LTROaring

The ECB's Feb-12 EUR530bn offering was, in our view, the most significant capital markets event of 1Q12. Bearing variable - but *low* - interest rate (only 1% at the time of the issue), the 3-year offering increased the total ECB 'sugar rush' Long-Term Refinancing Operation stimulus (LTRO) to just over EUR1tr. As expected, banks used the first lending package (EUR489bn, Dec-11) to cover their maturing debt, and invest in high-yielding government securities: in Jan-12 alone, Italian and Spanish banks reportedly bought almost EUR45bn of government debt; other banks were less active but may have devoted fresh fund to finance other investors' positions in European sovereign bonds. There is little doubt that LTRO bought – literally - the European Governments time (though we *do* doubt it'll prove as long as 2-3 years, as Chancellor Merkel opined) to seek a more permanent solution; on the flip side, though, questions – valid, in our view - are being asked as to whether this might be too much of 'a good thing'[1]: we cannot relate the recent rally in equities - MSCI All-World IMI and S&P 500 advanced 11-12% in 1Q12 before retreating somewhat in April - to macro fundamentals, which we believe remain shaky. As do, evidently, investors: European equity funds have suffered some of their biggest outflows in 1Q12, with money probably going to the US shares and bonds and, to a lesser extent, emerging markets. We expect to see another round of highly risk-distortive 'quantitative easing' in 2H12, quite possibly in both Europe and the US.

In the (geo)political arena, we see no signs that the rift between GIIPS and their creditors (chiefly, Germany, with EUR0.5tr+ share of ECB credits as of Feb-12) is on the mend. Quite the contrary: in Mar-12, apparently considering the possible consequences of EUR breaking up, Bundesbank's President Weidmann proposed that ECB claims should be securitised; ECB recently said it cannot accept Greek sovereign debt as collateral for its lending operations without enhancement, so the collateral would presumably be tangible assets, e.g. property. Mr Weidmann does not speak for ECB, but his statement came mere weeks after Germany's Jan-12 call for Greece to surrender its budgetary (i.e. state) sovereignty to the EU. Taken together, these statements suggest to us a continuation of the trend which may nudge Greece to eventually exit the eurozone. Further, as there is no consensus on the likely consequences of EUR break-up (e.g. national central banks may not be in a hurry – or able - to settle funds owed under various monetary union arrangements), it seems to us that Mr Weidmann's proposal, while understandable from Bundesbank's point of view, also increases the uncertainty by highlighting the possibility of EUR collapsing.

The successful completion of the Greek swap - announced on 9-Mar – was widely expected (a number of European banks wrote down the value of their holdings well ahead of the announcement) and is therefore the secondary event of 1Q12. Within hours of the announcement, though, London-based marketmakers were reportedly testing the 'grey' market for new Greek 2042 step-up bonds at 17-22% range of face value. In view of ISDA' prevarication (followed up beautifully by Commerzbank's CEO Martin Blessing likening the Greek private sector debt swap deal to Spanish Inquisition) and the unemployment rate of 20%+ in Nov-11 and rising, this is hardly a wonder.

Elsewhere, auctions of government paper in Italy and Spain in Mar/Apr-12 demonstrate, to our mind, that the market remains jittery at best, not least due to what we referred to as 'the crisis in the political economy' in our 2Q11 Results Update. Italy's Prime Minister Mario Monti did not help when he opined that Spain (somewhat downcast, having announced a fiscal adjustment target equal to 5.5% of GDP –a fiscally impossible task, in our view) was the key cause for the worsening market sentiment. Monti's statement looked particularly odd when IMF stated, mere days later, that it believes Italy will miss its 2012 budget deficit target of 1.2% of GDP and instead report 2.4%; which rhymes with Italy's own worsening medium-term projections. Unsurprisingly in view of this ongoing turmoil, the Bank of America Merrill Lynch' Apr-12 Fund Manager Survey found that investor concerns about Europe have risen sharply; 54% of the panel view EU sovereign debt funding as the main risk (up from 38% in Mar-12), and Spain and France as the most likely bearers of negative surprises in 2012.

[1] *We recommend a read of Jim Grant's (of Grant's Interest Rate Observer) speech to The New York Federal Reserve in Mar-12, freely available on the Internet. We do not necessarily buy into every argument of the article, but it is a timely reminder of what The Fed's – soon to mark (celebrate?) its centenary in Dec-13 – original purpose was and how far it strayed away since. It also raises interesting questions regarding the relationship between the departure from the gold standard; the emergence of LTRO-like 'money' and the fixation with growth as essential (to finance the increasing amount of debt, perhaps?).*

Results Overview

At the global level, primary fees generally disappointed in 1Q12. M&A and ECM volumes and fees dropped sharply; DCM loan volumes also weakened – by as much as 25% for the global leaders, according to some sources – but we hear that fees declined by a comparably mild 10-15% in 1Q12/1Q11. Our sources generally DCM bonds put in a comparably strong performance: the 1Q12 volume was flat-ish versus 1Q11, but fee margins grew during the period. Highlights:

- M&A fees were below the consensus and our expectations. We estimate global deal volume for the Top 10 peers dropped by as much as 40% in 1Q12 vs 1Q11; in EMEA, fees were likely down by half during the same period, while APAC ex-Japan performed only slightly better. Americas was stronger overall, but with greater concentration of fees wallet going to the leaders. We continue to expect (see 4Q11 Results Update) a recovery in volumes in the US and the Far East, and corporates from both regions looking for European acquisitions; but likely not before Europe – which in our view remains the most important factor – notches at least one crisis-free quarters; and not before doubts about the US and APAC economic outlook subside.
- ECM was another area of weakness: we hear the Top 10 competitors saw their respective regional fee take drop by 25% in Americas and APAC fees; APAC may have had the slowest start for a decade. Europe held up a lot better (down about 10% y/y), but in terms of absolute volumes, the region remains far below either the US or APAC, and we do not foresee a near-term recovery in fee margins, either.
- Distressed and high yield loans in Europe remain depressed; 1Q12 volume was about 1/3 below 1Q11. There are signs that 2012 may prove to be a lively year in Europe; while LTRO may have given European banks some breathing room before they (re-)start their disposal of risky assets, market participants generally agree this is but a temporary respite. According to a recent study by Dealogic for Linklaters, $550bn of European LBO (leveraged buyout loans) are due to mature during 2012-2016; of that, $69bn is due in 2012, surging to $140bn in each of 2014 and 2015. European banks, dealing with the sovereign crisis and pressed by the regulatory and/or capital requirements, will likely remain reticent, giving ground to large US banks. More interestingly, large US funds (Avenue, Apax, Blackstone, Warburg Pincus, Oaktree, to name but a few) are searching for distressed opportunities in Europe and seeking to raise fairly colossal sums; European funds (e.g. GLG, but also a score of relative newcomers) are also getting into the game. There have been false starts in this market in recent years, and renewed quantitative easing in Europe (not an unlikely prospect in 2012, in our view) may well yet again remove immediate investment opportunities; or, maybe this time, a flow of distressed deals will start.
- There is little doubt, however, that LTRO had a dramatic impact on investment grade bond issuance in Europe. In investors' mind, the ECB's intervention removed the immediate prospect of asset (fire)sales by European banks; spreads tightened in response, and issuance boomed as companies (a high proportion of which find loan financing increasingly scarce) rushed to capitalise on favourable interest rates and investors' demand. According to the FT, European non-financial companies issued $55bn worth of high-grade bonds by mid-Mar-12, versus $125bn in FY11. The outlook, of course, is largely dependent on macro and/or GIIPS developments in Europe.
- The outlook for Contingent Convertible (CoCo) issuance – very much in question since June-11 Basel Committee on Banking Supervision ruling in June-11 (2Q11 Results Update) – may be improving; but issuers are struggling to define the target investor group. As part of our wider capital/Equity modelling of the capital markets universe, we first studied CoCos in 4Q10, when the Swiss financial regulators first voiced their intention to introduce 'Swiss finish' on the country's banks' capital requirements: core capital of 10% of risk-weighted assets (RWA; the equivalent Basel 3 requirement is 7%) and additional 9% of RWA in contingent convertible bonds (CoCos), through the combination of 'high-trigger' (3%) and 'low-trigger' (6%) securities[2]. The 'high-trigger' paper automatically converts into equity if the Tier 1 ratio to risk-weighted assets (RWA) falls below 7%[3] (the Basel 3 requirement); the likelihood of 'low-trigger' being tripped is less

[2] In Dec-11, European Banking Authority (EBA; a successor to CEBS) also recommended that Tier 1 capital may include 'Buffer Convertible Capital Securities' (BCCS).

[3] A bank is also obliged to take strong measures if its Tier 1 falls below 10% of RWA. Finally, the trigger is also tripped if the Swiss regulator determines that the bank in question requires financial support to survive as a going concern; this applies to both high- and low-trigger CoCos.

likely (e.g. Tier 1/RWA falls to 5%, as per UBS' Mar-12 issue - see below; the reported Tier 1 was 14.1% at end-2011), but there is no equity conversion and the writedown is permanent. The Swiss Government, seeking to *help* banks issue the required capital, in Dec-10 proposed to *end the tax* (!) on bond issuance, thus setting itself apart from the vast majority of EU Governments.

Among the banks in our core coverage, Credit Suisse (CS) proceeded with enthusiasm, fulfilling 70% of its regulatory CoCo high-trigger need by the end of Feb-11 via a swap with investors it knew well, and then a $2bn public offering (rated BBB by Fitch). In Mar-12, CS placed another high-triger CoCo, this time CHF700m/$760m (3x its stated minimum target) 10-year non-call five priced at 7.125%. UBS, by contrast, took a cautious view of CoCos, seeking instead to fulfil the 3% 'Swiss finish' requirement via common equity. In Feb-12, it issued $2bn of low-trigger 10-year non-call five CoCo, priced at 7.25%. Some analysts said that 60% of the issue was taken up by private APAC banks. Both banks will need to issue more low-trigger CoCos to fulfil regulatory requirements: UBS said it plans to hold just under $3bn of low-trigger CoCos by end-2012, with additional <$2bn by end-2013; CS will likely make its own debut before end-2012.

There is a considerable disagreement between market observers as to what structure is more likely to acquire a permanent following. On one hand, low-trigger CoCos are more likely to catch on, because of their simpler structure; on the flip side, though, low-trigger CoCos only seem suitable for banks perceived as strongly capitalised, and there is currently shortage of such institutions in Europe. In the risk-averse environment, the latter consideration may well negate European Banking Authority's (EBA) Dec-11 recommendation that Tier 1 capital may include 'Buffer Convertible Capital Securities': we note that CS and UBS issues, despite their different structures, in late Mar-12 traded very close to each other, which to us suggests that the issuer's perceived strength matters rather more than the 2%-odd difference in the level of the trigger.

In **secondary markets**, the lack of volatility across *all* main asset classes was, to us, the defining feature of 1Q12. In equities, VIX, V2X, VHIS (the 'APAC VIX') all dropped from 40+ level at the beginning of Oct-11 to sub-20 at end-1Q12; there is no doubt LTRO and similar liquidity interventions contributed to the decline. In credit and rates markets, Merrill Lynch's benchmark volatility MOVE index declined from 116 on 1-Nov-11, to just 77 at the end of March-12 and the low of 63 at the end of April; the uncertain economic outlook means that interest rates are unlikely to rise and without signs of sustained recovery/stabilisation in Europe, we expect US Treasury paper will continue to be in demand. Commodities (see Fixed Income highlights, below) and currencies (importantly, including US$-vs-EUR rate) also saw a sharp reduction in volatility. This calm may not last: several of our sources have opined that there is a rising demand from investors for hedges against increased volatility, especially in equities, and we note that the appetite for 'dual directional' structured notes– which pay out if the index stay within a predetermined up/down range - in the US surged in 1Q12.

Equity markets highlights:

- <u>Cash equity</u> volumes and revenue dropped in 1Q12 across all three main regions. There are variations – e.g. in the USA, investors are generally worried whether the 45-degree rally from 1Q12 is sustainable; Europe is comparably jittery; and APAC awaits macro developments from both – but broadly, we expect banks will continue shifting resources from cash equity and into flow derivatives, including Delta-1, throughout 2012 and possibly beyond (4Q11 Results Update).
- Following a muted 4Q11, <u>retail structured products</u> picked up slightly in 1Q12, though business was still below 1Q11. Our recent analysis of global trends in this market shows that Europe – which suffered a 25%+ fall in 4Q11/3Q11 volume on main exchanges – remains very sensitive to demand in Germany and, to lesser extent, Switzerland. In the UK, the main banks are arguably not overly enthusiastic about offering retail investment advice through their branch networks, which may have contributed to a 20% (in US$ terms) fall in the sales volume in FY11/FY10. The 3rd-party distribution, however, grew by about 15%: we attribute this to investors' growing realisation that these products (the great majority of which remain FTSE 100-linked vanilla products) can offer diversification and targeted protection from volatile markets, inflation etc.

  In APAC, the Hong Kong and Singapore regulators' 2009/10 clampdown on sales of structured products to retail investors have caused a shift in that market towards plain-vanilla instruments. While restrictive to investors seeking yield, these products are more attractive to the wider investor base and more stringent regulations are bringing the confidence back into the market that was all but closed in 2009. Professional investors, for their part, are enthusiastically returning to the market and many of the banks we cover – including Credit Suisse, Royal Bank of Scotland, Societe Generale and UBS - are ramping up their regional capability[4].

In contrast to European regulators, the US Financial Industry Regulatory Authority (FINRA) in Apr-12 ruled out intervention to ban retail structured products even if they seem too complex for the target market. Our sources generally agree that the outlook is broadly positive, despite some challenging areas. In our view, if there is a slowdown in the US, it will likely be due to retail and mass-affluent investors having concerns about ETFs, as highlighted by FINRA's May-12 $9.1m fine handed out to Citi, Morgan Stanley, UBS and Wells Fargo for mis-selling leveraged and inverse ETFs.

- Equity derivatives market in APAC is maturing. In our 26-Apr note, which summarised the findings from our recent study, we identified 16 key client/product segments in the region (excluding Japan), and highlighted what we believe are two critical factors for success in this market: a balanced client mix emphasising local institutional investors (including hedge funds) and high-net worth individuals (HNWIs), both increasingly covered on regional basis; and automation of flow and customised structured product offering. As an aside, the regional centralisation of equity derivatives teams to Hong Kong continues, with several of 'our' banks relocating their Tokyo-based traders to there in recent months.
- On a related note, in late Mar-12, BRICS Exchange Alliance, founded by the five leading emerging markets exchanges in Oct-11, started cross-listing equity derivative indices in a bid to attract interest from investors based in other emerging markets and dealing in their local currency. The first securities listed are futures of Brazil's IBOVESPA, Hong Kong Hang Seng, Russia's MICEX and South Africa's FTSE/JSE Top 40. The exchanges will focus on index and cash equity products before expanding into other asset classes; provided, of course, that there is sufficient liquidity, the lack of which has been the main impediment to the success of single-market tracking product in recent years.

Fixed income markets highlights:

- FX trading 1Q12 revenues were moderately ahead of the prior year period. There is increasing evidence that smaller players are challenging the incumbents; our recent research suggests, however, that the breadth and depth of the leaders' offering will ensure their retaining their global market share in 2012/13. Firstly, we expect they will retain their lead in the fast-growing electronic trading. In its oft-quoted Apr-12 study, Greenwich Associates estimated that, by late 2011, electronic trading accounted for 60% of global FX volume; our research suggests this proportion is somewhat lower than that, mostly because APAC (presently) lags Europe and the USA in 'electronification', but there is little doubt of the overall growth trend. The advanced e-capability has, in short, become an entry-level requirement, and the incumbent leaders generally 'outinvest' the newcomers. Second, some of the leaders are boosting their local teams in Europe and APAC to supplement trading hubs, and providing targeted client-type coverage (for example, dedicated institutional and corporate teams). Structuring capability is the third differentiating factor, as the ongoing Europe/GIIPS crisis – and the attendant hedging against EUR collapse – continues to demonstrate.
- Following widespread weakness in 4Q11, credit trading revenue (excluding securitisation) recovered in 1Q12, even exceeding 1Q11 in flow revenue in some regions. Our 'market wallet' CF Index (3Q11 Results Update), which is ready well in advance of the banks' quarterly results, shows that, in the USA, the increase in traded volume was driven by both high yield bonds (1Q12 monthly average 57% above 4Q11) and high grade bonds (+40% vs 4Q11); further, the spread between corporate (HG and HY) and the US Government debt narrowed. In Europe, the LTRO 'sugar rush' eased (temporarily, we believe) worries about the macro outlook, leading to stronger performance; assuming a continued recovery in the USA and barring a sudden downturn in European outlook, we expect solid 2Q12 and 3Q12.

[4] *By contrast, in Apr-12, RBS announced it agreed the sale of its APAC (including Australia) cash equity and associated investment banking business to Malaysia's CIMB Group, for a cash consideration, based on net asset value, for £75m/$120m. RBS expects the deal will be completed in all jurisdictions by 4Q12.*

- Credit Default Swaps (CDS) update:
  - In the immediate aftermath of Greek debt restructuring deal, International Swaps & Derivatives Association (ISDA) ruled that Greece's use of collective action clauses (CAC) to force private bondholders to take a loss on their holdings of Greek sovereign debt constitutes 'credit event', which triggered c.US$3bn payout to holders of CDS[5]. The relatively small size of the total payout belies the importance of the ruling: market participants were relieved that CDS proved a valid instrument of insurance, though we expect doubts will remain: ISDA did, after all, took its time to arrive at this – to many obvious - conclusion.
  - In late Feb-12, the Council of the European Union adopted a regulation on CDS and short-selling. Our understanding is that, while there is an agreement on broad ('Level 1') rules, regulators and market participants continue to disagree over the exact definition of uncovered/'naked' CDS which are - not unreasonably, in our view (3Q11 Results Update) - seen as an abusive instrument. The debate about 'Level 2' detail (currently being drafted by European Securities & Markets Authority - ESMA) is likely to go on for a while; for the moment, the crunch points seem to be whether cross-border hedging should be allowed (we think it should, in most instances), whether the focus should be on detail or the whole-portfolio (we would emphasise the latter, in the context of stated investment objective/ strategies), and involuntary CDS positions. We expect ESMA will seek to define principles, rather than prepare an overly-precise rulebook.
- In CMBS, Uni-Invest/Opera Finance NV – which missed the repayment of EUR600m/$790m commercial real estate loan in Feb-12 – in Apr-12 put to vote a proposal to its bondholders to either restructure the bonds by extending them to 2016 and appoint a seller for its real estate backing the CMBS (in this case, Blackstone's affiliate); or sell their notes to bidders (here, Patron Capital Partners and the rapidly-expanding TPG Capital are bidding for the Class A notes, which Fitch Ratings downgraded to distressed/CCCsf in June-11 and then to Csf in Dec-11). The key investors rejected the restructuring option, which would have seen senior holders receive no immediate payout but instead be repaid from the sale of securitised assets over 4 years. Instead, they opted for the TPG/Patron proposal which gives Class A holders 40% of $480m they are owed, and rolls the balance into new notes; the subordinate Class B/C/D holders will likely not receive any of $320m they are owed.

  This event could set an interesting precedent, by demonstrating European investors' appetite for disposals (firesale?) of real estate assets or, failing that, the securities. That appetite, however, may need to be considerable. In Apr-12, Bloomberg quoted Morgan Stanley estimate that $60bn+ of CMBS loans may mature within three years; while Fitch, in Feb-11, reported that the proportion of fully-performing CMBS loans fell below 63% in 4Q11, down 3% from 3Q11; and loans in default (even taking into account restructurings, extensions etc) rose from 16% in 3Q11 to 20% in 4Q11. In its Nov-11 study, S&P went even further, estimating that as much as 60% of European CMBS could fail to repay by end-2012. (For comparison, in its Apr-12 study, Fitch estimated the default rate of new US CMBS notes will reach 14.5% by end-2012, down from end-2011, figure of 15% including modified loans).
- We maintain positive view of the 2012 outlook for muni-related earnings of the investment banks under our coverage; but also acknowledge the increasingly lively discussion in the wider market. In recent months, some commentators have pointed out that US local governments' finances may eventually be overwhelmed by the pension liabilities; others stressed there are vast differences between individual states (e.g. according to NASRA, California and Alaska allocated 6-6.5% of their total 2009 spend to pensions, versus 3% at the US level) and that, anyway, some of those liabilities may be 'renegotiated' if states cannot pay, due for example to budget cuts: indeed, public workers in 43 USA states saw their pension benefits sharply decline since 2009, according to National Conference of State Legislatures. (As an aside, following a demise of several AAA-rated insurers, this discussion logically leads into whether munis are actually a rates product – driven by interest rates – or a credit product, subject to the perception of the issuer's credit quality.) The regulatory clouds have been gathering since 2010, when SEC - which regulates brokers, advisers and other financial participants in the muni market – established a dedicated

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5 *According to FT and WSJ, which quoted EBA data as of Sept-11, banks facing losses include UniCredit (c.EUR240m/$315m), Deutsche Bank ($130m), and BNP Paribas (c.$100m); HSBC and RBS may gain $232-254m.*

muni unit, which wasted no time in bringing fraud charges against several high-profile market participants (including San Diego officials, New Jersey, Wachovia). SEC's initiative will likely continue apace, but we do not expect fundamental changes to disclosure rules in the election year. Similarly, in Feb-12, Obama administration proposed, in its fiscal 2013 budget, a reduction in tax breaks to families with annual income exceeding $250k+. Considering the importance of such retail investors in the muni market, this could have visible impact; and yet, the market shrugged off the move, assuming that the proposal will not make it through the fractured Congress anytime soon. Finally, there is an omnipresent Volcker rule, the strict interpretation of which could adversely impact issues by non-state public agencies (housing agencies, hospitals etc.), which some sources put at 40% of the market.

Notwithstanding these significant factors, we do not expect a slowdown in the market in 2012. To the contrary, we note that some of the main market participants (including the banks our core coverage) have been hiring across the board in recent times (see our Jan-12 'Muni Market Resilience: why the sell-side headcount matters'); JPM laid off some staff in Mar-12 from its Public Finance Group, but this amounted to <5% of the total team. We also expect that exceptionally strong inflows into muni funds in 1Q12 (spurred on by 10%+ returns in 2011) will translate into higher demand for fresh issues – and therefore stronger revenue for 'our' banks.

- In Commodities, we hear the persistent strength of oil price was generally anticipated; we cannot see which macroeconomic *fundamentals* could be underpinning the oil price strength, and so attribute this, to a degree, to governments' fiscal interventions (LTRO and equivalents). At approximately $125/bbl at end-1Q12, Brent Crude Oil is far below the July-08 high of $147; *but* it has traded well above $100/bbl since mid-2011, firmly establishing the three-digit price as 'normal'. Our specialist sources disagree regarding the crude price outlook, although only by a small margin. Some say that price will weaken 15%+ in the coming months, driven down by normalisation on the geopolitical scene (principally Iran), deceleration in China's economic growth, increase in the US shale production, and bulls unwinding their positions; others, however, see no lasting downward pressure on price and expect any weakness to be both smaller and *very* temporary. We expect the lack of volatility (the OVX ['Oil VIX'] index has been trending down from Oct-11 59 level to end 1Q12 at 29 and down to 25 at end-April, levels seldom seen in the past 2 years) and range-bound pricing to contribute to a slowdown in oil trading revenues among banks we follow.
- On a related note, copper futures have been oscillating in a narrow range throughout 1Q12 – until early Apr-12, when the price dipped before recovering. Banks frequently make sizeable directional bets in metals trading; 2011 featured Credit Suisse, Barclays Capital, JP Morgan, among others. If the copper price breaks through the 4-month support level, it could have a meaningful positive or negative impact on banks' 2Q12 metals trading revenue.

Themes

On the salary/bonuses front, the latest rumour is that EU lawmakers – reportedly responding to EBA's recent study - are seeking to enforce a cap on bonuses. In late Mar-12, Reuters quoted Othmar Karas, the Austrian centre-right lawmaker and the EU Parliament's chief negotiator, as saying that '…variable pay should be no more than double the fixed.'; in mid-Apr-12, the FT reported that Mr Karas as signalling the bonus may be capped at the level equal to the salary. Other, even more exotic, suggestions reportedly include limiting the top pay of bankers to 4x that of the nation's chief watchdog, 3x the salary of the nation's head of government, etc. Whatever variable/fixed ratio may finally be imposed it will reduce banks' cost flexibility, already eroded in the wake of the EU's 2010 curbing the size of the cash portion of an overall pay package. At the time, banks surged fixed salaries to compensate their key employees caught by the scheme for the loss and/or deferral of the bonus; in their responding to this latest move from the EU lawmakers, we expect they would do so again.

Imposing a fixed ratio – as opposed to achievement of dynamic financial targets - especially in the industry as cyclical as capital markets is, put mildly, unwise. In fact, we would not be surprised to see banks taking legal action to define the extent and the depth to which governments should be able to impose pay practices at privately-owned firms; or – as we believe – this is the matter for Board of Directors/equivalent and increasingly assertive shareholders e.g. Citi's and Barclays' shareholders revolt over executive pay in Apr-12[6] (the Company Section, below). We understand these votes are not legally binding, and banks' Boards do not have to follow them; but then, shareholders do not have to hold on to their shares either (except, perhaps, the typically docile tracker funds), so there is a nice balance. We are also curious to hear about regional detail: unless the US and APAC legislate similar limits (which seems doubtful, even with the US in the election year), Europe - and London in particular - could be disadvantaged indeed. The European Parliament is set to vote on this issue on 8-May-12.

In Feb-12, the UK's Financial Services Authority (FSA) approved, in principle, 'liquidity swaps' for UK banks. Under this arrangement – which was under formal review since July-11 - banks would swap their portfolios of less liquid assets (e.g. mortgages, corporate loans, other) for UK Government paper and/or other highly liquid bonds held by pension funds, insurers, asset managers, investment banks, and similar. In theory, both sides benefit. Banks may use their new 'liquidised' portfolios as collateral for cheap loans from Bank of England (BoE) and the ECB. The lenders of liquid paper – some of which operate under capital rules significantly different from those governing corporate banks – will benefit from higher interest rates typically generated by less liquid assets; they will also charge a fee for the swap, and apply a discount to the illiquid assets they received. Clearly, the swaps are far from risk-free –a point emphasised by the BoE's Deputy Governor Paul Tucker in his Mar-12 speech to the Association of British Insurers (ABI) - but the benefits could also be considerable. On balance, we would not be surprised to see such liquidity swaps becoming popular across Europe and possibly beyond.

The latest gem from the US financial regulators, led by The Fed, concerns the 'Volcker Rule', which seeks to ban standalone proprietary trading in certain products, and hedge and private equity fund activities. In Apr-12, the Fed Board advised banks they will not have to be fully compliant with the Rule until late July-14; the 2-year deadline for full implementation is longer than many (including us) anticipated, and The Fed left open the possibility of this deadline being extended beyond July-14. To us, this suggests the final version will be less stringent than originally intended. More importantly, though, The Fed's announcement extends the central theme of the implementation of the Rule: utter confusion. In its Statement of Policy, The Fed wrote that '…banking entities should engage in good-faith planning effort...', which '…may include complying with reporting or recordkeeping requirements if such elements are included in the final rules…': with the Rule yet to be finalised, it is not clear at all what steps banks were supposed to take.

[6] *Barely a week after Barclays' shareholder vote, it was Aviva's turn: the insurer announced its CEO will not receive a salary rise, and that the firm will undertake a wide review of whether executive remuneration is justified by shareholders returns. Needless to say, the announcement received widespread media attention, from which we single out the truly outstanding 'The New Puritanism' article published by Jonathan Guthrie in 30-Apr-12 FT Lombard section.*

Results Summary

Product Revenue: Summary

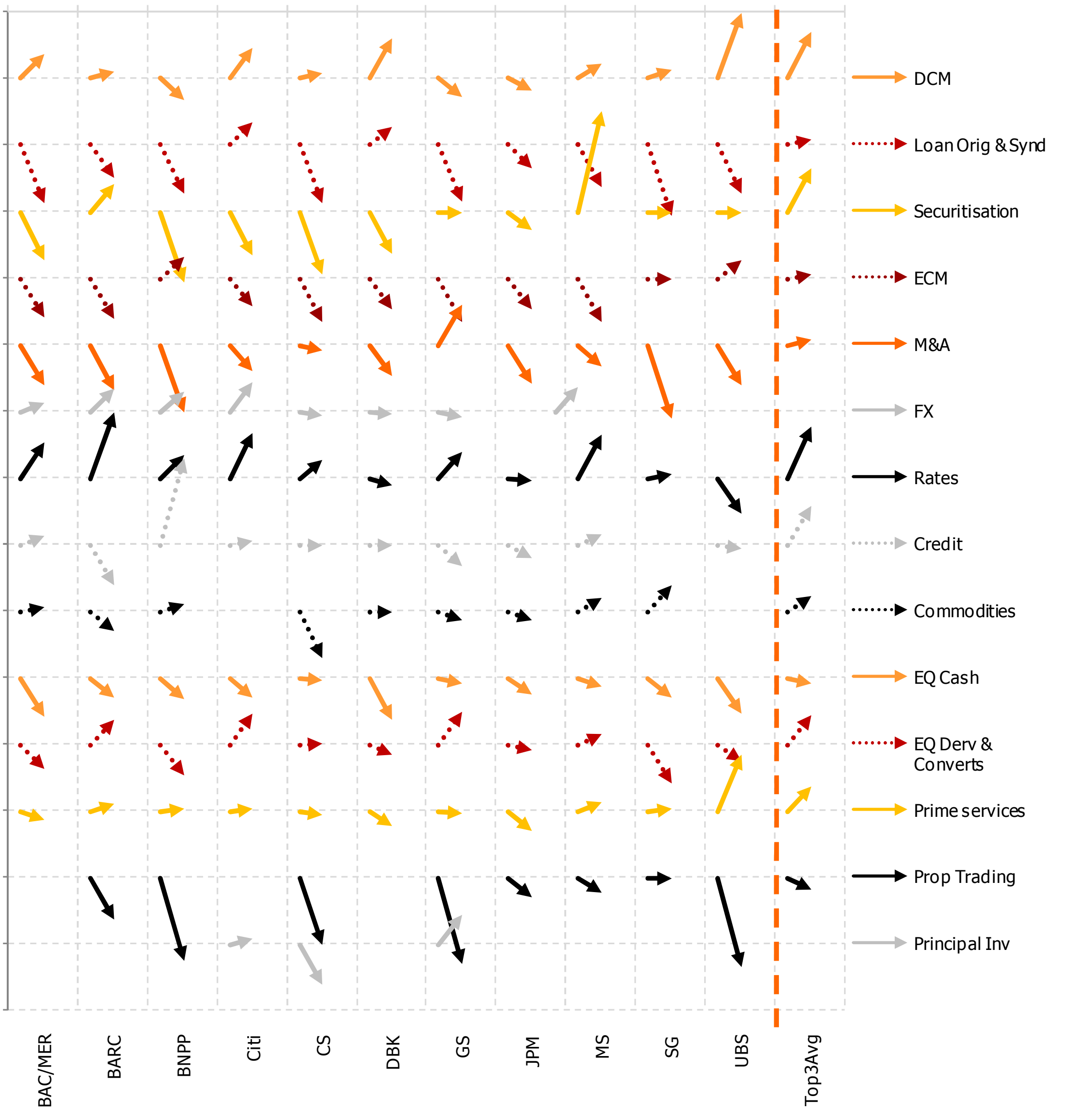
(Peer Group Average*, TRIC product definitions, post-writedowns, US$m, Level 1 estimate)

	FY09	FY10	1Q11	2Q11	3Q11	4Q11	FY11	1Q12	1Q12/1Q11: Top 3 growth
Total: TRIC definition	20,206	18,409	5,665	4,461	2,691	2,651	15,467	5,256	Citi / BARC / MS
Primary	3,142	4,360	1,210	1,222	784	737	3,952	933	Citi / DBK / BARC
DCM	1,083	1,024	268	212	94	197	770	299	UBS / DBK / Citi
Loan Orig & Synd	597	1,012	284	338	244	207	1,073	184	Citi / DBK / JPM
Securitisation	-670	423	178	82	81	-28	313	98	MS / BARC / JPM
ECM	1,171	912	224	262	116	116	717	155	BNPP / UBS / Citi
M&A	961	988	256	328	249	245	1,078	197	GS / CS / MS
Secondary	17,175	13,777	4,404	3,199	1,952	1,858	11,412	4,269	MS / Citi / BARC
FX	1,771	1,786	460	420	425	392	1,698	493	CS / BNPP / BARC
Rates	5,108	3,360	995	770	609	547	2,919	1,239	BARC / SG / Citi
Credit	3,060	2,983	1,163	676	36	32	1,906	1,051	BNPP / MS / BAC/MER
Commodities	1,130	766	267	142	200	136	745	261	SG / UBS / MS
EQ Cash	1,643	1,374	426	323	308	268	1,325	344	CS / GS / MS
EQ Derv&Conv't	2,047	1,883	611	508	322	261	1,701	576	GS / Citi / BARC
Prime services	870	786	207	212	199	191	809	218	UBS / GS / MS
Prop Trading	1,545	839	274	147	-146	32	308	86	SG / MS / JPM
Principal Inv	-111	272	51	40	-45	56	103	55	DBK / GS / Citi

** (1) Peer Group: BAC/MER, BARC, Citi, CS, DBK, GS, JPM, MS, UBS. (2) 'Averages are calculated on a line-by-line basis.*

Product Revenue: Momentum*

1Q12/1Q11 (TRIC product definitions, post-writedowns, % change, Global Level 1 estimate)



*Source: Tricumen analysis. * The up/down angle of arrows represent growth/decline in revenues, in US$.*

Notes & Caveats

Tricumen Limited has used all reasonable care in writing, editing and presenting the information found in this report. All reasonable effort has been made to ensure the information supplied is accurate and not misleading. For the purposes of cross-market comparison, all numerical data is normalised in accordance to Tricumen's proprietary product classification and may contain +/-10% margin of error.

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