

Financial services: challenges and prospects

**Sector research on the impact of globalisation
on the financial services**

**Draft case study report – part 5:
Case study 3: Companies with a “Liberal” approach**

Study for
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EUROFOUND

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Abbreviations

| | |
|---------|---|
| ABF | Asset Based Finance (division of Commerzbank) |
| ABS | Asset-backed Securities |
| AGM | Annual General Meetings |
| AM | Asset Management (division of Deutsche Bank) |
| ATM | Automatic Teller Machine |
| BaFin | German Federal Financial Supervisory Authority |
| BFSR | Bank Financial Strength Rating |
| BGI | Barclays Global Investors (division of Barclays) |
| bn | Billion = 10 ⁹ |
| bps | Basis points |
| BSA | Building Societies Association |
| CB&S | Corporate Banking & Securities (division of Deutsche Bank) |
| CCP | Central Counter Parties |
| CDO | Collateralized Debt Obligation |
| CEA | European Insurance and Reinsurance Federation |
| CEE | Central and Eastern European Countries |
| CEIOPS | Committee of European Insurance and Occupational Pensions Supervisors |
| CIB | Corporate & Investment Banking (division of Unicredit) |
| CIS | Commonwealth of Independent States |
| CMBS | Commercial Mortgage-backed Securities |
| CRM | Customer Relationship Management |
| CRO | Chief Risk Officer |
| CTA | Commodity Trading Advisors |
| DNB | Dutch Central Bank |
| EACB | European Association of Cooperative Banks |
| EBF | European Banking Federation |
| ESRB | European Systemic Risk Board |
| ESRC | European Strategic Risk Council |
| ETN | Exchange Traded Note |
| ETP | Exchange Traded Product |
| EURIBOR | Euro Interbank Offered Rate; Euro based interest rate for interbank credits |
| FIC | Fixed Income & Currencies |
| FICC | Fixed Income, Currency and Commodities |
| FSA | Financial Services Authority in the UK |
| FSB | Financial Stability Boards |
| FSCS | Financial Services Compensation Scheme |
| FT | Financial Times |
| FTD | Financial Times Deutschland |
| FTE | Full-time Equivalents |
| FYE | Fiscal Year End |
| GRCB | Global Retail and Commercial Banking (division of Barclays) |
| GTB | Global Transaction Banking (division of Deutsche Bank) |
| H109 | First half of 2009 |

| | |
|-------------|--|
| HB | Handelsblatt |
| HR Treasury | Her Majesty Treasury |
| HVB | Hypo Vereinsbank |
| IASB | International Accounting Standards Board |
| IBIM | Investment Banking and Investment Management (division of Barclays) |
| ICAAP | Internal Capital Adequacy Assessment Process |
| IFRS | International Financial Reporting Standards |
| IIF | Institute of International Finance |
| IMF | International Monetary Fund |
| IPO | Initial Public Offer |
| LBO | Leveraged Buyout |
| LIBOR | London Interbank Offered Rate; the interest rate for interbank credits |
| LOHAS | Lifestyle of Health and Sustainability |
| m | Million = 10^6 |
| M&A | Mergers & Acquisitions |
| MIB | Markets & Investment Banking (division of Unicredit) |
| NPL | Non-performing Loans |
| OCG | Office of Governmental Commerce |
| OTC | Over-the-Counter Trade |
| PLC | Public Limited Company |
| PPL | Potential Problem Loans |
| PRU | Portfolio Restructuring Unit (division of Commerzbank) |
| PWM | Private Wealth Management (division of Deutsche Bank) |
| REIL | Risk Elements in Lending |
| RMBS | Residential Mortgage-backed Securities |
| RWN | Rating Watch Negative |
| SGB | Social Code |
| SIV | Structured Investment Vehicle |
| SME | Small and Mid-sized Enterprises |
| SoFFin | Financial Market Stabilization Fund in Germany |
| SZ | Süddeutsche Zeitung |
| TITF | Too Important to Fail |
| VaR | Value at Risk |

Counting convention Million = 10^6 ; billion = 10^9 ; trillion = 10^{12}

List of reports

This report is part of the study “Financial services: challenges and prospects. Sector research on the impact of globalisation on the financial services” which contains the following reports:

- Part 1: Draft final overview report
- Part 2: Case study methodology and annex
- Part 3: Case study 1: Building societies in the UK
- Part 4: Case study 2: Generali
- Part 5: Case study 3: Companies with a “Liberal” approach
- Part 6: Case study 4: Companies with a “Sustainable Finance” approach
- Part 7: Case study 5: Companies with a “State Ownership” approach

The ‘liberal’ approach

A broad group of financial institutions follow a ‘liberal’ approach based on the free movement of capital and unrestricted innovation in capital markets. Retail banking is the basis of this business model; investment banking is also an important part. Many of the big players in European banking markets, such as Deutsche Bank, Barclays, Unicredit, BNP Paribas, Société Générale, see themselves as universal banks, which offer all types of financial services. Nevertheless, this group also includes a great variety of investment banks, funds and intermediaries, which service the big consumer-oriented banks with specialised financial products. Moreover, the big institutions have created their own investment banking subsidiaries. Their shared view is that the pre-crisis business model has strong advantages, since capital markets proved to be efficient and provided important market opportunities and profits.

Of course, many companies in this segment are going to adapt their business models in response to the financial crisis. They started to raise equity ratios during 2009, improve risk assessment tools, reduce costs by cutting jobs, and revise their bonus systems. These adaptations however, do not affect the core business, which includes a strong investment segment in addition to retail and commercial banking.

The strategy was reaffirmed by the rapid recovery of profits in 2009. Profit rates are not yet back to the pre-crisis levels, but are comparable to average long-run achievements. The recovery is mainly attributed to trading activities and the upgrading of assets in the course of the recent upswing. The fair-value principle and the ‘cheap money’ policy of central banks have both contributed to profits. This confirms that the previous business model is economically reasonable, no fundamental change being seen as required.

For this case study, three financial institutions representing this ‘liberal’ approach were selected: Barclays, Deutsche Bank and Unicredit. The companies’ financial details are outlined in Table 1.

Table 1: Representative companies – financial details

| Financial institution | Economic performance 2009 | Income structure 2009 | Business model |
|------------------------|---|---|---|
| Deutsche Bank, Germany | Pre-tax profit: €5 billion Tier 1 capital ratio: 12.6% Leverage ratio: 23 Employment: 77,100 Employment 2008–2009: -4.2% | Corporate and investment banking (70%) Asset and wealth management (10%) Private and business clients (20%) | Goal: to be the leading global investment bank Operation: strengthening profitability of corporate and investment banking; focusing on asset and wealth management; expanding operations in Asia |
| Unicredit, Italy | Pre-tax profit: €3.3 billion Tier 1 capital ratio: 7.6% Leverage ratio: 24 Employment: 165,100 Employment 2008–2009: -5.4% | Retail banking (41%) Commercial and investment banking (36%) Central and Eastern Europe (23%) | Goal: to be a universal bank with strong customer orientation Operation: customer centred, by promoting proximity and simplicity; cost efficiencies by concentrating activities |
| Barclays, UK | Pre-tax profit: €1.6 billion Tier 1 capital ratio: 13% Leverage ratio: 20 Employment: 144,200 Change in employment 2008–2009: -5.6% | Investment banking and asset management (48%) Retail and commercial banking (52%) | Goal: to be a universal bank leading the global financial services industry Operation: pioneering financial markets with best people and strong customer orientation |

Source: Company information, press media

Response to the crisis

None of the three banks relied on public financial support during the crisis. Josef Ackermann the CEO of Deutsche Bank said, in an interview with Der Spiegel in October 2008: 'It would be a shame for Deutsche Bank to apply for the taxpayers' support'. Similarly, Barclays raised €3.3 billion (GBP 7 billion as at 16 July, 2010) on its own in 2008, rejecting an offer of help from the UK government, when other banks were being recapitalised. Unicredit also raised new capital in 2009–2010.

The crisis enforced substantial writedowns on assets. In 2008, Deutsche Bank had to compensate for a €10 billion loss from the trading book and the bank's own investments. Similarly, Barclays had a writedown of €9.4 billion (GP 8.0 billion) in 2008. At the same time, provisions for credit losses increased over the course of the crisis. Unicredit had to correct values of both assets and credits by €3.7 billion in 2008 and €3.3 billion in 2009. All three banks reacted to the financial crisis with strong deleveraging. The volume of total assets has decreased by 10% for Unicredit and by around 30% for both Barclays and Deutsche Bank. Risk-weighted leverage ratios have been substantially and accordingly reduced.

The 2009 upswing on stock exchanges all over the world brought banks back to profitability. Barclays in particular achieved an almost 100% increase of pre-tax profits in comparison with its already remarkable profits in 2008. This resulted in a 24% profit rate for shareholders in 2009. Deutsche Bank achieved a profit rate of 15% after a similar loss in 2008. Unicredit achieved a profit of only 5.5%, which was due to the significant rise of writedowns in 2009.

Business models

The banks see themselves as universal banks, but nevertheless have different goals. Barclays and Unicredit have a stronger retail banking orientation, while Deutsche Bank describes itself as a universal investment bank. They all want to be a market leader in financial services. Barclays and Deutsche Bank define this goal in a global context. Unicredit sees itself as a strong leader in its core markets of Italy, Germany, Austria and the central and eastern European (CEE) countries. All three banks have a strong corporate and investment banking pillar, which was the major source of revenues in 2009. This is particularly the case for Deutsche Bank, which earned 70% of its 2009 revenues in this segment. For Barclays, the share was 48% and for Unicredit 36%.

Customer relations became a core element of the business strategies over the course of the crisis. Unicredit developed the 'One For Clients' approach, which started restructuring customer services with the aim of increasing proximity and simplicity. Deutsche Bank launched 'Phase Four' of its management plans, which has the aim of making the company the leader, in its home markets, in private banking and asset management.

Nevertheless, shareholder value is the top goal of the banks' strategies. Barclay's, in its 2009 Annual Report, states: 'Our primary objective is generating returns for shareholders. But we recognise that we can, and should, in ways consistent with that objective, contribute to the well-being of society by conducting our business responsibly and by performing well, on behalf of our customers, our core functions of payments and money transmission, safe storage of deposits, maturity transformation and lending, and the provision of advice and execution in underwriting and trading' (Barclays, 2009). Deutsche Bank also wants to '... turn strong relative performance through the crisis into profitable growth for our shareholders in the post-crisis environment' (Deutsche Bank, 2009a). This indicates that market services, customer relations, investment strategies, and jobs are instrumental rather than generic targets.

During the crisis the banks continued their expansionary strategies. Barclays acquired Lehman Brothers' North American Investment Bank in 2008. Deutsche Bank bought parts of Deutsche Postbank AG (which has a sizeable retail banking arm), the Sal. Oppenheim Group (which has strong asset management facilities), and ABN Amro's commercial banking branch. Moreover, it expanded its Chinese exposures. Unicredit continued with integrating its Italian subsidiaries and restructuring their activities abroad. The companies have used financial strength they regained to grow by expanding.

Employment

The adjustment strategies of all three companies included a significant decline in the number of jobs. In 2009, Barclays cut 5.6% of its jobs, Unicredit reduced staffing levels by 5.4% and Deutsche Bank by 4.2%. These job cuts are unprecedented in the recent history of the companies. They were particularly severe in retail banking and asset management. Head offices were, however, not affected in the same way and some – as in the case of Barclays – even expanded.

The reduction of employment contributed to profitability in a substantial way. Cost-income ratios declined between four and six percentage points, falling to 58% and 56% for Barclays and Unicredit respectively. Deutsche Bank almost halved its ratio to 72% (losses in 2008 had shifted its costs well above its income).

Remuneration

All three banks adjusted their remuneration schemes by introducing long-term incentives. Bonus payments are now being deferred over a period of years and equity-based remuneration is a substantial part of total compensation for executives. At Deutsche Bank, employees who create risk positions receive 14% of their remuneration as part of a fixed salary, 36% as a cash bonus and 50% as deferred awards over a period of three and three-quarter years. Similar relations are applied by Unicredit and Barclays.

Regarding top management remuneration, the CEOs of Barclays and Deutsche Bank did not receive any performance bonuses in 2008. Barclays gave no salary increases and no annual performance bonuses to employees in 2008, and long-term awards were 64% lower than in 2007. In general, institutions are much more sensitive to public criticism regarding bonus practices. Banks have started to publish remuneration reports on a voluntary basis and are following the suggestion to introduce long-term incentives. In the meantime, however, the growing need for investment bankers will test these new initiatives.

Risk management

All banks have made considerable efforts to realign risk management and improve assessment methods. The chief risk officer is usually a member of the management board and a series of risk committees execute the risk assessment in various operational segments. Performance targets are used to monitor the different activities.

Financial capital is used as a principal approach for calculating the capital needed to absorb severe and unexpected losses arising from exposures. It is calculated for credit risks, market risks (including traded default risks), operational risks and general business risks. In the course of the crisis, however, economic capital has been continually recalibrated to reflect the extreme market moves of 2008. This means that the concept strongly relies on past experience, which is misleading in times of radical change. Economic capital amounted to €21 billion at Deutsche Bank, €24 billion at Barclays and €4 billion at Unicredit.

Stress tests have been used to evaluate the impact of changes in general economic conditions on credit risks, and the effect of extreme market developments on asset values. Moreover, operational and liquidity risks have been assessed with assumptions beyond the key model parameters.

Table 2 gives information about risk-weighted assets and Tier 1 ratios for the three selected banks.

Table 2: Risk weighted assets and Tier 1 ratios (€billion)

| | Deutsche Bank | Barclays | Unicredit |
|--|---------------|----------|-----------|
| Total assets | 1,501 | 1,603 | 929 |
| Risk-weighted assets | 273 | 448 | 452 |
| Core Tier 1 capital | 23.8 | 44.8 | 38.3 |
| Tier 1 capital | 34.4 | 58.3 | 42.9 |
| Core Tier 1 capital / Risk-weighted assets | 8.7% | 10% | 8.5% |
| Tier 1 capital/ Risk-weighted assets | 12.6% | 13% | 9.5% |

Source: Company information, Economix

Ratings

During the first year following the crisis, the ratings for the three banks were slightly downgraded. This is remarkably positive, since these banks operate in the centre of capital markets and have a strong international orientation. The banks did not capture their aggregate exposures to the underwriting of different asset classes sufficiently and thus were unable to exit markets as quickly as was needed. The banks were therefore left with large, ‘lumpy’, higher-risk credit market exposures on their books as capital markets closed. They experienced large writedowns but were able to compensate for these losses with sufficient resources, cost savings and a rapid recovery. They all successfully survived the crisis and see no reason to change their business strategies.

One of the reasons for the minor downgrading is that all three banks profited from being ‘systemically important’ banks. They did not receive public support directly; however, the indirect stabilisation of the financial system by the provision of liquidity and guarantees was a significant help to them in recovering from the crisis and compensating for the high volume of write-downs. The supportive stance of national governments and the prospect of a gradual recovery of the European economies thus positively affected the 2009 ratings. The corollary of this is that a weakening ability of governments to expand public debt and to promote economic growth might again reduce the ratings for these banks. The deleveraging of exposures has also contributed to the stable ratings. According to rating agency Fitch, sound liquidity and diversified funding, the ongoing reduction of risk, and improving capitalisation are all substantial positive factors in the assessments.

Nevertheless, concerns exist regarding volatile and uncertain operating environments. The growing weight of investment banking and the challenges of managing the rapid growth of investment banking activities weigh negatively on the ratings. This is reinforced by the expectation that impairment charges are likely to grow. Further write-downs, particularly in the remaining leveraged finance transactions and monoline-wrapped securities, are expected. The continuing preponderance of capital market activities and the ensuing challenges for risk management have prompted Moody’s to downgrade Deutsche Bank’s long-term rating by two grades from Aa1 to Aa3. Similarly, for Unicredit, the on-balance sheet risks from its main investment banking arm, HVB, is assessed as being a weak point. Moreover, exposure to emerging markets in Europe – seen as a major strength by the Unicredit management board – is viewed by the rating agencies as a potential risk.

A third reason for the stable ratings in 2009 was cost efficiencies, which were used by all banks to compensate for potential losses. The reduction in the number of jobs and the adjustment of compensation and bonuses was assessed positively. The banks are expected to successfully implement further cost savings.

Outlook

According to the ratings agencies, the operating environment will continue to be difficult in 2010. Balance sheets are still vulnerable to the currently difficult economic and operating environment and capital ratios are expected to remain above historical levels. This will limit expansionary plans and burden profitability. An upgrade in the ratings would depend on a number of factors; these include:

- a reduced reliance on capital market activities;
- clear evidence that risk management and business line activities are working together efficiently;
- improved structural liquidity through a combination of a higher proportion of liquid assets and a reduced reliance on short-term wholesale funding.

The banks expect not only to remain profitable but to increase profitability in the medium and long term. Adjustments of operational business proved to be efficient and the opportunity to expand operations in growth markets is opening up. Deutsche Bank plans to increase profitability in investment banking ('... while satisfying discipline in risk and balance sheets'), expand retail banking and asset management, approach Asian markets and revitalise its performance. In total, this should yield a €10 billion profit in 2011, compared with €5 billion in 2009.

Unicredit's strategy relies on further growth in the countries of the CEE and the former Soviet Commonwealth of Independent States (CIS) and on the worldwide economic recovery. With limited growth for foreign and government debt, the bank feels well positioned in these markets. Nevertheless, profits will continue to be under pressure in the short term due to deteriorating credit quality and lower net interest incomes. In the long run, however, the bank's profitability is expected to improve significantly. The bank feels well positioned to exploit growth opportunities and cost efficiencies.

Barclays plans to deleverage its activities further and gradually bring down the loan-to-deposit ratio. The bank puts returns before growth, and believes that prudence should determine the approach to balance sheet size. According to the bank, it will '... continue to act as responsible corporate citizens' and 'ensure its wider responsibilities to society'. This, however, appears to contradict its strong commitment to provide returns to its shareholders as long as there is no switch to long-term sustainability. The overall strategy therefore remains unclear.

Deutsche Bank

Deutsche Bank is a leading global investment bank with a strong private client franchise. The bank's businesses are mutually reinforcing. As a leader in Germany and Europe, the bank is growing strongly in North America, Asia and key emerging markets. It has 77,053 employees and about 2,000 branches in 72 countries (as of 31 March 2010),

Financial performance

Deutsche Bank recovered in 2009 after suffering difficulties in 2008. The pre-tax results improved in 2009 compared with 2008, rising from a loss of €5.7 billion to a profit of €5.2 billion. Nevertheless, the results are poorer than before the financial crisis: in 2006, the pre-tax results were €8.3 billion, while in 2007 they were €8.7. A similar development can be seen in net profits. The Tier 1 capital ratio rose to 12.6% in 2009 compared with 10.1% in 2008. The amount of total assets was reduced from €2,202 billion to €1,501 billion between 2008 and 2009.

Table 3: Deutsche Bank, performance data, 2006–2009 (€billion)

| | 2006 | 2007 | 2008 | 2009 |
|---------------------|------|------|-------|-------|
| Pre-tax results | 8.3 | 8.7 | -5.7 | 5.2 |
| Net profit | 6.1 | 6.5 | -3.9 | 5.0 |
| Net interest income | 7.01 | 8.85 | 12.45 | 12.46 |

| | | | | |
|--------------------------|-------|-------|-------|-------|
| Tier 1 capital ratio (%) | 8.5 | 8.6 | 10.1 | 12.6 |
| Total assets | 1,584 | 2,020 | 2,202 | 1,501 |

Source: Deutsche Bank, annual reports 2007–2009

The total net revenues totalled €28.1 billion in 2009. Of this, the Corporate and Investment Banking division attained 66.9%, with the Private Clients and Asset Management bringing in 29.5% and Corporate Investments 3.6%.

Table 4: Deutsche Bank – Net revenues (€billion)

| | 2007 | 2008 | 2009 |
|-------------------------------------|------|------|------|
| Total net revenues | 30.2 | 13.5 | 28.1 |
| Corporate and Investment Bank | 18.8 | 3.2 | 18.8 |
| Private Clients an Asset Management | 10.1 | 9.0 | 8.3 |
| Corporate Investments | 1.3 | 1.3 | 1.0 |

Source: Deutsche Bank (2009a)

The provision for credit losses amounted to €2,630 billion in 2009 and was 144.4% more than in 2008. The leverage ratio accounted for 23 per target definition by the end of 2009.

Employment and branches

Number of employees

The number of employees decreased by 4.2% in 2009 compared with 2008. Of the reduction in staff capacity of 3,403 in 2009, around 48% of these jobs were lost in Europe (including Germany) and 33% in North and South America.

Table 5: Deutsche Bank – Number of employees by region

| | 2009 | 2008 | 2007 | 2006 |
|--|--------|--------|--------|--------|
| Total (full-time workers) | 77,053 | 80,456 | 78,291 | 68,849 |
| Percentage change from previous year | -4.2 | 2.8 | 13.7 | – |
| Germany | 27,354 | 27,918 | 27,793 | 26,369 |
| Europe (minus Germany), Middle East and Africa | 22,037 | 23,091 | 22,000 | 20,035 |
| North and South America | 11,173 | 12,310 | 13,466 | 11,704 |
| Asian-Pacific | 16,489 | 17,137 | 15,032 | 10,740 |

Source: Deutsche Bank, annual reports 2007–2009, Economix

The reduction of employees mainly affected the Corporate and Investment Banking division, where 641 employees were laid off, and Private Clients and Asset Management, where the workforce was reduced by 1,997 employees. The Infrastructural Area, where the company's internal services are globally performed, shed 771 jobs (Deutsche Bank, 2009a).

The amount of employees decreased by around 5.2% in Private Clients and Asset Management and by 5.8% in Corporate and Investment Bank (including Corporate Investments). The number of employees in Infrastructure/Regional Management decreased by 2.6%.

Table 6: Deutsche Bank – Proportion of employment, by business sector (%)

| | 2007 | 2008 | 2009 |
|---|------|------|------|
| Private Clients and Asset Management | 39.9 | 40.2 | 39.8 |
| Corporate and Investment Bank (Including Corporate Investments) | 21.1 | 18.7 | 18.4 |
| Infrastructure/Regional Management | 39.0 | 41.1 | 41.8 |

Source: Deutsche Bank (2009)

Profile of employees

The number of employees who have a university degree is high and only marginally decreased between 2007 and 2009.

Table 7: Deutsche Bank – Educational level of employees (%)

| | 2007 | 2008 | 2009 |
|-------------------------------------|------|------|------|
| University degree | 64.4 | 64.0 | 63.5 |
| High-school certificate | 17.4 | 17.3 | 19.1 |
| Other school qualifications degrees | 18.2 | 18.7 | 17.4 |

Source: Deutsche Bank (2009)

The majority of employees at Deutsche Bank are between 25 and 44 years old. The age distribution has not changed in recent years.

Table 8: Deutsche Bank – Age distribution of employees (%)

| | 2007 | 2008 | 2009 |
|--|------|------|------|
|--|------|------|------|

| | | | |
|-------------------|------|------|------|
| Aged 24 and under | 10.0 | 9.9 | 8.4 |
| Aged 25 to 34 | 35.2 | 35.5 | 35.0 |
| Aged 35 to 44 | 32.3 | 31.7 | 32.2 |
| Aged 45 to 54 | 17.9 | 17.9 | 19.0 |
| Aged 55 and over | 4.6 | 5.0 | 5.4 |

Source: Deutsche Bank (2009)

Since 1999, Deutsche Bank has been surveying the satisfaction and commitment of its employees every year. The so-called index of commitment among employees rose from 71 in 2007 to 74 in 2008 and to 77 in 2009. The average length of service at Deutsche Bank was 10.1 years in 2009.

The number of apprentices remained almost stable in 2009, at 1,429 (it had been 1,462 in 2008). Moreover, Deutsche Bank recruited 771 university graduates and offered 670 eight-week internships to students in 2009.

Branches

The number of branches has continually increased in recent years and lies at 1,964 in total. Of these, 961 branches are in Germany. The number of branches in Germany decreased by 28 (around 3%) between 2007 and 2008 but remained stable in 2009.

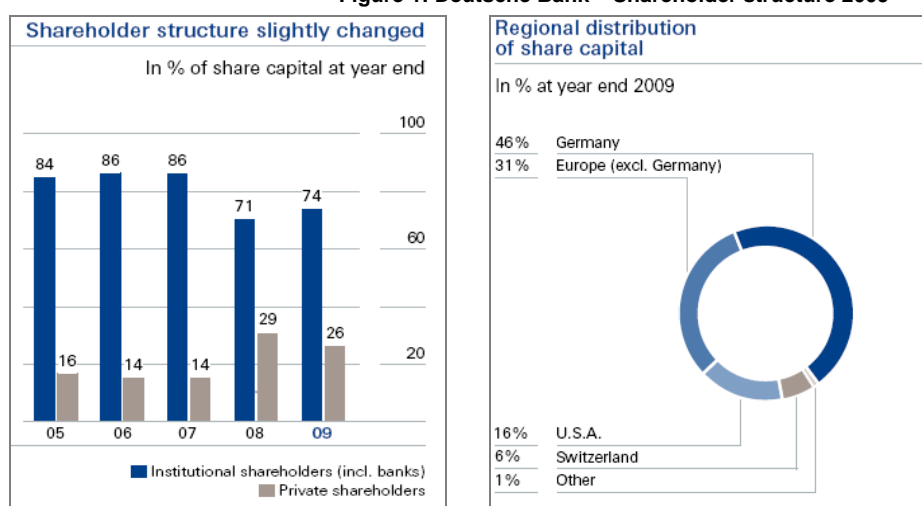
Table 9: Deutsche Bank – Number of branches

| | 2006 | 2007 | 2008 | 2009 |
|---------|-------|-------|-------|-------|
| Total | 1,717 | 1,889 | 1,950 | 1,964 |
| Germany | 934 | 989 | 961 | 961 |

Source: Deutsche Bank, annual reports 2007–2009

Ownership structure

Figure 1: Deutsche Bank – Shareholder structure 2009



Source: Deutsche Bank (2009a)

The number of outstanding shares increased from 562.7 million in 2008 to 628.1 million in 2009. The total number of shareholders remained stable at around 580,000. The share price collapsed between

2007 and 2008 and recovered at a higher level in 2009. The basic earnings per share increased from € 7.61 in 2008 to €7.92 in 2009.

Table 10: Deutsche Bank – Shares, share prices and shares earnings

| | 2007 | 2008 | 2009 |
|---|---------|---------|---------|
| Number of outstanding shares (millions) | 501.1 | 562.7 | 628.1 |
| Total number of shareholders | 360,785 | 581,938 | 586,295 |
| Shares price in € ^{a)} | 89.40 | 27.83 | 49.42 |
| Basic earnings per share in € | 13.65 | -7.61 | 7.92 |

Note: ^{a)}Xetra - closing price

Source: Deutsche Bank, annual reports 2007–2009

A dividend of €0.75 per share was recommended by the bank for 2009, an increase of 50% over 2008 (when the dividend per share was €0.50). In 2007, the recommended dividend per share was €4.50. The bank points out that the dividend increased only modestly in 2009 because strengthening the capital base is the number one priority.

Key acquisitions (not sure about this being H2)

In 2010, Deutsche Bank acquired parts of ABN Amro's commercial banking activities in the Netherlands for €700 million. The acquisition includes 34,000 new clients and 1,300 new employees. With the acquisition, Deutsche Bank became the fourth largest commercial bank in the Netherlands.

Moreover, the Sal. Oppenheim Group was purchased for €1 billion in 2010, excluding BHF Asset Servicing which was being sold on. Sal. Oppenheim is an asset management bank with its headquarters located in Luxembourg.

In 2009, Deutsche Postbank AG shares worth €50 million (approximately 22.9% of the total shares) were transacted to Deutsche Bank, while the Deutsche Post will hold a stake of approximately 8% of Deutsche Bank. The Deutsche Postbank AG is the leading retail bank in Germany and the major low-cost provider for retail banking services.

Deutsche Bank's strategy

Deutsche Bank is a leading global investment bank and the largest bank in Germany. The bank employs around 80,000 people and serves around 14 million customers in 72 countries. The business model for Deutsche Bank is included in the bank's management agenda, which was established in 2002. It contains three phases: the first phase (2002–2003) involved refocusing the business and concentrating on the Deutsche Bank platform. The second (2002–2005) focused on growth in core businesses and the achievement of a pre-tax return on equity of 25%. The third phase (2006–2008), as set out by the bank's CEO Josef Ackerman, comprised the leveraging of the global platform for accelerating growth and included four core elements:

- maintaining cost, risk, capital and regulatory discipline;
- investing in core businesses, both through organic growth and through incremental acquisitions;
- growing the global transaction banking and private client and asset management businesses;
- establishing a competitive edge in corporate and investment banking.

A new, fourth phase was launched in December 2009 and covers the period up until 2011. It contains the following pillars.

Corporate and Investment Banking This pillar comprises the following goals:

- increase the profitability and quality of earnings using renewed risk and balance-sheet discipline;
- strengthen global equity, commodity and electronic trading platforms;
- reach a global position in the top five for corporate finance;
- maintain profitable growth in global transaction banking.

Private Clients and Asset Management This pillar comprises three key tactics:

- focusing on core businesses and home market leadership;
- focusing on core product groups and improved efficiency in Asset Management; and
- strengthening leading positions in the sub areas of private and business clients and private wealth management in Germany.

Focus on Asia Deutsche Bank sees this as the main driver of revenue growth in the industry. It plans to:

- create further investments to strengthen the position in corporate and investment banking and global transaction banking within the region;
- double the size of the the private wealth management business.

Vitalise performance culture The bank plans to do this by:

- Insensitive concentration on cost discipline and optimising the infrastructure processes;
- improving control of the bank by implementing new performance metrics and enhancing the value-based management system.

Moreover, the bank focuses on four key elements in corporate governance in order to lay a foundation for a responsible and performance-oriented management. These are:

- good relations with shareholders;
- effective cooperation between the management board and the supervisory board;
- a performance-related compensation system;
- transparent and timely reporting.

Performance of business segments

Deutsche Bank has operations in Germany, the rest of Europe, the Middle East and Africa, North and South America, and Asia-Pacific.

The management structure is illustrated in Figure 2. The main group divisions are corporate and investment banking, corporate investments and private clients and asset management. These are divided into a number of subgroups.

Figure 2: Deutsche Bank – Management structure

| | | |
|--|--------------------------|---|
| Functional Committees | | |
| Group Executive Committee Management Board Business Heads/Regional Head | | |
| Corporate and Investment Bank | Corporate Investments | Private Clients and Asset Management |
| Regional Committees | | |

Source: Deutsche Bank (2009a)

Corporate and investment banking

The group's Corporate and Investment Bank division is responsible for Deutsche Bank's capital markets business, which includes the organisation, sales and trading of capital market products (including debt) and other securities, corporate advisory, corporate lending and transaction banking businesses.

The subdivision Corporate Banking and Securities comprises the businesses Global Markets and Corporate Finance and includes the origination, sales and trading of securities, as well as corporate advisory and mergers and acquisitions (M&A) businesses.

The second subdivision, Global Transaction Banking, comprises cash management, trade financial business and trust and securities services.

Table 11: Deutsche Bank – performance of Corporate and Investment Bank (€ billion)

| | 2007 | 2008 | 2009 |
|--|-------|-------|-------|
| Net revenues | 18.8 | 3.2 | 18.8 |
| Income before income tax | 5.15 | -7.37 | 4.32 |
| Total provision for credit losses | 0.11 | 0.41 | 1.81 |
| Risk-weighted assets (% of assets in this segment) | 12.5% | 12.2% | 15.2% |

Source: Deutsche Bank, 2007 and 2009a

After the crisis, the Corporate and Investment segment recovered in 2009. Net revenues increased from €3.2 billion to €18.8 billion. The upswing was driven mainly by the sales and trading business, realising revenues in some areas higher than before the crisis. The advisory business remained at low levels and low interest rates dampened the revenues from transaction banking.

The amount of total provision for credit losses was 4.5 times higher in 2009 than in 2008. Simultaneously, risk-weighted assets increased by three percentage points from 12.2% to 15.2% between 2008 and 2009.¹

Private Clients and Asset Management

The Private Clients and Asset Management division comprises the investment management business for private and institutional clients and traditional banking activities for private clients and medium-

¹ Risk-weighted assets (RWA) are positions that carry credit, market and/or operational risk, weighted according to regulatory requirements. RWAs are regulatory capital requirements multiplied by 12.5, or in other words, capital requirements equal to 8% of RWA (Annual Report 2009, p. 350)

sized companies. The Private Clients and Asset Management division includes two subdivisions: Asset and Wealth Management and Private & Business Clients.

Asset and Wealth Management again comprises two business divisions: Asset Management (AM) and Private Wealth Management (PWM). Within AM, the offer of mutual fund products to retail clients has been combined with the DWS franchise.² (Deutsche Bank, 2009b). Pension funds and a broad range of services and investments are provided to institutional clients and insurance companies. The other business division, PWM, offers wealth management, serves the needs of wealthy individuals and families globally, and comprises inheritance planning and advisory services for people working for charities. The subdivision Private & Business Clients offers traditional banking products such as current accounts, deposits and loans and management products.

In 2009 the Private Clients and Asset Management division strengthened its leadership in the German market for private client business. The branch network of Private & Business Clients comprises 1,821 branches in Germany, Italy, Spain, Belgium, Portugal, Poland, India, and China. The cooperation with Deutsche Postbank AG in this division includes standardised advisory services and cross-selling financial products. Synergy effects and additional long-term growth are anticipated, thanks to this cooperation.

The net revenues in this segment decreased by 9% in 2009 compared with 2008. The number of risky assets decreased considerably – by 26.6% between 2007 and 2009. Simultaneously, the total provision for credit losses increased by 62.0% from €0.50 billion in 2007 to €0.81 billion in 2009.

Table 12: Deutsche Bank – Performance of the Private Clients and Asset Management division (€billion)

| | 2007 | 2008 | 2009 |
|--|-------|-------|-------|
| Net revenues | 10.1 | 9.04 | 8.26 |
| Income before income taxes | 2.06 | 0.42 | 0.67 |
| Total provision for credit losses | 0.50 | 0.67 | 0.81 |
| Risk-weighted assets (% of assets in this segment) | 54.7% | 28.4% | 28.1% |

Source: Deutsche Bank, 2007 and 2009a

Corporate Investments

The group division Corporate Investment covers the bank's global investment activities, which comprise industrial shareholdings, equity investments (such as in Deutsche Postbank AG) and non-core assets such as real estate and credit exposures.

In 2009, the industrial shareholdings were reduced by a market value of €154 million, including the investment in Daimler AG, which fell from 2.7% to 0.04%, and the sale of the remaining stakes in Linde AG (2.4%). At the end of 2009, equity investments comprised Deutsche Postbank AG, Maher Terminals (a port operating company) and the Cosmopolitan Resort and casino property in Las Vegas. The latter two, however, are not part of the core business.

At the end of 2009, Deutsche Bank had non-core assets of around €6.1 billion. In December, a €12 billion liquidity facility was repaid by the Deutsche Pfandbrief AG (former Hypo Real Estate Bank AG) and €9.2 billion were entered into a new liquidity facility for the Deutsche Pfandbrief AG, particularly into European Central Bank (ECB)-eligible notes fully guaranteed by the German

²DWS Investment comprise the total stock business of Asset Management of the Deutsche Bank Group

Financial Market Stabilisation Fund (SoFFin). Moreover, €2.3 billion of ECB-eligible notes, guaranteed by SoFFin, were used to participate in a liquidity facility for banking entity SdB for claims of the Lehman Brothers creditors in Germany.

Table 13: Deutsche Bank – Performance of Corporate Investments (€billion)

| | 2007 | 2008 | 2009 | | | |
|--|-------|-------|-------|--|--|--|
| Net revenues | 1.30 | 1.29 | 1.04 | | | |
| Income before income taxes | 1.30 | 1.19 | 0.46 | | | |
| Total provision for credit losses | 0.003 | 0.001 | 0.008 | | | |
| Risk-weighted assets (% of assets in this segment) | 37.6 | 14.7 | 59.5 | | | |

Source: Deutsche Bank, 2007 and 2009a

The net revenues in Corporate Investment decreased by almost 20% in 2009 and the amount of risk-weighted assets increased sustainably by 44.8% from 14.7% in 2008 to 59.5% in 2009.

New remuneration model

As a result of the financial crisis, Deutsche Bank has adjusted its remuneration system to meet the requirements of the German Federal Financial Supervisory Authority (BaFin) and the Financial Stability Boards (FSB) as well as the guidelines of the G20 governments. Moreover, the bank has voluntarily published a remuneration report, which explains the compensation structure and practices, along with the related corporate governance structure and the basic remuneration of the management board and the supervisory board (Deutsche Bank, 2010b).

The management board received a total of €38,978,972 in 2009 (compared with €4,476,684 in 2008), which comprised both a non-performance-related amount and a performance-related amount. The various components are presented in Table 14. In 2008, the management board waived its performance-related remuneration. The performance-related components comprise bonuses, mid-term incentives and a division incentive for the management board, which is responsible for the Corporate and Investment Banking division. The value of the return on equity is essential for the validation.

In order to meet adequately the composition of variable and fixed remuneration, the basic salary of a member of the management board is set at €1.15 million, with €1.65 million for Josef Ackermann. At least 60% of the variable remuneration has long-term incentives.

Table 14: Deutsche Bank – Remuneration components of management board (€)

| | 2008 | 2009 |
|--|-----------|------------|
| Non-performance related components | | |
| Base salary | 3,950,000 | 5,950,000 |
| Other benefits | 526,684 | 849,346 |
| Performance-related (variable) components | | |
| Without long-term incentives (non-deferred, or immediately paid out) | - | 9,587,269 |
| With long-term incentives (deferred) | - | 22,592,357 |
| Total compensation | 4,476,684 | 38,978,972 |

Source: Deutsche Bank, 2010a

In the Remuneration Report, the wage structure of risk-taking employees,³ is also illustrated. Their wage consists of a fixed remuneration of €367 million, and a variable remuneration, which comprises €21 million as a cash payment and €1,278 million as deferred awards. All deferred awards are dependent on the bank's future financial success. Of the awards, €961 million are restricted equity awards linked to the price of shares and with a duration of three and three-quarter years. The remaining €317 million are restricted incentives awards with a duration of three years, linked to the pre-tax result and with a variable adjustment on the basis of the return on equity minus the cost of funds. On average, around 60% of the variable remuneration is deferred and dependent on the future performance of the bank.

Deutsche Bank offers its employees performance-led pay. Changes to the pay structure because of the financial crisis comprise a number of features.

- The decrease in variable elements, such as bonuses, has been offset by an increase in the fixed rate of pay.
- For some employees, the bonus will be made more contingent on the risks taken, the necessary capital expenditure for the bonus, and the sustainability of profits.
- As well as bonus payments in good times, there is a clawback in bad times.
- Bonuses will be mostly paid in the form of shares, held back for a period of up to three and three-quarter years. All or part of this may be forfeited in the event of Deutsche Bank reporting a loss.

Overall, employees' pay totalled €1.3 billion in 2009, a decrease of 14% compared with 2007.

Evaluation of ratings agencies

The rating by Standard & Poor's for Deutsche Bank in February 2010 remained stable. The rating agency said that this was because of the bank's strong franchise in its global capital market businesses, its good performance in global transaction banking, a stable management team, and a consistent strategy. However, the agency adds that these strengths are partly offset by relatively small and declining contributions to pre-tax income from the bank's private clients and asset management division, a high dependence on wholesale funding, and vulnerability to the volatile cycles of the capital markets in the securities trading and underwriting business lines (Standard and Poor's, 2010).

Table 15: Deutsche Bank – Overview of ratings

| | Long-term | | | Short-term | | | Financial strength | | |
|-------------------|-----------|------|------|------------|------|------|--------------------|------|------|
| | 2008 | 2009 | 2010 | 2008 | 2009 | 2010 | 2008 | 2009 | 2010 |
| Standard & Poor's | A+ | A+ | A+ | - | A-1 | A-1 | - | - | - |
| Fitch Ratings | AA- | AA- | - | - | F1+ | | - | - | - |
| Moody's | Aa1 | Aa1 | Aa3 | - | P-1 | P-1 | - | B | C+ |

Note: An explanation of rating codes can be found in the Annex.

Source: Deutsche Bank annual reports 2007–2009, Deutsche Bank website (Investor Relations section), Economix

Fitch's rating for the bank in October 2009 has also remained stable because of the bank's strong position in commercial banking in Germany and its good global international franchise in corporate

³The so-called risk takers are executives with special risk responsibility; meaning that they are allowed to take on risks in the name of the bank within their tasks or function level.

and investment banking. The Issuer Default Rating benefits from Fitch Ratings' expectation that Deutsche Bank will gain a majority stake in Deutsche Postbank AG, which will make it Germany's leading retail bank. Further positive rating factors include revenue diversification, sound liquidity and diversified funding, ongoing risk reduction and improving capitalisation. The ratings also consider Deutsche Bank's vulnerability to market volatility and risks from corporate/investment banking. (More details are available on the 'Ratings page' of the 'Investor Relations' section of the bank's website).

Moody's downgraded Deutsche Bank's long-term rating by two grades from Aa1 to Aa3 and its financial strength from B to C+. According to the Financial Times Deutschland and Moody's Credit Opinion, the main reasons were the takeover of Deutsche Postbank AG and the risk on the capital market for Deutsche Bank. (Financial Times Deutschland, 2010; Moody's Investor Services, 2010a).

According to Moody's, the downgrading primarily reflected a combination of three factors.

- The continuing preponderance of capital market activities and the ensuing challenges for risk management potentially expose the bank to earnings volatility, which is inconsistent with the bank's previous ratings.
- The delay in the acquisition of Deutsche Postbank AG (rated D+/A1) is set to defer the possible benefits of this acquisition beyond what Moody's had previously anticipated.
- Deutsche Bank's other businesses, which had been expected to provide a more stable earnings anchor, have shown a greater degree of earnings volatility than Moody's had previously expected.

Asset quality

According to Moody's, the financial crisis has led to higher levels of problem loans at Deutsche Bank. By the end of 2009, problem loans had increased to €8.9 billion, up from €4.6 billion a year previously. Of this amount, €7.2 billion were considered impaired under International Financial Reporting Standards (IFRS). Nearly 40% of impaired problem loans consist of assets reclassified from the trading book to the loan portfolio, including leveraged loans, commercial real estate, and other exposures. At €2.8 billion, this amounted to 8.3% of reclassified assets at the end of the year. Moody's expects some further deterioration in asset quality, as economic weakness takes its toll on the bank's commercial and consumer finance customers, and the rating agency believes that credit costs, especially within the aforementioned portfolio of reclassified assets, are likely to remain high.

Risk management

According to Fitch, Deutsche Bank has substantially lowered its risk profile by reducing proprietary trading and higher-risk assets, but its remaining exposures to leveraged finance loans, commercial real estate and monoline-insured assets could incur further impairment charges.

Risk management

Deutsche Bank's risk report summarises quantitative and qualitative disclosures regarding credit, market and other risks (Deutsche Bank, 2010c).

Organisation

The chief risk officer, who is a member of the management board, is responsible for the group-wide credit, market, operational, liquidity, business, legal and reputational risk management, as well as capital management activities; the officer also heads the integrated legal risk and capital function. Two functional committees, the risk executive committee and the capital and risk committee, both chaired by the chief risk officer, are central to the legal risk & capital function (Deutsche Bank, 2010c)

Strategy

The legal, risk and capital function annually develops its risk and capital strategy in an integrated process, together with the group divisions and finance, ensuring a group-wide alignment of risk and performance targets. The strategy is ultimately presented to and approved by the management board (Deutsche Bank, 2010c). According to Deutsche Bank's financial report, targets and projections are set for various parameters and at different levels of the group. Performance is monitored regularly against these targets and a report on selected important, high-level targets is brought to the direct attention of the chief risk officer and/or the management board. Amendments to the risk and capital strategy must be approved by the chief risk officer or the full management board, depending on the significance.

Risk management tools

Deutsche Bank uses a range of measures to monitor and manage risk (Deutsche Bank, 2010c). The appropriateness and the reliability of these measures are continuously assessed in light of the changing risk environment. The key measures in use are:

- financial capital;
- expected loss;
- value-at-risk;
- stress testing.

Economic capital measures the amount of capital needed to absorb very severe unexpected losses arising from exposures. 'Very severe' in this context means that financial capital is set at a level to cover, with a probability of 99.98%, the aggregated unexpected losses within one year. The economic capital is calculated for the default risk, transfer risk and settlement risk elements of credit risk, for market risk including traded default risk, for operational risk and for general business risk. During the course of 2009, the financial capital stress tests for market risk were – according to Deutsche Bank – recalibrated to reflect the extreme market moves observed in the later part of 2008.

Expected loss is used as a measure of the bank's credit and operational risk. When calculating expected loss for credit risk, credit risk ratings, collateral, maturities and statistical averaging, procedures are taken into account to reflect the risk characteristics of the different types of exposures and facilities. All parameter assumptions are based on statistical averages of up to seven years based on internal default and loss history as well as external benchmarks. The results of the expected loss calculations are also considered as a component of collectively assessed allowance for credit losses included in the financial statements.

The **value-at-risk** approach is used to derive quantitative measures for the bank's trading book market risks under normal market conditions. The value-at-risk figures are used by Deutsche Bank for both internal and external (regulatory) reporting. For a given portfolio, value-at-risk measures the potential future loss (in terms of market value) that, under normal market conditions, will not be exceeded with a defined confidence level in a defined period. The value-at-risk for a total portfolio represents a measure of the diversified market risk (aggregated, using pre-determined correlations) in that portfolio.

Stress testing supplements the analysis of credit, market, operational and liquidity risk. For credit-risk management purposes, stress tests are performed to assess the impact of changes in general economic conditions or specific parameters on credit exposures or parts thereof, as well as the impact on the credit worthiness of the bank's portfolio. For market-risk management purposes, stress tests are performed because value-at-risk calculations are based on relatively recent historical data, only purport to estimate risk up to a defined confidence level, and assume good asset liquidity; therefore, they only reflect possible losses under relatively normal market conditions, according to the risk report of the Deutsche Bank. Stress tests help the bank to determine the effects of potentially extreme market developments on the value of market risk sensitive exposures, both on the highly liquid and less liquid trading positions, as well as the investments. For operational-risk management purposes, stress tests

are performed on the economic capital model to assess its sensitivity to changes in key model components, which include external losses. And for liquidity-risk management purposes, stress tests and a scenario analysis are performed to evaluate the impact of sudden stress events on the bank's liquidity position.

Consumer credit exposure

The volume of consumer credit exposure rose by €5.2 billion, or 6%, from 2008 to 2009, driven by the volume growth of Deutsche Bank's portfolio in Germany (up by €2.7 billion), as well as outside Germany (up by €2.5 billion) with strong growth in Italy (€1.1 billion), Poland (€1.0 billion) and Spain (€0.2 billion) (Deutsche Bank, 2010c).

Total net credit costs as a percentage of total exposure were, according to the Risk Report 2009, positively affected by changes in certain parameter and model assumptions, which reduced provisions by €146 million. The increase in net credit costs in 2009, compared with 2008, reflected – according to Deutsche Bank – the bank's strategy of investing in higher-margin consumer finance business as well as the deteriorating credit conditions in Spain. The increase in net credit costs took place in the bank's portfolios outside Germany and was driven mainly by the economic crisis in Spain, which adversely affected the mortgage loan and commercial finance portfolios there, and by the bank's consumer finance business in Poland and India.

Table 16: Deutsche Bank – Net credit costs as percentage of total exposure

| In% | 2009 | 2008 |
|--|------|------|
| Consumer credit exposure Germany | 0.55 | 0.65 |
| Consumer and small business financing | 1.69 | 1.98 |
| Mortgage lending | 0.22 | 0.18 |
| Consumer credit exposure outside Germany | 1.27 | 0.94 |
| Total consumer credit exposure* | 0.79 | 0.74 |

Note: *Includes impaired loans amounting to €2.3 billion as of December 31, 2008.

Source: Deutsche Bank, 2010a.

Refined framework and derisking discipline

In 2009, Deutsche Bank implemented new processes within Market Risk Management to improve the monitoring and reporting of key risks. These processes included creating a list of exposures which had been targeted for de-risking. The identification of such positions was guided by a four step de-risking framework. (Deutsche Bank, 2010c) The first step, reducing risk concentration, consists of adapting the size of the position size to liquidity environment, and unwinding the most illiquid risk positions. The second, the continued use of active hedging, involves the active programme of macro hedging and improving the hedging efficiency of individual strategies. The third, deleveraging the balance sheet, entails reducing gross and net exposure and aligning the market risk appetite to new balance sheet and leverage targets. Finally, reducing uncertainty requires that the bank avoid exposure to difficult-to-value products and reduces its reliance on complex and highly structured products.

Overall risk position

The overall (non-regulatory) risk position was determined by considering diversification benefits across risk types, except for business risks, which were aggregated by simple addition. Table 17 shows Deutsche Bank's overall risk position at year-end 2009 and 2008 as measured by the financial capital calculated for credit, market, business and operational risk. The table outlines a number of points.

- Capital usage increased by 8% from €19.3 million to €20.7 million between 2008 and 2009. The increase reflects the acquisition of the minority stake of Deutsche Postbank AG.
- Capital usage for credit risk decreased by €1.5 billion (17%), due mainly to lower derivative exposure (€1.3 billion) and a broader diversification of the bank's portfolio.

- The market risk's capital usage rose by €3.7 billion (42%), driven mainly by the non-trading market risk (€4.6 billion, or 142%), which also reflects the acquisition of the minority stake of Deutsche Postbank AG (€4.3 billion).
- Capital usage for operational risk decreased by €654 million (16%), due to improved insurance coverage and new monitoring and control mechanisms.
- The capital usage for business risk remained almost unchanged and amounted to €501 million, consisting of strategic risk and a tax risk component.

Table 17: Deutsche Bank – Overall risk position (financial capital usage, €million)

| | 2008 | 2009 |
|--|--------|--------|
| Credit risk | 8,986 | 7,453 |
| Market risk | 8,809 | 12,515 |
| – Trading market risk | 5,547 | 4,613 |
| – Non-trading market risk | 3,262 | 7,902 |
| Operational risk | 4,147 | 3,493 |
| Diversification benefit across credit, market and operational risk | -3,134 | -3,166 |
| Sub-total credit, market and operational risk | 18,808 | 20,295 |
| Business risk | 498 | 501 |
| Total financial capital usage | 19,306 | 20,796 |

Source: Deutsche Bank, 2010c

Outlook

Company's position

Deutsche Bank is orientating its strategy further on the fourth phase of the management agenda (see 'Deutsche Bank's strategy' above). The bank has not yet published any strategic expectations regarding employment developments. Each of the four business divisions has set out its own forecast (Deutsche Bank, 2010a and 2010c)

The **Corporate Banking and Securities** division foresees the following developments:

- higher liquidity and greater volatility than during the crisis;
- an increase of premium revenues in corporate finance, although uncertainty persists regarding the extent of economic recovery;
- stable trade volumes;
- higher margins than before the crisis;
- growth of customer-focused business areas, at the same time as economic recovery and a return in the trust of shareholders;
- lower revenues than before the crisis in the Sales and Trading division in 'flow' products, such as foreign exchange, money market and interest rate products;
- higher revenues in the customer-focused business due to a new orientation on liquidity-based customer activities, the investment in bonds of emerging countries, raw material trade and spot transactions;
- stabilising corporate finances but a high demand for recapitalisation and restructuring consulting;
- stable volumes of investment-grade bonds and high-yield bonds, at least in the first half of 2011;
- a lag in commercial property investment until further stabilisation of assessment;
- a potential pre-tax result for the division of €6.3 billion in 2011.

In **Global Transaction Banking (GTB)**, the following is the forecast.

- Low interest income is foreseen due to the low interest-rate level and slow growth in trade finance because of the slow economic recovery in the euro area and other important markets.
- The weakening of the euro could increase exports and prove advantageous to transaction banking.
- Revenues of global transaction banking could benefit from growth in Asia, and from the stabilisation of the US economy and a possible increase of the interest rate in the US.
- GTB is well positioned, due to continuing profitable growth and the extension of its client base in recent years.
- GTB's pre-tax result is estimated at €1.3 billion in 2011.

Asset and Wealth Management (AWM) foresees:

- increased revenues from performance-dependent and volume-dependent premia;
- stimulated investment interest in multi-asset products, alternative investments and stock products due to the need to redeem losses of recent years;
- positive impacts on revenues and new possibilities for investments because of demographic change, increasing wealth in developing countries and a switch from state pension funds to private pension funds;
- A return of the client preference for investing in simple products with a low premium and products with credit guarantees;
- the introduction of the dynamic wealth allocation model, leading to an increase of wealth administration mandates;
- a pre-tax result for AWM of €1 billion.

Private & Business Clients foresees:

- an increase of market share in Germany from client acquisition, rising sales thanks to the recruitment of highly-qualified employees, and a target-oriented expansion of the branch network;
- the possibility, due to cooperation with Deutsche Postbank AG, for Deutsche Bank to expand as a leading provider in Germany and to catch up with leading merchant banks in Europe;
- the negative influence on divisional performance of high unemployment, insolvencies and low interest rates;
- an estimated pre-tax result for the division of €1.5 billion in 2011.

Rating agencies' position

Standard & Poor's expect that the operating environment for the bank will continue to be difficult in 2010. Deutsche Bank's trading and underwriting revenues will – according to the rating agency – decline in 2010, compared with 2009, due to narrower, more normalised bid–ask spreads and lower customer orders. Moreover, Standard & Poor's also expects further provisions for remaining legacy portfolios in 2010 and a higher than historical rate of credit-loss provisioning, similar to that of 2009. Regulatory and market driven forces will influence Deutsche Bank to maintain its regulatory Tier 1 capital ratio target of 10%, despite the still difficult operating environment. The acquisition of Sal. Oppenheim and parts of ABN Amro's Dutch commercial banking network will marginally increase risk assets in 2010. Deutsche Bank will most likely increase its stake in Deutsche Postbank AG to become a majority owner within two years. While an integration of Postbank would shift the group's business profile toward the less risky business line of retail banking, Postbank is relatively inefficient and only weakly profitable.

Given Deutsche Bank's great systemic importance, Standard & Poor's believes that the German Federal Government would support the bank if the bank were to encounter substantial problems. This acts as a counter to potential downward pressure on Deutsche Bank's stand-alone credit profile. Nevertheless, a downgrade could still occur if additional material charges from trading, impairments, or litigation were to substantially reduce capital ratios, or if earnings of the retail banking, transaction banking, and wealth management businesses do not improve over time. An upgrade is unlikely in the current environment, according to Standard & Poor's.

Fitch also believes that, given Deutsche Bank's international and domestic importance, the probability of German government support, if needed, is extremely high. Their negative outlook is due the failure to keep a reduced risk profile, to strengthen retail business or to contain risks in legacy portfolios. These would be likely to result in a downgrade, as would sustaining core earnings and capital erosion.

Moody's said that Deutsche Bank's rating could be upgraded again if the following conditions were met:

- a reduced reliance on capital markets activities due to greater earnings contributions from the bank's retail banking and asset management divisions;
- clearer evidence that market risk management and the business activities are working together effectively;
- improved structural liquidity due to a combination of a higher proportion of liquid assets and a reduced reliance on short-term wholesale funding.

On the other hand, Moody's also reported that the rating could be downgraded further if there were an increase in the bank's risk appetite, as evidenced by increased leverage or increased market risk. This could be indicated by an increase in value-at-risk, financial capital, stress test results, or an increase in the bank's exposures to more capital-intensive or illiquid businesses.

Unicredit Group

The Unicredit Group is one of the major financial institutions in Europe with around 10,000 branches in 22 countries. Based in Milan, Italy, the company also operates in Germany, Austria and the CEE. In addition to its presence in the new EU Member States, the group is also represented in Croatia, Russia, Turkey and Ukraine. It controls around 1,100 companies in the banking and investment sector and employs around 166,000 people.

Unicredit emerged from the liberalisation of the Italian banking market in 1990. This allowed the merger of large regional savings banks to form the Credito Italiano. Acquisitions of further savings and investment banks were finally formed into the Unicredit Group in 2002. This process was governed by Alessandro Profumo, who has been CEO of the group since 1994. The German HypoVereinsbank was acquired in 2005, one of the biggest mergers in the European banking sector. At the same time, the group expanded to into central and eastern Europe.

Financial performance

In 2009, operating income reached €27,572 million, an increase of 2.6% compared with the income one year previously (7.2% on a constant currency and perimeter basis). This came almost exclusively from corporate and investment banking, while net interest incomes declined (Table 18).

The group's portion of net profit in 2009 was €1,702m compared with €4,012 m in the previous year, achieved, however, under much less favourable global macro-economic conditions. The quarterly

trend shows profits dropped from €490 m in the second quarter of 2009 to €94 m in the third quarter of 2009, and €371m in the fourth quarter of 2009.

Table 18: Unicredit – Performance data (€million)

| | 2006 | 2007 | 2008 | 2009 |
|---|---------|-----------|-----------|---------|
| Total assets | 823,284 | 1,021,758 | 1,045,612 | 928,760 |
| Operating income | 23,464 | 25,893 | 26,877 | 27,572 |
| of which: Net interest income | 12,860 | 14,843 | 19,385 | 17,616 |
| Net non- interest income (investment banking) | 10,604 | 11,050 | 7,492 | 9,956 |
| Pre-tax profits | 8,210 | 9,355 | 5,458 | 3,300 |
| Net profit attributable to the group | 5,448 | 5,961 | 4,012 | 1,702 |

Source: (Unicredit Group, 2008) and Unicredit Group results 2009, available through ‘Investors’ section of Unicredit website (<http://unicreditgroup.eu>)

The group nevertheless survived the crisis without any financial losses. In 2009, total assets were reduced by 11%, mainly by disinvestments in the trading book and the shrinkage of customer credits. This allowed the decline of the group’s leverage ratio to 24.4. The core Tier 1 ratio reached 7.62% in December 2009: profits, improved reserves and a decrease in risk-weighted assets translated into a rise of more than one percentage point (104 basis points) with respect to the previous year, excluding the effects of the capital increase in September 2009. The capital increase was announced on 29 September 2009 and was successfully completed in February 2010; the core Tier 1 ratio reached 8.47%, the Tier 1 ratio 9.49% and the total capital ratio 12.88%.

Table 19: Unicredit – Capital ratios

| | 2007 | 2008 | | |
|--|-------|-----------------------------|------------------------------|-----------------------------|
| | | After capital strengthening | Before capital strengthening | After capital strengthening |
| Core Tier 1 ratio | 5.83 | 6.58 | 6.00 | 8.47 |
| Total capital ratio (Total regulatory capital /Total risk-weighted assets) | 10.11 | 11.23 | 10.64 | 12.88 |

Note: Figures for 2008 and 2009 are for 31 December of those years; ^{a)} Values restated considering the inclusion in Tier 2 capital of the portion of the translation reserve associated with foreign net investments, re-computing the deductions for fair values changes due to differences in own credit rating, and re-calculating the intercompany components of subordinated debts; 2009 after capital increase figures include the capital increase announced on September 29 2009.

Source: (Unicredit Group, 2008) and Unicredit Group Results results 2009, available through ‘Investors’ section of Unicredit website (<http://unicreditgroup.eu>)

The improvement of capital ratios was due to the 12% reduction of risk-weighted assets. The proportion of impaired loans to total customer loans nevertheless increased from 3.2% in 2008 to 5.5% in 2009.

Employment and branches

Employment and branches

At the end of December 2009, the group employed 165,062 full-time staff, 1,359 fewer than in September of that year, and 9,457 fewer than in December 2008 (Table 20). At the same time, the number of branches also declined (by 452), totalling 9,799 at the end of 2009.

Table 20: Unicredit – Number of employees and branches, 2006–2009

| | 2006 | 2007 | 2008 | 2009 |
|--|---------|---------|---------|---------|
| Employees ^{a)} | 137,197 | 169,816 | 174,519 | 165,062 |
| Employees (subsidiaries are consolidated proportionally) | 127,731 | 159,949 | 163,991 | 155,000 |
| Branches ^{b)} | 7,357 | 9,714 | 10,251 | 9,799 |

Notes: ^{a)} Full time equivalent data. These figures include all employees of subsidiaries consolidated proportionately, such as Koç Financial Services Group employees.

^{b)} These figures include all branches of subsidiaries consolidated proportionately, such as Koç Financial Services branches.

Source: Unicredit Group results 2009

Employees and branches are still concentrated in Italy, where one third of the total staff is employed. The major locations outside of Italy are Germany and Poland, with around a 12% share of total employment, and Turkey and Austria (with 10% and 6% respectively).

Table 21: Unicredit – Employees and branches, by country, 2009

| Country | Percentage share of employees | Number of branches |
|---------|-------------------------------|--------------------|
| Italy | 33.8 | 4,696 |
| Germany | 12.6 | 783 |
| Austria | 6.3 | 326 |
| Poland | 12.2 | 1,030 |
| Turkey | 9.8 | 889 |
| Others | 25.3 | 2,075 |
| Total | 100 | 9,799 |

Note: Full time equivalent data; these figures include all employees of subsidiaries consolidated proportionately, such as Koç Financial Services Group employees.

Source: Unicredit Group, 2010

Cuts in jobs and costs

As has already been noted, the full-time equivalent number of employees at 31 December 2009 was 165,062, a reduction of 5.4% compared with the previous year. As Table 22, shows all business divisions shed jobs. The most serious job cuts were executed in asset management and corporate and investment banking.

Table 22: Unicredit – Job cuts, by business division

| | Full-time employees, end 2009 | Fall from previous year |
|----------------------------------|-------------------------------|-------------------------|
| Retail | 49,476 | 5.3% |
| Corporate and investment banking | 14,694 | 6.5% |

| | | |
|----------------------------|---------|------|
| Private banking | 3,002 | 2.4% |
| Asset management | 1,962 | 9.4% |
| Central and eastern Europe | 52,337 | 6.7% |
| Poland | 20,270 | 5.3% |
| Parent company | 23,321 | 2.3% |
| Total | 165,062 | 5.4% |

Source: Unicredit Group 2010

Job cuts allowed both the reduction of administrative expenditure, and of operating costs by 7.1% in 2009. Payroll costs were reduced by €2.3 billion, a decline of 3.1% compared with 2008. This contributed to an improvement of the cost–income ratio by more than six percentage points to 55.6% in 2009.

Only half the numbers of job were cut among managers and senior managers than were cut among other positions (Table 23). The number of agency workers and freelancers was cut by 20%.

Table 23: Unicredit – Employment, by occupation, 2009

| | Proportion as at 31 December 2009 | Fall from previous year |
|-------------------|-----------------------------------|-------------------------|
| Employees | 98.5% | 4.9% |
| - senior managers | 1.3% | 1.5% |
| - managers | 23.6% | 2.5% |
| - remaining staff | 73.5% | 5.7% |
| Other staff | 1.5% | 21.2% |
| Total | 100% | 5.4% |

Source: Unicredit Group 2010

Ownership structure

On 31 March 2010, share capital totalled €9.6 billion. In 2009, the dividend was €0.03 per ordinary share and €0.045 per savings share; in 2008, no dividends were paid for ordinary shares but amounted to €0.025 per savings share.

As at 31 December 2008, the shareholder register showed the following ownership structure: domestic shareholders owned about 52% of capital and foreign shareholders owned 48%, while 97% of ordinary share capital was held by legal entities and the remaining 3% by individuals. The Italian Mediobanca and regional savings banks are among the major shareholders, together with international investors, such as the Central Bank of Libya, Black Rock Investment Management (UK) and the German Allianz Group (Table 24).

Table 24: Unicredit – Major shareholders (holding more than 2%)

| | Percentage of ordinary capital |
|---|--------------------------------|
| Mediobanca S.p.A.* | 5.14 |
| Central Bank of Libya | 4.99 |
| Fondazione Cassa di Risparmio Verona, Vicenza, Belluno e Ancona | 4.98 |
| Fondazione Cassa di Risparmio di Torino | 3.31 |
| BlackRock Investment Management (UK) Limited | 3.31 |
| Carimonte Holding S. p. A. | 3.17 |

| | |
|----------------|------|
| Gruppo Allianz | 2.04 |
|----------------|------|

*Note: *For 97% of these shares, Unicredit S.p.A. holds the right of usufruct.*

Source: Unicredit website, 'Governance' section

Important events in Unicredit's history

2005

Unicredit merged with the German HVB Group, which was created in 1998 from the combination of two Bavarian banks (Bayerische Vereinsbank and Bayerische Hypotheken- und Wechsel-Bank), thereby giving rise to a single, large European bank. In addition, the company expanded in Expansion in growth markets, acquiring Yapi Kredi by koç (in Turkey).

2006

The Markets & Investment Banking division unified the investment banking activities of Bayerische Hypo-und Vereinsbank AG (HVB Corporates & Markets), Bank Austria Creditanstalt (International Markets and CA IB) and Unicredit Banca Mobiliare SpA into a single, global division.

2007

The company continued to expand into growth markets: the group spread its presence in the CEE with its expansion into Ukraine, and it has pushed into central Asia with acquisitions in Kazakhstan, Tajikistan and Kyrgyzstan.

Unicredit Group strengthen its position in the Italian market thanks to its merger with and integration of the Capitalia Group (formed in 2002 out of a combination of the Bancaroma Group and the Bibop-Carino Group; Banco di Sicilia, MCC and Fineco are also part of the group).

2009

On 29 September, Unicredit's share capital increased by €4 billion. This was expected to strengthen the group's capital base. The positive impact on the group's Core Tier 1 ratio, which stood at 6.85% in June 2009, was expected to amount to 80 basis points (Unicredit S.p.A, 2009).

After the capital increase, the bank reorganised its activities. Investment banking will be concentrated in the German Hypo-Vereinsbank.

2010

On 13 April, the board of directors at Unicredit approved the 'One for Clients' project, as well as the merger of seven subsidiary banks (Unicredit Banca, Unicredit Banca di Roma, Banco di Sicilia, Unicredit Corporate Banking, Unicredit Private Banking, Unicredit Family Financing Bank, Unicredit Bancassurance Management & Administration) with the parent company Unicredit Spa.

The implementation of the plan was controversial as it included the elimination of up to 80 board seats at the bank's domestic divisions (Financial Times, 2010a).

The programme's objectives are to improve customer satisfaction in all customer segments by changing the current business model and corporate culture to further enhance the group's closeness to

local communities in Italy. This is to be achieved by improving the dialogue with customers, so that Unicredit may better understand regional and local needs better.

In line with the structure that currently exists in Austria, Germany and Poland, the board also decided to appoint a country chairperson for Italy. The role will involve acting as a point of reference for the group's activities in the Italian market and coordinating its territorial strategies. The chairperson will be responsible for the business results, together with the Italian network heads.

Strategy

The Unicredit Group defines its strategy according to a number of criteria:

- strength in its four core markets;
- value creation and clear governance;
- specialised division model;
- global product factories;
- a strategy for dealing with the crisis.

Strength in the four core markets

Unicredit aims to strengthen its position in its four core markets: Italy, Germany, Austria, and Central and Eastern Europe (CEE). This is to be done by focussing on internal growth as well as by seizing new growth opportunities outside the group. The goal is to become a market leader in each of these areas. The group is convinced it has already proved its ability to grow in a variety of business areas and to function successfully as a consolidator in the European banking market.

Value creation and clear governance

The ability of an investment ability to create value depends to a great degree on clear governance guidelines. Strong governance is a key factor in the group's investment policy.

Divisional model

Unicredit recognises the importance of specialisation. The group utilises a divisional business model that optimises its ability to offer personalised services to meet the needs of a variety of customer segments. Unicredit Group's divisional model is based on identifying well-defined business areas common to all the markets in which the group operates: retail, corporate, private, investment banking and asset management. The emphasis is on creating specialised product factories and centralising support services. The group uses a multi-local approach to apply this model. The approach is consistent with the group's goal of being recognised as a highly capable domestic player in each of the markets in which it is present. Emphasis is placed on the value of establishing a presence in local communities.

Global product factories

Global product factories are a key feature of the divisional model. They should help to exploit the growth potential of the group's vast branch network. The group has centralised production in the following business areas:

- leasing;
- asset management;
- consumer credit;
- mortgages;
- investment banking.

Centralisation makes it possible to oversee the value chain, take advantage of synergies, and make use of the group's size and diverse scope. In this way, the group expects to offer the best products and services to customers in all countries.

Crisis-related strategy

In the group's annual report for 2007 the arising financial turmoil was addressed. The crisis of the US real estate sector was joined by marked financial turbulence relating to the valuation of the financial instruments associated with that industry. This caused growing uncertainty in financial markets, which translated into higher costs of funding, increased risk aversion, and renewed regulatory pressure. All these factors put pressure on profitability and caused substantial writedowns and sizable losses, which significantly eroded market confidence.

Unicredit explains its comparatively good performance during the banking crisis as follows: 'We believe it is this unequalled geographic presence in Europe, coupled with the on-going implementation of our divisional model, that sets us apart in the European banking landscape and provides us with a key strategic advantage.' The discipline in risk management enabled Unicredit Group to reduce an already minor exposure to US subprime mortgages (as low as €164 million at the year end, and profit from a structured loan portfolio of excellent quality (94% of assets at investment grade). According to the bank, strong risk-control and diversification, together with the European franchise system and the strength of the group's employees, were the qualities that enabled the group to weather the market turmoil with relative ease.

Performance of business segments

2009 began in an ongoing recession with continuing weakness in financial markets, but in the summer the first weak signs of recovery were seen. Credit impairment required increased provisions – a further charge on banks' financials, already weakened by the reduction in traditional income. The Unicredit Group was able to maximise the competitive advantage provided by its geographic and business diversification. In 2008, Corporate and Investment Banking had suffered due to the difficult conditions of the financial markets, but this area succeeded again in 2009 and helped to offset the difficulties encountered by commercial business lines.

Table 25: Unicredit – Key figures, by business segment, 2008–2009 (€million)

| | Retail | Corporate & Investment Banking | Private banking | Asset management | Central and eastern Europe | Poland | Parent company and other subsidiaries (consolidation adjustments included) | Consolidated Group total |
|--------------------------|--------|--------------------------------|-----------------|------------------|----------------------------|--------|--|--------------------------|
| Operating income | | | | | | | | |
| 2008 | 11,466 | 6,474 | 916 | 1,088 | 4,732 | 2,183 | 16 | 26,878 |
| 2009 | 9,846 | 10,033 | 779 | 733 | 4,613 | 1,634 | -66 | 27,572 |
| Operating costs | | | | | | | | |
| 2008 | -7,612 | -3,484 | -544 | -508 | -2,223 | -1,060 | -1,252 | -16,692 |
| 2009 | -7,026 | -3,309 | -544 | -455 | 1,949 | -853 | -1,189 | -15,324 |
| Operating profit | | | | | | | | |
| 2008 | 3,855 | 2,991 | 363 | 581 | 2,509 | 1,123 | -1,236 | 10,185 |
| 2009 | 2,821 | 6,724 | 236 | 278 | 2,664 | 780 | -1,255 | 12,248 |
| Profit before tax | | | | | | | | |
| 2008 | 3,026 | 690 | 366 | 599 | 2,026 | 1,110 | -2,359 | 5,458 |
| 2009 | 945 | 1,555 | 203 | 287 | 908 | 692 | -1,290 | 3,300 |
| EVA^{a)} | | | | | | | | |
| 2008 | 992 | -1,376 | 208 | 388 | 767 | 404 | -1,633 | -252 |
| 2009 | 130 | -480 | 108 | 180 | 46 | 215 | -2,191 | -1,992 |

| | | | | | | | | |
|-------------------------|--------|--------|-------|-------|--------|--------|--------|---------|
| Cost/income ratio (%) | | | | | | | | |
| 2008 | 66.4 | 53.8 | 60.4 | 46.7 | 47.0 | 48.6 | n.s. | 62.1 |
| 2009 | 71.4 | 33.0 | 69.8 | 62.0 | 42.3 | 52.2 | n.s. | 55.6 |
| Employees ^{b)} | | | | | | | | |
| As at Dec 31, 2008 | 52,233 | 15,711 | 3,077 | 2,165 | 56,066 | 21,406 | 23,861 | 174,519 |
| As at Dec 31, 2009 | 49,476 | 14,694 | 3,002 | 1,962 | 52,337 | 20,270 | 23,321 | 165,062 |

Notes: Figures were adjusted, where necessary, to include changes in scope of consolidation, in scope of operations and in assets held for sale and private equity activities; ^{a)} 2008 figures were recast, where necessary, on a like-to-like basis to consider changes in scope of business segments and computation rules; ^{b)} "Full time equivalent": these figures include all the employees of subsidiaries consolidated proportionately, such as Koç Financial Services.

Source: Unicredit Group, 2010

The Corporate & Investment Banking division (CIB) experienced a 55% increase in operating income. Meanwhile, Retail decreased by 14%, Private banking by 15% and Asset management by 33%. Central and eastern Europe (CEE) had a small reduction of 3% in operating income compared with 2008 while Poland's market shrunk by 25%. The interest income of fees and commissions decreased by 9.5% and were valued at €1,579 million in 2009.

In 2008, Unicredit experienced a loss of €2,555 million in net trading, hedging and fair-value income, while in 2009 the income of these activities was €91 million. Risk-weighted assets decreased by 9% compared with 2008 and the volume of loans provided to customers declined by 12%.

The improved results in CIB reflect the implementation of a risk reduction policy by Unicredit, which included modifying the customer portfolio in the context of a broader strategy to reduce the group's leverage. The deterioration in the international economic situation, which started in 2008, has accelerated the evolution of the group business model. The new CIB organisational structure has been implemented by merging previous Corporate and Markets & Investment banking (MIB) divisions. The change was implemented in line with three fundamental principles:

- a major emphasis on customers and core products;
- the consolidation and centralised management of non-core portfolios, based on downsizing and rationalisation principles;
- optimisation and efficiency improvements in all other business activities.

New remuneration model

A new group compensation policy was introduced in 2009 with an emphasis on sustainability. The Group Compensation Policy, was approved by shareholders at their meeting in April 2010 to comply with the Bank of Italy's 'Supervisory Provisions concerning Banks Organisation and Corporate Governance' and with recent international regulations. The Unicredit compensation approach seeks to be performance-oriented, transparent and competitive. Particular emphasis is placed on the long-term orientation of the policy. Sustainable pay should be achieved by means of three key factors:

- a balanced total compensation structure;
- a direct link between pay and performance;
- a multiannual view of performance.

Long-term incentives are provided by:

- adopting a combination of performance stock options and performance shares;
- linking performance to remuneration through both performance shares and stock-option vesting;
- a 10 year total plan life with a 3 year performance period;

- equity incentives ranging between 0% and 150% of target grants: company performance below the threshold results in a zero grant while outstanding performance will lead to the maximum grant of 150%;
- a comprehensive view of performance, including internal and external measures risk & cost of capital adjusted.

Variable and fixed pay elements

According to Unicredit's Directors' Report for the current shareholders' meeting, the proportion of variable and fixed income components varies according to position in the company. While the pay of the chairperson and directors is entirely fixed, the variable performance-related pay for group executives is between 63% and 81%. On average, 16% of all employees' pay is performance related.

Table 26: Unicredit – Variable performance-related pay composition, 2010

| | Total compensation | | Variable performance related pay | | | |
|--|---|----------------------------------|----------------------------------|----------|-------------------|--------|
| | Fixed & other non-performance related pay | Variable performance-related pay | Annual | Deferred | Forms of deferral | |
| | | | | | Cash | Equity |
| CEO | 26% | 74% | 28% | 72% | 26% | 74% |
| Deputy CEOs | 19% | 81% | 33% | 67% | 33% | 67% |
| Senior Executive Vice-Presidents ^{a)} | 26% | 74% | 28% | 72% | 35% | 65% |
| Heads of Control Functions ^{b)} | 27% | 73% | 30% | 70% | 55% | 45% |
| Executive Vice-Presidents | 37% | 63% | 35% | 65% | 35% | 65% |

Note: ^{a)} excluding Heads of Control functions (reported separately)

^{b)} Heads of Audit, Legal & Compliance, CRO and CFO.

Source: Unicredit website, 'Governance' section

In Table 26, variable performance-related pay for senior executives and other employees with material impact on firm risk exposure is shown. A notable part (between 65% and 72%) of the variable, performance-related compensation is paid under deferral arrangements over a period of years. For all positions, equity-based compensation represents the major part of variable deferred compensation (between 45% and 74%).

Table 27: Unicredit – Deferred compensation amounts and forms (€thousand)

| In €thousand | Deferred compensation | | | | |
|--|--|--------|--|----------|--------|
| | Paid out in 2009 ^{c)} Based on multi-year performance achieved | | Outstanding Based on future performance | | |
| | Cash | Equity | Vested | Unvested | |
| | | | Equity ^{d)} | Cash | Equity |
| CEO | 0 | 0 | 0 | 6,302 | 3,501 |
| Deputy CEOs | 0 | 0 | 0 | 7,973 | 4,026 |
| Senior Executive Vice Presidents ^{a)} | 542 | 1,073 | 210 | 9,630 | 4,493 |
| Heads of Control Functions ^{b)} | 88 | 0 | 0 | 5,681 | 1,495 |
| Executive Vice Presidents | 841 | 508 | 1,517 | 32,670 | 14,345 |

Note: ^{a)} excluding Heads of Control functions (reported separately); ^{b)} Heads of Audit, Legal & Compliance, CRO and CFO; ^{c)} including that part of amounts that has been deferred from previous years and subsequently paid out in the financial year 2009; amounts shown as equity compensation reflect the market value of the shares at the date of actual grant or the difference between the market value of the shares and the strike price of the stock options at the date of exercise; ^{d)} Based on the 'Hull & White' option pricing model, the fair-value estimates of the equity instruments as at 1 January 2010 are (in €thousand): 4,481 for the CEO, 2,774 for the Deputy CEOs, 1,625 for the Senior Executive Vice-Presidents, 433 for the Heads of Control Functions and 4,869 for the Executive Vice-Presidents.

Source: Unicredit website, 'Governance' section

Deferred amounts paid out in 2009, as shown in Table 27, include payouts based on demonstrated multi-year performance achievements. Amounts shown as outstanding deferred compensation represent the potential gain on deferred awards that remain subject to future performance. Thereby, the vested component refers to equity awards to which beneficiaries have already acquired the right but on which they have not yet realised any actual gain. The unvested component refers to cash and equity awards to which the right has not yet matured and for which any potential future gain has not yet been realised and remains subject to future performance.

Evaluation by rating agencies

The ratings given for Unicredit by the three rating agencies Fitch, Moody's and Standard and Poor's are shown in Table 29.

Table 28 Ratings of Unicredit

| Rating Agencies | Short-term debt | | | Medium and long-term debt | | | Outlook | | |
|---------------------------|-----------------|------|------|---------------------------|------|------|----------|----------|----------|
| | 2007 | 2008 | 2009 | 2007 | 2008 | 2009 | 2007 | 2008 | 2009 |
| Fitch Ratings | F1 | F1 | F-1 | A+ | A+ | A | Positive | Negative | Negative |
| Moody's Investors Service | P-1 | P-1 | P-1 | Aa2 | Aa3 | Aa3 | Stable | Stable | Stable |
| Standard & Poor's | A-1 | A-1 | A-1 | A+ | A+ | A | Stable | Negative | Stable |

Note: An explanation of rating codes can be found in the Annex.

Source: Unicredit Group (2008), Unicredit Group results for 2009, and annual report for 2008

Capital strengths and challenges

Moody's sees Unicredit as having a number of capital strengths and challenges. The company's capital strengths comprise:

- a strong franchise in Italy strengthened by the acquisition of Capitalia;
- good geographic and business diversification;
- a strong track record of integrating acquisitions.

Its capital challenges are as follows:

- to deliver the group's strategic objectives in the currently difficult operating environment;
- to prevent further erosion of profitability and efficiency measures;
- to manage deteriorating asset quality across the group's market.

Rationale for agencies' ratings

Fitch Ratings downgraded its Long-term Issuer Default Rating of Italy-based Unicredit S.p.A. to 'A' from 'A+' in April 2009 (Fitch, 2009a). This 'reflects the bank's exposure to emerging markets in Europe, as well as performance pressure in its main markets and selected operations.'

Fitch noted Unicredit's 'increasing vulnerability to potentially severe stresses in Central and Eastern Europe and the Commonwealth of Independent States (CIS, to which the bank was significantly exposed through its various subsidiaries.' Unicredit was also exposed to various on-balance sheet risks from its main investment banking arm, HVB. In Fitch's opinion, the performance of these operations will remain under pressure in the quarters ahead. In addition, Fitch was particularly concerned with the bank's leveraged buyout exposure, which bears some concentration risk, as well as its exposure to

more volatile markets – including shipping and commercial real estate. The two main markets of export-oriented Italy and Germany were proving particularly vulnerable to the global recession, which was likely to result in further loan impairment charges and deteriorating asset quality.

Standard & Poor's affirmed its 'A/A-1' long-term and short-term counterparty credit ratings thanks to Unicredit's announcement that it will launch a €4 billion capital increase in early 2010 to strengthen its capital (Standard & Poor's, 2009) The ratings on Unicredit reflect both a weaker credit and financial performance, as well as an adequate capital base, substantial business and earnings diversification, and its strong franchises in Austria, Bavaria, Italy and the CEE countries.

According to Standard & Poor's, Unicredit's balance sheet is still vulnerable to the currently difficult economic and operating environment. The deteriorating economic conditions and the prospects for a feeble recovery in 2010 are weakening Unicredit's asset quality because of materially high inflows of problem loans. This was evident in the first half of 2009, when the cost of risk reached a high of 149 basis points.

Unicredit's profitability has significantly weakened in the past few years; previously, it was among the key strengths for the ratings. Nevertheless, it still provides a good cushion to absorb losses thanks to adequate and diversified revenue generation and good cost control. Standard & Poor's confirms the expectation of significant pressure in 2009 and 2010 regarding earnings because of much higher credit provisions associated with increased non-performing loans. But Standard & Poor's still expect Unicredit to remain profitable. The benefit of geographic diversification, which partly explained the positive revenue trend from 2004 to 2007, will nevertheless be limited.

Capital adequacy

Standard & Poor's assessed Unicredit's liquidity profile as adequate, in the context of ongoing tighter access to funding. The bank has benefited from a large pool of customer deposits. Recourse to short-term sources is still significant, but is counterbalanced by a good number of assets eligible for repurchase agreements.

Moody's sees a neutral trend for Unicredit's capital adequacy. Although the capital ratios are improving, Moody's view the higher capital as a necessity to deal with the increasing risks faced in the group's key markets. Moreover, Moody's appreciates the completed capital strengthening measures announced in October 2008. It also positively evaluates the fact that Unicredit used a raising of ordinary share capital than the previously planned government capital instruments, which Moody's considered to have certain debt-like characteristics. [reference for Moody's report]

Risk management

Risk strategy

In *Unicredit Group 2009 consolidated reports and accounts*, the challenges of risk management are explained as follows.

Credit market turmoil has affected the global banking system since the second half of 2007, contributing to a sharp slowing of the world economy. This macroeconomic scenario has entailed an increase in the cost of credit risk, a decrease in asset values, as well as higher costs deriving from write-downs and depreciation of some assets combined with a decrease in profitability. Although the Group has an adequate level of portfolio diversification, it is nevertheless exposed to risks if loan counterparties become insolvent or are unable to meet their obligations. Difficulties could arise in the recovery process of asset values proving inconsistent with current appraisals.

In light of the still challenging macroeconomic environment, sound and effective risk management has the highest priority within the Group. Therefore the Group CRO has implemented in 2009 a new risk governance model emphasizing this guiding principle and aimed to:

- strengthen the capacity of steering, coordination and control activities of some aggregated risks (so called ‘Portfolio Risks’) through dedicated responsibility centres (‘Portfolio Risk Managers’), totally focused and specialized on such risks, from a Group and cross-divisional perspective;*
- enhance coherence with the Group business model, ensuring clear specialisation and focus – from a purely transactional perspective – on specific centres of responsibility on risks originated by the Group ‘risk taking’ functions, at the same time keeping these ‘centres of responsibility’ (‘Transactional Risk Managers’) totally independent from the ‘risk taking’ functions (i.e. Business units, Treasury, Asset Management, CEE countries).*

Consistently with the Risk Management architecture redesign, the set-up, role and rules of the Group Committees responsible for risk topics have been revised. In order to strengthen the capacity of independent steering, coordination and control of Group risks, and to improve the efficiency and the flexibility on the risk decision process and to address the interaction between the relevant risk stakeholders, three distinct levels of Risk committees have been set-up:

- the ‘Group Risk Committee’ being responsible for the Group strategic risk decisions;*
- the ‘Group Portfolio Risks Committees’, tasked with addressing, controlling and managing the portfolio risks;*
- the ‘Group Transactional Committees’ that will be in charge of evaluating the single counterparts/transactions impacting the overall portfolio risk profile.*

In accordance with the roll-out plan for the Advanced Internal Rating Based (A-IRB) criteria, communicated to the Bank of Italy in September 2008, the Group has either implemented or is in the process to extend the A-IRB approach to further Subsidiaries of the Group that are yet to adopt the approach.

Regarding the compliance with Pillar II of the New Capital Accord (Basel II), a specific capital adequacy valuation process was developed in 2009, based on existing approaches. It envisages a general framework as well as a set of specific guidelines aimed at setting out a common approach at Group level in the areas of capital planning, the definition of risk appetite and the measurement, management, control and governance of risks. In addition, synthesis elements concerning risk measurements were introduced to better support processes such as capital planning and capital adequacy.

Internal capital

The report goes on to say: ‘The Group’s risk profile is represented by internal capital that is calculated by aggregating risks, net of diversification benefits, plus a ‘cushion’ which incorporates model risk and the variability of the economic cycle [...] Internal capital is the sum of the aggregated economic capital and a cushion that considers the effects of the cycle and model risk’ At the end of 2009, internal capital amounted to €43.9 billion.

Impaired losses

In 2009, net impairment losses on loans plus provisions for guarantees and commitments amounted to €3.3 billion, compared with €3.7 billion on 31 December 2008. This increase involved all business sectors, particularly CIB (a rise of €2.3 billion), CEE (€1.2 billion) and retail (€20 million).

Table 29: Unicredit – Loans to customers’ asset quality (€million)

| | Non-performing loans | Doubtful loans | Restructured loans | Past-due loans | Impaired loans | Performing loans | Total customer loans |
|--------------------------------|----------------------|----------------|--------------------|----------------|----------------|------------------|----------------------|
| As at 31 December 2008 | | | | | | | |
| Face value | 28,772 | 8,949 | 1,856 | 2,205 | 41,782 | 595,314 | 637,096 |
| – as percentage of total loans | 4.52 | 1.40 | 0.29 | 0.35 | 6.56 | 93.44 | |
| Writedowns | 18,308 | 2,772 | 593 | 281 | 21,954 | 2,662 | 24,616 |
| – as percentage of face value | 63.6 | 31.0 | 32.0 | 12.7 | 52.5 | 0.4 | |
| Carrying value | 10,464 | 6,177 | 1,263 | 1,924 | 19,828 | 592,652 | 612,480 |
| – as percentage of total loans | 1.71 | 1.01 | 0.21 | 0.31 | 3.24 | 96.76 | |
| As at 31 December 2009 | | | | | | | |
| Face value | 32,836 | 16,430 | 4,436 | 3,932 | 57,634 | 537,032 | 594,666 |
| – as percentage of total loans | 5.52 | 2.76 | 0.75 | 0.66 | 9.69 | 90.31 | |
| Writedowns | 20,144 | 4,883 | 1,130 | 428 | 26,585 | 3,095 | 29,680 |
| – as percentage of face value | 61.3 | 29.7 | 25.5 | 10.9 | 46.1 | 0.6 | |
| Carrying value | 12,692 | 11,547 | 3,306 | 3,504 | 31,049 | 533,937 | 564,986 |
| – as percentage of total loans | 2.25 | 2.04 | 0.59 | 0.62 | 5.50 | 94.50 | |

Source: Unicredit Consolidated Reports and Accounts 2009 (Draft)

Asset quality data as shown in Table 29 confirm this trend. The face value is the nominal value of a bond at maturity while the carrying value (or called book value) is the value of an asset according to its balance sheet account balance. The carrying value of impaired loans was €31 billion in 2009, an increase of 56.6% compared with 2008; this accounted for 5.5% of customer loans, as against 3.24% in December 2008.

The €1.2 billion increase in impaired loans included €2.2 billion in non-performing loans, €5.4 billion in doubtful loans, €2 billion in restructured loans and €1.6 billion in past dues. The increase was mainly due to group entities operating in Italy, which recorded an increase of some €5.5 billion, and to a lesser extent to those operating in Germany (an increase of €1.1 billion) and in the CEE markets (€1.4 billion). Source: Unicredit Consolidated Reports and Accounts 2009 (Draft)

Outlook

Rating agencies' outlook

Standard & Poor's rated Unicredit's outlook as stable due to its diversified earnings stream and strengthened capital cushion. Worsening economic conditions, which have negative implications for Unicredit's earnings and asset quality could result in a weaker stand-alone credit profile. However, Standard & Poor's expects that the impact on the ratings would be mitigated by the potential extraordinary government support that Unicredit would be likely to receive given that it is an institution with high systemic importance. Conversely, a positive rating would be given if prospects for Unicredit's earnings and asset quality were to strengthen significantly and enduringly.

Moody's also evaluated Unicredit's long-term debt and deposit ratings outlook as stable, thanks to a very high expectation of systemic support. However, the outlook for the bank's financial strength rating is negative due to the sustained difficult economic and market conditions across the group's main markets. Another reason for the negative outlook is the economic downturn in Italy and the CEE region.

Unicredit's outlook

According to the Draft 2009 Consolidated Reports and Accounts, Unicredit expects the following developments:

The second half of 2009 was marked by relatively robust growth in both the US and the eurozone, but the recovery could lose some of its initial impetus in mid-2010. Without some important temporary factors that helped to sustain the recovery in previous quarters – especially restocking and the strong fiscal stimulus – growth will be more moderate.

The group expected that both the euro zone and the US will grow below their potential in 2010 and will return to more sustainable recovery only in 2011. In the CEE countries 2010 began with better prospects. On the back of global recovery, average growth in the region will be positive, possibly 2.3%. In this regard Turkey and Poland appear to be the best-equipped countries for a more decided recovery. By contrast, we cannot rule out the Baltic and Balkan countries, together with Hungary, growing more slowly. Looking further ahead, beyond 2011, CEE economies' growth will be strong, on average, but will in any case be slower than before the crisis: this reflects not only more modest growth in the world economy, but also the fact that the credit boom, which was fed by foreign money, will not be repeated with as intensely as in the past. Given strong economic growth that will however be more modest than that of the recent past, the CEE countries will follow the path of much more sustainable and balanced growth, while limiting the growth of foreign and government debt.

Despite the encouraging signs of recovery in the economic cycle, European banks' profits will continue to be under pressure in 2010 due to weaker revenue and deteriorating credit quality. Net interest income will tend to suffer from the reduction in business volumes and narrowing banking spreads. Lower net interest income and the still rather high cost of risk will hamper profit growth this year. However, this effect will be attenuated by an expected recovery in non-interest income, given the stock markets' recovery. CEE banks' profitability will also improve sharply in 2010. However, in some countries, deteriorating credit quality will reduce profits again in 2010 (non-

performing loans should peak in the first half of the year). Therefore, while on the one hand the banks in some countries –Ukraine, Kazakhstan and the Baltics – will inevitably stay under pressure in 2010, on the other hand the more solid countries from a macro-economic standpoint – Poland, Turkey and the Czech Republic – will see an improvement in the banking industry's prospects.

In the group's opinion, company capital has been strengthened both organically and through recourse to the market, the structure of balance sheets has been improved by sharply reducing leverage, and a solid liquidity position and strong discipline in cost control has been maintained. The group feels ready to exploit growth opportunities, which will be exploited thanks to a redesigned organisational and business model, particularly in Austria, Germany and Italy, with a view to improving proximity to customers and regions.

Barclays Group

Barclays is a major global financial services provider with an extensive international presence in Europe, the Americas, Africa and Asia. With over 300 years of history and expertise in banking, Barclays operates in over 50 countries, employs more than 144,000 people and serves more than 48 million customers and clients worldwide.

Financial performance

Barclays came through the financial crisis without any serious consequences for its financial performance. Total net income and pre-tax profits were reduced by around one eighth in 2008 but recovered strongly in 2009. Total net interest income rose by 4.2%, total net income by 29.5% and pre-tax profits by 91.6%. Barclays achieved a pre-tax profit of €13.8 billion (GBP 11.6 billion) in 2009, an increase of 95% on 2008. This included the Barclays Global Investors business (BGI) gain on sales of €7,569 million (GBP 6,331 million) before tax, and was achieved after absorbing €7,276 million (GBP 6,086 million) in writedowns on credit market exposures, including impairments of €1,995 million (GBP 1,669 million), other group impairments of €7,654 million (GBP 6,402 million) and a charge of €2,175 million (GBP 1,820 million) relating to the tightening of own credit spreads. Profits included €1,500 million (GBP 1,255 million) of gains on debt buy-backs and extinguishment. However, in looking at the 95% increase in pre-tax profit, it must be borne in mind that the profit before tax was strongly reduced by 14% in 2008 due to, among other things, large gross credit market losses and impairments of €9,628 million (GBP 8,053 million). In 2008, Barclays also acquired Lehman Brothers' North American businesses, which caused a gain of €2,704 million (GBP 2,262 million).

Impairment charges against loans and advances, available-for-sale assets and reverse repurchase agreements increased 49% to €9,649 million (GBP 8,071 million) reflecting deteriorating economic conditions, portfolio maturity and currency movements. In 2008, impairment charges and other credit provisions amounted to €6,478 million (GBP 5,419 million), whereas they had been €3,341 million (GBP 2,795 million) in 2007.

Regarding the development in total assets, a strong increase can be seen in 2008, caused mainly by an increase in derivative assets. In 2009, there was a drop of €805 billion (GBP 674 billion) in total assets to €1,648 billion (GBP 1,379 billion), which primarily reflects movements in market rates and active reductions in derivative balances.

Barclays also strongly improved its Tier 1 Capital ratio in 2009 to 13% compared with 5.6% in the previous year. At the same time, the adjusted gross leverage (the multiple of adjusted total tangible assets over total qualifying Tier 1 capital) was reduced from 28x in 2008 to 20x in 2009. This reflects Barclays' view that lower leverage is regarded as a key measure of stability.

Table 30: Barclays – Performance data, 2006–2009 (GBP million)

| | 2006 | 2007 | 2008 | 2009 |
|--|------|------|------|------|
| | | | | |

| | | | | |
|--------------------------|---------|-----------|-----------|-----------|
| Total assets | 996,787 | 1,227,361 | 2,052,980 | 1,378,929 |
| Net interest income | 9,143 | 9,610 | 11,469 | 11,951 |
| Net income | 19,441 | 20,205 | 17,696 | 22,915 |
| Profit before tax | 7,136 | 7,076 | 6,077 | 11,642 |
| Tier 1 Capital ratio (%) | 7.7 | 7.8 | 8.6 | 13.0 |
| Core Tier 1 (%) | 5.3 | 4.7 | 5.6 | 10.0 |

Source: Barclays PLC Annual Report 2009 and 2007

The group comprises two main parts: Global Retail and Commercial Banking (GRCB), and Investment Banking and Investment Management (IBIM). The table below shows the units in each part. In 2009, GRCB contributed 22% to the group's pre-tax income and IBIM 83%. In 2008, the proportion had been completely different: 63% and 37% respectively. Regarding total income in 2009, GRCB contributed 48% and IBIM 52%.

Table 31: Barclays – Group structure

| Global Retail and Commercial Banking | Investment Banking and Investment Management |
|--|--|
| <ul style="list-style-type: none"> • UK Retail Banking • Barclays Commercial Bank • Barclaycard • GRCB – Western Europe • GRCB – Emerging Markets • GRCB – Absa (South Africa) | <ul style="list-style-type: none"> • Barclays Capital • Barclays Global Investors • Barclays Wealth |

Source: Barclays PLC Annual Report 2009

The geographical diversification of Barclays reflects the importance of the UK market: the majority of employees (39%) work in the UK where and the highest amount of pre-tax income (47%) is gained there.

Table 32: Barclays – Regional performance

| Region | Number of employees | Income (GBP billion) | Profit before tax (GBP million) |
|------------------------|---------------------|----------------------|---------------------------------|
| US | 12,300 | 6.6 | 400 |
| UK | 55,700 | 13.3 | 2,500 |
| Rest of Europe | 13,500 | 4.5 | 900 |
| Africa and Middle East | 50,700 | 3.9 | 900 |
| Rest of world | 12,000 | 2.7 | 600 |
| Total | 144,200 | 31 | 5,300 |

Note: Data excludes gain on sale of Barclays Global Investors business (BGI).

Source: Barclays PLC Annual Report 2009

Employment and branches

Employment

The number of employees decreased by 5.6% between 2008 and 2009. In the GRCB division, Emerging Markets experienced the greatest decrease of 13%, while GRCB shrunk by 7%. In UK Retail Banking division there was a 6.7% reduction in employment. In Barclays Capital – including investment banking – the number of employees increased slightly (by 0.4%) and in head office

functions and other operations increased by 7%. Information about the future number of employees is not shared externally.

Table 33: Barclays – Employment, 2007–2009

| | 2007 | 2008 | 2009 |
|--|---------|---------|---------|
| UK Retail Banking | 31,900 | 32,600 | 30,400 |
| Barclays Commercial Bank | 9,300 | 9,500 | 9,100 |
| Barclaycard | 9,400 | 10,600 | 10,300 |
| GRCB – Western Europe | 8,200 | 11,800 | 11,600 |
| GRCB – Emerging Markets | 13,300 | 20,100 | 17,400 |
| GRCB – Absa | 35,200 | 35,800 | 33,300 |
| Barclays Capital | 16,200 | 23,100 | 23,200 |
| Barclays Wealth | 6,900 | 7,900 | 7,400 |
| Head office functions and other operations | 1,100 | 1,400 | 1,500 |
| Total ^{a)} | 131,500 | 152,800 | 144,200 |

Note: Numbers as at 31 December for each year; ^{a)}Total group permanent and fixed-term contract staff worldwide

Source: Barclays PLC Annual Report 2009

In 2008, staff costs had been €3,613 million (GBP 7,204 million). In 2009, they rose by 38 % – a jump of €3,280 million (GBP 2,744 million) to €1,894million (GBP 9,948 million). This rise was driven by a 40% increase in salaries and accrued incentive payments, primarily in Barclays Capital, reflecting the inclusion of the acquired Lehman Brothers' North American businesses and the associated net increase of 7,000 employees in September 2008.

Tables 34 and 35 outline the structure of employment at Barclays in terms of gender, age and position. In the group, 51.1% of employees, and 15.3% of senior executives, are women. In the UK – the core market of Barclays – the proportion of female workers in the group is slightly higher; the average length of service is 10 years.

Table 34: Barclays – Global employment statistics, 2008 and 2009

| | 2008 | 2009 |
|---|---------|---------|
| Total employee headcount | 152,800 | 144,200 |
| Percentage of employees who are women | 53.5% | 51.1% |
| Percentage of senior executives who are women | 15.1% | 15.3% |
| Percentage of senior managers who are women | 24.2% | 23.6% |
| Percentage of employees working part time | 8.6% | 5.2% |
| Turnover rate | 21.1% | 16.9% |

Note: The figures for both years excludes Iveco (Corporate Subsidiary)

Source: Barclays PLC Responsible Banking Review 2009

Table 35 Barclays – UK employment statistics, 2008 and 2009

| | 2008 | 2009 |
|---|-------|-------|
| Percentage of employees who are women | 56.6% | 52.4% |
| Percentage of senior executives who are women | 14.5% | 14.8% |
| Percentage of managers who are women | 28.1% | 26.9% |

| | | |
|---|---------|----------|
| Percentage of all employees who belong to ethnic minorities | 12.2% | 13.7% |
| Percentage of managers who belong to ethnic minorities | 11.5% | 12.6% |
| Percentage of senior executives belong to ethnic minorities | 8.1% | 8.6% |
| Percentage of employees who are disabled | 2.0% | 1.7% |
| Percentage of employees working part time | 16.4% | 12.0% |
| Turnover rate | 19.5% | 16.5% |
| Average length of service | 9 years | 10 years |
| Active members of UK pension fund | 58,316 | 54,655 |
| Pensioners | 50,499 | 52,936 |
| Percentage aged under 25 | 15.7% | 13.3% |
| Percentage aged 25–29 | 18.5% | 19.1% |
| Percentage aged 30–49 | 55.5% | 56.7% |
| Percentage aged 50+ | 10.3% | 10.9% |

Note: The figures for both years excludes Iveco (Corporate Subsidiary)

Source: Barclays PLC Responsible Banking Review 2009

Branches

Barclays has 4,197 branches worldwide and 564 additional sales centres (Barclays PLC Results 2009). The majority of branches (1,698) are located in the UK. There are 1,128 branches in other countries in western Europe and 514 in emerging markets. Absa, a subsidiary of which Barclays holds 55.4% of shares, has 857 branches in South Africa, Mozambique and Tanzania.

Ownership structure

Tables 36 and 37 outline the structure of Barclays' shareholdings, and information about the company's shares.

Table 36: Barclays – Structure of shareholdings

| | Number of shareholdings | Percentage of holders | Shares held (millions) | Percentage of capital |
|------------------------|-------------------------|-----------------------|------------------------|-----------------------|
| Total | 752,000 | 100.00 | 11,411.58 | 100.00 |
| Personal holders | 732,028 | 97.34 | 762.49 | 6.68 |
| Banks and nominees | 18,083 | 2.40 | 9,537.83 | 83.58 |
| Other companies | 1,859 | 0.25 | 1,111.18 | 9.74 |
| Insurance companies | 12 | – | 0.05 | – |
| Pension funds | 18 | – | 0.03 | – |
| United States holdings | 1,595 | 0.21 | 3.39 | 0.03 |

Notes: Figure are valid as at 31 December 2009

Source: Barclays PLC Annual Report 2009, p.329

Table 37: Barclays – Information about shares

| | 2009 | 2008 |
|--|-------|-------|
| Basic earnings per share | 86.2p | 59.3p |
| Dividend per ordinary share | 2.5p | 11.5p |
| Return on average shareholders' equity (%) | 23.8 | 16.5 |

Source: Barclays PLC Annual Report 2009

Shareholders with a controlling interest of over 3% of Barclays issued share capital. These shareholders were:

- Qatar Holding LLC, with 814 million shares, or 6.8% of the Barclays register;
- PCP3, with 626.8 million shares (5.2% of the register);
- Legal and General, with 544.7 million shares (4.5%);
- BlackRock (BGI fund), with 485.2 million shares (4%).

The remaining top Middle Eastern and Asian shareholders include:

- China Development Bank, with 248.9 million shares (2.1% of the register);
- Challenger Universal Ltd, with 313.7 million shares (2.6%);
- Sumitomo Trust & Banking, with 168.9 million shares (1.4%).

During 2009, Barclays highest share price was €4.59 (GBP 3.84) and the lowest was €0.60 (GBP 0.51). The share price at year end was €3.29 (GBP2.76).

Important recent business events

The turbulence during the financial crisis caused a short-term liquidity problem at Barclays. However, the bank recovered rapidly and was able to use the opportunities for expansion in the USA, Asia and Russia. The history of recent major events is outlined here.

2007

In August, Barclays was forced to borrow a €1.9 billion (GBP 1.6 billion) standby facility from the Bank of England. This is made available as a last resort when banks are unable to settle their debts to other banks at the end of daily trading (Bloomberg 31.07.2007, 2007). (<http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aqA8hFXWD3JY&refer=uk>)

2008

In October 2008, Reuters reported that the British government was willing to inject €47 billion (GBP 40 billion) into three banks, including Barclays. While Barclays may have been able to seek over €8 billion (GBP 7 billion) from the offer, (<http://www.reuters.com/article/idUSTRE49B37P20081012?sp=true>) Barclays later confirmed, according to the *Banking Times* (<http://www.bankingtimes.co.uk/13102008-barclays-confirms-65bn-fundraising/>) that it had rejected the government's offer and would instead raise €7.7 billion (GBP6.5 billion) of new capital. Of this, €2.3 billion (GBP 2 billion) would result from cancelling dividends and €5.3 billion (GBP4.5 billion) would come from private investors.

Due to the crisis, Barclays had credit market writedowns in 2008 of €9,628 million (GBP 8,053 million). In 2009, the figure was €7,276 million (GBP 6,086 million). The 2008 figure included €7,520 million (GBP 6,290 million) in credit market losses, and €2,107 million (GBP 1,763 million) in impairment. In 2009, the credit market losses were €5,280 million (GBP 4,417 million) and impairment totalled €1,995 million (GBP 1,669 million).

On 16 September 2008, Barclays had announced its agreement to purchase, subject to regulatory approval, the investment banking and trading divisions of Lehman Brothers, a United States financial conglomerate that had filed for bankruptcy. In 2009, Barclays acquired Lehman Brothers North American investment banking and capital markets businesses. In the deal, Barclays would also acquire the New York headquarters building of Lehman Brothers.

Barclays acquired the leading Russian bank Expobank. The bank became part of Barclays Global Retail and Commercial Banking Emerging Markets Business Unit. Barclays also opened for business

in Pakistan, with branches in Karachi, Lahore and Islamabad. This is the 14th emerging market into which Barclays Global Retail and Commercial Banking has entered since March 2007.

2009

In 2009, Barclays completed its acquisition of PT Akita, a privately owned bank with 10 outlets in three cities in Indonesia. The move makes Indonesia the 15th country to become part of Barclays Global Retail and Commercial Banking Emerging Markets Business Unit.

The board of directors of Barclays PLC announced in a press release in June 2009 that it had received a binding offer from BlackRock, Inc. for the purchase of the Barclays Global Investors business (BGI) for the consideration of approximately €10.6 billion (USD 13.5 billion). As part of the consideration offered, Barclays would receive 37.78 million new BlackRock shares giving it a financial interest of approximately 19.9% in the enlarged BlackRock Group, to be renamed BlackRock Global Investors. BlackRock thus became the world's largest money manager (Bloomberg, 12 June 2009). <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aP8IpRzYSu2o>)

In April 2010, Barclays announced its re-entry to the UK's exchange traded product (ETP) market with the launch in London of a range of exchange traded notes (ETNs). Barclays will offer nine commodity and three stock-market volatility based ETNs, as it seeks to rebuild a presence in the European ETP market, which it forecast would grow by 25% in 2010, to €216 million (USD 280 million) (Financial Times, 27 April 2010). [Barclays back in the ETP market, <http://www.ft.com/cms/s/0/af5fd3e4-5214-11df-8b09-00144feab49a.html>]

Changes in customer behaviour

Due to the crisis, Barclays experienced changes in customer behaviour. Broadly speaking, according to Barclays Group Media Relations, customers at all levels have been deleveraging, paying down debts and building up savings. Barclays has improved its counselling services in order to rebuild customers' trust. For example, the bank has been committed to working with customers who experience difficulties and this has continued to be the case throughout the financial crisis and economic downturn.

Strategy

Barclays' strategy, according to its website, is to 'achieve good growth by diversifying its business base and increasing its presence in markets and segments that are growing rapidly. This is driven by the Group's ambition to become one of a handful of universal banks leading the global financial services industry'. Among its priorities, Barclays plans to :

- build the best bank in the UK;
- accelerate the growth of global businesses;
- develop retail and commercial banking activities in selected countries outside the UK.

Barclays has five guiding principles, which are important to the way the business operates:

'- Winning together – achieving collective and individual success;

- Best people – developing talented colleagues to reach their full potential, to ensure that Barclays retains a leading position in the global financial services industry;

- *Customer and client focus – understanding customers and serving them brilliantly;*
- *Pioneering – driving new ideas, adding diverse skills and improving operational excellence;*
- *Trusted – acting with the highest integrity to retain the trust of customers, external stakeholders and colleagues.’*

Focus on shareholders

According to its Annual Report 2009, Barclays’ main goal is to produce top quartile total shareholder returns over time. In order to satisfy shareholders, the following strategic framework is applied:

- ‘ – *continue to act as responsible corporate citizens;*
- *maintain a sound financial and organisational footing;*
- *pursue a progressive dividend policy;*
- *allocate capital on an economic and strategic basis;*
- *deliver another year of significant profitability.*

Investment banking and proprietary trading activity

The guiding principle of Barclays Capital is that it serves clients. Barclays does not engage in walled-off proprietary trading activities with any relation to client business. According to Barclays Group Media Relations, proprietary trading activity to support client business accounts for less than 5% of Barclays’ capital top line income and under 3% of group income.

Future source of income

According to the annual report In 2009, Barclays ‘invested in building out our equities and advisory platforms in Europe and Asia, which will be sources of income growth in Barclays Capital in the years ahead.’ In the section of the annual report dealing with Barclays’ outlook, the strategic framework for 2010 is described in more detail.

Performance of business segments

Table 38: Barclays – Financial performance of business divisions (GBP million)

| | Global Retail and Commercial Banking | | | | | | Investment Banking and Investment Management | | | Head office functions and other operations |
|---------------------|--------------------------------------|--------------------------|-------------|----------------------|------------------------|-------------|--|---------------------------|-----------------|--|
| | UK Retail Banking | Barclays Commercial Bank | Barclaycard | GRCB- Western Europe | GRCB- Emerging Markets | GRCB – Absa | Barclays Capital | Barclays Global Investors | Barclays Wealth | |
| Net interest income | | | | | | | | | | |
| – 2009 | 2,624 | 1,741 | 2,723 | 1,182 | 743 | 1,300 | 1,598 | 43 | 504 | -507 |
| – 2008 | 2,996 | 1,757 | 1,786 | 856 | 616 | 1,104 | 1,724 | -38 | 486 | 182 |

| | | | | | | | | | | |
|--|--------|-------|--------|--------|--------|--------|--------|-------|-------|-------|
| Net fee and commission income | | | | | | | | | | |
| – 2009 | 1,225 | 926 | 1,271 | 438 | 232 | 943 | 3,001 | 1,757 | 802 | -418 |
| – 2008 | 1,299 | 861 | 1,299 | 383 | 223 | 762 | 1,429 | 1,917 | 720 | -489 |
| Total income | | | | | | | | | | |
| – 2009 | 4,053 | 2,753 | 4,062 | 2,295 | 1,045 | 2,720 | 11,625 | 1,903 | 1,333 | 28 |
| – 2008 | 4,517 | 2,745 | 3,230 | 1,795 | 1,019 | 2,324 | 5,231 | 1,844 | 1,024 | -377 |
| Impairment charges and other credit provisions | | | | | | | | | | |
| – 2009 | 936 | 974 | 1,798 | 667 | 471 | 567 | 2,591 | / | 51 | 16 |
| – 2008 | 602 | 414 | 1,097 | 296 | 166 | 347 | 2,423 | / | 44 | 30 |
| Net income | | | | | | | | | | |
| – 2009 | 3,049 | 1,779 | 2,244 | 1,056 | 574 | 1,982 | 9,034 | 1,903 | 1,282 | 12 |
| – 2008 | 3,880 | 2,331 | 2,122 | 1,134 | 8,53 | 1,851 | 2,808 | 1,844 | 1,324 | -407 |
| Profit before tax | | | | | | | | | | |
| – 2009 | 612 | 749 | 761 | 130 | -254 | 506 | 2,464 | 7,079 | 145 | -550 |
| – 2008 | 1,369 | 1,266 | 789 | 257 | 134 | 552 | 1,302 | 595 | 671 | -858 |
| Employees | | | | | | | | | | |
| – 2009 | 30,400 | 9,100 | 10,300 | 11,600 | 17,400 | 33,300 | 23,200 | / | 7,400 | 1,500 |
| – 2008 | 32,600 | 9,500 | 10,600 | 11,800 | 20,100 | 35,800 | 23,100 | 3,700 | 7,900 | 1,400 |

Source: Barclays PLC Annual Report 2009

Table 39: Barclays – Performance of business divisions, percentage change from previous year

| | Global Retail and Commercial Banking | | | | | | Investment Banking and Investment Management | | | Head office functions and other operations |
|--|--------------------------------------|--------------------------|-------------|---------------------|-----------------------|-----------|--|---------------------------|-----------------|--|
| | UK Retail Banking | Barclays Commercial Bank | Barclaycard | GRCB-Western Europe | GRCB-Emerging Markets | GRCB-Absa | Barclays Capital | Barclays Global Investors | Barclays Wealth | |
| Net interest income | -12 | -1 | 52 | 38 | 21 | 18 | -7 | - | 4 | -379 |
| Net fee and commission income | -6 | 8 | -2 | 14 | 4 | 24 | 110 | -8 | 11 | -15 |
| Total income | -10 | 0 | 26 | 28 | 3 | 17 | 122 | 3 | 30 | - |
| Impairment charges and other credit provisions | 55 | 135 | 64 | 125 | 184 | 63 | 7 | - | 16 | -47 |
| Net income | -21 | -24 | 6 | -7 | -33 | 7 | 322 | 3 | -3 | - |
| Profit before tax | -55 | -41 | -4 | -49 | / | -8 | 89 | 1090 | -78 | -36 |
| Employees | -7 | -4 | -3 | -2 | -13 | -7 | 0 | - | -6 | 7 |

Source: Barclays PLC Annual Report 2009, Economix

Performance of business segments in Global Retail and Commercial Banking

In Global Retail and Commercial Banking, a strong decrease occurred regarding pre-tax profits. Due to economically challenging conditions, the pre-tax profit dropped by 55% in UK Retail Banking, by 49% in GRCB-Emerging Markets and by 41% in Barclays Commercial Bank.

Regarding total income, UK Retail Banking was the only division with a loss. There, the decrease of 11% reflected the impact of deposit margin compression net of hedges, partially offset by good growth in home finance. In comparison, total income increased in Barclaycard by 26%, which reflected strong growth across the businesses, driven by increased lending and improved margins. In BRCB-Western Europe, income growth was 28%, as the expanded network continued to mature while customer deposits increased from €9.3 billion to €27.9 billion (GBP 7.8 billion to GBP 23.4 billion). In GRCB-Absa, total income increased by 17%, a rise driven by solid balance sheet growth, the appreciation in the average value of the rand against sterling, and higher fees and commissions.

The development of impairment charges showed strong increases, particularly in Barclays Commercial Bank, GRCB-Western Europe and GRCB-Emerging Markets. Overall, the impairment charges and other credit provisions increased from €4,689 million (GBP 3,922 million) in 2008 to €6,472 million (GBP 5,414 million) in 2009 – a rise of 85%. In Barclays Commercial Bank, impairment charges increased to €1,164 million (GBP 974 million), which reflects the impact of the weak business environment with rising default rates and falling asset values across all business segments. In GRCB-Western Europe, impairment charges increased by €442 million (GBP 370 million) to €797 million (GBP 667 million), largely driven by losses in Spain in commercial property, construction and SME portfolios. The strong increase in GRCB-Emerging Markets was driven by significant increases in India and the United Arab Emirates, reflecting the impact of the economic recession across the business with continued pressure on liquidity, rising default rates and lower asset values.

In all divisions, the number of employees was reduced – mainly because of tighter cost management. In GRCB-Western Europe, the decrease in employment was driven by restructuring in Spain and Russia. The biggest decrease was experienced in GRCB-Emerging Markets (a drop of 13%), due mainly to the introduction of more effective and efficient structures.

Performance of business segments in Investment Banking and Investment Management

Barclay's positive pre-tax result in 2009 was driven mainly by Investment Banking and Investment Management, which contributed 82% of Barclays' pre-tax income.

In Barclays Capital, pre-tax profits increased by 89% to €2,945 million (GBP 2,464 million) as a result of very strong performances in the UK. European and US profits were partially offset by a charge of €2,175 million (GBP 1,820 million) relating to own credit. This was a gain on 2008 of €1,988 million (GBP 1,663 million). Income in Investment Banking more than doubled. The results also reflect excellent results across the client franchise and a resilient fourth quarter. Fixed income, currency and commodities were up €6.6 billion to €15 billion (GBP 5.6 billion to GBP 13.0 billion) following the expansion of the business and increased client flows. Total credit market exposures were reduced by €16.8 billion (GBP 14.1 billion). In addition, €6 billion of credit market assets (GBP 5.1 billion) and €2.8 billion of other assets (GBP 2.4 billion) were sold to Protium Finance LP. Operating expenses were 75% higher than in 2008, given the substantial increase in the overall scale of the business.

In regarding the pre-tax result in Barclays Global Investors, the disposal of the division to BlackRock with a profit on disposal before tax of €7,569 million (GBP 6,331 million) should be kept in mind. However, profit before tax also increased by 26% to €894 million (GBP 748 million), excluding the profit on disposal. This compares with a 2008 figure of €711 million (GBP 595 million) This increase was caused by a recovery on liquidity support charges and an 18% appreciation in the average value of the US dollar against sterling.

Barclays Wealth pre-tax profits fell by 78% to €173 million (GBP 145 million), principally as a result of the impact of the sale of the closed life business in 2008 and the cost of integrating Barclays Wealth Americas during 2009. Excluding the impact of these transactions, there was solid growth in income due to growth in the client franchise and the product offering. Operating expenses grew by 22%,

reflecting the integration of the US business, partially offset by the disposal of the closed life business. Total client assets increased by 4%, or €7.1 billion (GBP 6 billion), to €180 billion (GBP 151 billion). The number of employees increased by 100 to 23,200 in Barclays Capital: a net reduction in the first half of the year was offset by strategic growth in the business and the annual graduate intake. The number of employees in Barclays Wealth decreased by 500 to 7,400, reflecting active cost management including efficiency savings in non-client facing areas.

Performance of Head Office Functions and Other Operations

Head Office Functions and Other Operations made a pre-tax loss of €657 million (GBP 550 million), which was an improvement of €368 million (GBP 308million) compared with 2008. The increase was the result of gains on debt extinguishment of €1,391 million (GBP 1,164million), partially offset by increased costs in central funding activity due to money market dislocation (in particular, LIBOR resets), and the cost of the announced UK bank payroll tax charge of €227 million (GBP 190 million) in respect of 2009 cash compensation, and €41 million (GBP 35 million) in respect of certain prior year awards that may fall within the proposed legislation.

Remuneration

New remuneration policy

According to some newspapers, the large profits enjoyed by bankers prompted widespread public anger because they were widely perceived to have taken dangerous risks which led to the global recession. According to the British Broadcasting Corporation BBC, bank chiefs insist they are paying out less of their revenues as bonuses than they normally do in order to show they are sensitive to the mood of the public. (Barclays bank bonuses expected to reach £2bn <http://news.bbc.co.uk/2/hi/business/8514650.stm>)

In 2009, Barclays reviewed its remuneration practices. According to Sir Richard Broadbent (Chairman of the Board Human Resources and Remuneration Committee.),

‘the objective was to ensure that the principle of pay-for-performance, which underpins the business, continues to be implemented in a way that is consistent with and supportive of delivering returns to shareholders, strengthening the balance sheet, protecting the business franchise and delivering the appropriate management of risk.

According to the Remuneration Report 2009, the following points characterise the new remuneration practices. [<http://www.barclaysannualreport.com/ar2009/index.asp?pageid=38>

Statement from the Chairman of the Board HR and Remuneration Committee]

... – a significantly greater proportion of incentives will be longer term and more will be deferred in order to contend with greater risk adjustment, industry cyclicality and market volatility

– the use of equity for employee remuneration remains central to ensuring the alignment of shareholder and employee interests

– there will be a greater emphasis on the detailed consideration of risk associated with individual performance

– *there is a role for greater exercise of discretion to avoid the perverse results that can arise, particularly from long-term schemes being tied to over-precise performance projections. Discretion should be exercised within the context of a robust framework of performance and risk data, and be associated with appropriate levels of accountability.*

A Barclays investor presentation of spring 2010 outlines the concrete changes in remuneration (<http://group.barclays.com/Investor-Relations/>):

- total group discretionary cash payments for 2009 amounting to €1.7 billion (GBP 1.5 billion);
- additional long-term awards of €1.4 billion (GBP 1.2 billion), vesting over three years and subject to clawback;
- 73% of new long-term awards in equity;
- long-term awards being granted to 5,000 employees.

Bonuses and remuneration

In February 2010, Barclays announced it would pay more than €3.2 billion (GBP 2.7 billion) in bonuses. Of this, €1.7 billion (GBP 1.5 billion) would be paid out over the course of 2010 and €1.4 billion (GBP 1.2 billion) within the subsequent three years (Financial Times, 30 April, 2010 Barclays' investment banking arm stalls <http://www.ft.com/cms/s/0/07387120-542c-11df-b75d-00144feab49a.html>) On average each of the 23,000 investment bankers is to receive €228,356 (GBP 191,000).

Table 40: Barclays – Remuneration 2009 (GBP thousand)

| | Average total discretionary award per employee | Average total compensation per employee | Average total income generated per employee |
|---|--|---|---|
| Group excluding Barclays Global Investors (BGI) | 19 | 54 | 106 |
| Barclays Capital | 95 | 191 | 515 |

Source: Barclays: Spring 2010 Investor Presentation

Remuneration of executive directors

In 2009, Barclays paid no annual performance bonuses to the chief executive and the president. Moreover, it paid out no long-term awards to the chief executive. This was the second successive year in which the chief executive and the president received fewer bonuses and long-term awards. Moreover, executive directors' performance was more closely assessed with regard to non-financial measures and risks; in addition, current executive directors with long-term performance shares agreed to voluntary clawback arrangements. These amendments of the executive directors' pay follow on from the changes in 2008: no salary increases or annual performance bonuses were paid; long-term awards were 64% lower than in 2007 with no awards for the chief executive or the president; and long-term awards to executive directors, due to be given in 2009, were deferred for a further two years subject to additional financial performance over that period.

Evaluation by rating agencies

The following table shows the credit ratings for Barclays. The long-term rating indicates a 'high grade' rating by all three agencies.

Table 41: Barclays – Credit ratings for Barclays Bank PLC

| | Short-term | Long-term | Bank's financial strength rating (BFSR) |
|--|------------|-----------|---|
| | | | |

| | 2009 | 2009 | 2008 | 2007 | 2009 | 2008 | 2007 |
|---------------------------|------|------|------|------|--------------|--------------|---------------|
| Fitch Ratings | F1+ | AA- | AA+ | AA+ | C (negative) | B (negative) | B+ (negative) |
| Moody's Investors Service | P-1 | Aa3 | Aa3 | Aa3 | | | |
| Standard & Poor's | A-1+ | AA+ | AA- | AA- | | | |

Note: An explanation of rating codes can be found in the Annex. The lowest long-term credit rating that Barclays Bank PLC has had in the past 20 years is AA- (from Standard and Poor's), Aa3 (Moody's) and AA (Fitch).

Source: Barclays website (Investors relations)

In the following, the ratings of Moody's and Fitch are described in more detail. Both generally see a stable trend for Barclays, due in part to the high probability of its receiving governmental support should this be needed. The increase of Tier 1 capital is appreciated, as well as the reduction of the leverage ratio. However, Moody's remains cautious due to the growing weight of investment banking in the Barclays business mix.

Change in rating by Moody's

In March 2010, Moody's changed the outlook on Barclays C Bank Financial Strength Rating (BFSR) from negative to stable and affirmed the Aa3 senior debt and deposit ratings (stable outlook) and P-1 short-term rating (iStockAnalyst.com Moody's Changes Barclays Outlook on C Bfsr to Stable From Negative <http://www.istockanalyst.com/article/view/iStockNews/articleid/3974061>). Its change in the BFSR outlook is based on the improvements in Barclays' balance sheet over the previous 18 months in terms of capital, leverage and liquidity, backed up by the more active approach the bank has taken to establish solid capital buffers.

Outlook of rating agencies

Moody's evaluates companies according to the Bank Financial Strength Rating (BFSR), which was rated as stable for Barclays. In the future, as the Finchannel.com article makes clear, Moody's thinks that any further upward pressure on the BFSR is unlikely until it is clear that the management of limits is sufficiently robust in the face of the pressures that arise from a growing business.

According to Elisabeth Rudman, a senior credit officer at Moody's and lead analyst for Barclays, quoted in the article;

'With the measures that Barclays has taken to strengthen its balance sheet and liquidity, its stand alone credit strength is now well captured [...] with limited downside risks. This includes our concerns about the ongoing volatile and uncertain operating environment especially in the UK. At the same time, Moody's does not expect upward rating pressure on the stand-alone rating, since the growing weight of investment banking in the business mix and the challenges of managing the rapid growth of investment banking activities at Barclays Capital weigh negatively on the rating.'

The article concludes that 'Any upward pressure would require a visible and sustained track record that the growth can be well controlled and not lead to a significant increase in risk appetite for the firm.'

Over the medium term, an increase in the proportion of revenues from less volatile businesses, such as retail and commercial banking and wealth

management – which is also formulated in Barclays' strategic goals – would be positive for the stand-alone BFSR. However, downward pressure on the ratings could arise if Moody's believed that there was a significant growth in risk appetite at the bank, which could be evidenced through an increase in stress test results, economic capital, leverage, expected shortfall or value at risk.

Fitch's rating

In an article, *Fitch Affirms Barclays at 'AA-'; Outlook Stable*, on the [Finchannel.com](http://www.finchannel.com) website, describes how Fitch rated Barclays at 'AA-', saying that the outlook for the bank was stable.

*([.finchannel.com/ Fitch Affirms Barclays at 'AA-'; Outlook Stable](http://www.finchannel.com/Fitch_Affirms_Barclays_at_'AA-';_Outlook_Stable)
http://www.finchannel.com/news_flash/Banks/50692_Fitch_Affirms_Barclays_at_'AA-';_Outlook_Stable_/)*

The rating affirmation reflects the stabilisation in financial markets following a prolonged period of severe turbulence that had put pressure on banks with large wholesale and investment banking businesses [...]. Fitch has removed the RWN [rating watch negative'] from Barclays' Individual rating to reflect the reduction in near-term concerns. Significant improvements to the group's capital base in 2008 and H109 have mitigated concerns over the potential for additional asset deterioration and the adequacy of impairment charges in credit-market portfolios wrapped by sub-investment grade monoline insurers.

[...] There is a limited downside risk to Barclays' IDR [issuer default rating] given the strongly supportive stance of UK authorities to large troubled banks in that sector. The most significant threats to the individual rating would be a material increase in the scale of the group's investment banking activities relative to its retail and commercial businesses, heightened earnings volatility in the investment bank, a greater-than-expected impact of a weak global economic environment on more vulnerable portfolios such as retail, unsecured and commercial real estate and a material adverse change to capital relative to risks. [...] The UK authorities have provided a substantial amount of support to both the UK banking system and to specific UK banks. Barclays has not made use of direct capital support and will not be required to join the Asset Protection Scheme. It has, however, participated in various schemes to support system-wide liquidity and wholesale funding, including the 'Credit Guarantee Scheme' under which it has issued 'AAA'-rated debt.

Capital position

According to the article, Barclays has:

...improved its capital position significantly since the end2007. Including the effects of the sale of BGI, its reported core tier 1 and tier 1 ratios would have been 8.8% and 11.7%, respectively, at end-June 2009, thereby providing a stronger cushion against further asset deterioration. In recognition of

changing market perceptions, Barclays has reduced its adjusted leverage ratio (the most significant adjustment being the elimination of net/collateralised derivative balances) to 20x at end-June 2009 (including the effects of the BGI sale) from 32x a year earlier. Fitch views Barclays' capitalisation as adequate relative to its risk profile and notes that despite improvements it remains somewhat weaker than many large global peers. The agency expects Barclays to maintain capital ratios above the group's historical levels while market conditions remain uncertain. Material downward pressure on capital, which could arise from organic growth and/or acquisitions, is likely to be tempered by external influences, such as evolving regulatory requirements.

Moody's rating

In March 2010, Moody's changed its Barclays outlook on C Bfsr to stable (from negative), as another article on iStockAnalyst makes clear. [Moody's Changes Barclays Outlook on C Bfsr to Stable From Negative - <http://www.istockanalyst.com/article/viewiStockNews/articleid/3974061>]

The Aa3 senior debt rating, with a stable outlook, continues to incorporate an expectation of high support from the UK government. When downgrading Barclays' ratings in February 2009 from B/Aa1 to C/Aa3, Moody's highlighted the risk for further writedowns on credit -market exposures at Barclays and higher loan loss impairments. But since that time the bank has improved its ability to absorb these challenges by increasing its Core Tier 1 capital ratio from 5.6% at FYE 2008 to 10.0% at FYE 2009, increasing the liquidity pool from GBP43 bn [€51 billion] to GBP127bn [€152 billion] over the same period, and improving reported adjusted leverage from 28x to 20x. According to our calculation of leverage, Barclays is currently better placed than a number of other European wholesale investment banks, although Moody's expects that all banks will come under pressure from local regulators and international bodies to reduce leverage further. The bank reported credit market-related writedowns and impairments of GBP6.09bn [€7.2 billion], leading to a total of GBP17bn [€20.3 billion] in writedowns over the three year period from 2007–2009.

Writedowns

The article continues, by looking at writedowns:

Moody's considers there could be further writedowns, particularly for the remaining leveraged finance transactions and monoline-wrapped securities, and notes that Barclays has not reduced these assets as quickly as some other wholesale investment banks. However the rating agency considers that further expected writedowns on the GBP27bn [€32 billion] of remaining assets (including the Protium loan) – as well as other structured product exposures, such as non-US RMBS [residential mortgage-backed securities] exposures – can be absorbed due to the bank's C BFSR rating. In addition, the rating agency noted that the bank is exposed to more fragile economies – such as the UK, the US, Spain, and South Africa– and reported increased loan loss impairments (excluding credit-market related impairments) of GBP6.4bn [

€7.6 billion] in 2009 (up from GBP3.7bn [€4.4 billion] in 2008. However, Moody's also considers that in some areas Barclays has demonstrated stronger loan underwriting than peers (for example, its mortgage book in the UK and commercial property lending in the UK). Moody's central scenario for the UK economy is a sluggish recovery; and, whilst a double dip recession could lead to higher provisioning in the bank's UK loan books, Moody's considers this could still be absorbed at the current rating level. A key criterion focus when giving ratings of complex wholesale investment banks, such as Barclays, is to determine to what extent the firm's risk appetite and the management of the capital market activities exposes investors to higher volatility and tail risk.

Risk management

The article goes on to look at risk management in Barclays:

Barclays suffered from shortcomings in how it managed risk in its underwriting business during the crisis. The bank did not capture sufficiently well its aggregate exposures to the underwriting of different asset classes , needing to exit through the capital markets, and – as at many other wholesale investment banks – the bank was left with large, lumpy, higher-risk credit-market exposures on its books when the capital markets closed. Moody's notes that the bank has taken measures to address these issues by means of tighter underwriting limits, stricter ageing policies and greater integration of credit- and market-risk management. In general, Moody's considers that Barclays benefits from a highly involved board, which takes an active part in setting risk appetite and in monitoring the bank's risk profile on a regular basis. [...]many board members, including non-executive members, have expertise in investment banking. Moreover stress testing is widely used throughout the bank and is a core part of risk management. However, Moody's remains concerned over the increasing share of the firm's profits from capital market activities and the further geographical expansion of the equity/ M&A business that received a boost from the acquisition of Lehman Brothers' North American businesses in September 2008. Given how quickly a bank can build up large positions in its trading books, it is challenging to track such changes from outside the institution. In this context, Moody's pays particular attention to how limits are managed within the trading businesses. We also focus on the conformity of the business's risk profile to the high-level limits set by the Board for those businesses.

Evaluation of single business divisions

In addition to rating the banks as corporate entities, the rating agencies also evaluate single business divisions. According to the Finchannel.com article on Fitch's rating of Barclays.

Barclays Capital was hit hard by the credit crisis in 2008, although many of its peers fared much worse. Excluding fair value gains on its own debt, large credit-market write-downs and impairment charges meant it was loss-making in 2008. In common with many other investment banks, Barclays Capital has benefited from favourable market conditions in the first half of H109 resulting

in a strong rebound in profitability. Strong income growth in H109 was driven in part by the transformation in the scale of its US offering as a result of the acquisition of Lehman Brothers' North American businesses.

Barclays enjoys a strong retail and commercial banking franchise in the UK which should be capable of generating sound profitability and capital over the cycle. However, earnings and asset quality are currently being impacted on by a weak UK operating environment, and impairment charges are likely to rise significantly in UK commercial and retail unsecured portfolios throughout 2010. In mitigation, Barclays has a relatively conservatively positioned UK residential mortgage portfolio and is less exposed than several of its domestic peers to commercial property.

Risk management

According to the Annual Report 2009, Barclays 'has clear risk management objectives and a well-established strategy to deliver them, through core risk management processes'.

It goes on to say

At a strategic level, the risk-management objectives are:

- to identify the Group's material risks.*
- to formulate the Group's Risk Appetite and ensure that business profile and plans are consistent with it.*
- to optimise risk/return decisions by taking them as closely as possible to the business, while establishing strong and independent review and challenge structures.*
- to ensure that business growth plans are properly supported by effective risk infrastructure.*
- to manage risk profile to ensure that specific financial deliverables remain possible under a range of adverse business conditions.*
- to help executives improve the control and co-ordination of risk taking across the business.*

The Group's strategy is to break down risk management into five discrete processes: direct, assess, control, report, and manage/challenge. Each of these processes is broken down further to establish end to end activities within the risk management process and the infrastructure needed to support it.

Modelling risk

The annual report for 2009 goes on to discuss the bank's strategy for modelling risk:

Risk-taking on any meaningful scale requires quantification. Barclays uses risk models in an extensive range of decisions, from credit grading, pricing and approval to portfolio management, risk appetite setting, economic capital allocation and regulatory capital calculations. The key inputs into the models used to quantify credit risk are:

- *Probability of default (PD);*
- *Exposure at default (EAD);*
- *Loss given default (LGD).*

These models are used in a range of applications that measure credit risk across the Group. For example, Barclays can assign an expected loss over the next 12 months to each customer by multiplying these three factors.

Stress testing

A key element of managing risk is stress testing, as the annual report makes clear:

A fundamental duty of risk management is to ensure that organisations do not neglect to prepare for the worst event as they plan for success. Stress testing helps Barclays understand how its portfolios would react if business conditions became significantly more challenging. We generate specific forward-looking scenarios and analyses how well our profitability would hold up, whether our levels of capital would be adequate and what managers could do ahead of time to mitigate the risk. Stress tests capture a wide range of macroeconomic variables that are relevant to the current environment, such as:

- *GDP;*
- *unemployment;*
- *asset prices; and*
- *interest rates.*

Expected losses

Basel II was introduced in 2008 and includes, for those aspects of an entity's exposures that are on an Internal Ratings Based approach, a statistical measure of credit losses known as expected loss (EL). EL is an estimate of the average loss due to the following:

- defaulted and past due items at the reported date (that is, incurred losses);
- for performing exposures, modelled default events over a future 12-month period.

On the performing portfolios, EL is calculated as the product of probability of default, exposure at default and loss given default. EL is assessed against both the performing and non-performing parts of the group's portfolios. EL considers average credit conditions, generally uses a 'through-the-cycle' probability of default and incorporates an adjustment to loss given default, which represents economic conditions in a downturn.

The expected losses amounted to €9.1 billion at the end of 2009 (GBP7.6 billion). These were 0.56% of the balance sheet sum and 66% of the 2009 pre-tax profit.

Table 42 Barclays – Total expected losses and Internal Ratings Based, 2008 and 2009 (GBP million)

| | 2008 | 2009 |
|--|-------|-------|
| UK Retail Banking | 1,258 | 1,702 |
| Barclays Commercial Bank | 819 | 776 |
| Barclaycard | 910 | 1,261 |
| GRCB-Western Europe | - | 243 |
| GRCB-Emerging Markets | - | - |
| GRCB-Absa | 692 | 1,158 |
| Barclays Capital | 1,557 | 2,467 |
| Barclays Wealth | - | 23 |
| Head office functions and other operations | 1 | 11 |
| Total EL on IRB portfolios | 5,237 | 7,642 |
| Total regulatory impairment allowance on ITB portfolios | 4,672 | 7,592 |
| Total regulatory impairment allowance on standardised portfolios | 2,560 | 4,693 |

Note: figures are as at 31 December for both years.

Source: Barclays Annual Report 2009

Economic capital

In its annual report for 2009, Barclays outlines its approach to economic capital, economic capital being an ‘internal measure of the minimum equity and preference capital required for the group to maintain its credit rating based upon its risk profile’ [reference to annual report 2009]. As the report makes clear:

Barclays assesses capital requirements by measuring the group’s risk profile using both internally and externally developed models. The Group assigns economic capital primarily within the following risk categories: credit risk, market risk, operational risk, private equity and pension risk.

The Group regularly reviews its economic capital methodology and benchmarks outputs to external reference points. The framework uses default probabilities during average credit conditions, rather than those prevailing at the balance sheet date, thus seeking to remove cyclicity from the economic capital calculation. The economic capital framework takes into consideration time horizon, correlation of risks and risk concentrations.

Economic capital is allocated on a consistent basis across all of Barclays’ businesses and risk activities. A single cost of equity is applied to calculate the cost of risk.

The total average economic capital required by the Group is compared with the supply of economic capital to evaluate economic capital utilisation. The supply of economic capital is based on the available shareholders’ equity adjusted for certain items (e.g. retirement benefit liability, cash flow hedging reserve) and including preference shares.

Economic capital forms the basis of the group's submission for the Basel II Internal Capital Adequacy Assessment Process (ICAAP).

In 2008, the total economic capital requirement was €46,116 million (GBP 38,500 million) or 2.6% of total assets. Therefore, the greatest share of economic capital was necessary for Barclays Capital – the investment banking segment.

Table 43: Barclays – Average economic capital (GBP million)

| | 2008 | 2009 |
|---|--------|--------|
| UK Retail Banking | 3,950 | 3,750 |
| Barclays Commercial Bank | 3,500 | 3,450 |
| Barclaycard | 2,700 | 3,350 |
| GRCB-Western Europe | 1,900 | 2,500 |
| GRCB-Emerging Markets | 1,100 | 1,200 |
| GRCB-Absa | 1,100 | 1,200 |
| Barclays Capital | 8,250 | 10,750 |
| Barclays Global Investors | 400 | 1,000 |
| Barclays Wealth | 500 | 550 |
| Head office functions and other operations | 50 | 100 |
| Economic capital requirement (excluding goodwill) | 23,450 | 27,850 |
| Average historic goodwill and intangible assets | 9,450 | 11,000 |
| Total economic capital requirement | 32,900 | 38,850 |

Note: figures are as at 31 December for both years.

Source: Barclays Annual Report 2009

Outlook

Barclays' own outlook

In the Annual Report for 2009 John Varley, Group Chief Executive, has the following prognosis for 2010:

'The economic outlook remains uncertain. The worst of the financial crisis is behind us but the environment remains unpredictable, and for that reason, Barclays has to be very clear about the strategic framework in which it will be doing business in 2010 and beyond.'

He goes on to outline the principal components of that strategic framework.

The bank must continue to act as a responsible corporate citizen. Barclays will ensure that its wider responsibilities to society are reflected in how the bank acts.

He stresses the importance of ensuring the maintenance of a sound financial and organisational footing, one which anticipates and adapts to the regulatory changes that will be required. Meanwhile, Barclays is seeking to anticipate many of the changes that may be required of the bank in the areas of capital, leverage and liquidity. It will maintain high levels of liquidity, and will be attentive to the size and composition of the balance sheet. In particular, the bank will manage leverage tightly, and will seek to bring down, over time, the loan-to-deposit ratio. Stress testing has been institutionalised across Barclays in recent years. This is also now part of the FSA supervision cycle. Barclays will ensure that it continues to regularly monitor its responsiveness to changing economic, market and operational environments and align its views with those of regulators.

Barclays has recommenced dividend payments in accordance with its prior commitments. Three quarterly fixed payments will be made in 2010 and a final variable payment relating to the calendar year 2010 will be paid out in March 2011.

Mr Varley states that across the group capital will continue to be allocated on both an economic and a strategic basis, reflecting the goal of increasing the international diversification of income sources in the pursuit of medium-term growth. Barclays will nurture Barclays Wealth, Barclays Corporate, Absa and GRB, while ensuring that Barclays Capital takes advantage of the structural changes in the investment banking sector. 2010 will be another year, however, in which Barclays puts returns before growth, and where prudence will determine its approach to balance-sheet size.

He concludes by stating that the balance of earnings is also important: Barclays will continue to aim for two thirds of its profits coming from GRB, Absa, Barclays Wealth and Barclays Corporate and one-third from Barclays Capital. This goal should be achieved through growth of all Barclays' businesses due to global economic recovery. This is expected to reduce impairment in retail and commercial banking businesses and increase profits. However, no timescale is given for these aspirations by Barclays.

Kurt Vogler-Ludwig, Danielle Kaisergruber and Helene Giernalczyk with support from Luisa Stock and Simone Poppe

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