has successfully overhauled its balance sheet structure in the last five years, making it much more liquid and less reliant on short-term wholesale funding.
- (−) The risk-asset intensity of SocGen (i.e. its ratio of risk-weighted assets to assets) remains low by international standards, raising questions about the modeling of the bank's IRB risk-weighting.

Rating change drivers

The capacity of SocGen to recover lost revenues in some of the bank's key differentiating franchises (financing & advisory, international retail banking and, to a lesser extent, equity derivatives) will be closely monitored by Scope and could lead to positive rating changes.

SocGen has successfully built-up its Basel 3 CET1 ratio to roughly 10%, and management intends to run the bank at this level of capital. However, both Crédit Agricole and BPCE in France have clearly expressed 12-13% targets. Assuming management feels compelled to raise the bank's capital to this level, the impact would be positive on the credit ratings – unless this increase required further deleveraging that would be detrimental to the bank's franchise.

Recent events

SocGen reported remarkably resilient Q4 2013 results. In particular, the domestic retail banking division reported a record quarter in revenue terms, while solid equity revenues supported the profitability of the Global Markets division. Looking at 2013 as a whole, the loan loss charges at group level stabilized at EUR 3.652bn (excluding litigation provisions). The cost of risks stood at 1.09%, still a high level for SocGen over the cycle.

In March 2014, SocGen announced its decision to sell its private banking activities in Asia to DBS for a cash consideration of USD 220m. The transaction also includes a partnership agreement with DBS whereby SocGen's clients will gain access to DBS's private banking offering in Asia. Reciprocally, DBS's clients will gain access to SocGen's private banking and corporate and investment banking offerings in Europe.

Following the signature of a concerting shareholders' agreement with Caixa Group, SocGen also recently announced its intention to buy out the minority shareholders (other than Caixa Group) of Boursorama, its online bank present in France, Spain, Germany and the United Kingdom.

However, the most important recent event, in our view, was the announcement by SocGen last November that it was considering the full acquisition of Newedge, its current 50/50 joint-venture in derivatives brokerage with Crédit Agricole. SocGen agreed to pay Crédit Agricole EUR 275mn in cash as well as 5% of SocGen's stake in Amundi. This acquisition, if successfully completed, would enable SocGen to have a privileged, integrated position in the derivatives value chain, from execution to clearing to custody. This would give the group a clear competitive advantage in a regulatory environment in which regulators are encouraging banks to switch from OTC derivatives to centralized clearing platforms as much as possible.

The three transactions described above (together with the bank's minority stake in Amundi) show that SocGen, while making arbitrages in its portfolio of assets (sale of Asian Private Banking, reinforcement in online retail banking), is ultimately choosing partnerships to operate in several businesses. For example, SocGen has decided to outsource its asset management and its Asian private banking offerings, while maintaining a minority stake in Amundi and a partnership with DBS. On the other hand, it has decided to take the lead in OTC clearing through the considered acquisition of Newedge, and in online retail banking through the buy out of Boursorama's minorities, excluding Caixa Group, which still owns 21% of the capital of the company.

This partnership strategy enables the bank to maintain a presence in a vast combination of markets while focusing its financial resources on a more limited amount of essential businesses, thus optimizing its capital allocation.

Rating drivers (Details)

1. A reliable management team

Over the last six years, SocGen's management team successfully handled:

- The Kerviel fraud (EUR 4.9bn loss) in January 2008 during which the bank liquidated all the positions and underwrote a EUR 5.5bn capital increase before making the fraud public;
- Losses and mark-downs from assets repatriated to SocGen's balance sheet by clients of the Asset Management division in 2007-2008 (EUR 4.7bn estimated). This was one reason why the bank reduced its position in Asset Management. The other was a lack of critical mass, an issue solved by the creation of Amundi, which includes the assets of Société Générale Asset Management (SGAM) and enables the bank to maintain a minority stake in this business without bearing the cost of a full infrastructure. To this day, SocGen only owns a 25%, equity-accounted stake in Amundi, which is likely to be brought down to 20% once the Newedge transaction is completed (see above);
- Losses and mark-downs from legacy assets (estimated cumulative losses of EUR 10.6bn at September 30, 2013). From 2011 onwards, SocGen stepped up the reduction of the legacy assets portfolio through a very aggressive strategy of assets disposals, restructuring and natural run-off. As of year-end 2013, the net losses on the legacy asset portfolio were a modest EUR 210m. The bank believes that the portfolio will not generate any negative contribution from 2014 onwards.
- Aggressive deleveraging and asset disposals between 2011 and 2013 to enable the bank to meet Basel 3 regulatory standards (the object of the second rating driver).

Overall we believe that without a strong management team SocGen might have fared worse in the face of so many hurdles. Over the last six years, the bank has shown an adequate mix of composure and a sense of urgency where needed. This may serve the bank well as it gathers its forces to rebuild its franchise and re-launch its growth strategy.

2. An uncompromising deleveraging and capital build-up effort

SocGen had to resolutely change its strategy in the autumn of 2011 following (1) the implementation of tighter Basel 3 capital rules; (2) strains on liquidity following the withdrawal of US money-market funds from the French banking sector, and (3) the impact of the euro area crisis on market sentiment regarding European banks. These factors led SocGen to drop the growth strategy announced in 2010 and launch a complete overhaul of its balance sheet management. This included building up an imposing liquidity buffer of EUR 174bn, which covers 140% of the short-term funding needs of the bank as of year-end 2013, and securing Liquidity Coverage Ratio (LCR) levels that are above 100%. The legacy assets portfolio was disposed of more aggressively from 2011 onwards: after standing at an overall book value of around EUR 37bn in 2009, the portfolio is now worth EUR 5.1bn (after provisions and impairments), of which only EUR 0.7bn are non-investment grade. Furthermore, SocGen sold off significant parts of its corporate and investment banking loan portfolio from June 2011 to December 2012: a total of EUR 16bn of assets, for recorded losses on disposals of EUR 652m. It also began disposing of some subsidiaries. The sale of asset manager TCW to Carlyle Group was announced on August 2012, contributing 13bps of supplementary CET 1. This was followed by the sale of the Greek subsidiary Geniki to Piraeus Group for EUR 1m. The sale of these two assets was positive as they were non-strategic.

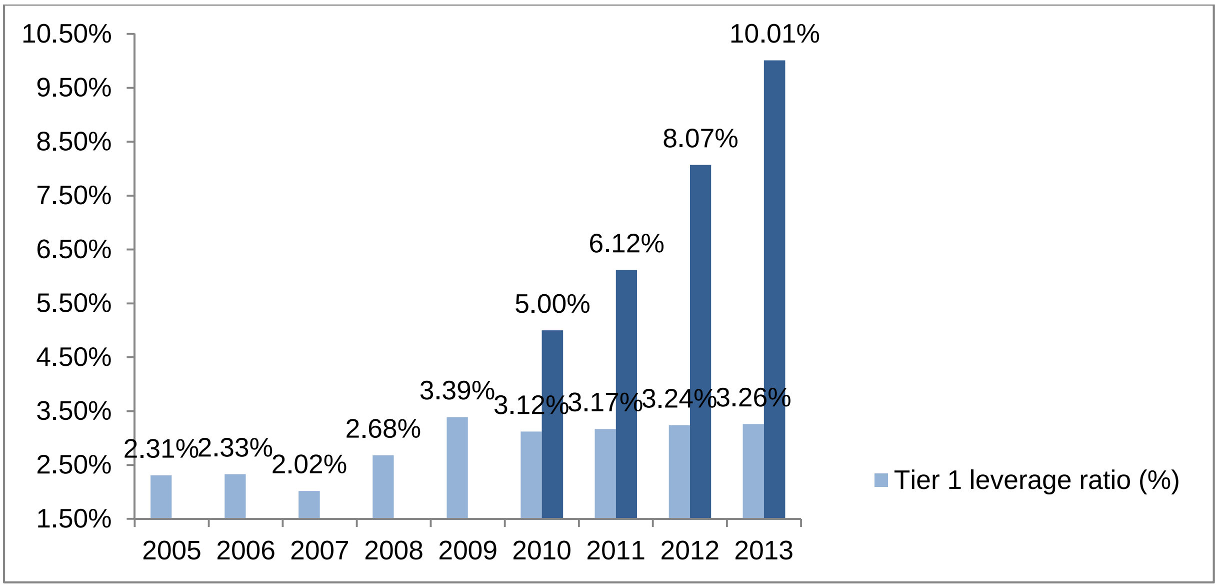
Less straightforward, in our view, was the disposal of National Société Générale Bank (NSGB), the bank's flagship in Egypt and one of the main contributors to the International retail division (after Komercni Banka), with reported net profits of close to EUR 187m at year-end 2012. At least the disposal was made at a good price, as SocGen sold NSGB for 2x book value and close to USD 2bn, a capital gain of EUR 350m and a positive impact on the Basel 3 CET1 ratio of 30bps.

The overall results of these transactions can be seen in Chart 1.

The bank did manage to accelerate its Basel 3 CET1 accumulation by a sizeable 500bps (on our estimates) in three years, of which close to 200bps in 2012 and in 2013. The Basel 3 CET1 of SocGen stood at 10.01% at year-end 2013, in line with its target.

The other section of the chart is dedicated to the leverage ratio of the bank, i.e. Tier 1 capital as a percentage of total IFRS assets (with standard switching from Basel 2.5 to Basel 3 in 2013).

Chart 1: Capital position of Société Générale 2005-2013 (in %)



Source: Scope Ratings estimates, SNL, Company data

3. The rapid transformation of the bank had some negative impact on its revenues

One of the key drivers of SocGen's rating is our belief that the uninterrupted crisis environment experienced by SocGen between 2008 and 2012 (with the notable exception of 2010) may have taken its toll on some of the key franchises of the bank. On Table 1 we have attempted to assess more thoroughly the damage by looking at the yearly revenue growth (expressed in EUR million) of the main divisions of the bank. We have restated the revenues to exclude non-recurring items such as gains/losses on own credit and the losses on sales of the corporate loan book between 2011 and 2012. We have also restated CVA/DVA adjustments. However we have not restated legacy mark-downs, or the lost revenues from deleveraging, which are both parts of the day-to-day business of the bank, in our view.

As a result, some revenue metrics are materially different from what the bank is disclosing.

Table 1: Divisional annual revenue growth at Société Générale between 2006 and 2013 (EUR m)

	2006	2007	2008	2009	2010	2011	2012	2013
Domestic Retail Banking	538	189	389	55	325	374	-4	74
Int'l Retail & Spec FinServ.	792	984	1,891	-141	420	-97	-112	-486
Asset Mgt, PB, SS	611	381	-731	-311	-207	-158	-9	-115
CIB - Financing & Advisory	71	300	-48	699	234	-266	-407	-298
CIB - Fixed Income	494	-3,219	2,758	2,116	-1,452	-693	1,028	-526
CIB - Equities	598	465	-2,402	2,319	-965	-87	-294	397
CIB - Legacy Portfolio	0	0	-3,333	513	2,891	-547	208	418
Insurance	32	108	-39	-5	61	88	84	66
Other	41	-407	2,502	-5,381	3,047	-76	-567	317
Underlying revenues	3,177	-1,199	987	-136	4,354	-1,462	-73	-153
Excl. Legacy portfolio	3,177	-1,199	4,320	-649	1,463	-915	-281	-571

Source: Company data, Scope Ratings estimates

We can draw several conclusions from the table. First, SocGen significantly restated its international retail business by including the consumer finance product engine (essentially servicing foreign markets). This has the consequence of including mature markets in the international retail banking division and therefore making long-term comparisons difficult. As a result, we opted to “merge” the international retail banking division with the specialized financial services division, so as to find a comparable ground for both divisions.

The second major conclusion is that some businesses that formerly enjoyed rapid growth were hurt by the crisis and the ensuing deleveraging. This is the case for the “Financing & Advisory” division due to the sale of the corporate loan book mentioned above, but also for the equities business; despite a significant recovery in 2013, the division is still far from its peak revenues of EUR 3-3.5bn annually. The international business, for its part, has been penalized by the sale of NSGB. We note that after years of stable growth, the French retail business has plateaued, while at group level the revenue picture is somewhat flattered by the shrinking marks on the legacy portfolio.

The third conclusion is that the vast majority of revenue growth for 2008, 2009 and 2012 can largely be attributed to the FICC business. Low interest rates and the ECB's help are probably responsible for this fact as SocGen has never been, in our opinion, a major fixed income franchise, but we are surprised by the extreme volatility of this business – as can be seen in the table. Lastly, after having been a major drag on the company's revenue growth, the legacy portfolio has more recently contributed positively to SocGen's income, even if this is bound to disappear as this portfolio has now diminished to quasi-insignificant levels.

The fourth and last conclusion is that SocGen is putting more emphasis on the profitability of its different businesses, and revenues are only one part of the equation. SocGen has moved its strategy towards optimizing client satisfaction, and the bank has announced a new cost savings program of EUR 900m, following on the EUR 550m achieved in 2012. There are therefore more variables to be considered than just revenues.

4. Overhaul of the balance sheet structure

One of SocGen's major successes in the last five years has been its ability to materially de-risk its balance sheet and increase liquidity. Table 2 compares the funded balance sheets (i.e. the balance sheet excluding insurance and netting of derivatives, repos and accruals) of the bank in 2007 and 2013.

In absolute terms, total assets have not materially changed (going from EUR 660bn to EUR 641bn – a CAGR of less than -1%) but the overall composition is significantly different.

In 2007, SocGen was a very aggressively funded bank: about EUR 55bn of the loan book was funded by short-term wholesale funds and the remaining EUR 53bn of short-term funding supported a sizeable trading assets portfolio of EUR 210bn.

The interbank position of SocGen was as net debtor (by more than EUR 70bn), and the bank had just EUR 8bn in cash and very little equity.

The 2013 balance sheet in Table 2 shows how successful SocGen has been in terming out its funding. Short-term wholesale funding decreased by more than EUR 60bn versus 2007, while long-term debt increased by EUR 46bn. The interbank positions have been drastically reduced and, even if SocGen is still a net interbank debtor, the net position in 2013 (EUR -20bn) bears no resemblance to the 2007 position (EUR -71bn). At the same time, the shareholders' equity of the bank almost doubled while its cash balances have increased nearly eight-fold.

All in all, the loan-to-deposit ratio of the bank improved 10 percentage points from 120% to 110% between 2007 and 2013. The bank is now much more liquid, and its funding is far more balanced towards long-term debt and deposits.

Table 2: Funded balance sheet Société Générale 2007 & 2013 (EUR bn)

	2007	2013
Cash & central banks	8	63
Due to banks	51	45
Trading assets	210	85
Securities	44	59
Customer loans	332	354
Long-Term & fixed assets	15	35
TOTAL ASSETS	**660**	**641**

ST wholesale funding	118	56
Due from banks	122	65
Other liabilities	20	9
LT wholesale funding (> 1 year)	91	137
Customer deposits	277	322
Shareholders' equity	32	52
TOTAL LIABILITIES + SHAREHOLDERS EQUITY	**660**	**641**

Source: Company data

5. Low risk-weighted asset intensity

Amongst its global peers, French banks post among the lowest risk-weighted intensity in the sector. In other words, the proportion of risk-weighted assets to assets remains low versus international peers. Within the French banking sector though, SocGen strikes us as the one where the RWA % assets ratio has declined steadily: from around 30% (under Basel 2 between 2005 and 2011) to 25% since the introduction of Basel 2.5. Investors have shown some concern about the degree to which model changes have underpinned the fall in the French bank's risk intensity.

When restated for the accounting differences between IFRS and US GAAP (as enabled by IFRS 7), SocGen's RWA intensity increases to 35%, still a comparatively low level versus peers.

In the case of SocGen, the bank has made clear that its credit weightings under IRB have remained stable overall during the last five years. Looking at the bank's Pillar 3 report, one can see that the small increases in corporate and financial institutions' weights (43% and 15% respectively as of December 31, 2012) are due to rating migrations. Moreover, the total home loan risk weight is close to 15%. Sovereign weighting remains low, at about 5%.

Overall, we will carefully monitor the evolution of the risk-weighted assets-to-assets ratio in future. Considering its current level, we do not expect it to materially fall further.

Peer Comparison

At Scope Ratings, we compare banks within peer groups at domestic and cross-border level.

In its domestic market, Société Générale is comparable to BNP Paribas, Crédit Agricole Group, BPCE and Crédit Mutuel Group.

Looking at the performance of SocGen versus domestic peers, it is interesting to note that on many metrics the five rated banks show very similar rankings. This is particularly the case of liquidity metrics, since the loan-to-deposits ratio of all French banks is comprised between 110% and 130%. Société Générale has strongly improved this metric over the years and appears among the best positioned, even if the weight of wholesale funds to total funds remains higher than domestic peers.

In asset quality terms, French banks are clearly divided between domestically-biased and internationally-biased banks. The internationally-biased banks (SocGen and BNPP) post higher impaired loans-to-total loans ratios, but the coverage ratios are homogenous.

It is only in profitability terms that French banks can properly be differentiated, and this is where SocGen has the biggest room for improvement. Loan loss charges have remained high over the years due to the credit costs of the international retail portfolio. The cost-income ratio has also been at the upper end of the peer group, resulting in disappointing return metrics and therefore lower internal capital generation than peers in times of intense deleveraging.

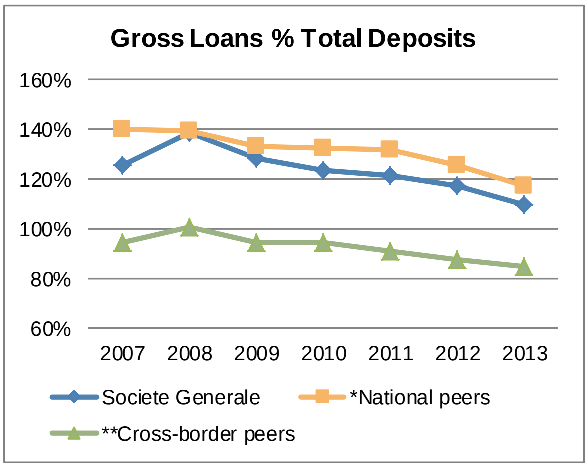
The story is a bit different at cross-border level. Outside France, we have positioned SocGen in the bucket of large universal banks operating in a variety of markets and geographies. This peer group includes HSBC, Barclays, Deutsche, UBS, Credit Suisse, Citigroup, Bank of America, JP Morgan as well as BNP Paribas.

Within its peer group, SocGen has an acceptable position. SocGen's only relative weakness is the loan-to-deposit ratio, where the two large French banks post the worst metrics. We nonetheless note that SocGen's reported loans-to-deposits ratio has improved by almost 30 percentage points between 2008 and 2013, declining from 138% to 110% - quite an achievement in our opinion.

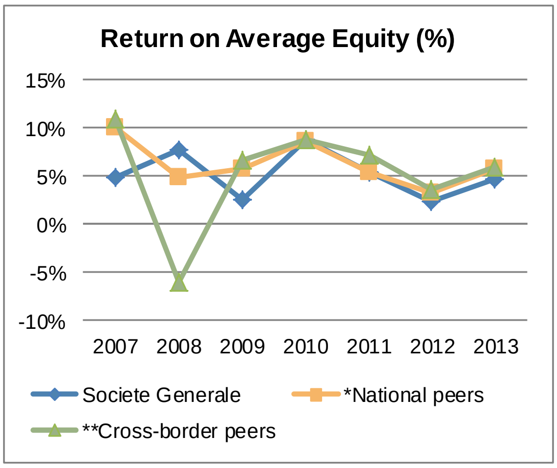
Following six very difficult crisis years and a comprehensive restructuring effort, SocGen is starting 2014 on the front foot, in our view.

The bank's major challenge will be to recover some of the lost revenue ground in selected areas of its business model.

Peer Comparison - Societe Generale group



Source: SNL Financial, Scope Ratings



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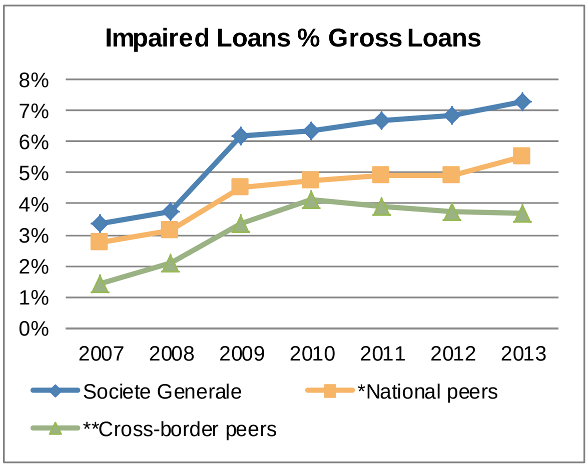

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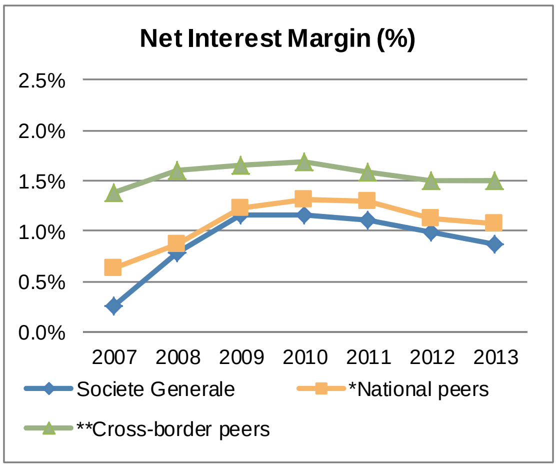

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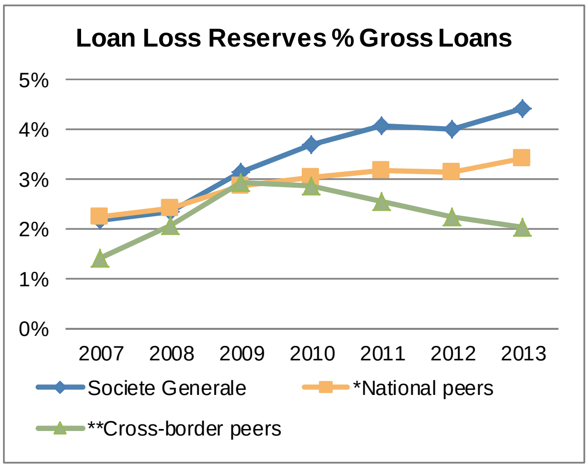

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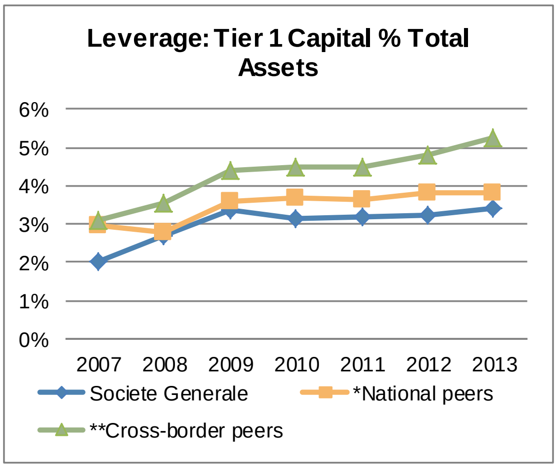

Source: SNL Financial, Scope Ratings

*National peers: BNP Paribas, Credit Agricole Group, Credit Mutuel Group, Groupe BCPE, Societe Generale
**Cross-border peers: Bank of America Corp, Barclays, BNP Paribas, Citigroup Inc, Credit Suisse, Deutsche Bank, HSBC, JP Morgan Chase, Societe Generale, UBS

Selected Financial Information - Societe Generale group

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Balance Sheet summary (EUR billion)									
Assets									
Cash and balances with central banks	11.3	13.7	14.4	14.1	44.0	67.6	66.6	82.5	113.0
Interbank assets	73.1	71.2	67.7	70.3	86.4	77.2	84.8	84.8	84.8
Total securities	429.8	260.5	315.5	370.1	307.0	394.8	457.3	457.0	467.8
of which debt instruments	240.2	157.0	162.4	174.5	170.8	185.9	208.1	197.7	197.7
of which equity instruments	127.3	67.9	101.7	109.2	60.9	99.5	144.5	154.7	165.5
Derivatives	153.1	320.3	185.3	201.3	257.7	238.5	177.2	177.4	180.6
Gross customer loans	339.4	392.1	385.6	416.3	413.6	394.8	378.0	378.0	381.6
of which impaired loans	11.4	14.7	23.7	26.4	27.7	26.9	27.6	27.0	26.5
Total funded assets	910.2	819.3	839.0	926.7	925.0	1,014.3	1,055.7	1,069.8	1,113.5
Total Assets	**1,071.8**	**1,130.0**	**1,023.7**	**1,132.1**	**1,181.4**	**1,250.9**	**1,235.3**	**1,249.6**	**1,296.6**
Liabilities									
Interbank liabilities	134.9	121.8	92.6	80.1	112.2	124.4	94.7	94.7	94.7
Senior debt	253.2	185.8	214.9	235.7	189.0	243.0	287.3	287.3	316.0
Derivatives	161.5	310.7	184.7	205.3	256.4	236.6	179.6	179.8	183.1
Customer deposits	270.7	282.5	300.1	337.4	340.2	337.2	344.7	351.6	358.6
Subordinated debt + hybrid securities	11.5	13.9	12.6	12.0	10.5	7.1	7.4	6.7	6.0
Total Liabilities	**1,040.5**	**1,089.1**	**976.9**	**1,081.1**	**1,130.3**	**1,197.3**	**1,181.2**	**1,194.0**	**1,239.4**
Ordinary equity	19.9	25.7	34.8	39.1	40.8	42.5	43.9	45.4	47.1
Minority interests		4.8	4.6	4.6	4.0	4.3	3.1	3.1	3.1
Total Liabilities and Equity	**1,071.8**	**1,130.0**	**1,023.7**	**1,132.1**	**1,181.4**	**1,250.9**	**1,235.3**	**1,249.6**	**1,296.6**
Core Tier 1 Capital [1]	*20.2*	*22.8*	*26.9*	*27.8*	*29.2*	*29.9*	*34.3*	*35.8*	*37.4*
Income Statement summary (EUR billion)									
Net interest income	2.5	7.9	11.6	12.0	12.2	11.3	10.1		
Net fee & commission income	7.5	7.4	7.8	7.5	7.2	7.0	6.5		
Net trading income	10.4	5.5	2.7	5.6	4.7	3.4	4.1		
Operating Income	**22.1**	**22.6**	**23.5**	**26.8**	**26.0**	**23.5**	**23.0**	**23.7**	**24.3**
Operating expenses	14.3	15.5	15.7	16.5	17.0	16.4	16.4	16.3	16.7
Loan loss provision charges	1.0	3.4	7.7	4.4	3.7	4.1	2.4	3.3	3.0
Non-recurring items	-4.9	0.6	0.7	0.0	-0.9	-0.5	-1.1	0.1	0.1
Pre-Tax Profit	**1.9**	**4.0**	**0.8**	**5.8**	**4.1**	**1.6**	**3.1**	**4.1**	**4.6**
Income tax	0.3	1.2	-0.3	1.5	1.3	0.3	0.5	1.1	1.4
Net profit attributable to minority interests	0.7	0.8	0.4	0.4	0.4	0.4	0.4	0.5	0.5
Net Income Attributable to Parent	**0.9**	**2.0**	**0.7**	**3.9**	**2.4**	**0.8**	**2.2**	**2.5**	**2.7**

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] CRD 4 basis from 2011 onwards

Ratios - Societe Generale group

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Funding/Liquidity									
Gross loans % Total deposits	125.4%	138.8%	128.5%	123.4%	121.6%	117.1%	109.7%	107.5%	106.4%
Total deposits % Total funds	40.0%	46.0%	47.8%	50.2%	51.7%	46.9%	46.5%	47.0%	45.8%
Wholesale funds % Total funds	60.0%	54.0%	52.2%	49.8%	48.3%	53.1%	53.5%	53.0%	54.2%
Asset Mix, Quality and Growth									
Gross loans % Funded assets	37.3%	47.9%	46.0%	44.9%	44.7%	38.9%	35.8%	35.3%	34.3%
Impaired loans % Gross loans	3.3%	3.7%	6.2%	6.3%	6.7%	6.8%	7.3%	7.1%	6.9%
Loan loss reserves % Impaired loans	63.1%	60.8%	51.2%	57.9%	60.5%	58.8%	60.6%	61.9%	63.1%
Gross loan growth (%)	14.7%	15.5%	-1.7%	8.0%	-0.7%	-4.5%	-4.3%	0.0%	1.0%
Impaired loan growth (%)	16.2%	29.1%	61.8%	11.3%	4.9%	-2.8%	2.4%	-2.0%	-2.0%
Funded assets growth (%)	9.5%	-10.0%	2.4%	10.5%	-0.2%	9.7%	4.1%	1.3%	4.1%
Earnings									
Net interest income % Revenues	11.3%	35.2%	49.4%	44.7%	46.9%	48.2%			
Fees & commissions % Revenues	34.1%	32.8%	33.2%	28.0%	27.6%	29.7%			
Trading income % Revenues	47.0%	24.4%	11.7%	20.9%	18.2%	14.5%			
Other income % Revenues	7.6%	7.6%	5.7%	6.4%	7.3%	7.6%			
Net interest margin (%)	0.4%	1.2%	1.9%	1.9%	1.8%	1.6%			
Pre-provision Income % Risk-weighted assets (RWAs)	2.4%	2.1%	2.4%	3.1%	2.6%	2.2%	2.1%	2.1%	2.1%
Loan loss provision charges % Pre-provision income	13.2%	47.9%	97.1%	42.9%	41.7%	58.4%	36.0%	44.5%	39.6%
Loan loss provision charges % Gross loans (cost of risk)	0.3%	0.9%	2.0%	1.1%	0.9%	1.1%	0.6%	0.9%	0.8%
Cost income ratio (%)	64.7%	68.6%	66.6%	61.8%	65.5%	70.0%	71.2%	68.7%	68.6%
Net Interest Income / Loan loss charges (x)	2.4	2.3	1.5	2.7	3.3	2.8			
Return on average equity (ROAE) (%)	4.3%	8.8%	2.2%	10.6%	6.0%	1.9%	5.0%	5.6%	5.8%
Return on average funded assets (%)	0.1%	0.2%	0.1%	0.3%	0.2%	0.1%	0.1%	0.2%	0.2%
Retained earnings % Prior year's book equity	2.2%	6.6%	1.9%	10.1%	6.1%	1.6%	3.3%	3.4%	3.6%
Pre-tax return on common equity tier 1 capital	9.3%	17.6%	3.0%	21.0%	14.1%	5.2%	8.9%	11.5%	12.3%
Capital and Risk Protection [1]									
Common equity tier 1 ratio (common equity tier 1 capital % RWAs)	6.2%	6.6%	8.3%	8.3%	6.1%	8.1%	10.0%	10.3%	10.4%
Tier 1 leverage ratio (%)	2.0%	2.7%	3.4%	3.1%	3.2%	3.2%	3.3%		
Median of tier 1 leverage ratio and common equity tier 1 ratio (%)	4.1%	4.6%	5.8%	5.7%	4.6%	5.7%	6.6%		
Total loss coverage (CET 1 capital + loan loss provisions) % RWAs	8.4%	9.2%	12.0%	12.9%	13.2%	14.1%	16.2%	16.2%	15.2%
Non-senior bailinable debt cushion (as % of total liabilities)	1.8%	2.2%	2.0%	1.8%	1.5%	1.1%	1.2%	1.1%	1.0%
Asset risk intensity (RWAs % total assets)	30.5%	30.6%	31.7%	29.6%	29.5%	25.9%	25.5%	27.7%	27.7%

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] CRD 4 basis from 2011 onwards

METHODOLOGIES USED FOR THIS REPORT

For the rating and analysis contents of this report Scope has used the following methodologies which were published on www.scoperatings.com:

"Bank Rating Methodology" (February 2014)

"Forecasting Bank Financials Methodology" (February 2014)

Forecasting bank financials: Forward-looking estimates are an important analytical tool underpinning Scope's bank ratings. These forecasts cover the current financial year (before final year-end figures are published by the bank) plus the forthcoming two years. Depending on the complexity of the bank being assessed, different forecasting tools will be used. For a majority of banks operating primarily commercial and retail banking franchises (loans and deposits) the analysis is underpinned by an **accounting** forecast of the balance sheet and profit and loss account. For more complex groups with multiple ranges of activities – notably those with material wholesale and investment banking operations – Scope uses an **analytical** forecast, relying on the bank's business-line reporting to come up with plausible estimates. For all banks Scope also include a **regulatory metrics** forecast, considering the growing importance of this aspect in bank analysis.

For complex banks, divisional data is used to forecast profit and loss accounts and basic divisional balance sheet metrics. For less complex banks, a line-by-line forecasting of major P&L elements is forecast.

For balance-sheet forecasts, Scope estimates of all major balance sheet lines, using the P&L estimates to complete the forecast of the capital/shareholders' equity line. This comprehensive methodology for estimating the balance sheet is used for all the banks in our universe, irrespective of size and complexity.

Lastly, our forecasts include assessments of the major regulatory metrics: Tier 1 and CET 1 (historically CT1), Leverage, Liquidity Coverage Ratio, and Net Stable Funding Ratio (the latter two when and if sufficient public information to compute them is available).

Scope will not aim to forecast financials when it considers the public disclosure of the bank as insufficient for a transparent and credible outcome.

All Scope's bank financial forecasts are based on public information. For its forecasts Scope will not use any non-public information or data, even if such information or data were provided by rated banks. Scope's forecasting process is transparent, with a detailed roadmap provided in its *"Forecasting bank financials"* methodology.

UBS AG
Issuer Rating Report

A STABLE OUTLOOK
Financial Institutions

Overview

Scope Ratings assigns an Issuer Credit-Strength Rating (ICSR) of A to UBS AG with a stable outlook. This rating reflects the significant downsizing of the bank during the crisis and good relative levels of underlying profitability from core franchises over the past five years. At the same time, the rating reflects the uncertain outcome of several high-profile litigation cases as well as the lack of clarity attached to the de-risking of the investment bank (IB).

The A rating applies to senior unsecured debt issued by UBS AG. However, the rating is not applicable to unguaranteed debt issued by subsidiaries of UBS AG.

Ratings (assigned on April 2, 2014)

Issuer Credit-Strength Rating	**A**
Outlook	Stable
Senior Unsecured Debt	A

Unsolicited ratings with issuer participation.

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Rating drivers (Summary)

The rating drivers, in decreasing order of importance in the rating assignment, are:

- (+) The bank has reduced its overall size by more than half since the crisis while increasing its tangible equity by more than 85%.
- (−) High-profile litigation cases and operational incidents have occurred since 2011 and raise uncertainties concerning UBS's ability to close the book on the crisis years.
- (+) UBS's Private Banking franchise has contributed to the resilience of the bank's earnings.
- (+) Despite a very momentous history since 2007, the relative profitability of UBS's assets (both on and off balance sheet) has remained consistent with pre-crisis levels.
- (−) In our opinion, the de-risking of the investment bank lacked clarity so far and has led to the formation of a very large, complex corporate center.
- (+) The influence of two very thorough, proactive public authorities (SNB and FINMA) in the field of financial stability and bank supervision in Switzerland.

Rating change drivers

The gross margin of UBS in wealth management is likely to have bottomed out. It has been declining steadily over the years, from 100bps in 1999-2006 to a current level of 85-90bps; thus demonstrating that Swiss banks can no longer charge for banking secrecy and that the business is geographically shifting to more transaction-driven (and therefore having lower margins) Asian and onshore US markets. However, less risk-adverse asset allocation from clients and supportive market conditions could strengthen the profitability of the wealth management business, secure its cash generation and make its earnings stream more stable, further reducing the bank's dependency on the more volatile investment banking business.

Since the beginning of the crisis, UBS has had four Chairmen of the Board, four CEOs, five heads (or co-heads) of the Investment Bank and three CFOs in quick succession. This high turnover has led to various shifts in strategy that have lacked clarity at times. More managerial stability should be positive for the rating and would help the bank assert its strategy and secure its financial recovery.

Recent events

UBS reported its Q4 2013 earnings at the beginning of February. The results show extremely good progress on balance sheet restructuring and capital build-up, including in particular an increase of the bank's fully applied Basel 3 core equity Tier 1 ratio to 12.8% (versus 11.9% at the end of September 2013) and a continuously aggressive reduction in total IFRS assets (from CHF 1,049bn on September 30, 2013 to CHF 1,010bn at the end of Q4). UBS also improved its leverage ratio from 3.0% to 3.4% over the same period (using the definition of fully applied Basel 3 tier 1 capital divided by total exposure).

In operating terms, the quarter was solid, helped by record results in Wealth Management Americas and a tax benefit of CHF 470m stemming from a Deferred Tax Assets (DTA) write-up of CHF 589m. Net new money growth was sustained in the Asia-Pacific (APAC) region, but down quarter-on-quarter in every other region. Lastly, UBS reported a sharp decline in litigation provisions (from CHF 586m in Q3 to CHF 79m in Q4), but the bank maintained its guidance of litigation provisions at a high level throughout 2014.

The most important news of the quarter, though, was the announcement by UBS that FINMA had agreed to the bank's supplemental analysis of operational risk capital to be held for litigation, regulatory and similar matters and other contingent liabilities. The incremental RWA calculated based on this supplemental analysis has replaced the temporary 50% operational RWA add-on decided by FINMA at the end of Q3. As of December 31, 2013 it was CHF 22.5bn; approximately CHF 5bn less than the amount requested by FINMA at the end of Q3.

Rating drivers (Details)

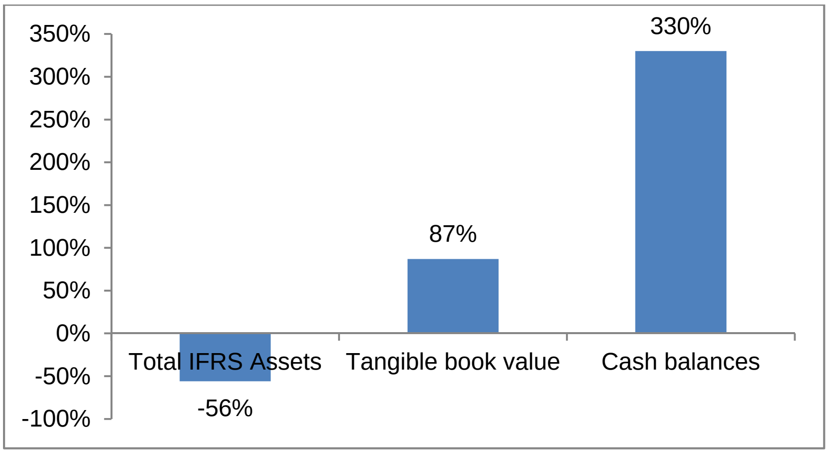
1. UBS has successfully reduced its size and increased its capital base since the crisis

Since 2007 and the outburst of the financial crisis, UBS has steadily reduced its level of assets. The pace of the reduction has been irregular (taking place essentially in 2009 and then 2012-2013), but very effective. Chart 1 (next page) shows the trends regarding the main metrics.

In six years, UBS has managed to reduce its total asset base by 56%, from CHF 2.3trn to CHF 1trn. This spectacular fall was fairly homogenous at every balance sheet line, except for cash balances (increasing by 330% during the same time period) and the tangible equity (up 87%, reflecting a 30% increase in shareholders' equity and a 57% decrease in goodwill and intangibles).

In terms of balance sheet structure, the metrics have not changed fundamentally since 2007. UBS was always a very liquid bank with a very low loan-to-deposits ratio and ample liquid assets. The improving liquidity trends have accelerated in 2013, with the weight of deposits to total funding now very close to 60% and the weight of liquid assets shifting towards more cash (as well as fewer repos, less interbank assets and fewer securities). We expect these trends to continue in 2014 and beyond.

Chart 1: Percentage change in key balance sheet aggregates at UBS – 2007-2013



Source: Company data, Scope Ratings estimates

2. Many unexpected incidents have occurred since 2011

Even if the bank has succeeded in considerably de-risking its balance sheet over the years, the ability to fully level the score with its checkered past remains a challenge. In our view, the scope and frequency of the litigation cases and various operational problems disclosed by UBS over the last two years explain why FINMA felt compelled to impose a capital surcharge on the bank. In September 2011, a trading incident involving unauthorized transactions was unveiled, revealing a USD 2.3bn fraud at the investment bank. The LIBOR fixing case (already mentioned in the 2010 annual report) led UBS to seek conditional immunity in different jurisdictions, enabling the bank to limit the damage of this case to total fines of CHF 1.4bn. However, after this case was made public, UBS revealed the extent of its exposure to the RMBS securities market and the warranties and representations made by the bank on loans transferred to securitization trusts. The scope of the problem came as a surprise since, amongst all global banks, UBS had kept most of these instruments on-balance sheet and was not perceived as having distributed many of them out. In July 2013, UBS announced a charge of CHF 865m ahead of its Q2 results publication, stating that the bank had settled claims related to US RMBS offerings between 2004 and 2007 with the FHFA (Federal Housing Finance Agency). In its Q3 2013 financial report, UBS confirmed that it had launched an internal investigation on "possible manipulation of the global foreign exchange market". In its press release on the Q3 results, UBS consequently announced that it "expected elevated charges for litigation and regulatory matters to continue through 2014". Until then, UBS had not indicated that litigation charges would continue beyond the end of 2013.

The hard work done by the bank on its balance sheet, its solid cash generation and the provisions and capital buffer already accumulated mean that the impact of these litigation events on UBS's CET 1 ratio would be limited to a very marginal -10bps (assuming a 25% payout ratio), based on Scope's estimates. However, collateral reputational risk is much more difficult to assess. Litigation risk is, in our view, the most important credit challenge that UBS will face in the near future.

3. UBS's Private Banking franchise has contributed to the resilience of the bank's earnings

It is difficult to analyze UBS's Private Banking business over a long period of time as the business has been subjected to numerous restatements over the years.

Table 1 summarizes some of the main metrics since before the crisis.

Table 1: UBS Wealth Management businesses – key metrics (CHF m except when indicated)

	2006	2007	2008	2009	2010	2011	2012	2013
Wealth Management revenues	10,555	12,473	10,500	7,427	6,703	7,228	7,040	7,573
Wealth Management Americas revenues	6,223	7,153	6,450	5,512	5,558	5,207	5,891	6,565
Total Wealth Management revenues	**16,778**	**19,626**	**16,950**	**12,939**	**12,261**	**12,435**	**12,931**	**14,138**
Total cumulative assets under management (AuMs) (CHF trn)	n/a	n/a	1,478	1,515	1,457	1,459	1,593	1,751
Total group revenues	46,895	28,516	1,820	26,140	30,770	27,155	27,155	27,829
Total Wealth Management revenues % total group revenues	36%	69%	931%	49%	40%	46%	48%	51%
Gross margin on AuM (%)	n/a	n/a	1.15%	0.86%	0.83%	0.85%	0.85%	0.85%

Source: Company data

As seen above, following a large decrease in revenues from the 2007-2008 levels, the Wealth Management business of UBS (defined as the addition of the Wealth Management and Wealth Management Americas divisions) stabilized its revenue contribution until 2012, while more favorable market conditions led to an encouraging upturn in 2013. The recovery of the US wealth management revenues in the course of 2013 has been very convincing.

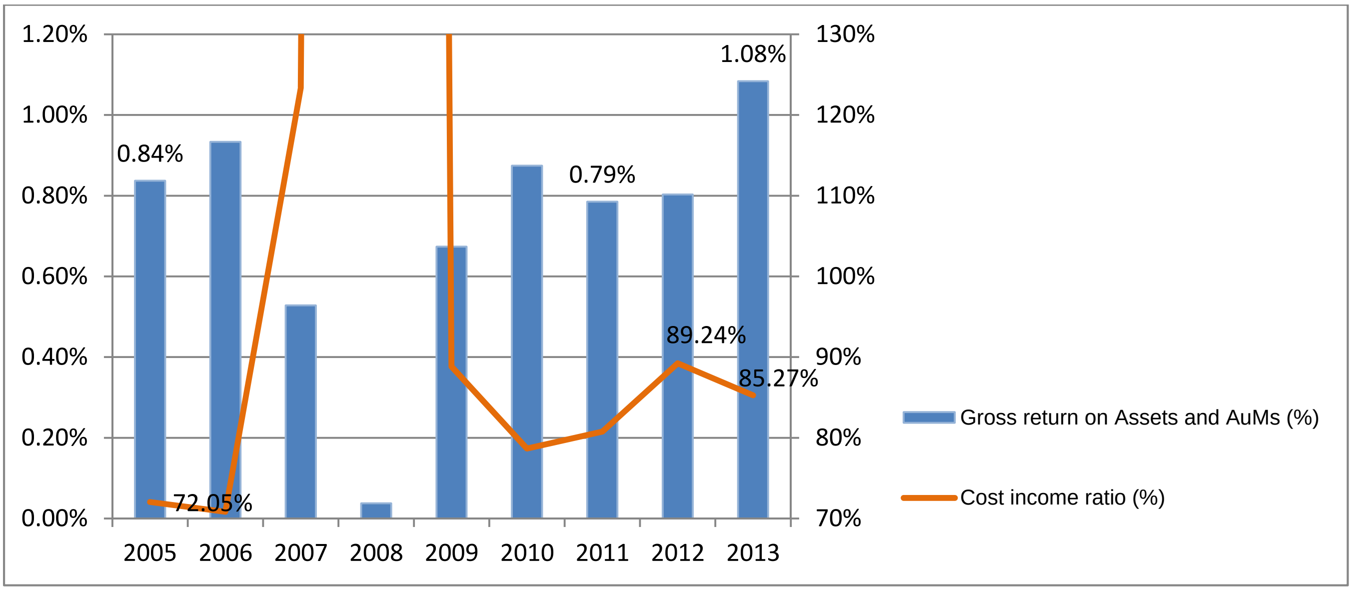
Since 2009, Wealth Management has accounted for about half of UBS's total revenue and the gross margin on Assets under Management (AuM) has been stable. UBS's weight in the wealth management business and its sheer size have proven to be very positive earnings stabilizers in the course of the financial crisis and we would expect this role to continue in the future.

4. Despite various restructurings, UBS's profitability has improved since the crisis

In light of the difficulty in tracing the performance of UBS at the divisional level (see above), we have decided to simplify our analysis and consider the profitability of the whole group. We have made very light restatements (in particular excluding own credit items, restructuring charges, property capital gains, goodwill impairments and strategic capital gains or losses) to the P&L and compared these restated revenues of UBS Group to the combination of on-balance sheet total IFRS assets plus the total assets under management of the bank.

By doing so, we compared the revenues of the bank to its real revenue-yielding assets. Indeed, working on the basis of traditional revenue-to-asset ratios would not give a fair view of the bank's real income generation, as all the off-balance sheet assets under management would be excluded from the metrics. Measuring revenues with both assets and assets under management enables us to include the key metric of AuM, which is the real determinant of the profitability of the wealth and asset management divisions. The conclusions are shown in Chart 2.

Chart 2: Gross margin on assets & AuM (%, LHS) and cost-income ratio (%, RHS) of UBS 2005-2013



Source: Scope ratings estimates, Company data

We find it very encouraging to see that, despite the extensive restructuring, the relative gross profitability of UBS on assets and AuM (defined as Group Revenues % Total assets & AuMs) has recovered since the financial crisis. At 108bps, this metric is pretty much at record levels. In our view, this means that UBS can extract the same level of profits from its franchise, even if the bank has thoroughly reduced its size since 2005.

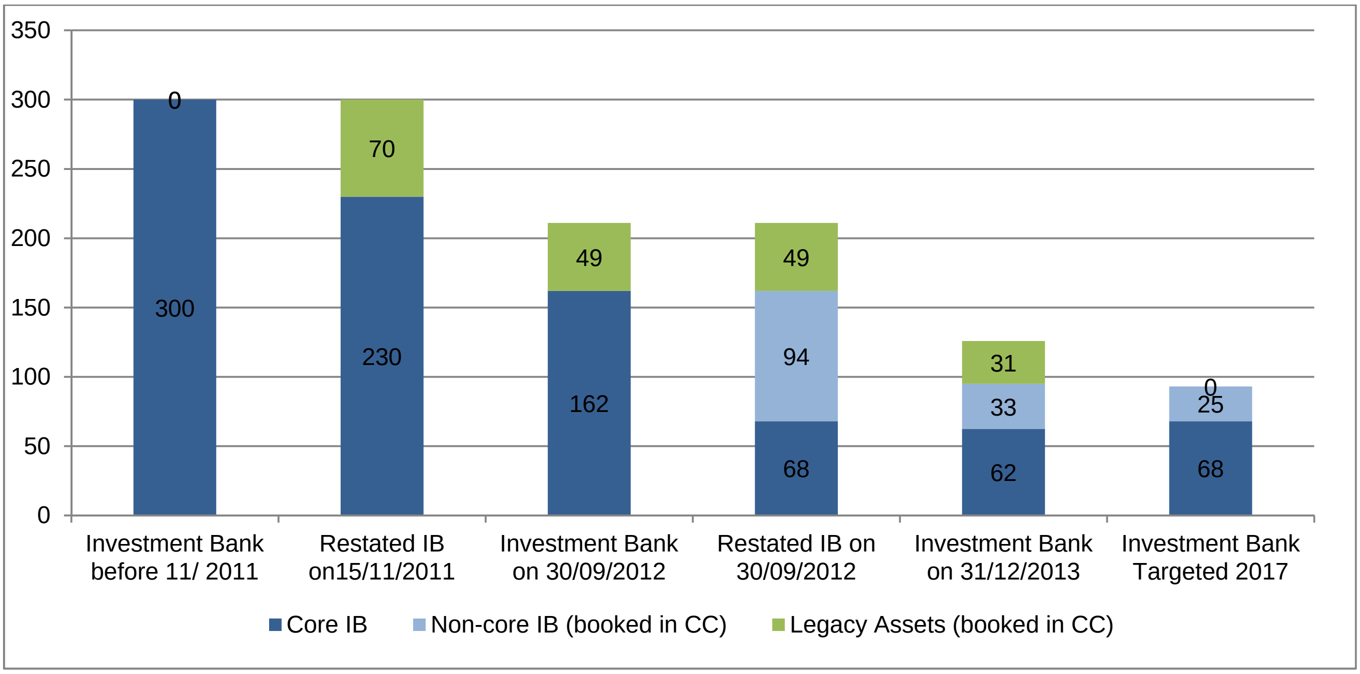
But the graph also illustrates the key problem preventing UBS from materializing in full the cash generation ingrained in the franchise that is its cost base, which is still very high considering the cost savings programs that have taken place at the bank since 2007-2008. Since 2009, the cost-income ratio of the bank has never dropped below 79% and it compares unfavorably with the 2005-2006 benchmarks of around 70%. Reassuringly though, once all the litigation issues are absorbed, the cost problem should be relatively easy to solve. In any case, UBS's recurring profitability issue is not linked to revenue – which would have been much more problematic.

5. The de-risking of the investment bank has lacked clarity so far and has led to the formation of a very large, complex corporate center

Since the management change that followed the September 2011 trading incident, UBS has launched two major overhauls of its strategy; the second one being admittedly an extension of the first. In October 2011, UBS had planned a CHF 145bn (or 50%) reduction in the RWAs of the IB by 2016. Roughly half of the RWA reduction was assumed to be completed through the extinction of a legacy portfolio and another half through business realignment and optimization of the current platform.

Following the appointment of a new Head of IB, UBS announced a follow-up to this strategy in November 2012. This time, the bank was more explicit in its view and more aggressive in its targets. On top of the above legacy asset portfolio to be exited, UBS announced the exit from businesses representing another CHF 90bn of IB RWAs. To be able to manage its core IB as efficiently as possible, UBS transferred this non-core portfolio to the corporate center (CC). This means that the investment bank as it was known in 2011 is now split into three components: a core business - the only one to be reported independently and the only true and recognized investment bank of UBS; a non-core business representing the soon-to-be exited businesses (November 2012); and the legacy businesses, which are also up for disposal since November 2011. Both legacy and non-core businesses are part of the corporate center. Chart 3 clarifies these restatements.

Chart 3: Basel 3 RWA trends at the IB of UBS, 2011-2017E (CHF bn)



Source: Company data, Scope Ratings estimates

In light of the last four quarterly results, the restructuring of the IB is significant since the bank has posted a pretax ROE of close to 30% in 2013 – an achievement easier to make than it may appear, considering the low RWAs of UBS's new core IB – but also a level which seems extremely high in comparison with peers. However, we are concerned by past asset transfers between the non-core and core IBs. We find evidence of this on page 62 of the Q2 2013 report. The largest decline in non-core IFRS assets quarter-on-quarter was attributed to the transfer of non-core Brazilian government bonds back to the emerging markets core business of the investment bank. Such transfers, if they were to recur, could be problematic for the risk profile of the company and the volatility of its earnings. Conversely, we also note that in Q4 2013 some CMBX positions were transferred from the investment bank to the legacy portfolio. We will carefully monitor the stability of the non-core portfolio's asset perimeter going forward.

Some collateral damage of the co-existence of two IB portfolios in the corporate center lies in the fact that the latter is becoming very large and more difficult to analyze. There are now 24,082 employees at the corporate center (out of a total of 60,205 FTEs at UBS Group) before cost allocations to the respective divisions. The bank has also changed treasury and cost allocations quite often since the crisis, which means that divisional performance has become increasingly difficult to assess over a long period of time. The opacity of the corporate center stemming from the realignment of the IB could lead to large, unattributed losses that would, in our opinion, be very difficult to trace.

6. The influence of two very thorough and proactive institutions in the field of financial stability and bank supervision

Following the financial crisis that brought another large bank to the brink of collapse, the Swiss financial authorities took steps to enhance the supervision of banks; in particular, the two large institutions that are critical in Switzerland as their banking assets represent five times the country's GDP. The respective prerogatives (and joint work) of the Swiss National Bank (SNB) and FINMA (Financial Regulator) are defined in the February 23, 2010 Memorandum of Understanding in the field of financial stability.

Measures implemented successfully since the crisis:

1. SNB and FINMA have managed to speedily insert Too Big To Fail (TBTF) and systematically-relevant-specific legislation within the 1934 Banking Act and the 1972 Ordinance on banks. The most important conclusions of Basel 3 rules and their Swiss interpretation (on minimum capital levels and liquidity) as well as the recommendations of the Financial Stability Board (FSB) on TBTF have all been incorporated into domestic regulations. For capital and liquidity, the Swiss Federal Council has written two specific ordinances (on June 1 and November 30, 2012) following — and sometimes going beyond — Basel 3 recommendations. All key measures have been enforced since January 2013.
2. On top of this extensive legislative effort, both SNB and FINMA have maintained a very close monitoring of the two large, systemically-relevant banks and have taken action when they deemed that some aspects of the financial fundamentals needed strengthening.

Most recently, FINMA has asked UBS to alter its computation of operational risk with a "supplemental analysis" (replacing a temporary CHF 28bn add-on announced in the course of the Q3 results). In doing so, FINMA has acted on one of the main risks at UBS since the "trading incident" in 2011: operational risk. The operational risk add-on represents CHF 22.5bn of supplementary RWAs. If we use the core equity Tier 1 ratio target of 13% for UBS, one could argue that the supplementary RWAs cover about CHF 2.9bn of supplementary capital that can be used to absorb the extra litigation charges and/or losses.

UBS reported CHF 1.6bn of litigation provisions in its FY 2013 report. If we assume that "elevated" (to quote the company) legal charges are in line with the 2012-2013 average of CHF 2.1bn, then it is probably fair to assume that UBS could probably reserve that same amount in 2014. Altogether, these P&L charges, existing provisions and capital add-ons would represent a total of around CHF 6.6bn (USD 7.3bn), to be compared, for example, with the JP Morgan mortgage settlement of USD 13bn with the FHFA (which is 1.8x higher than our UBS settlement estimates, bearing in mind that JP Morgan is about 2.5x bigger than UBS by total assets).

The Swiss supervisor has therefore preempted a potentially important credit problem and has forced UBS to allocate more capital to it, which we view as a very important intervention from a credit perspective.

Peer comparison

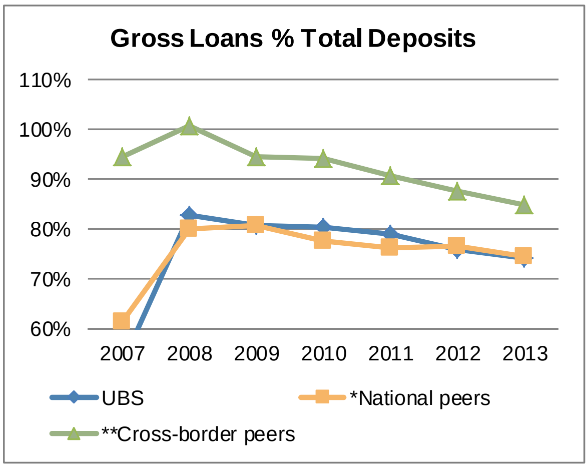
At Scope ratings, we compare banks within peer groups at the domestic and cross-border level.

Of the banks rated by Scope, UBS can only be compared to Credit Suisse at the domestic level. Since both banks are part of the same global peer group of large universal banks operating in varied markets, we do not focus specifically on the domestic comparison.

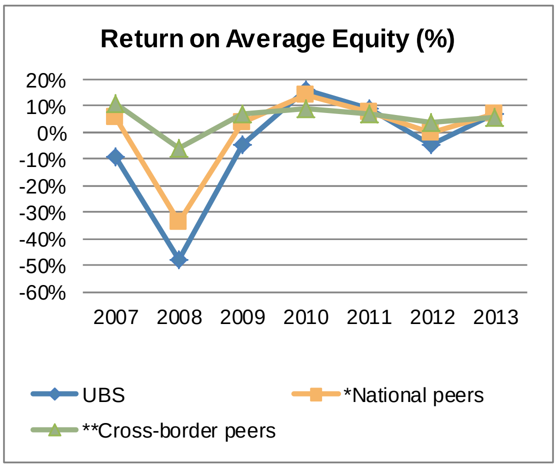
Scope's global peer group includes BNP Paribas, Société Générale, HSBC, Barclays, Deutsche Bank and Credit Suisse, in addition to Citigroup, Bank of America and JP Morgan in the United States.

Overall, we find that UBS's positioning is solid; particularly in light of the changes the bank underwent in the past years. Its total assets stand with those of the smaller-sized banks in the peer group, and it is undoubtedly clear that the low balance sheet usage of the bank helps, considering its mix of wealth management and less-capital-intense investment banking. The funding metrics are strong and UBS's leverage ratio is inching back towards European peer averages, even if it is still lower than that of its US peers. However, the optical superiority of the US group (as well as Credit Suisse) is explained by reasons linked to accounting differences.

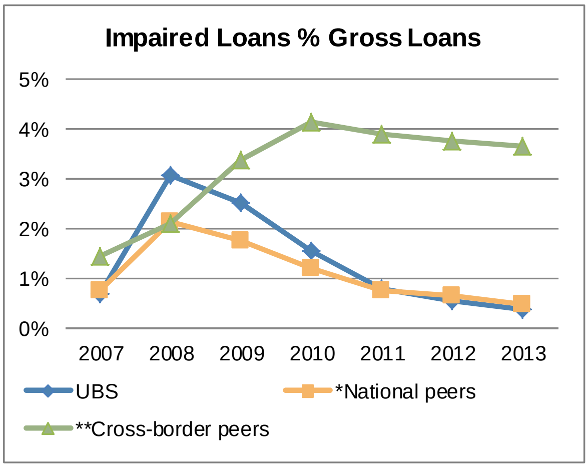
Peer Comparison - UBS group



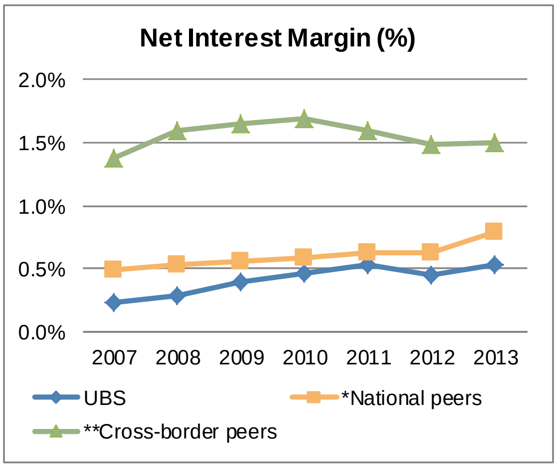
Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



Source: SNL Financial, Scope Ratings



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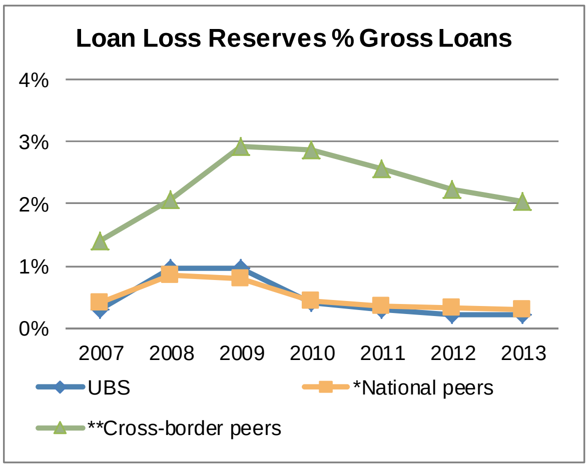

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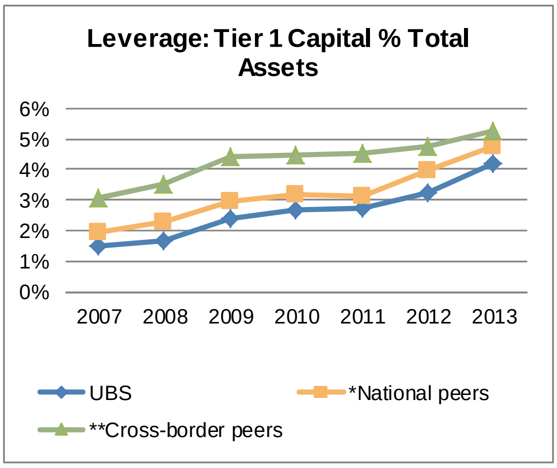

Source: SNL Financial, Scope Ratings

*National peers: Credit Suisse, UBS

**Cross-border peers: Bank of America Corp, Barclays, BNP Paribas, Citigroup Inc, Credit Suisse, Deutsche Bank, HSBC, JP Morgan Chase, Societe Generale, UBS

Selected Financial Information - UBS group

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Balance Sheet summary (CHF billion)									
Assets									
Cash and balances with central banks	18.8	32.7	20.9	26.9	40.6	66.4	80.9	95.1	104.8
Interbank assets	60.9	17.7	16.8	17.1	23.2	21.2	17.2	13.7	11.0
Total securities	1,371.0	758.3	554.2	552.4	555.3	431.8	336.8	274.9	225.4
of which debt instruments	1,128.8	582.6	402.2	431.2	442.2	319.9	256.8	205.4	164.3
of which equity instruments	210.6	78.9	58.9	46.1	36.7	49.2	52.5	42.0	33.6
Derivatives	428.2	854.1	421.7	401.1	486.6	419.0	245.8	224.2	208.2
Gross customer loans	341.0	299.5	273.1	267.0	270.7	283.4	287.6	287.6	290.5
of which impaired loans	2.4	9.1	6.8	4.2	2.1	1.6	1.1	1.0	1.0
Total funded assets	1,831.4	1,161.0	928.3	921.0	943.6	864.5	769.9	716.5	675.1
Total Assets	**2,274.9**	**2,012.9**	**1,338.2**	**1,314.8**	**1,417.0**	**1,259.8**	**1,009.9**	**935.3**	**878.4**
Liabilities									
Interbank liabilities	145.8	76.8	31.9	41.5	30.2	23.0	12.9	10.3	8.2
Senior debt	857.7	452.0	340.2	342.1	358.7	265.1	186.3	149.0	119.2
Derivatives	443.5	851.9	409.9	393.8	473.4	395.3	240.0	218.8	203.2
Customer deposits	641.9	362.6	339.3	332.3	342.4	373.5	390.8	398.6	406.6
Subordinated debt + hybrid securities	14.1	12.8	11.2	8.5	7.0	0.0	0.0	0.0	0.0
Total Liabilities	**2,231.1**	**1,976.6**	**1,292.9**	**1,266.0**	**1,364.0**	**1,210.7**	**959.9**	**884.0**	**826.3**
Ordinary equity	36.9	28.2	37.7	43.7	48.5	45.9	48.0	49.4	50.1
Minority interests	7.0	8.0	7.6	5.0	4.4	0.0	0.0	0.0	0.0
Total Liabilities and Equity	**2,274.9**	**2,012.9**	**1,338.2**	**1,314.8**	**1,417.0**	**1,259.8**	**1,009.9**	**935.3**	**878.4**
Core Tier 1 Capital [1]	*27.7*	*25.8*	*24.6*	*30.4*	*25.5*	*25.4*	*28.9*	*30.3*	*31.0*
Income Statement summary (CHF billion)									
Net interest income	5.3	6.0	6.4	6.2	6.8	6.0	5.8		
Net fee & commission income	30.6	22.9	17.7	17.2	15.2	15.4	16.3		
Net trading income	-5.0	-25.2	-0.2	7.7	5.3	3.5	5.3		
Operating Income	**32.1**	**4.0**	**24.7**	**31.9**	**27.9**	**25.5**	**27.7**	**30.0**	**32.4**
Operating expenses	35.4	27.8	23.9	24.6	22.4	24.2	24.4	25.7	27.6
Loan loss provision charges	0.3	3.2	2.2	0.1	0.1	0.1	0.2	0.1	0.3
Non-recurring items	0.0	0.0	0.1	0.2	0.0	0.0	0.1	0.0	0.0
Pre-Tax Profit	**-3.3**	**-27.3**	**-2.5**	**7.3**	**5.3**	**-1.8**	**3.3**	**4.2**	**4.5**
Income tax	1.4	-6.8	-0.4	-0.4	0.9	0.5	-0.1	0.4	0.7
Net profit attributable to minority interests	0.5	0.6	0.6	0.3	0.3	0.2	0.2	0.3	0.3
Net Income Attributable to Parent	**-5.2**	**-21.1**	**-2.7**	**7.4**	**4.1**	**-2.5**	**3.2**	**3.5**	**3.5**

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] CRD 4 basis from 2011 onwards

Ratios - UBS group

	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
Funding/Liquidity									
Gross loans % Total deposits	53.1%	82.6%	80.5%	80.3%	79.1%	75.9%	73.6%	72.1%	71.4%
Total deposits % Total funds	38.7%	40.1%	47.0%	45.9%	46.4%	56.2%	66.0%	71.2%	75.9%
Wholesale funds % Total funds	61.3%	59.9%	53.0%	54.1%	53.6%	43.8%	34.0%	28.8%	24.1%
Asset Mix, Quality and Growth									
Gross loans % Funded assets	18.6%	25.8%	29.4%	29.0%	28.7%	32.8%	37.4%	40.1%	43.0%
Impaired loans % Gross loans	0.7%	3.1%	2.5%	1.6%	0.8%	0.5%	0.4%	0.4%	0.4%
Loan loss reserves % Impaired loans	43.1%	32.0%	38.8%	26.0%	38.6%	45.5%	61.1%	62.4%	63.6%
Gross loan growth (%)	-2.3%	-12.2%	-8.8%	-2.3%	1.4%	4.7%	1.5%	0.0%	1.0%
Impaired loan growth (%)	-9.0%	282.3%	-25.3%	-38.9%	-48.8%	-27.4%	-31.2%	-2.0%	-2.0%
Funded assets growth (%)	-10.6%	-36.6%	-20.0%	-0.8%	2.4%	-8.4%	-10.9%	-6.9%	-5.8%
Earnings									
Net interest income % Revenues	16.6%	150.5%	26.1%	19.5%	24.5%	23.4%	20.9%		
Fees & commissions % Revenues	95.5%	576.0%	71.7%	53.8%	54.6%	60.3%	58.8%		
Trading income % Revenues	-15.6%	-633.1%	-0.9%	24.1%	18.9%	13.8%	19.3%		
Other income % Revenues	3.5%	6.7%	3.0%	2.6%	2.1%	2.5%	1.1%		
Net interest margin (%)	0.3%	0.5%	0.8%	0.9%	0.9%	0.8%	0.9%		
Pre-provision Income % Risk-weighted assets (RWAs)	-0.9%	-7.9%	0.4%	3.7%	1.4%	0.5%	1.5%	2.1%	2.4%
Loan loss provision charges % Pre-provision income	-9.3%	-13.4%	274.0%	1.9%	2.2%	8.7%	5.3%	2.9%	5.6%
Loan loss provision charges % Gross loans (cost of risk)	0.1%	1.0%	0.8%	0.1%	0.0%	0.0%	0.1%	0.0%	0.1%
Cost income ratio (%)	110.4%	698.3%	96.8%	77.2%	80.4%	94.7%	88.0%	85.6%	85.3%
Net Interest Income / Loan loss charges (x)	17.3	1.9	3.0	45.0	55.5	50.7	32.5		
Return on average equity (ROAE) (%)	-12.1%	-64.8%	-8.2%	18.3%	9.0%	-5.2%	6.8%	7.2%	7.1%
Return on average funded assets (%)	-0.2%	-1.0%	-0.2%	0.5%	0.3%	-0.2%	0.3%	0.3%	0.3%
Retained earnings % Prior year's book equity	-10.6%	-57.2%	-9.6%	19.8%	8.6%	-6.3%	4.9%	2.9%	1.4%
Pre-tax return on common equity tier 1 capital	-12.0%	-106.0%	-10.3%	24.1%	20.8%	-7.1%	11.3%	13.8%	14.5%
Capital and Risk Protection [1]									
Common equity tier 1 ratio (common equity tier 1 capital % RWAs)	7.4%	8.5%	11.8%	15.3%	6.7%	9.8%	12.8%	14.5%	15.8%
Tier 1 leverage ratio (%)	1.5%	1.6%	2.4%	2.7%	2.7%	2.0%	2.9%		
Median of tier 1 leverage ratio and common equity tier 1 ratio (%)	4.5%	5.1%	7.1%	9.0%	4.7%	5.9%	7.9%		
Total loss coverage (CET 1 capital + loan loss provisions) % RWAs	7.7%	9.5%	13.0%	15.8%	10.9%	13.5%	13.1%	14.8%	16.2%
Non-senior bailinable debt cushion (as % of total liabilities)	0.6%	0.6%	0.9%	0.7%	0.5%	0.3%	0.2%	0.2%	0.2%
Asset risk intensity (RWAs % total assets)	16.5%	15.0%	15.6%	15.1%	26.8%	20.6%	22.3%	22.3%	22.3%

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information. Please refer to "Methodologies Used for this Report" for further details.
[1] CRD 4 basis from 2011 onwards

METHODOLOGIES USED FOR THIS REPORT

For the rating and analysis contents of this report, Scope has used the following methodologies which were published on www.scoperatings.com:

"Bank Rating Methodology" (February 2014)

"Forecasting Bank Financials Methodology" (February 2014)

Forecasting bank financials: Forward-looking estimates are an important analytical tool underpinning Scope's bank ratings. These forecasts cover the current financial year (before final year-end figures are published by the bank) plus the forthcoming two years. Depending on the complexity of the bank being assessed, different forecasting tools will be used. For a majority of banks operating primarily commercial and retail banking franchises (loans and deposits) the analysis is underpinned by an **accounting** forecast of the balance sheet and profit and loss account. For more complex groups with multiple ranges of activities – notably those with material wholesale and investment banking operations – Scope uses an **analytical** forecast, relying on the bank's business-line reporting to come up with plausible estimates. For all banks Scope also includes a **regulatory metrics** forecast, considering the growing importance of this aspect in bank analysis.

For complex banks, divisional data is used to forecast profit and loss accounts and basic divisional balance sheet metrics. For less complex banks, a line-by-line forecasting of major P&L elements is forecast.

For balance-sheet forecasts, Scope estimates of all major balance sheet lines, using the P&L estimates to complete the forecast of the capital/shareholders' equity line. This comprehensive methodology for estimating the balance sheet is used for all the banks in our universe, irrespective of size and complexity.

Lastly, our forecasts include assessments of the major regulatory metrics: Tier 1 and CET 1 (historically CT1), Leverage, Liquidity Coverage Ratio, and Net Stable Funding Ratio (the latter two when and if sufficient public information to compute them is available).

Scope will not aim to forecast financials when it considers the public disclosure of the bank as insufficient for a transparent and credible outcome.

All Scope's bank financial forecasts are based on public information. For its forecasts Scope will not use any non-public information or data, even if such information or data were provided by rated banks. Scope's forecasting process is transparent, with a detailed roadmap provided in its *"Forecasting bank financials"* methodology.