MORNINGSTAR

European Banks

Higher profitability looks like it is here to stay.

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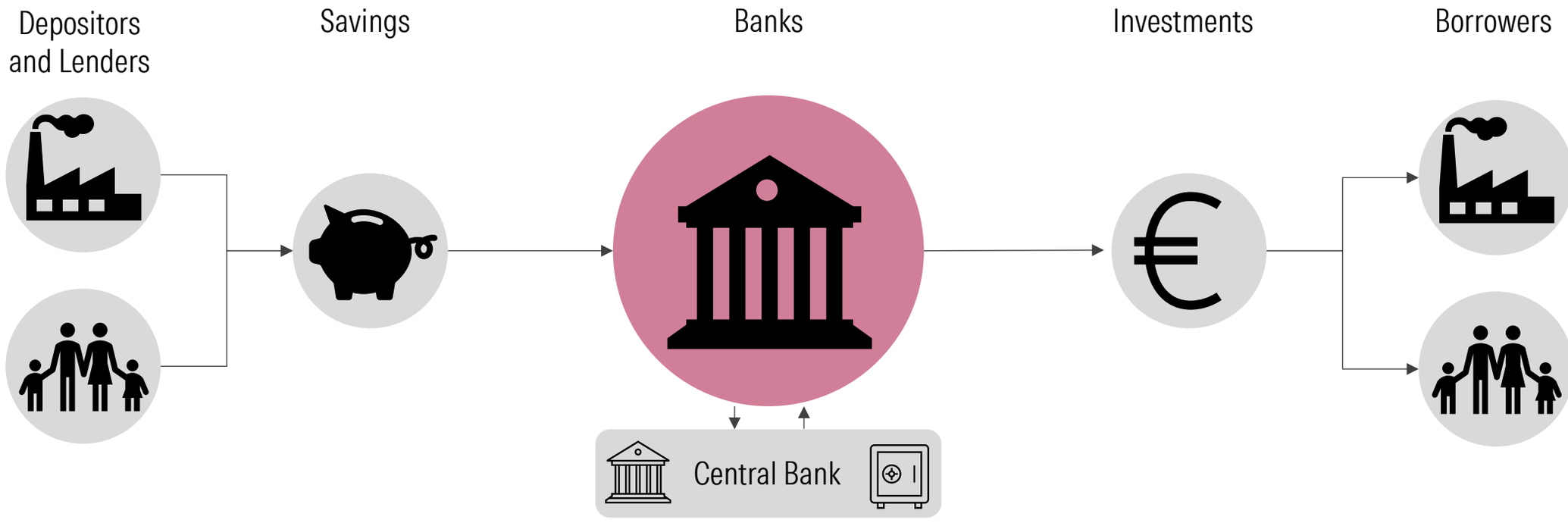
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Executive Summary

Industry Map

Banks sit at the center of every economy, connecting excess funds of savers with borrowers looking for funding to invest in their business, housing, or spending. The ability to take deposits sets banks apart from other corporations in the economy, solidifying the intermediary function that remains their core business. Banks also form an integral part of central banks' transmission mechanism of monetary policy. As central banks change interest rates, banks will adjust rates for both depositors and borrowers, affecting the real economy.

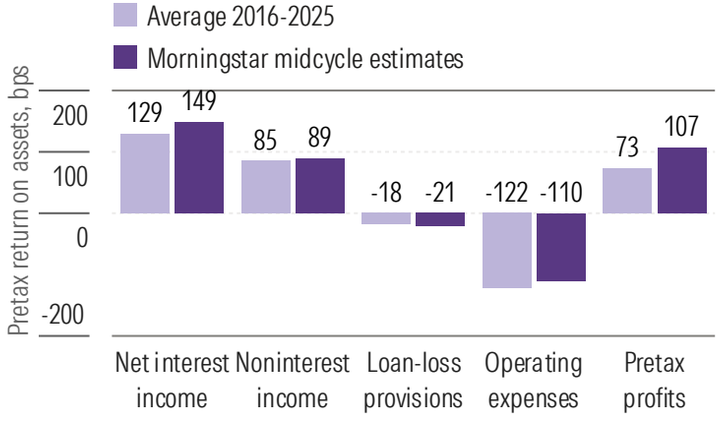
European Banks Industry Map



Source: Morningstar.

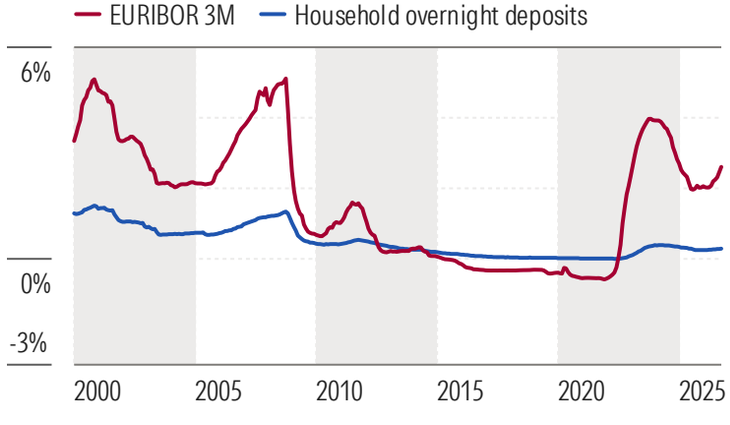
Key Industry Themes

Return on Assets Midcycle Compared With History



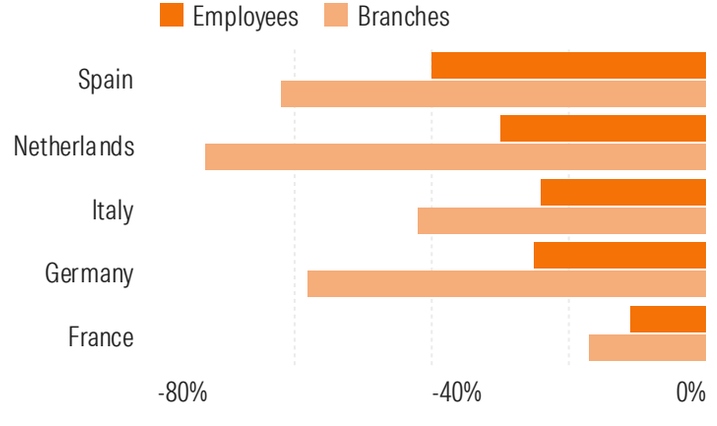
We estimate that European banks can generate a midcycle return on equity of 15% compared with the 10% average of the past decade. European banks are not a growth story; profitability gains will drive shareholder value. A structural change in net interest margins following the return of normal monetary policy is the main driver of increased profitability. Abnormally low net interest margins also obscured the major efficiency progress. Credit losses should increase from their current lows, but we think there has been an improvement in credit quality.

Banks Lost Money on Deposits Due to Negative Rates



Negative or zero interest rates depressed net interest margins over the past decade. European banks could not earn a spread on a significant part of their deposit base, turning deposit-taking—the cornerstone of retail banking—into a loss-making activity. Lower future interest rates will pressure deposit spreads, but favorable mix changes on both sides of the balance sheet will offset some of this. Net interest margins are less sensitive to interest rates than is often assumed, provided that rates remain positive.

Change in Bank Employees and Branches, 2007-25



Digitalization has led to a material reduction in the number of European banks' branches and employees. The pronounced increase in regulatory and compliance costs is largely in the base, and the efficiency gains achieved will be more visible in the future. European banks have a high degree of operating leverage, which amplifies the step change in net interest margins.

Source: Morningstar.

Income Statement

Stylized Income Statement

Interest income	19,096
Interest expense	(8,524)
Net interest income 1	**10,572**
Fee and commission income	9,637
Fee and commission expense	(3,038)
Net fee and commission income 2	**6,599**
Net trading income 3	8,049
Net investment income	(434)
Other income	170
Total income	**24,956**
Staff costs	(9,252)
Depreciation and amortisation	(3,435)
Administration and general expenses	(2,446)
Litigation and conduct 6	(1,597)
Operating expenses 4	**(16,730)**
Share of post-tax results of associates and joint ventures	6
Profit on disposal of subsidiaries, associates and joint ventures	-
Profit before impairment	**8,232**
Credit impairment (charges)/releases 5	(1,220)
Profit before tax	**7,012**
Taxation	(1,039)
Profit after tax	**5,973**

(1) Net interest income

Core income line for most European banks. Banks collect interest on loans (interest income) and pay interest to depositors and lenders (interest expense).

(2) Net fee and commission income

A catch-all line item that comprises different business lines and products, such as fees collected from investment banking, asset management, and payments as well as commissions received for the distribution of insurance and pension products.

(3) Trading income

Volatile item that tends to rise and fall with equity, debt, foreign currency, and derivatives markets depending in which markets the bank is active. Captures the changes in financial assets and liabilities measured at fair value through the profit and loss account.

(4) Operating expenses

Mostly driven by staff costs, expenses are typically expressed in the cost/income ratio. With most operating expenses largely fixed in the medium term, the cost/income ratio displays a bank's ability to benefit from operating leverage.

(5) Loan-loss provisions

Provisions set aside for loans failing to repay or expected to fail in the future. Driven by macroeconomic scenario analyses developed by banks and supervised by regulators. Increase and decrease as the macro backdrop worsens or improves, respectively.

(6) Impairments/write-offs

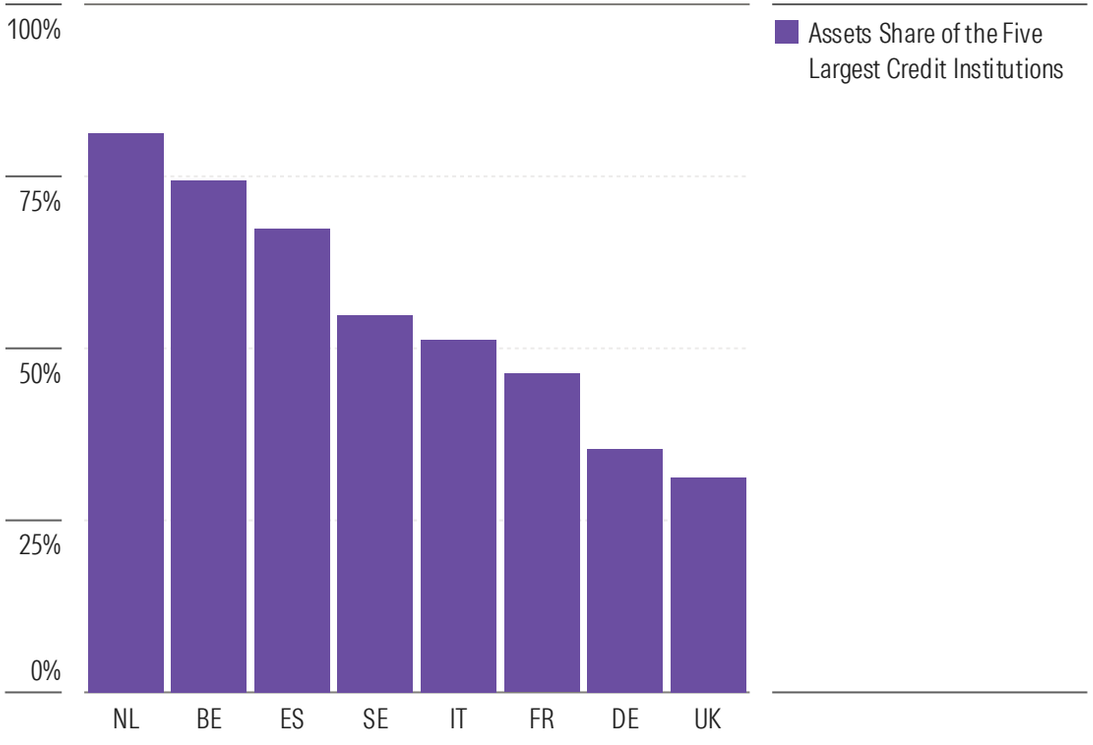
Covers fines and settlements that banks are charged occasionally for various missteps such as product misselling practices and anti-money-laundering control failures.

Source: Morningstar.

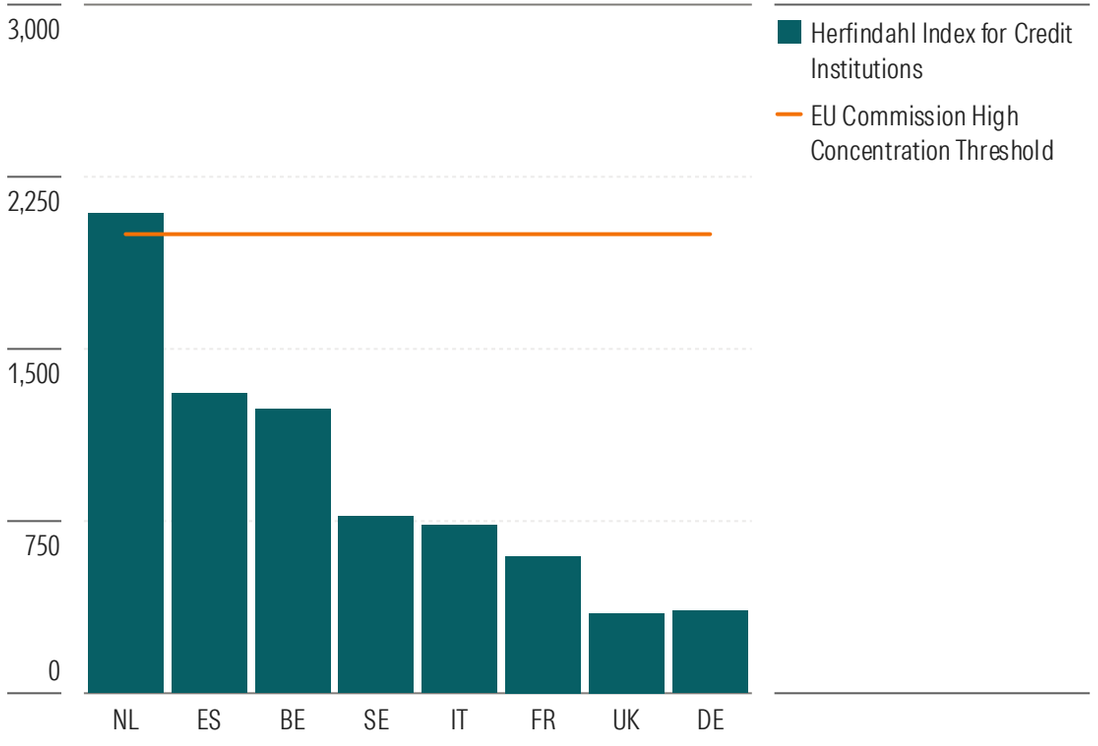
Market Concentration

The European banking space is fragmented along country borders. Within countries, levels of concentration vary, with smaller jurisdictions often showing larger control of assets by fewer banks. Based on the European Commission's definition of low competition, all European countries with the exception of the Netherlands show relatively low concentration. Spain and Italy have, however, become much more concentrated than a decade earlier.

Level of Concentration Varies Across European Countries



Concentration Level Relatively Low in Most of Europe



Source: Morningstar, European Central Bank. Data as of 2025; UK latest data as of 2019.

Coverage List and Ratings

European Banks Coverage

Company (Ticker)	Industry	Market Cap (Billions)	Moat Rating	Uncertainty Rating	Last Close	Fair Value Estimate	Star Rating	P/FVE	P/E	P/TNAV	Yield	YTD Return
ABN AMRO Bank (AMS:ABN)	Banks	67 EUR	None	High	40.99	39.00	★★★	1.05	12.6x	1.3x	4.3%	+43.3%
Banco Santander (MAD:SAN)	Banks	174 EUR	Narrow	High	12.03	11.30	★★★	1.06	11.6x	1.9x	2.2%	+20.7%
Banco Bilbao Vizcaya Argentaria (MAD:BBVA)	Banks	127 EUR	Narrow	High	23.18	26.50	★★★	0.87	11.1x	2.2x	4.5%	+20.4%
BNP Paribas (PAR:BNP)	Banks	98 EUR	None	High	89.55	123.00	★★★★	0.73	7.6x	0.8x	6.7%	+18.0%
Credit Agricole (PAR:ACA)	Banks	48 EUR	None	High	15.72	21.00	★★★★	0.75	6.8x	0.7x	7.5%	-0.8%
ING Group (AMS:INGA)	Banks	85 EUR	Narrow	High	30.06	29.00	★★★	1.04	11.9x	1.8x	4.4%	+30.6%
Intesa Sanpaolo (MIL:ISP)	Banks	106 EUR	None	High	6.15	6.40	★★★	0.96	10.4x	1.9x	7.2%	+7.0%
KBC Group (BRU:KBC)	Banks	48 EUR	Narrow	High	121.10	136.00	★★★	0.89	12.2x	1.9x	5.3%	+12.5%
Societe Generale (PAR:GLE)	Banks	47 EUR	None	High	64.47	92.00	★★★★	0.70	8.1x	0.7x	3.1%	-3.6%
UBS Group (SWX:UBSG)	Banks	121 USD	Narrow	High	39.63	40.00	★★★	0.99	10.9x	1.5x	3.2%	+9.6%
UniCredit (MIL:UCG)	Banks	115 EUR	None	High	76.19	88.00	★★★	0.87	10.3x	1.8x	4.9%	+9.9%
Barclays (LON:BARC)	Banks	58 GBP	None	High	4.33	5.10	★★★	0.85	7.1x	0.9x	3.5%	-6.7%
Commerzbank (ETR:CBK)	Banks	41 EUR	None	High	37.88	31.60	★★	1.20	10.3x	1.2x	4.3%	+8.0%
Danske Bank (CSE:DANSKE)	Banks	288 DKK	Narrow	Medium	357.80	320.00	★★	1.12	11.0x	1.7x	7.2%	+21.4%
Deutsche Bank (ETR:DBK)	Banks	55 EUR	None	High	29.33	25.50	★★	1.15	7.9x	0.8x	4.0%	-8.4%
Lloyds Banking Group (LON:LLOY)	Banks	60 GBP	Narrow	Medium	1.05	1.11	★★★	0.94	9.0x	1.6x	4.5%	+10.8%
NatWest Group (LON:NWG)	Banks	53 GBP	Narrow	Medium	6.66	7.50	★★★★	0.89	8.2x	1.5x	5.6%	+7.5%
Nordea Bank (STO:NDA SE)	Banks	53 EUR	Narrow	Medium	175.40	172.00	★★★	1.02	10.3x	1.9x	6.1%	+9.0%
Skandinaviska Enskilda Banken (STO:SEB A)	Banks	426 SEK	Narrow	Medium	219.30	191.00	★★	1.15	12.0x	1.9x	4.4%	+18.0%
Svenska Handelsbanken (STO:SHB A)	Banks	308 SEK	Narrow	Low	153.85	139.00	★★	1.11	12.7x	1.6x	6.8%	+27.5%
Swedbank (STO:SWED A)	Banks	452 SEK	Narrow	Medium	402.50	307.00	★★	1.31	13.1x	2.2x	5.9%	+34.6%
European Banks Average (Morningstar Europe coverage)								**0.98**	**10.2x**	**1.5x**	**5.0%**	**+13.8%**

Source: PitchBook, Morningstar. Data as of Oct. 19, 2026.

Economic Moat

Cost advantage and switching costs drive European banks' moat ratings.

Summary of Moat Ratings and Sources

Cost Advantage Is the Strongest Source of Moats for European Banks
Banks that can fund themselves more cheaply, manage their credit risk better, or have greater scalability should have a competitive edge over their rivals.

Funding Cost Advantage Driven by Funding Mix and Marginal Pricing Power
Banks with cheap, sticky retail deposits have lower overall funding costs. Dominant, well-known banks often pay lower interest rates to attract and keep deposits.

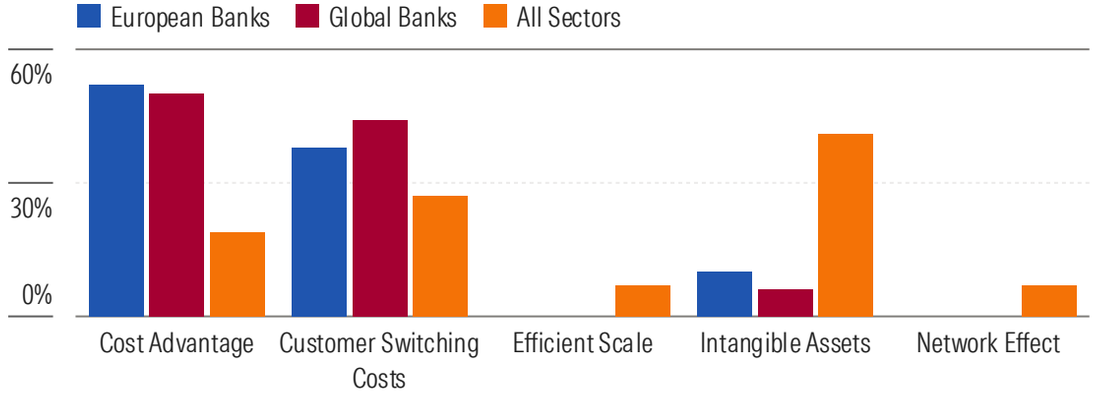
Perceived Cost of Switching Banks Exceeds Perceived Value of Switching
Clients view the time and hassle of switching banks as high. Clients see little benefit in changing between banks offering similar products and services.

Ancillary Businesses Can Support Moats
In-house wealth and asset managers, insurers, and investment banks can be moaty. Selling multiple products to the same client also improves overall profitability.

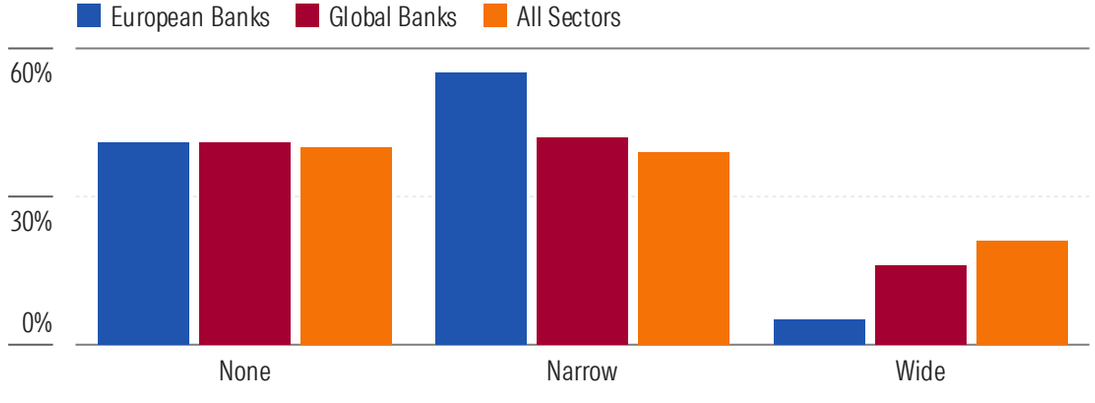
The System a Bank Operates in Can Support or Impede an Economic Moat Rating
Banks operating in systems we see as weak or unstable must clear a higher threshold to qualify for a Morningstar Economic Moat Rating.

Banks Have an Above-Average Risk of Material Value Destruction
Solvency and liquidity risk are higher for banks, which can rule out a moat.

Distribution of Moat Sources Compared With Cross-Sector Average



Distribution of Moat Ratings Compared With Cross-Sector Average



Source: Morningstar. Data as of September 2026.

Cost Advantage Is the Strongest Source of Moats for European Banks

Cost Advantage Sources for Banks and Metrics We Use To Evaluate Moat Potential

Funding Costs	Credit Costs	Operating Costs
• Net Interest Margin: Net interest income/interest-earning assets • Portion of funding from stable and sticky, low-cost current accounts • Portion of funding from expensive market-based sources • Credit Default Swaps/Bond Spreads: Provide an indication of wholesale funding costs	• NPL Ratio: Nonperforming loans/gross loans • Credit Loss Ratio: Loan-loss provisions/gross loans • Loan-loss provisions/net interest income or preprovision profits • Early Arrears: Loans not in default but with deteriorating credit quality/gross loans • Coverage Ratio: Loan-loss reserve/nonperforming loans	• Efficiency or Cost/Income Ratio: Operating expenses/revenue • Noninterest Revenue/Total Revenue: A high portion of noninterest revenue can indicate economies of scope

Low-Cost Deposit Funding Is a Key Source of Moats in the Banking Industry

Their size and reputation allow the larger, oligopolistic European banks to attract a greater share of sticky low-cost deposit funding than their peers. Apart from a favorable funding mix, these banks often benefit from lower marginal interest rates on similar instruments. Current or transactional accounts tend to pay little or no interest and underpin most of our funding costs moats. Regulated interest rates in some jurisdictions, notably France, diminish funding cost advantages.

Strong Credit Culture Supports Lower Credit Costs

Banks with strong credit cultures that limit credit costs relative to the risk taken will have an advantage over time. A strong credit culture takes time to develop and results from sound processes, institutional knowledge, and an appropriate risk appetite.

Economies of Scale and Scope Lower Marginal Operating Expenses

The bulk of a bank's costs are fixed in nature, which tends to lead to economies of scale for the larger dominant banks. Banks that provide their retail and commercial customers with various financial services can benefit from economies of scope, as operating costs are spread over more products.

We View Metrics in the Context of a Bank's Business Model and Geography

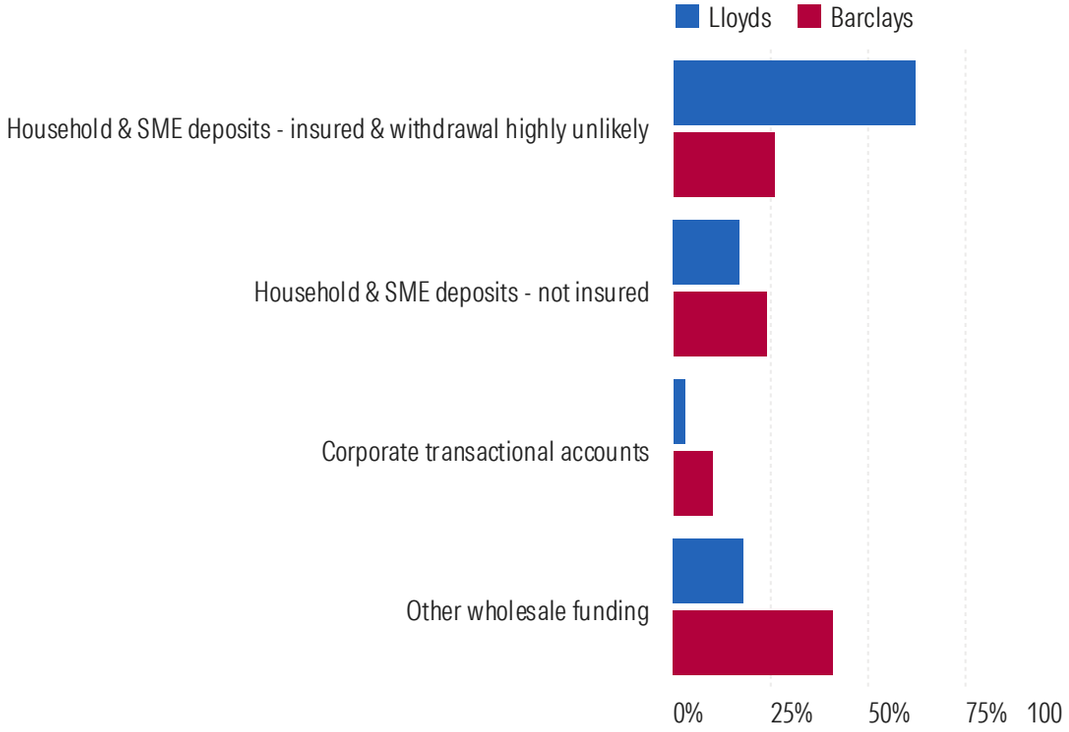
A bank's business model and the countries it operates in will have a material impact on the metrics we use to screen for moatiness. We consider this in our evaluation.

Source: Morningstar.

Funding Cost Advantage Driven by Funding Mix and Marginal Pricing Power

Favorable Funding Mix Example: Narrow-Moat Lloyds vs. No-Moat Barclays

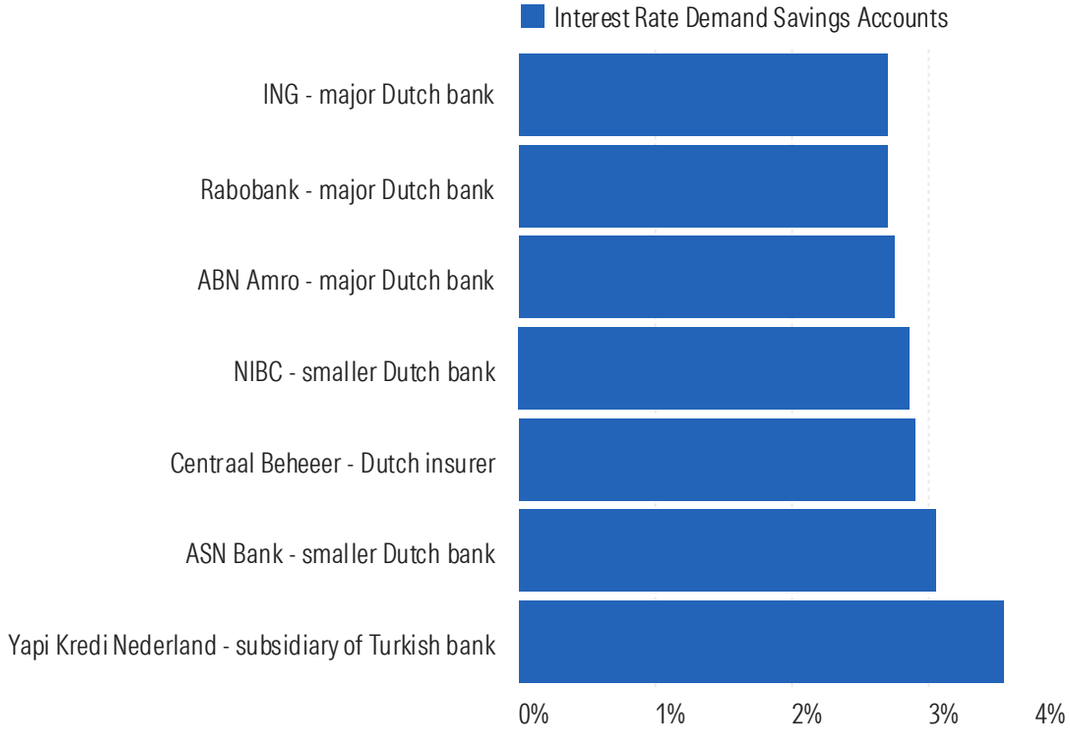
Favorable funding tilted toward retail deposits lowers Lloyds' funding costs.



In part, retail deposits are priced below prevailing market interest rates because of the presence of central bank-backed deposit insurance. Lloyds' substantial retail deposit base provides it with a funding cost advantage over wholesale-funded Barclays.

Marginal Pricing Power Example: Dutch Demand Savings Deposit Interest

Narrow-moat ABN Amro and ING pay materially less interest than smaller peers.

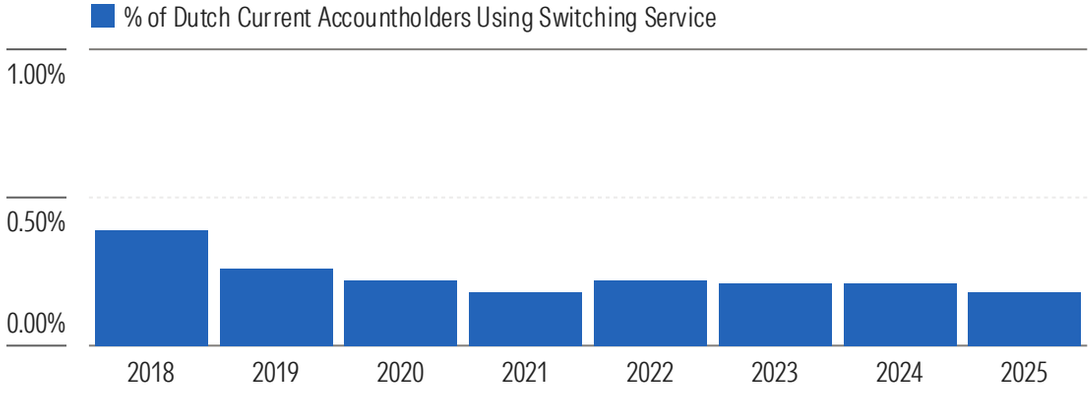


Despite the presence of deposit insurance, their highly recognizable brands, presence, and reputation allow the main Dutch banks to pay materially lower interest on the same deposit product compared with lesser-known and challenger banks.

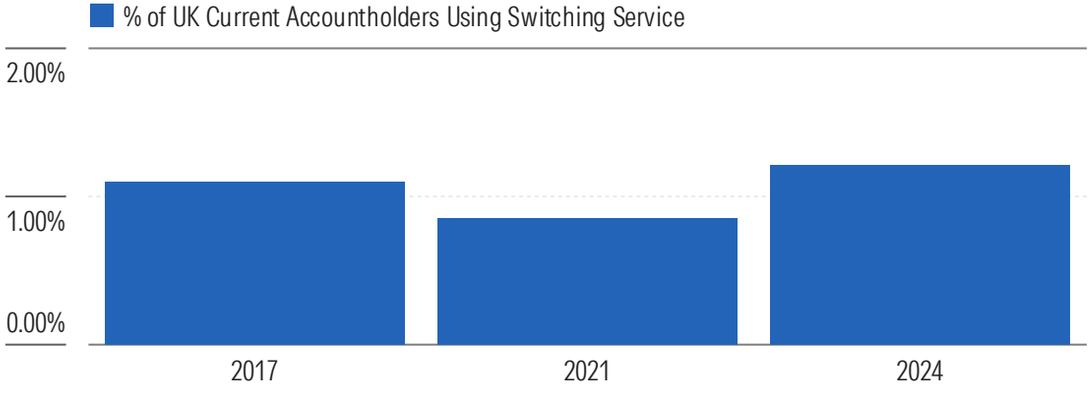
Source: Company reports. Spaarrente.nl. Data as of December 2025 and October 2026, respectively.

Perceived Cost of Switching Banks Often Exceeds Perceived Value of Switching

Example: Less Than 1% of Dutch Current Accounts Change Banks Annually



And Less Than 2% in the UK



Explicit Switching Costs Are Low, but Implicit and Perceived Costs Are High

While switching is nominally free, the benefits are often unclear, with similar bank products and service levels across firms. Despite efforts to make it easier, switching is viewed by customers as troublesome, especially for those who use multiple products from their bank.

Non-Spread-Based Services and Products Can Increase Switching Costs

When banks capture a greater share of retail and commercial bank customers' wallets with more products per customer, the banking relationship becomes more entrenched. As those relative switching costs (both implicit and explicit) increase, the returns and moats of those banks should also increase. Banks that offer ancillary services in wealth and asset management, insurance, and investment banking are well placed to capture a greater portion of the value chain.

Switching Costs Support Lower Funding Costs

Primary banked clients with multiple products at a particular bank are unlikely to change their transactional account from one bank to the next in search of the highest interest rate.

Long-Standing Relationships Are Important for Corporate and Wealthy Clients

Large corporate clients and high-net-worth individuals have complex needs that often require assistance from a trusted advisor. This relationship can stretch back years or generations for wealthy families.

Source: Dutch Payments Association, 2025; The Current Account Switch Service (Pay.UK) 2024 and Financial Conduct Authority 2024.

Stand-Alone Moats Possible in Nonspread Businesses, Complementing Overall Moatiness

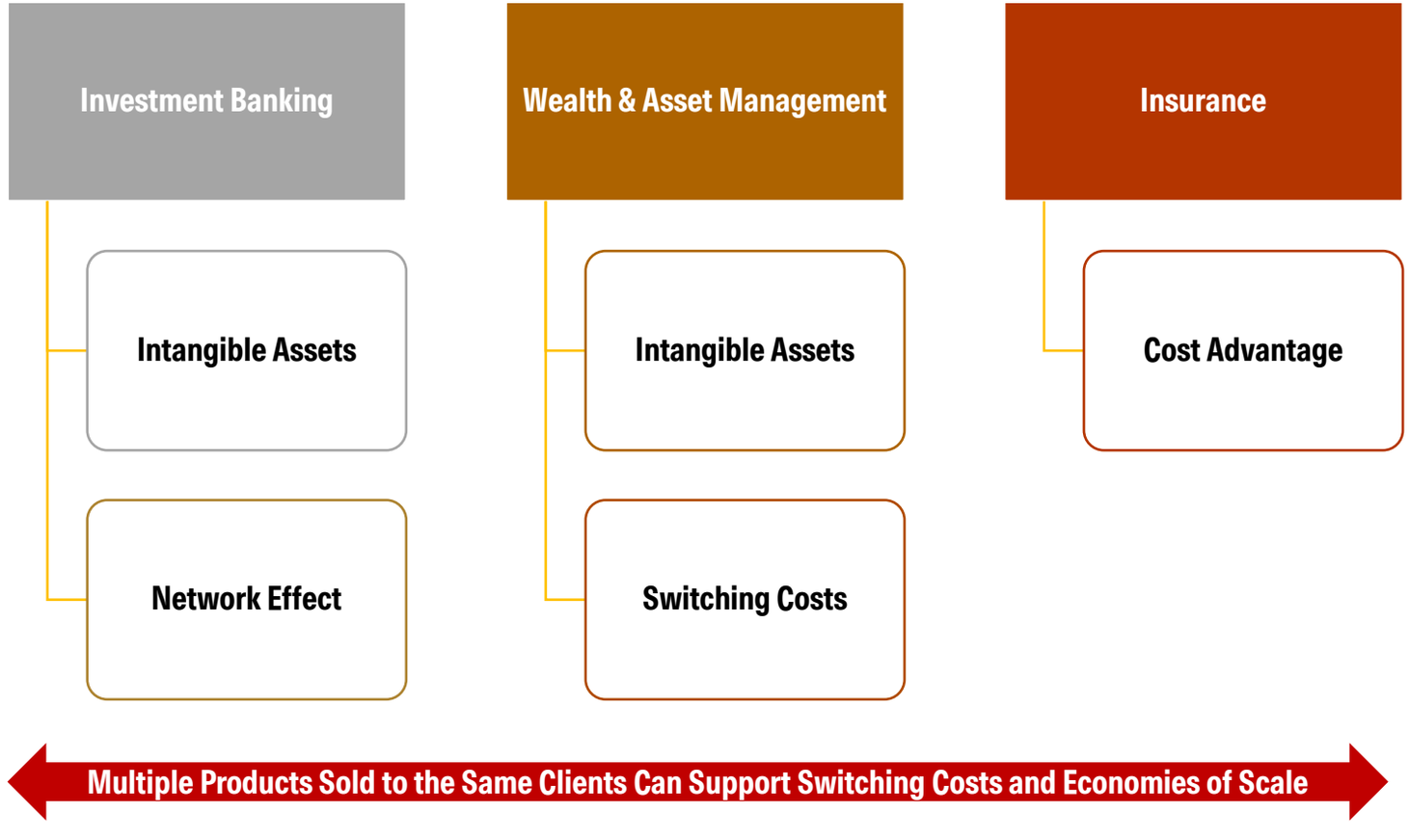
Support Switching Costs and Economies of Scale
While stand-alone moats are possible in ancillary businesses, selling multiple products to the same clients increases overall switching costs and lowers marginal costs.

Investment Banking
Intangible assets like reputation, scope of services, and relationships can help investment banks build moats. Network effects exist in bringing together buyers and sellers for complex financial products.

Wealth and Asset Management
Intangible assets are built on reputation, expertise, and performance. Losing relationships and the time and mental energy investment to switch represent high implicit switching costs.

Insurance
In our view, insurance is a commodity industry. Insurers can lower costs through an effective distribution platform. Banks with insurance subsidiaries can benefit from low customer acquisition costs.

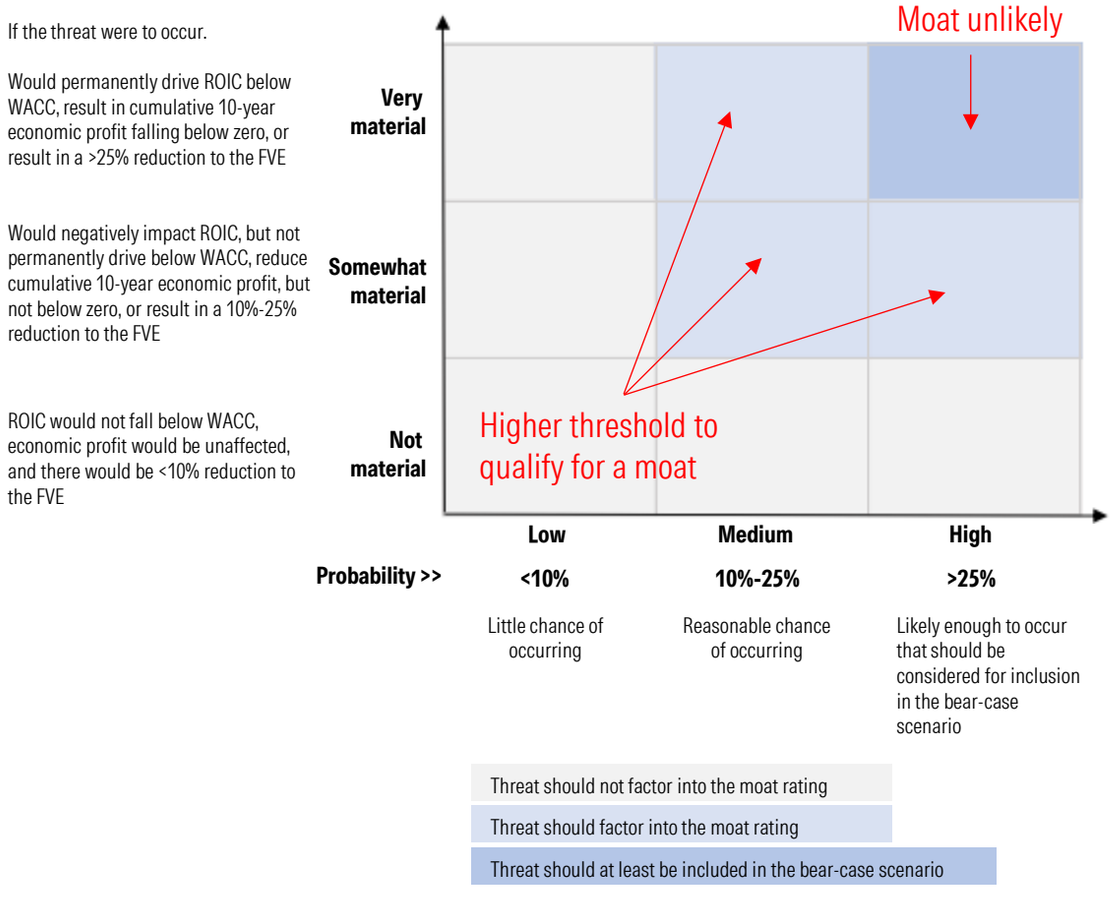
Potential Moat Sources for European Banks in Ancillary Businesses



Source: Morningstar.

Banks Have Above-Average Risk of Material Value Destruction

Morningstar Substantial Threat of Value Destruction Methodology



Even if a firm has moaty attributes, it must still clear two additional hurdles before we can award it a narrow Morningstar Economic Moat Rating:

- Excess normalized returns must more likely than not be positive 10 years from now.
- There must not be any substantial threat of major value destruction.

Ultralow interest rates have prevailed over the past decade in Europe, which has obscured the moatiness of European banks with favorable funding dynamics.

A substantial threat of value destruction refers to the black swan or tail risk events that we do not explicitly model but, when they occur, can have a devasting effect on a firm's financial health that can lead to bankruptcy, dilutive equity issuance, or a fire sale of moaty assets (low probability, high materiality).

Banks are highly leveraged with significant liquidity risk, as short-term liabilities often fund long-term assets. This makes banks more exposed to the risk of unforeseen events that can cause substantial value destruction.

Strong balance sheets with above-average capital adequacy and healthy liquidity supported by sticky, granular retail and operational deposits are banks' best defense against the threat of material value destruction.

Source: Morningstar.

Industry Basics

Transforming yield curves into financing that powers the economy—understanding how banks work.

European Banking Space Is Fragmented Along Country Borders

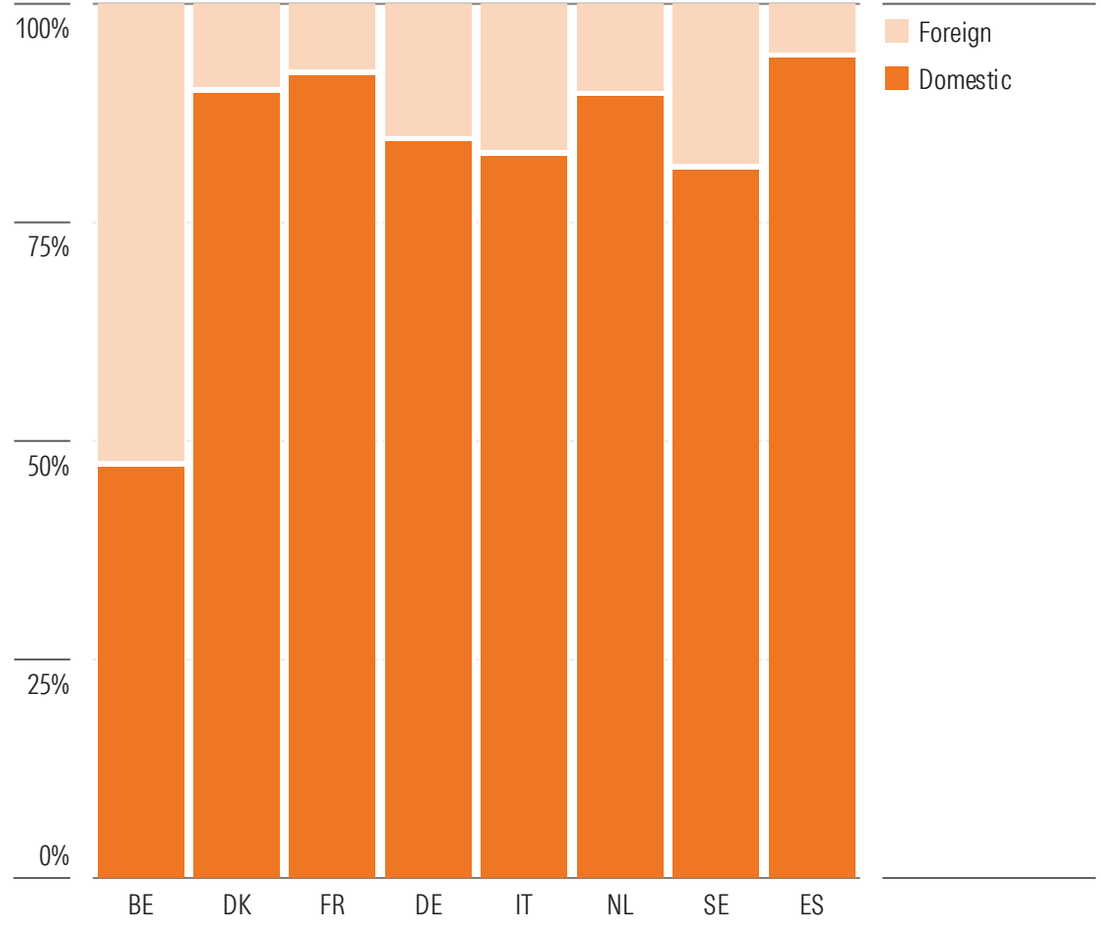
Cross-Border Banking Lacks Political and Regulatory Backing

The creation of a single Capital Markets Union in Europe faces primarily political and regulatory hurdles.

- Local champions: Politicians continue to hold on to the idea of needing to protect banks as local champions to secure national political and economic interests.
- Sovereign debt: European countries are unwilling to share sovereign debt equally across European banks' balance sheets, resulting in an unequal level of financial system risk across Europe.
- Deposit insurance schemes: Backstopping deposit losses at the Europe level rather than country level remains a politically sensitive discussion point.
- Standardized regulatory approach: Although the Basel framework leveled much of the regulatory playing field, different emphases on business models and financial market structures across Europe complicate a truly Europe-wide regulatory set of rules backed by all stakeholders.
- Scale: Although proponents of a single European banking market point toward scale benefits creating structurally safer banks, some stakeholders warn of creating systemically dominant institutions, even at the expense of potentially higher profitability across the sector.

Europe Is Not One Large and Homogeneous Banking Market

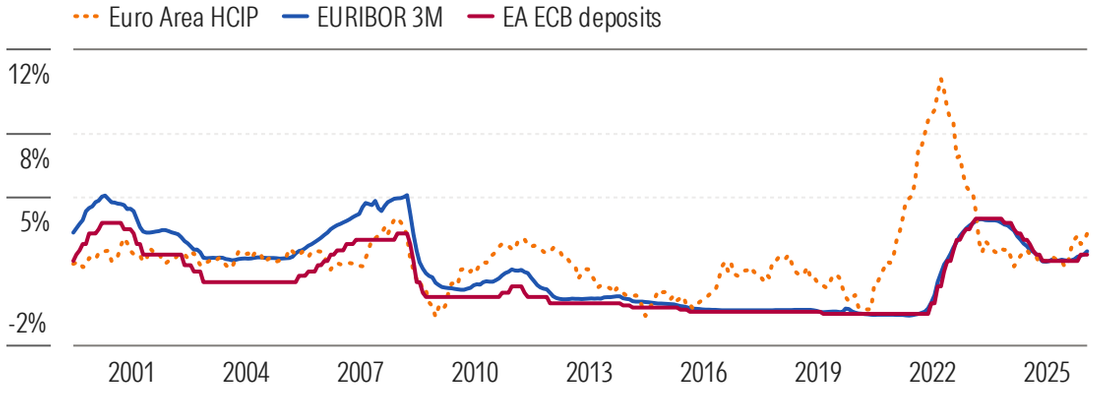
Asset share of domestic and foreign banks.



Source: Morningstar, ECB. Data as of December 2025.

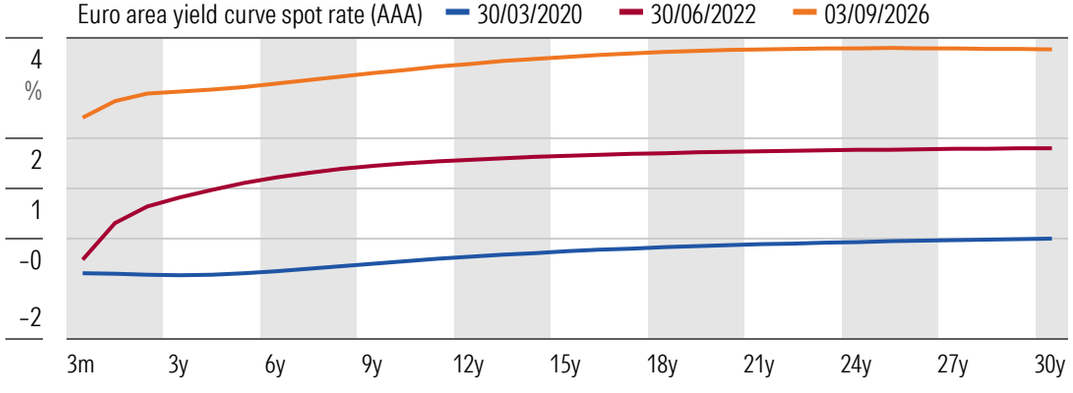
Net Interest Margin: Basics

Central Banks Drive Short-Term Rates



A wide range of variables flows into the decision-making process of central banks when setting base interest rates. The ultimate yardstick is price stability—most of the time defined as inflation at or around 2%. The European Central Bank also takes into account varying levels of government, corporate, and private indebtedness and differing economic growth trajectories across the European Economic and Monetary Union member states. Swiss and Swedish central banks also watch the development of their exchange rates relative to other major currencies such as the euro, the US dollar, and the British pound when setting interest rates.

Yield Curves Can Take Various Shapes



While the short end of the yield curve is driven by central banks' base rates and the market's expectation of changes in said base rates, the long end of the curve reflects economic growth expectations.

The shape of the yield curve is a core input value for banks. Most commonly, banks will position themselves to benefit from yield curves that are upward-sloping, the most common shape. When yield curves invert and start sloping down, the traditional banking model of funding long-term assets with short-term liabilities evaporates. Moreover, a downward-sloping yield curve can signal a coming recession, often pushing banks to tighten credit standards.

Source: Morningstar, ECB, Eurostat.

Net Interest Margin: Basics

(1) Funding Spread

A bank will look to secure cheap sources of funding, typically in the form of noninterest-paying deposit or checking accounts. It will pay an interest rate on savings accounts below the interbank rate while charging its customers beyond the interbank rate.

(2) Maturity Mismatch

As the adage goes, banks will borrow short and lend long. Given a typically upward-sloping yield curve, the bank will collect, for example, the spread between the overnight interbank lending rate and the five-year rate.

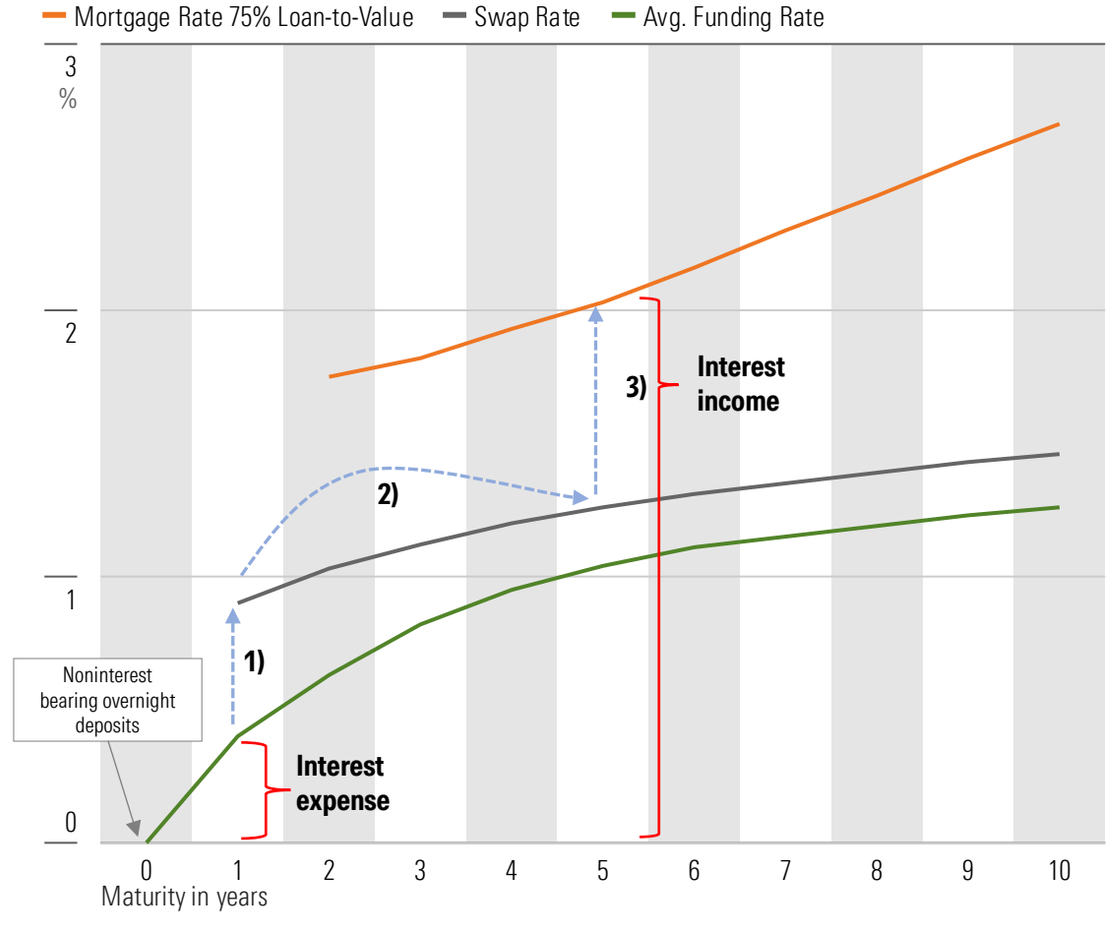
(3) Lending Spread

Banks will charge varying margins for different credit products (mortgage, car loan, credit cards, corporate loan) based on customer profile (for example, availability of cash flows), collateral, likelihood of default, and loss given default. As such, the product margin should cover any potential future losses. Last but not least, competition on the credit supply side will dictate the width of a product margin and therefore potential return. A profitable bank is able to underwrite credit at a profitable level through the cycle, meaning taking into account loan losses far into the future.

Net interest margin = (interest income – interest expense) / average interest-earning assets

Stylized Net Interest Margin Example

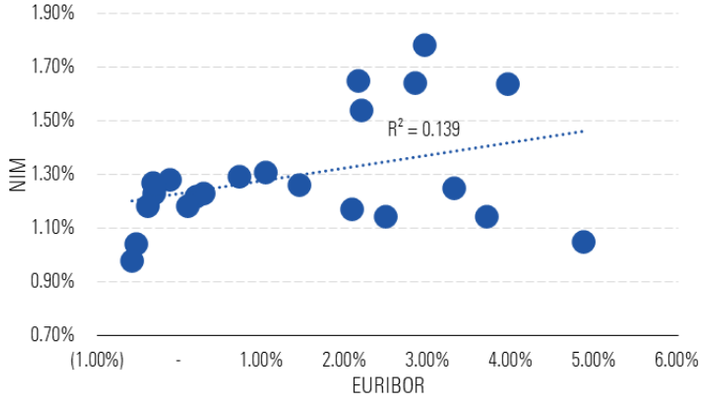
Banks earn a spread both on the funding and lending side.



Source: Morningstar.

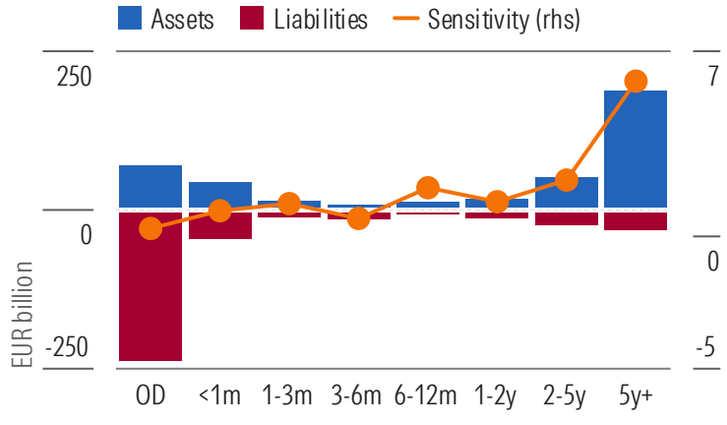
Net Interest Margin: Advanced

Weak Correlation Between NIM and Short-Term Rates



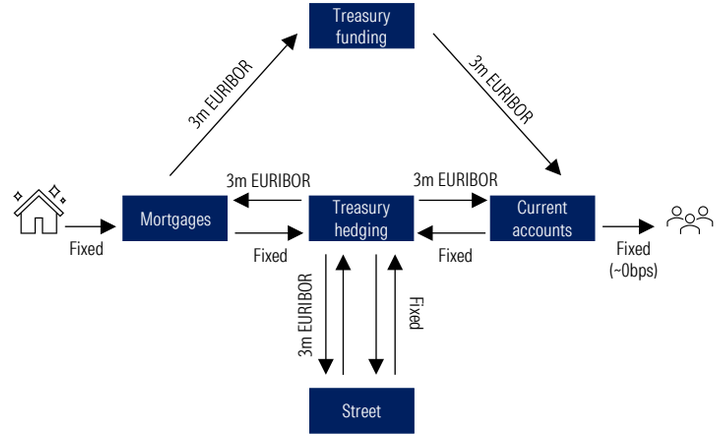
Higher short-term rates do not necessarily equate to wider net interest margins. The direction of change of interest rates, the shape of the yield curve, the speed of change of interest rates, and—often underappreciated—competition on both the funding and the lending side also play a role in determining a bank's net interest margin. The one exception to this otherwise complex picture is that interest rates close to or below zero are a clear negative for banks' NIMs, as it takes away the ability to earn a funding spread on noninterest-bearing deposits.

Gap Analysis Can Provide Indication of NIM Sensitivity



A bank's balance sheet will be asset-sensitive, liability-sensitive, or balanced when it comes to interest rate changes. Across different maturities, a bank will also experience different interest rate sensitivities on its assets and liabilities sides. Most common is a liability-sensitive balance sheet at short maturities (sensitivity less than 1) and an asset-sensitive balance sheet (sensitivity greater than 1)—that is, more assets reprice than liabilities, at longer maturities. Such a balance sheet benefits from a steepening yield curve.

Hedging Further Obscures Any Correlation

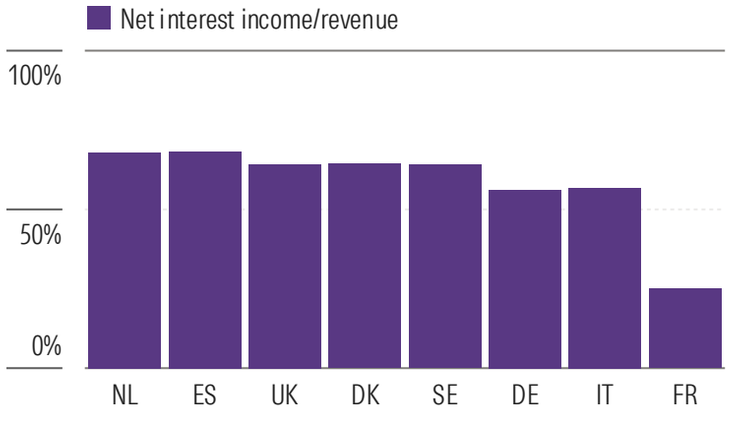


Banks' central treasury departments secure external funding and provide internal funding rates to their own business segments. In this process, a bank will determine its desired interest rate sensitivity across its business segment and the group as a whole, given its own interest rate outlook. Many banks will run natural hedges at a product level while adding hedges via derivatives at a group level to manage interest rate exposures. Product hedges reduce interest rate sensitivity, while groupwide hedges are used to reduce or increase net exposure to yield curve changes.

Source: Morningstar Investment Management, sample of 28 European banks, ABN Amro 2025 annual report. Sensitivity = assets/liabilities. Sensitivity of 1 = balanced. OD = on demand.

Net Interest Margin: Advanced

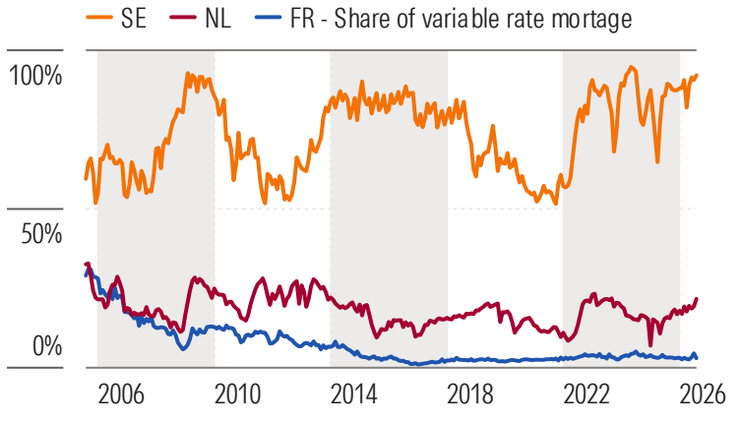
Not All Banks Are Equally Dependent on NIMs



Net interest income is the largest source of income for the majority of European banks. However, not all banks are equally dependent on it. The differences can be explained by banks' business models as well as regional differences across banking concentration, capital intensity of the economy, and level of market versus bank-based borrowing.

As a result, shifting interest rates will show divergent impacts across European banks.

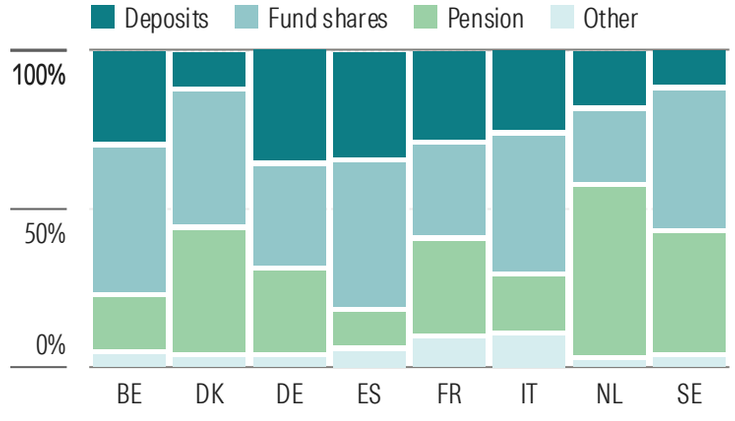
Regional Differences Drive Differing NIM Sensitivities



Net interest margin sensitivity is dependent on the maturity of the loan book as well as the share of variable versus fixed loans on a bank's balance sheet. A largely fixed-rate book will adjust to changes in interest rates gradually as maturing loans are replaced at new prevailing rates. A largely variable-rate loan book will display a quicker response in the bank's net interest margin.

In Europe, we see a highly divergent demand among countries for variable- and fixed-rate loans.

Funding Sources Also Vary Across Europe

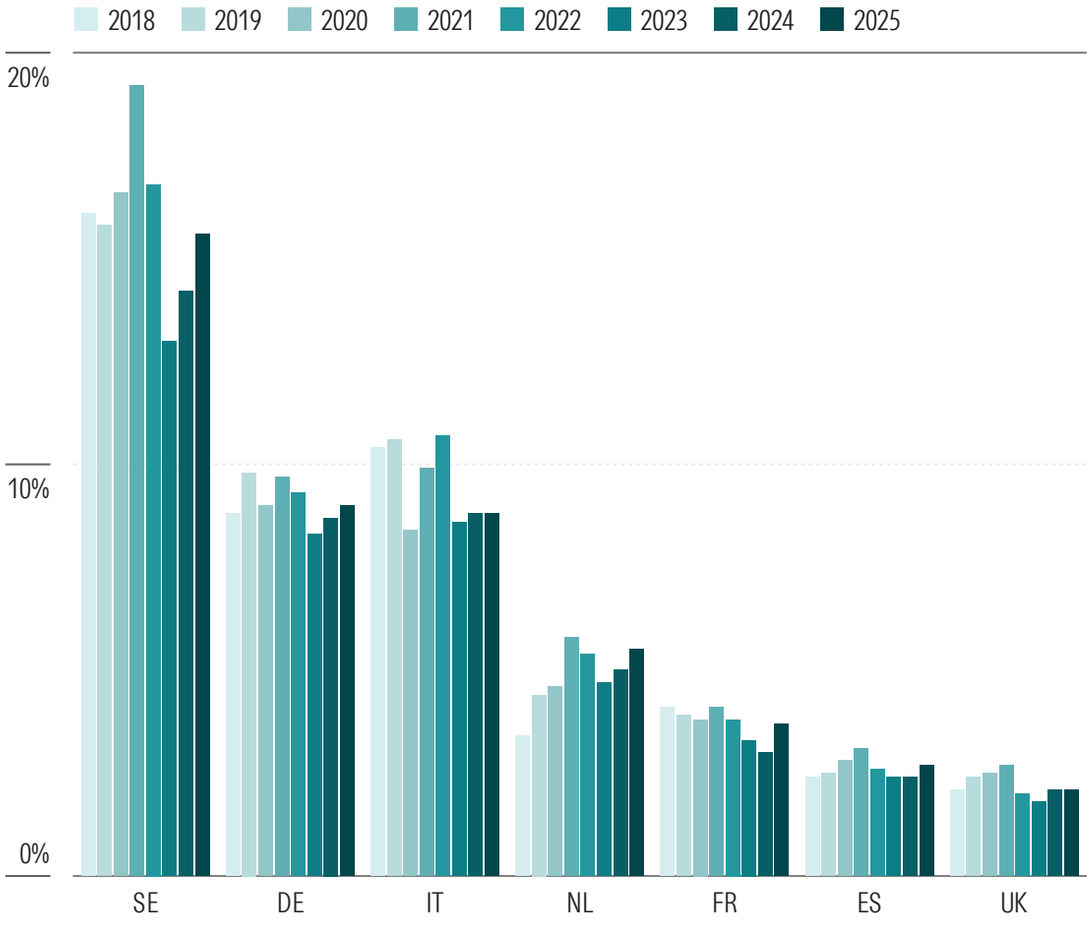


Regional differences in customer preferences as well as varying product offerings can introduce a mix in funding profiles across the European banking space. Covered bonds are a prime example of a European funding method that enjoys support in Germany and the Nordics but less in other European countries. Households also do not uniformly place their assets into the same savings and investment products across Europe, resulting in differing funding backdrops for European banks.

Source: Morningstar, PitchBook, company filings as of fiscal 2025, ECB (2024).

Fee and Commission Income

Asset and Wealth Management Fees Contribution



Investment Banking

Investment banking revenue consists primarily of fees collected for origination and advisory services for equity and debt products as well as leveraged loans. A subdivision of investment banking collects fees for guiding merger and acquisition transactions.

Asset and Wealth Management

Banks offer asset and wealth management products to their clients, collecting a fee in return. Fees in asset management are often tied to the volume of assets under management, while wealth management can cover various banking products and services.

Insurance and Pension

Some European banks offer insurance and pension products next to their banking products to generate scale benefits. The setup can vary between the bank distributing insurance and pension products only, creating the products in-house, or partnering with an insurance or pension provider via a joint venture. Often, insurance and pension providers are active in some banking products as well, such as mortgages, highlighting the overlap of these segments.

Payments

Banks provide payment services, such as merchant acquiring. Often a bank acts as a distributor of payment services, sometimes using white-label payment providers to power its offering. Some banks run in-house payment businesses.

Source: Morningstar, companies' filings, PitchBook, Crisil Coalition Greenwich, S&P.

Operating Expenses

Operating Leverage

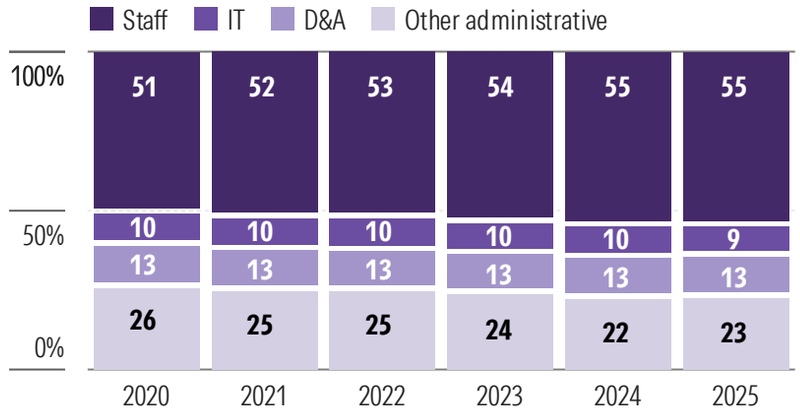
For the most part, a bank's operating expenses are fixed in the short to medium term, resulting in meaningful operating leverage.

Scale Important Differentiator of Operating Efficiency

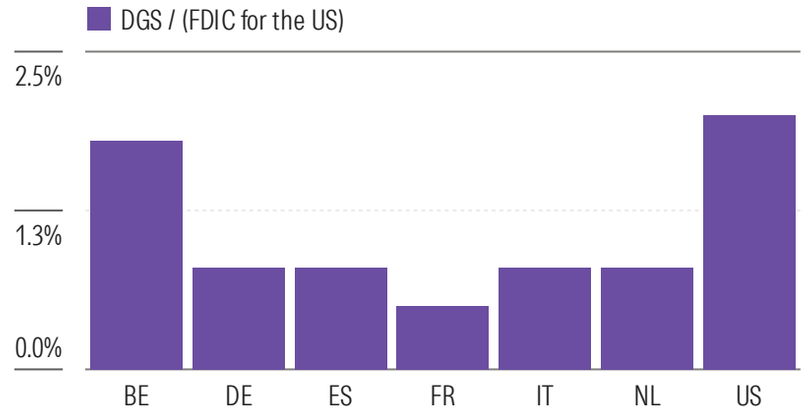
Compensation costs—like salaries, pensions, and performance-based bonuses—are typically the largest component of a bank's operating expenses. Apart from the ability to keep operating expenses under control relative to income, core determinants of operating efficiency are:

- Structural differences in the banking jurisdiction—for example, population density and adoption of online banking driving branch density need.
- Regulatory costs like national and European deposit insurance schemes.
- Business models—for example, a greater need for personnel in wealth management than retail banking.

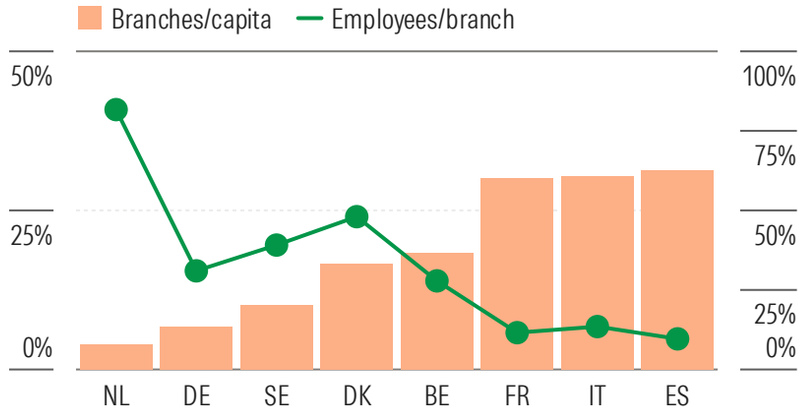
Sample Breakdown of Operating Expenses



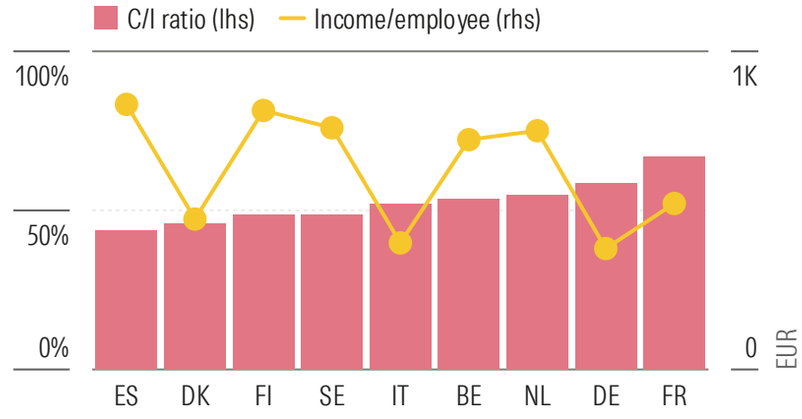
Deposit Insurance Coverage Targets



Scale: Efficiency Constrained by Different Branch Needs ...



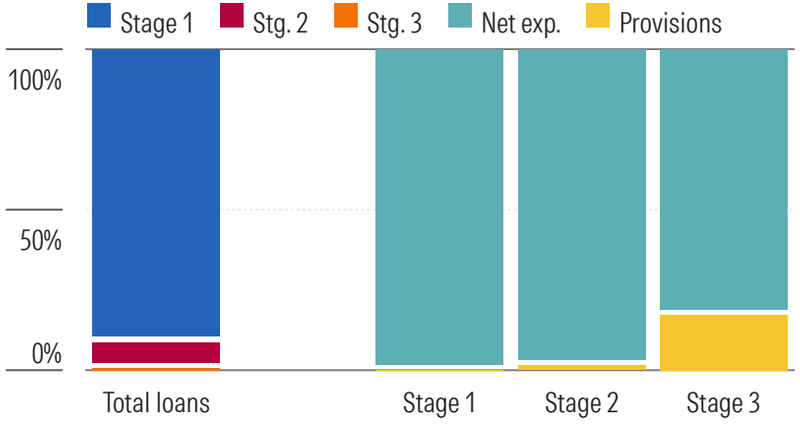
As Well as Employee Density Needs To Be Competitive



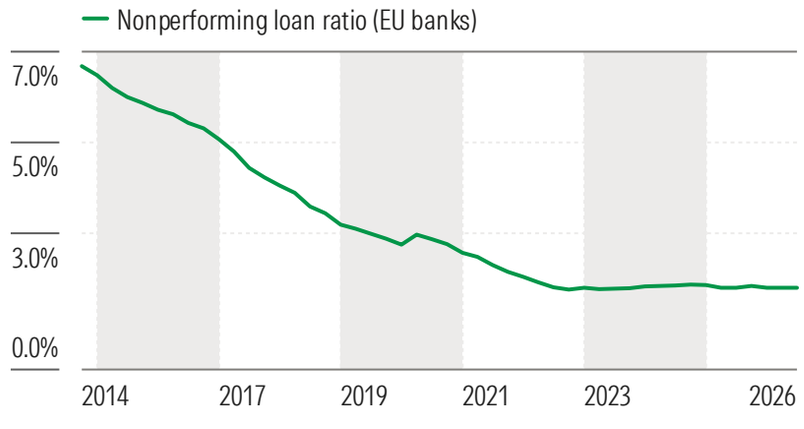
Source: Morningstar, World Bank, Santander 2025 annual report. EBA, FDIC. Branches per 100,000 adults. C/I = cost/income ratio.
Note: Data for Denmark as of 2023.

Loan-Loss Provisions

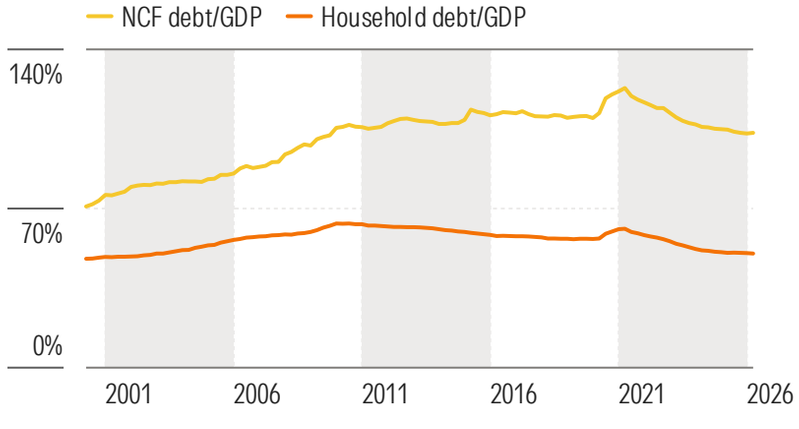
Loans Are Categorized by Likelihood of Default



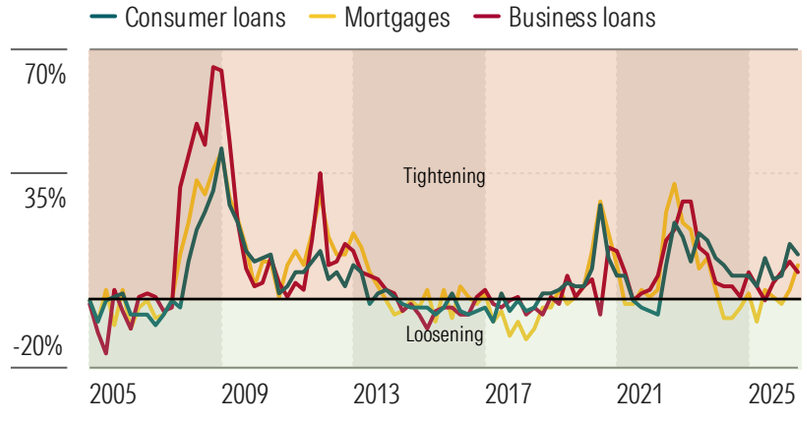
European Banks Have Reduced Nonperforming Loans



Debt Buildup Can Be Sign of Increased Risk in System



Banks Adjust Lending Standards To Manage Risk



Banks build provisions for loans turning sour via three buckets:

- Stage 1: Performing loans (all new loans)
- Stage 2: Underperforming loans (significant increase in credit risk since initial recognition)
- Stage 3: Nonperforming loans (credit-impaired assets)

Macroeconomic variables such as economic growth, inflation, debt levels, housing and commercial real estate prices, input costs such as oil and gas for production and manufacturing, and unemployment levels are core inputs banks use to forecast the adequate level of provisions and coverage of nonperforming loans.

As economies go through business cycles, financial and macro conditions shift, forcing banks to constantly adjust their lending standards in order to underwrite loans profitably through a full business cycle.

Source: Morningstar, European Central Bank, Bank for International Settlements, Swedbank 2025 annual report.

Loans

Loans Fuel the Economy

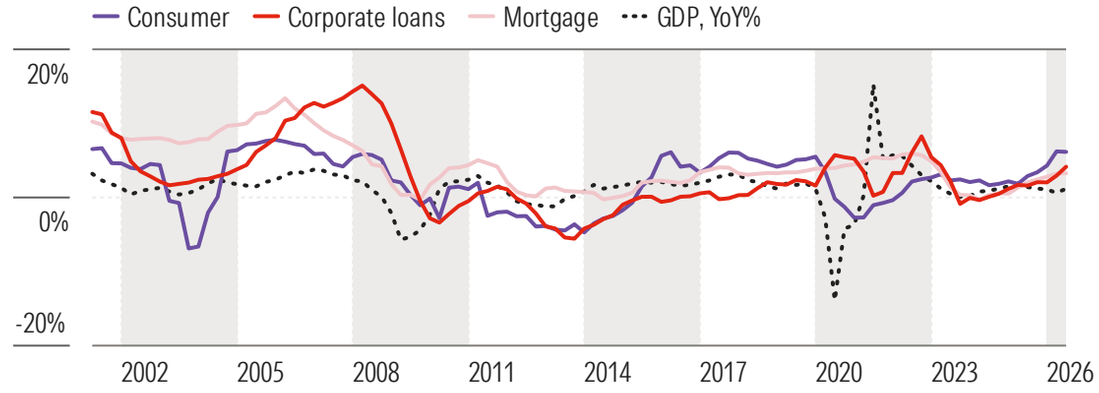
As the economy grows, corporations will look for loans to finance investment, while households see improving income levels support greater borrowing and higher spending. Moreover, expectations of economic growth drive demand for loans. As borrowers see their outlook improving, they will take a loan today to invest in tomorrow, seeking to reap the benefits. The opposite can be true, as well. As an example, Brexit in the UK and the delays around leaving the European Union put corporations in a heightened state of uncertainty with regard to their economic future. This led to muted loan demand as the required level and direction of investment were unknown for a prolonged time.

Mortgages: A mortgage is fairly low-risk because the house is posted as collateral against the loan. Mortgages make up the majority of European banks' loans to the public.

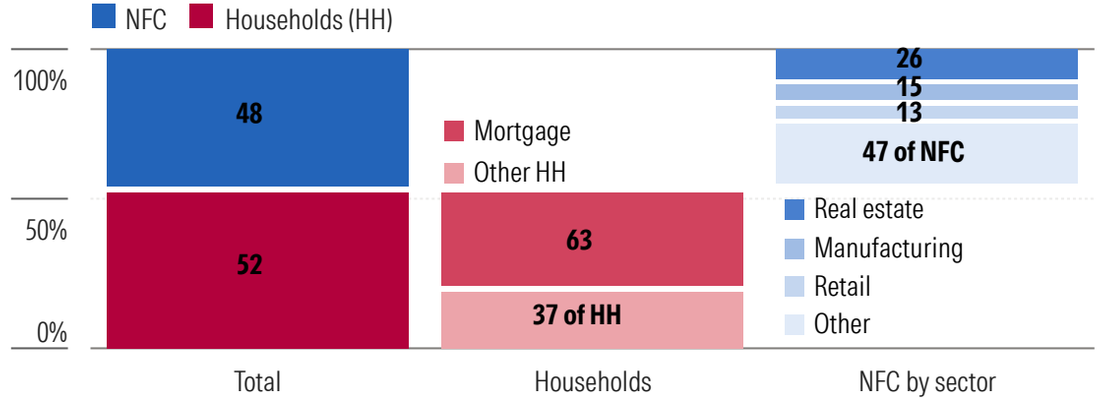
Consumer loans: Other loans to households, such as credit cards and car loans, are often not collateralized, demanding a larger spread to cover potential loan losses.

Corporate loans: European banks provide loans to small and large corporations, both collateralized and uncollateralized. Market financing through bond markets has increased in Europe, but banks remain the core source of funding for most corporates in Europe.

Loan Growth Tracks GDP



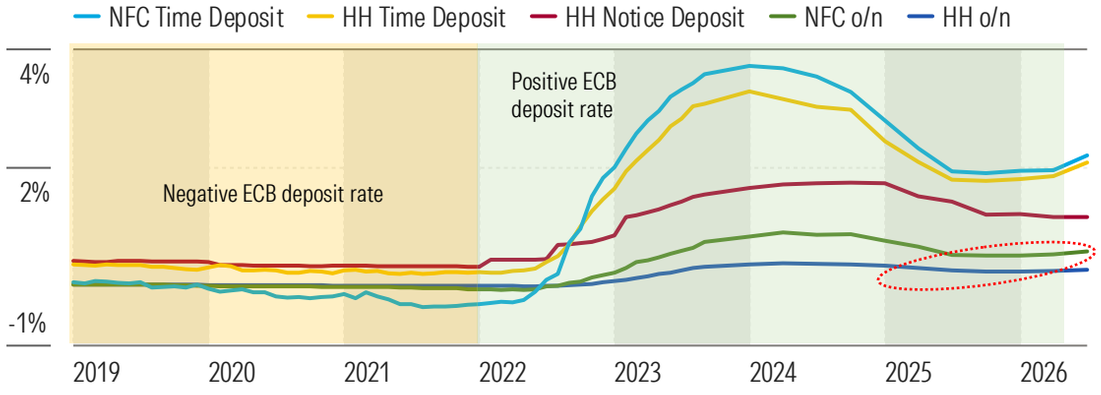
Loans Split by Sector



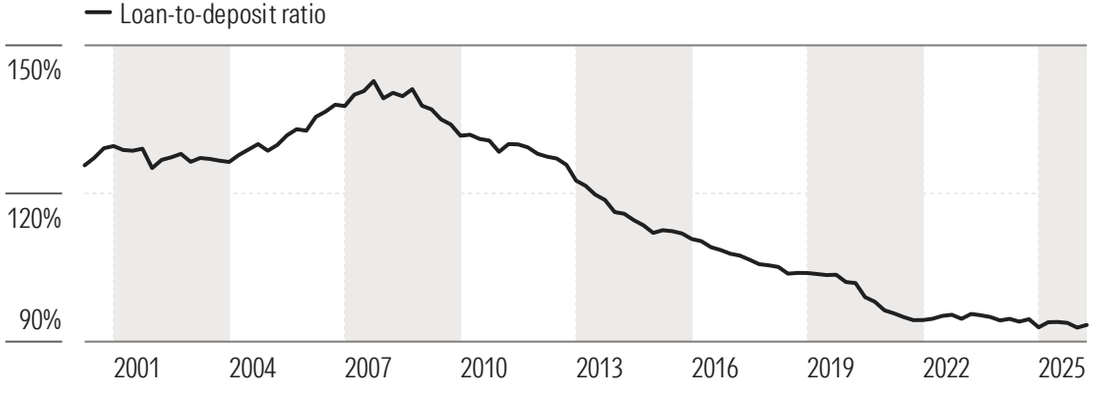
Source: Morningstar, European Central Bank, Eurostat, European Banking Authority.
Note: HH = household. NFC = nonfinancial corporation.

Deposits

Household Overnight Deposits Are the Cheapest and Stickiest Funding Source



European Banks Have Stocked Up on Deposits



Banks' Deposit-Taking Ability Is a Structural Advantage

The ability to take deposits as a source of funding sets banks apart from other companies.

- Household overnight deposits: Primarily current/checking accounts that retail clients use for daily purchases. Often noninterest-bearing. Customers rarely switch.
- Household notice deposits: Savings accounts with a fixed term typically between three months and one year.
- Household term deposits: Savings accounts with a fixed term typically beyond one year; they yield the highest interest rates due to the long fixed commitment.
- Corporate overnight deposits: Instant access accounts for corporates, paying rates close to market rate; corporates can shift funds quickly to increase yield.
- Corporate term deposits: Savings accounts with a fixed term. Yield higher interest rates due to fixed commitment. Yield closer to market rate than household term deposits due to corporates' higher propensity to switch account providers.

Lower Money Market Funding Has Decreased Risks of Bank Runs

Since the global financial crisis in 2008, European banks have slowly shifted funding away from money markets, attracting more deposits. As a result, they have reduced their liquidity risk of funds being pulled overnight. One big driver of this trend has been greater regulatory emphasis on funding stability, but the expanding balance sheet of central banks in Europe in combination with relatively limited levels of investment has also increased deposit volume across the region.

Source: Morningstar, European Central Bank. Deposit rates by EU banks.
Note: HH = household. NFC = nonfinancial corporation.

Regulatory Framework

The regulatory framework has been sharpened significantly since the global financial crisis in 2008. It is informed by learning from past crises and is focused primarily on ensuring that banks are adequately capitalized, are not overleveraged, and have sufficient stable funding sources available to withstand any liquidity crunches. The European Banking Authority together with local regulators also ensures that banks can be wound down in a controlled manner if necessary and that depositors are protected.

Regulatory Framework Cheat Sheet

Overview of the most important regulatory pillars.

Basel III			European Banking Authority	
Capital	**Leverage**	**Liquidity**	**Bank Resolution (BRRD)**	**Deposit Guarantee Scheme (DGSD)**
Aim: Increase resilience of banks to unexpected losses **Tool:** Increasing capital levels (common equity Tier 1 capital) plus "bail-in-able" debt (additional Tier 1) **Metric:** Common equity Tier 1 capital and CET1 capital ratio	**Aim:** Contain absolute leverage levels **Tool:** A non-risk-based minimum leverage ratio requirement **Metric:** Tier 1 capital over on- and off-balance-sheet assets (leverage ratio)	**Aim:** Prevent liquidity issues on both the asset and liability side **Tool:** Minimum requirement for level of stable deposit funding and liquid assets **Metric:** Net stable funding ratio and liquidity coverage ratio	**Aim:** Prevent risk contamination of the banking system in case of (imminent) bank failure **Tool:** Regulator recapitalizes or dissolves bank	**Aim:** Protect depositors and reduce likelihood of a bank run **Tool:** Banks contribute to scheme to cover potential losses

Source: Morningstar.

Capital

A Bank's Most Precious Resource

Capital, primarily in the form of tangible equity, can be viewed as a bank's fuel to do business. Banks will draw on their capital reserves for:

- Growth (for example, loans)
- Shareholder distributions (for example, dividends and share buybacks)
- Unexpected losses (like nonmodeled credit events and misconduct charges)

A Good Gauge of a Bank's Going Concern?

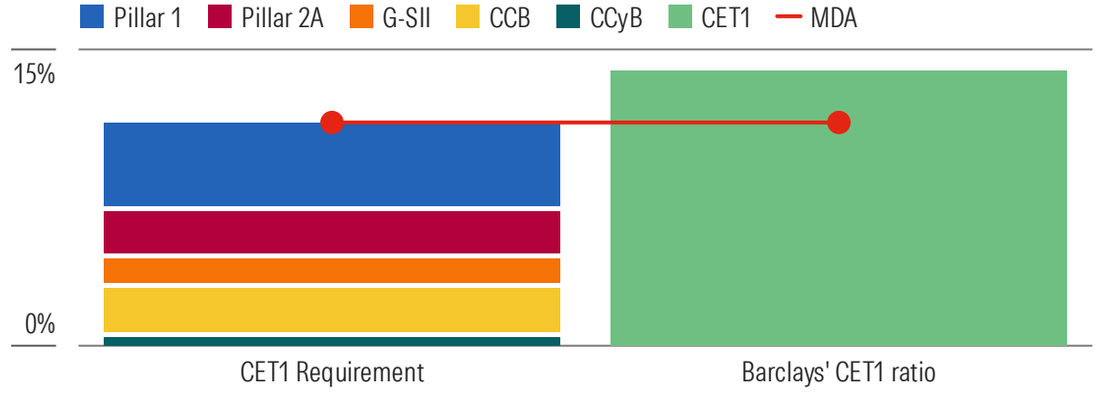
We believe that CET1 ratio levels relative to management targets are most meaningful because breaching management targets often suggests that banks will reduce shareholder distributions. Banks may even need to raise capital, although capital levels are still above regulatory minimum requirements to improve dwindling confidence in the bank's capital position, justified or not. We believe management targets are a good proxy for what the market views as adequate capital levels for the bank. Regulators have also shown a willingness in the recent past to step in before capital minimums are breached. As such, we view it as unlikely that banks will be allowed to ever dip into their buffers and rebuild as the regulatory framework was initially intended. As a result, one can conclude that the increased capital requirements reduce risk to taxpayers while also lowering contagion risk spreading through banking systems. However, from a bank investor's perspective, we believe the threshold when confidence in a bank declines has simply been moved upward. Should a bank's capital level drop to or even below the maximum distributable amount hurdle, chances are high that equityholders will be diluted materially.

Common Equity Tier 1 Capital

GBP millions.

Total equity excl. noncontrolling interests	**68,292**
(-) other equity instruments (AT1 capital)	(13,284)
(-) goodwill and intangible assets	(8,224)
(-) deferred tax assets	(1,500)
(-) defined benefit pension fund assets	(3,430)
(+) adjustment under IFRS 9 transitional arrangements	700
(+/-) other regulatory adjustments	4,324
Common Equity Tier 1 capital	**46,878**

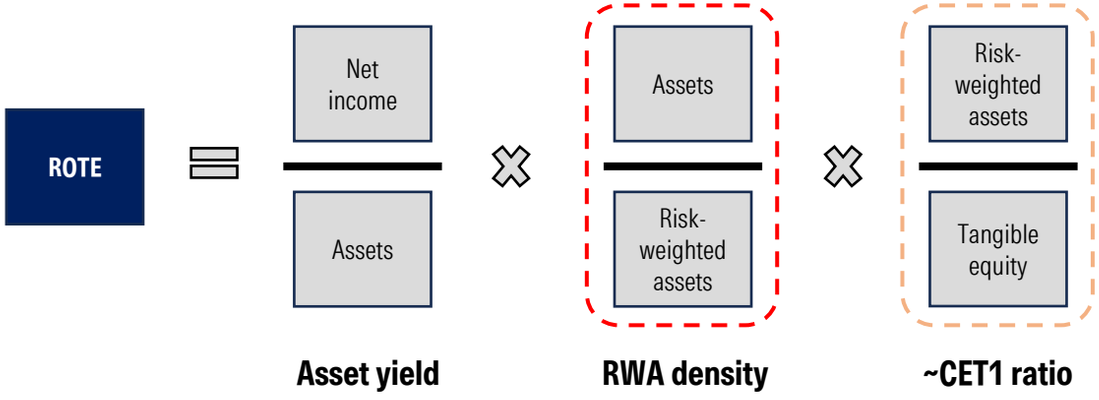
Banks Aim to Sit Above Minimum CET1 Requirements Set by Regulators



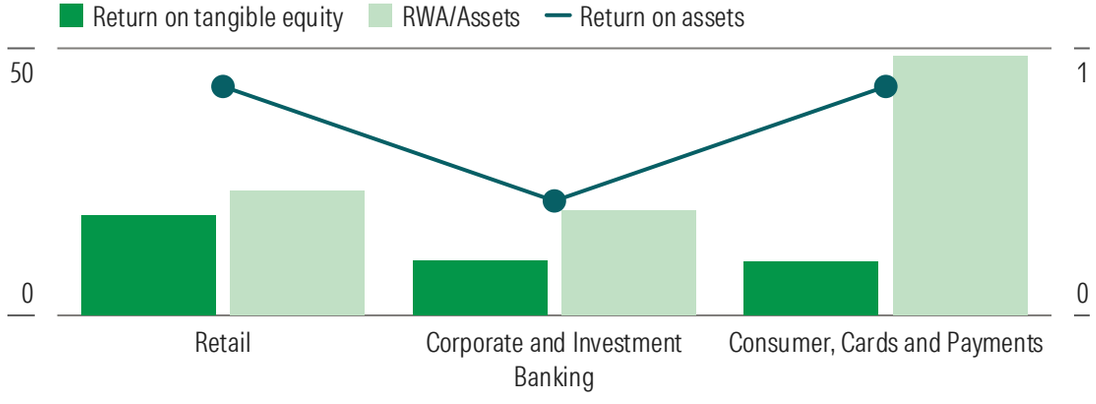
Source: Morningstar, Barclays 2022 annual report, Barclays fourth-quarter 2022 earnings presentation. MDA = maximum distributable amount hurdle.

Risk-Weighted Assets

DuPont Breakdown of Bank Returns



Risk-Weighted Assets Density Affects Returns



Risk-Weighted Asset Efficiency Is Core to Profitability

When breaking down the profitability of a bank (return on tangible equity), we have to add a step beyond the capital (CET1) and traditional leverage (equity/assets) components. Banks are required to weight their assets based on historical risk performance, after which regulators demand banks hold capital in the form of equity against these weighted assets. As such, reducing risk-weighted asset density increases leverage and profitability. On the flip side, a suboptimal risk-weighted asset structure binds capital that could be deployed toward growth of shareholder distributions instead.

What Is the True Cost of Doing Business for a Bank?

Risk weightings force banks to look beyond pure asset yields and leverage. Although one can argue about the levels of risk weighting that regulators and banks set for specific asset classes, in broad strokes, the framework does a decent job of having banks look at asset yields through an entire cycle. As a result, banks and investors obtain a clearer picture of the true cost of doing business across their segments.

Stranded Risk-Weighted Assets Can Cause Problems

In some cases, banks can find themselves stuck with excessive amounts of assets that bind capital but no longer contribute income (for example, nonperforming loans). Often the sale of such assets realizes losses and sometimes requires restructuring investments, eating into capital levels even further. As such, the regulatory framework can exacerbate problems at struggling banks.

Source: Morningstar, Barclays 2022 annual report.

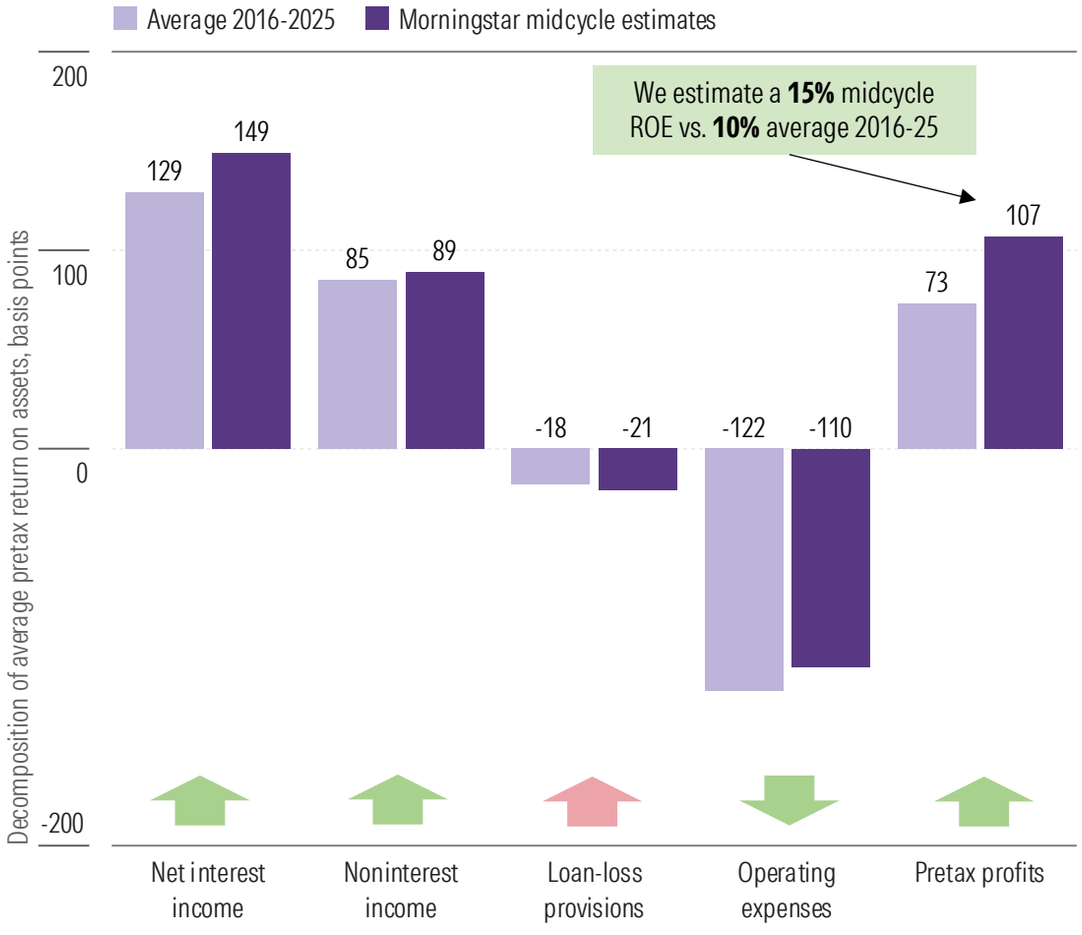
Outlook

Wider net interest margins and greater efficiency structurally increase European banks' profitability.

We Believe That European Banks' Profitability Has Structurally Increased

Wider Net Interest Margins and Greater Efficiency Lead to Higher Profitability

Decomposition of average pretax return on assets of European banks we cover.



Maturity Limits Excess Growth Potential

We see European banking as a mature industry with long term asset growth tracking at economic growth.

A Decade of Abnormal Monetary Policy Has Depressed Net Interest Margins

Negative or zero interest rates depressed net interest margins over the past decade. European banks could not earn a spread on a significant part of their deposit base, turning deposit-taking—the cornerstone of retail banking—into a loss-making activity.

Noninterest Revenue Trends Should Continue

European investment banking is in secular decline. The low capital intensity of asset and wealth management attracts investment from many European banks. We see less competition from financial technology firms in payments and transactional banking.

Credit Losses Should Increase From Current Cyclical Lows

We expect credit loss ratios to normalize upward, but healthier borrower balance sheets, higher collateral, and increased provisions support credit quality. We view commercial real estate as the key credit risk.

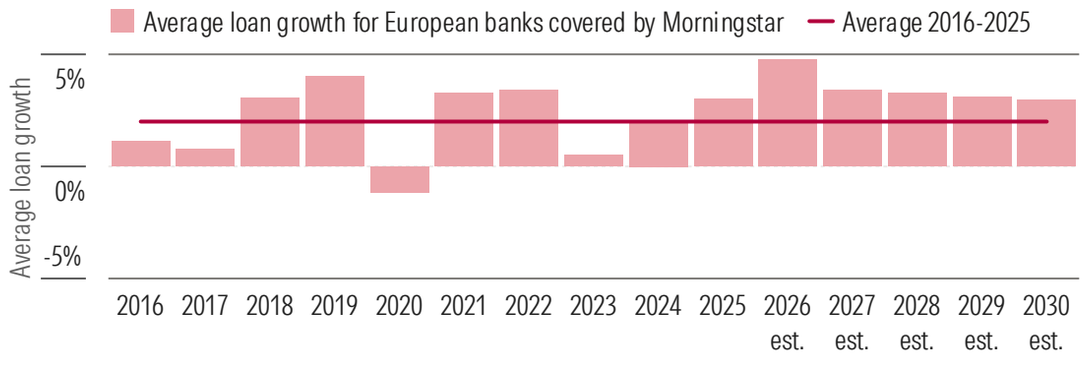
As Compliance Costs Moderate, Efficiency Gains Will Become More Visible

Digitalization has led to a material reduction in the number of branches and employees of European banks. The pronounced increase in regulatory and compliance costs is largely in the base, and the efficiency gains achieved will be more visible in the future.

Source: Morningstar, company data of European banks in our coverage. Data as of September 2026.

After a Decade Long Deleveraging, We See Loan Growth Tracking Economic Activity

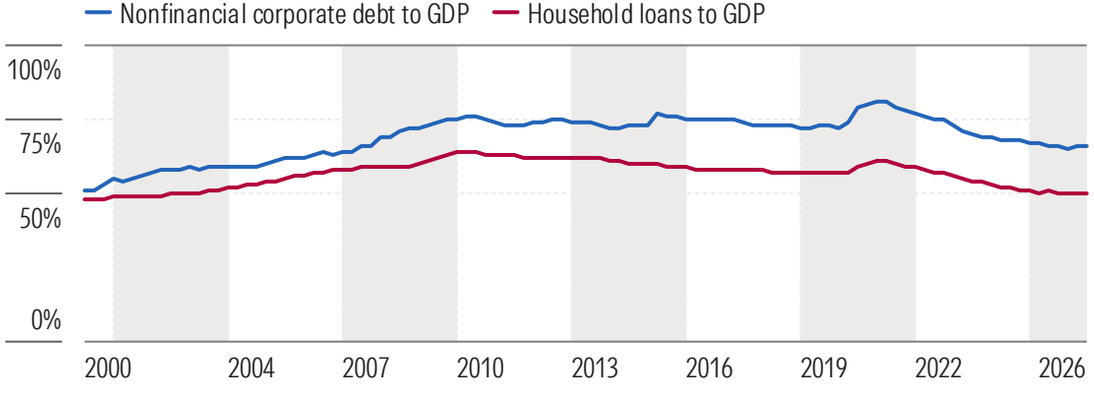
We Estimate Loan Growth Broadly in Line With Long-Term Average Growth



Long-term loan growth for European commercial banks is a function of:

- Economic growth
- The degree of leverage of firms and households, or credit penetration
- Competition from the bond market, nonbanks like insurers, neo banks, and in some markets, mutually or publicly owned banks that lack a clear profit motive

Euro Area Households and Firms Have Deleveraged



After a long period of rising debt levels, European households and firms started to deleverage after the global financial crisis. We do not think this trend will reverse.

- Much stricter regulations and capital requirements make it much more difficult to extend credit.
- Demographic changes in Europe constrain the demand for household credit especially. Older people have less need for credit than younger people buying their first house, for instance.

Source: Morningstar, European Central Bank, companies' data. Data as of June 2026/September 2026.

Competition From Nonbank Sources for a Slice of the Credit Pie Will Remain

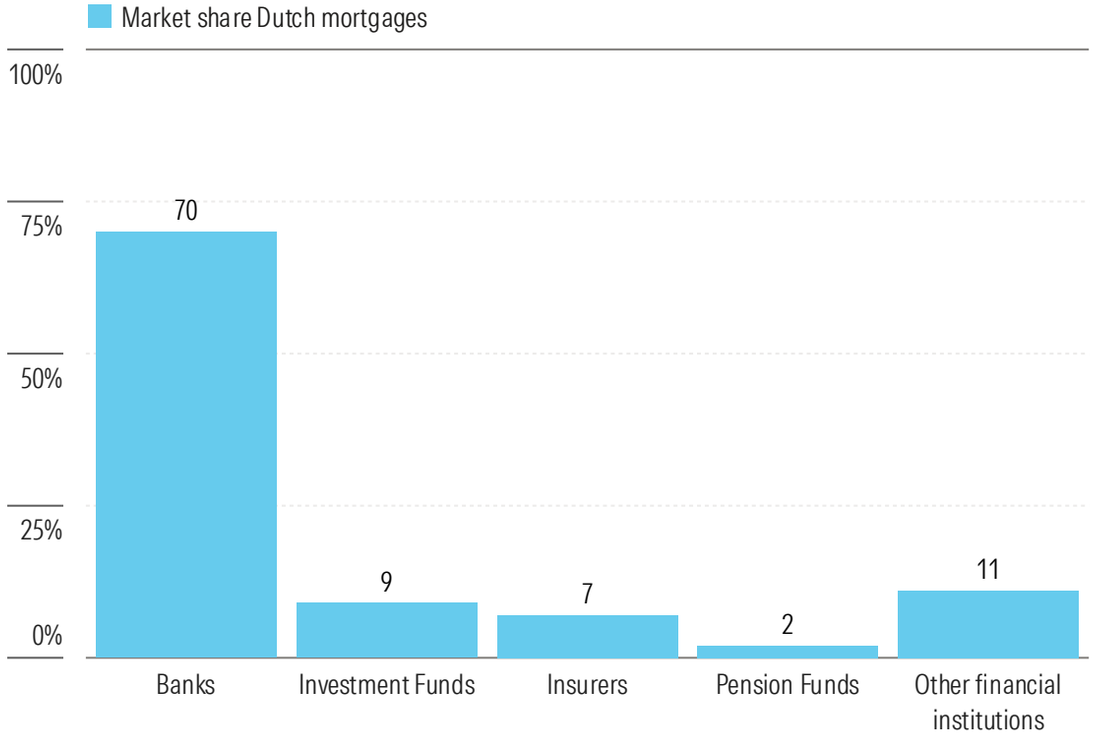
Debt Securities Have Grown Much Faster Than Bank Loans to Firms

Euro area outstanding debt security issues by nonfinancial corporates (year on year).



The corporate bond market is less well developed in Europe due to investor preference and the lack of full integration of European capital markets. The importance of bonds increased after 2008 as banks' risk appetite and capacity for lending declined.

Dutch Mortgage Market as an Example of Nonbank Competition

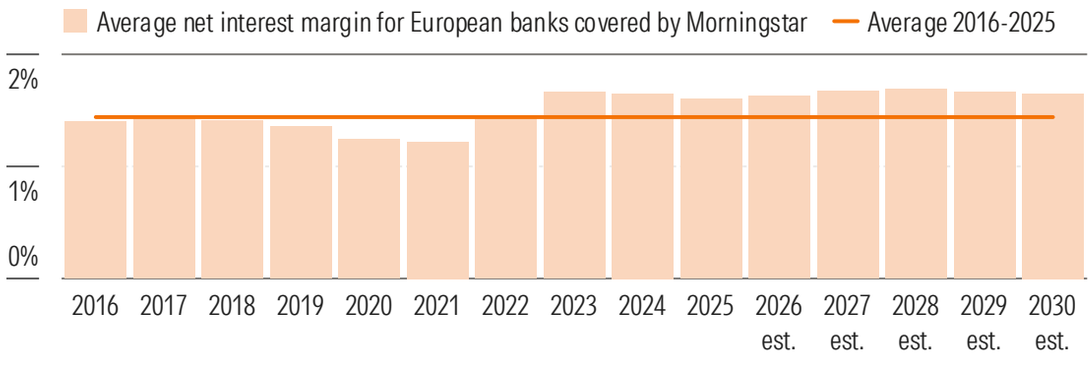


Higher interest rates, and therefore higher funding costs, could make it harder for some nonbanking players to compete with banks that sit on excess liquidity. In the longer term, competition will remain.

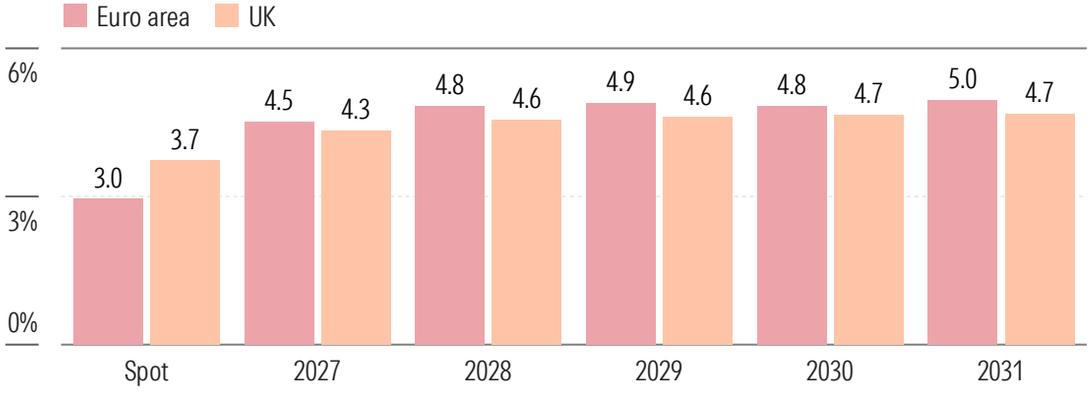
Source: Morningstar, European Central Bank – data as of June 2026, De Nederlandsche Bank – data as of June 2026.

We Think Net Interest Margins Have Seen a Lasting Structural Increase

We Estimate Midcycle Net Interest Margins Above Historical Average



Interest Rate Swaps Point to Higher Future European Interest Rates



Why We Believe Net Interest Margins Will Be Higher Than the Past Decade

- Negative or zero interest rates depressed net interest margins over the past decade as European banks could not earn a spread on a significant part of their deposit base.
- Expensive wholesale funding now makes up a smaller portion of overall funding for most European banks than in the past.
- Less competition from nonbanks due to higher funding costs could be positive for both lending and deposit margins.
- Most European banks have excess liquidity, which limits the need to compete on price for deposits.
- Expensive wholesale funding has decreased in importance, lowering funding costs, while loans make up a greater portion of bank assets, increasing interest income.

However, We Do Not See Margins Benefiting to Same Degree From Higher Rates

- European banks are increasingly hedged against interest rate volatility which delays the transmission of higher interest rates into higher net interest margins.
- We also expect depositors to increasingly switch from sight deposits to higher-yielding term and notice deposits.

Source: Morningstar, company data of European banks covered - data as of September 2026, Chatham Financial Oct. 6, 2026.

Negative Interest Rates Were Highly Detrimental to Net Interest Margins

Key Driver of Our Bullish View on NIMs

The return of European banks' ability to monetize their low-cost deposit base underpins our view that net interest margins will remain higher than they were for the past decade. Banks were largely unable to pass on negative interest rates. They were, however, earning a negative return on the proceeds of deposits, turning deposit-taking—the cornerstone of retail banking—into a loss-making activity.

Corporate Deposits More Price Sensitive

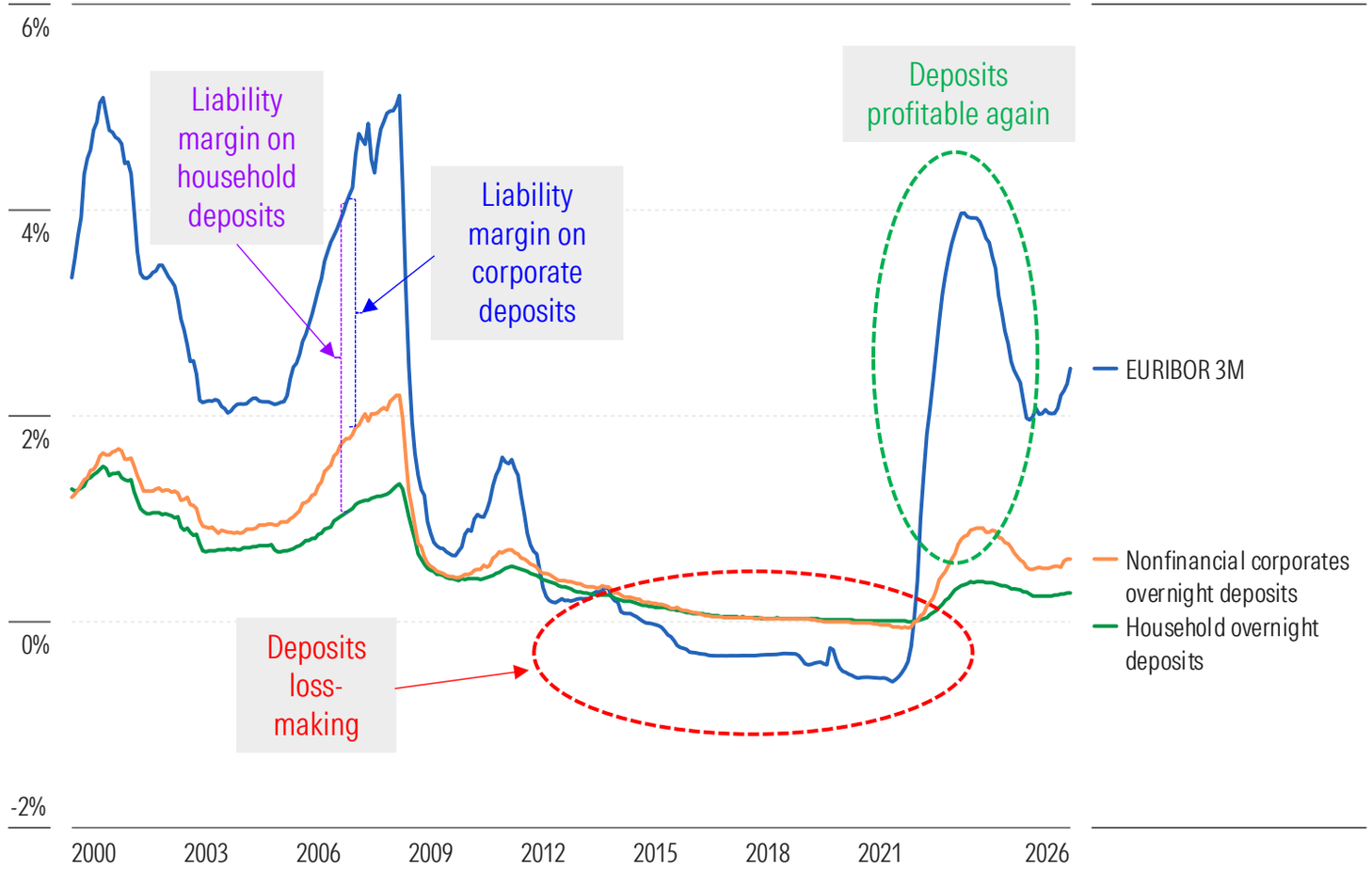
Overnight or sight deposits have a low sensitivity, or beta, to interest rates. Liability margins expand during periods of rising interest rates and contract when rates decline. Household deposits are less rate-sensitive than corporate deposits. Large firms tend to be more active in chasing slightly higher yields.

Hedging Smooths Liability Margins

European banks tend to hedge interest rate risk on sight deposits with a rolling portfolio of longer-duration swaps, leading to smoother liability margins. This also leads to a lag in the emergence of the full benefit of higher rates.

Interest Rate Paid on Overnight Deposits by Banks in the Euro Area Compared With Interbank Rate

European banks were losing money on overnight deposits during negative interest rate regime.

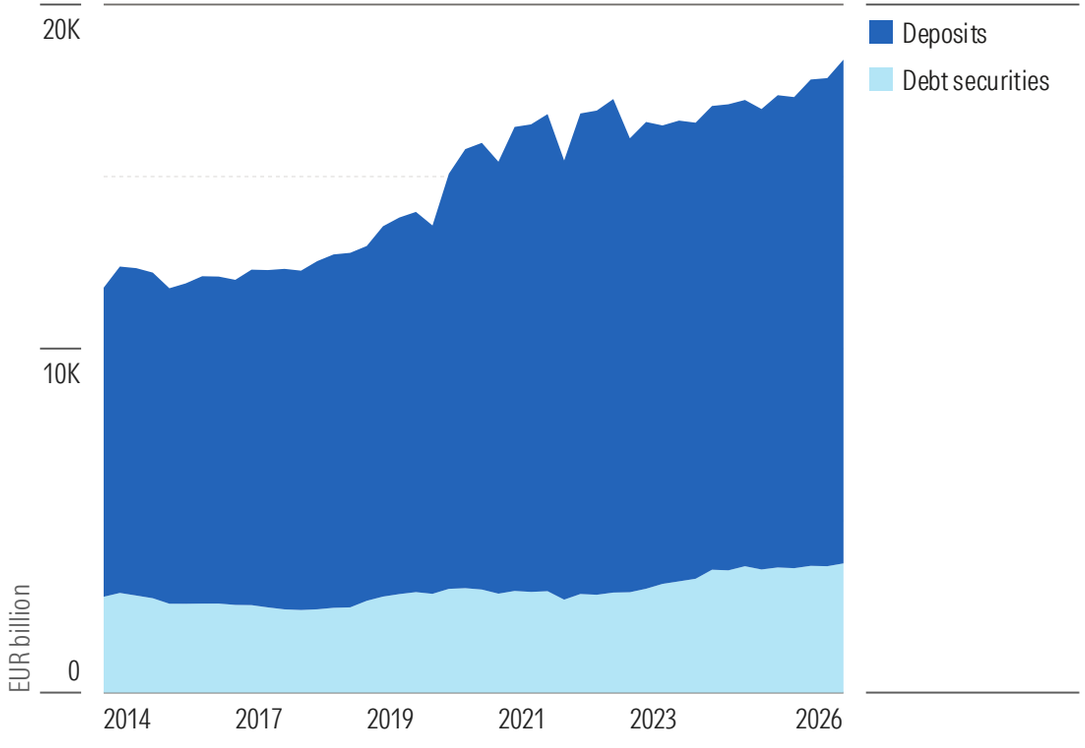


Source: Morningstar, ECB (Macrobond). Data as of August 2026.

Favorable Structural Changes on Both Sides of Balance Sheet Should Support Net Interest Margins

Euro Area Large Banks' Liability Structure

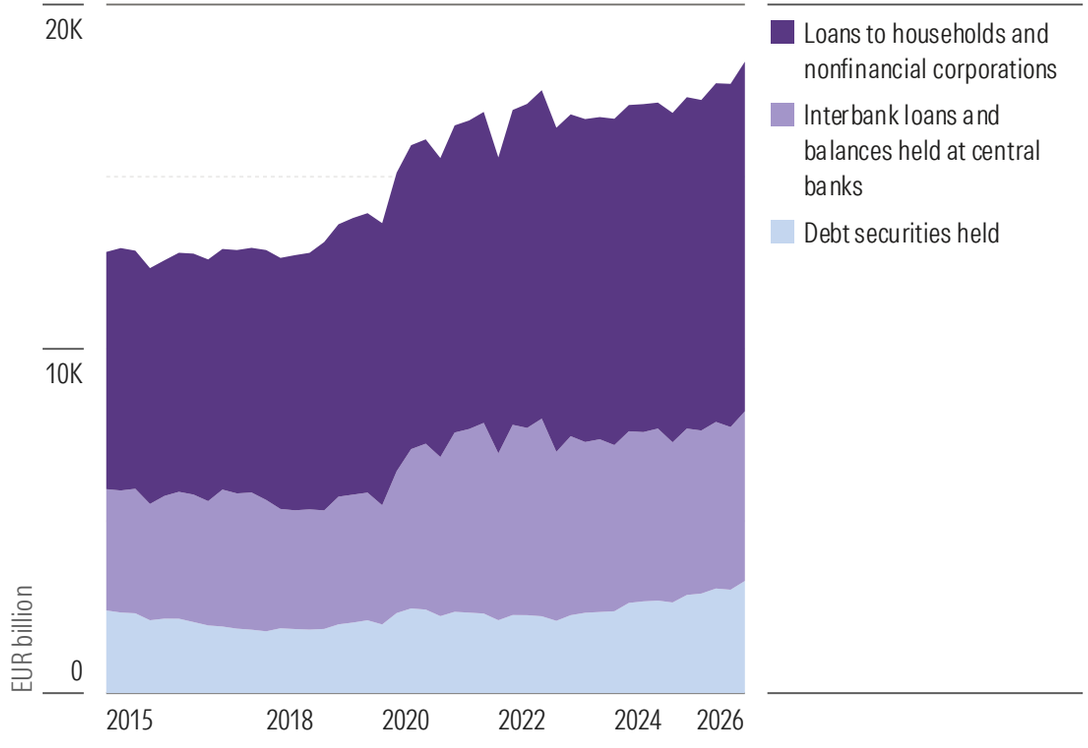
Favorable change in funding mix toward deposits.



Deposits are a far cheaper source of funding for banks than debt. The shift toward deposits should support net interest margins. European banks must keep a portion of debt funding to comply with regulatory requirements.

Euro Area Large Banks' Asset Structure

Higher-margin loans will continue to grow in importance.

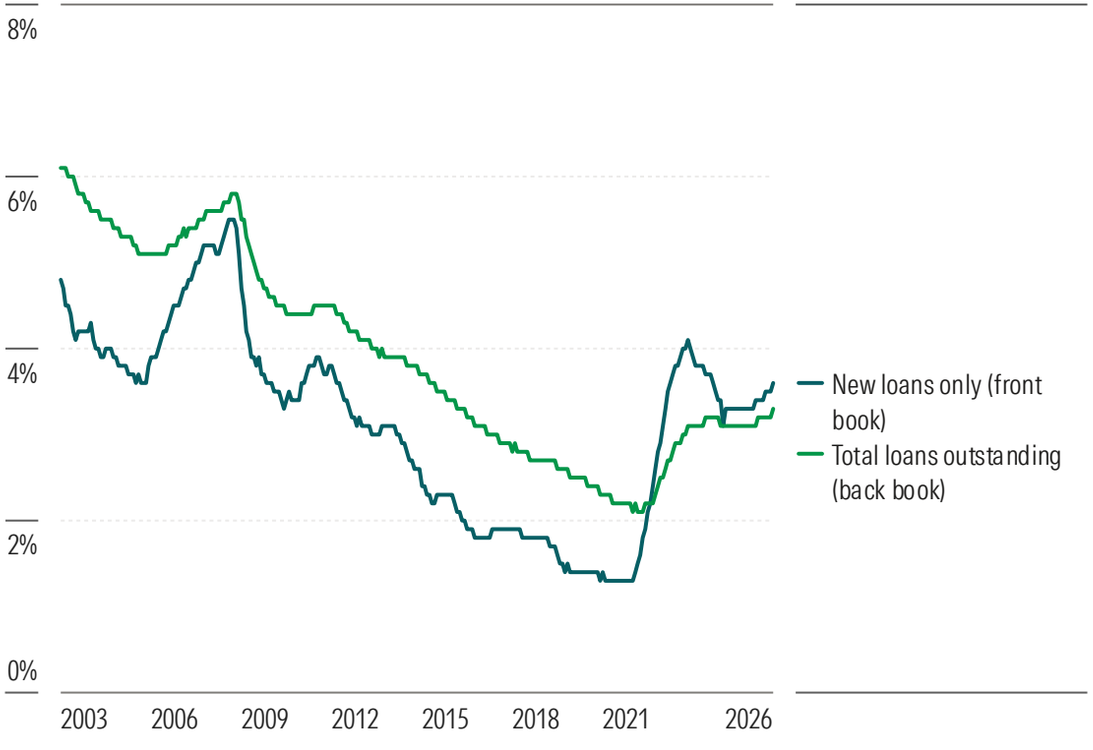


Customer loans generate higher margins and make up a larger portion of assets than previously. European banks have significant excess liquidity parked at central banks. Therefore, banks do not need to compete for deposits, supporting deposit pricing.

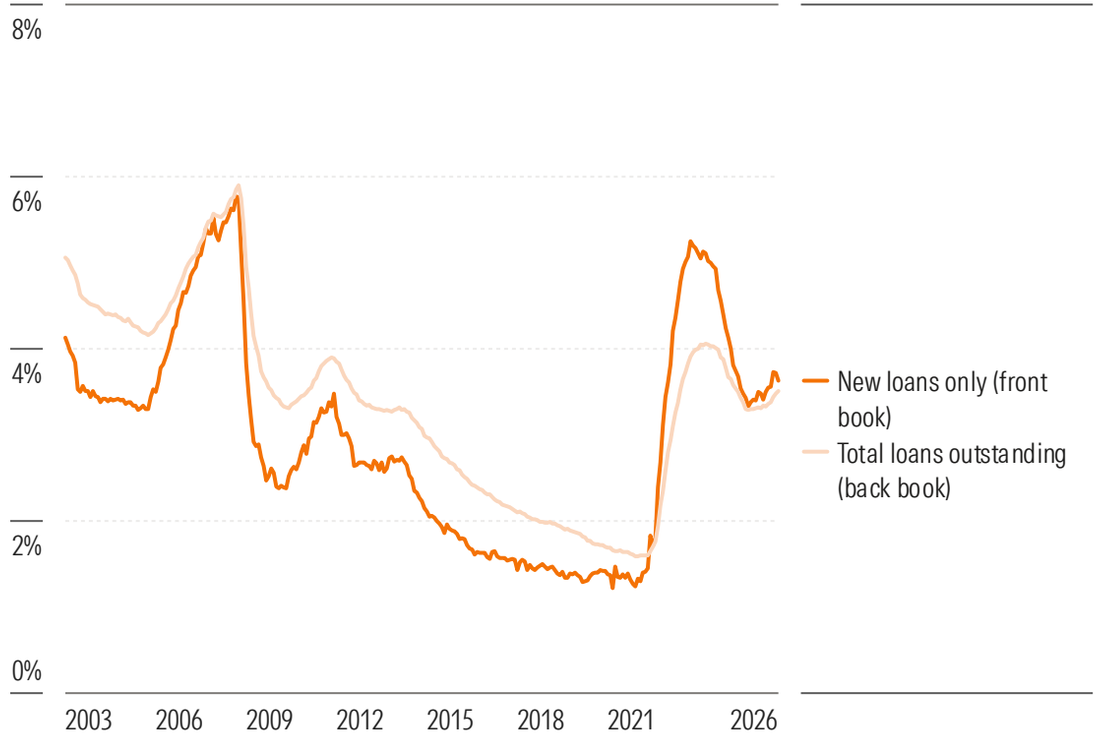
Source: Morningstar, European Central Bank. Data as of March 2026.

Higher Yields on New Loans Will Offer Ongoing Support to Margins As Back Book Continues to Reprice Upward

Mortgage Interest Rate in Euro Area



Nonfinancial Corporate Loan Interest Rate in Euro Area



Higher front book yields should support net interest margins over time as maturing loans reprice to reflect higher prevailing interest rates. The impact on margins will be less pronounced than the steep rate increase. European banks tend to hedge interest rate risk through floating-rate swaps. It is, however, easier to hedge large corporate loans than a granular mortgage book. Mortgage prepayments also slow when interest rates increase.

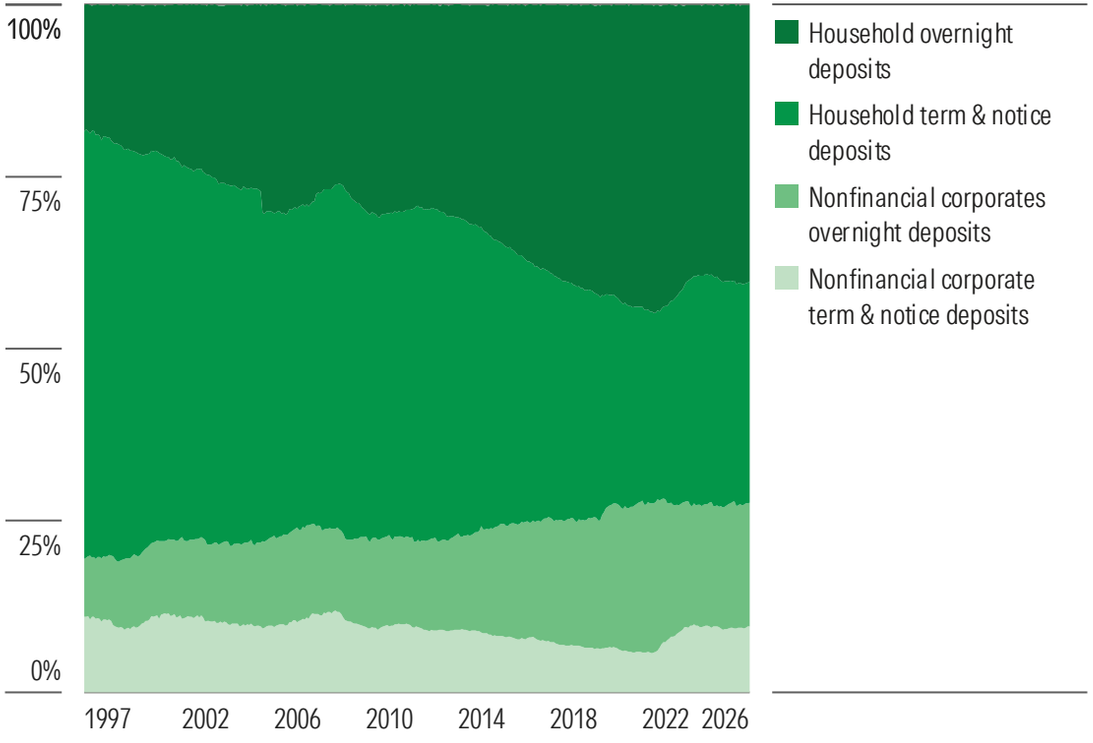
Source: Morningstar, European Central Bank. Data as of August 2026.

We Expect Some Net Interest Margin Pressure From Deposit Mix Changes

We expect that depositors will increasingly shift their excess liquidity to higher-yielding term and notice deposits. While there are country-specific differences, overnight deposits tend to be transactional or current account balances, while term and notice deposits are savings products. During the period of negative interest rates, excess liquidity built up in overnight deposits as there was little incentive to switch.

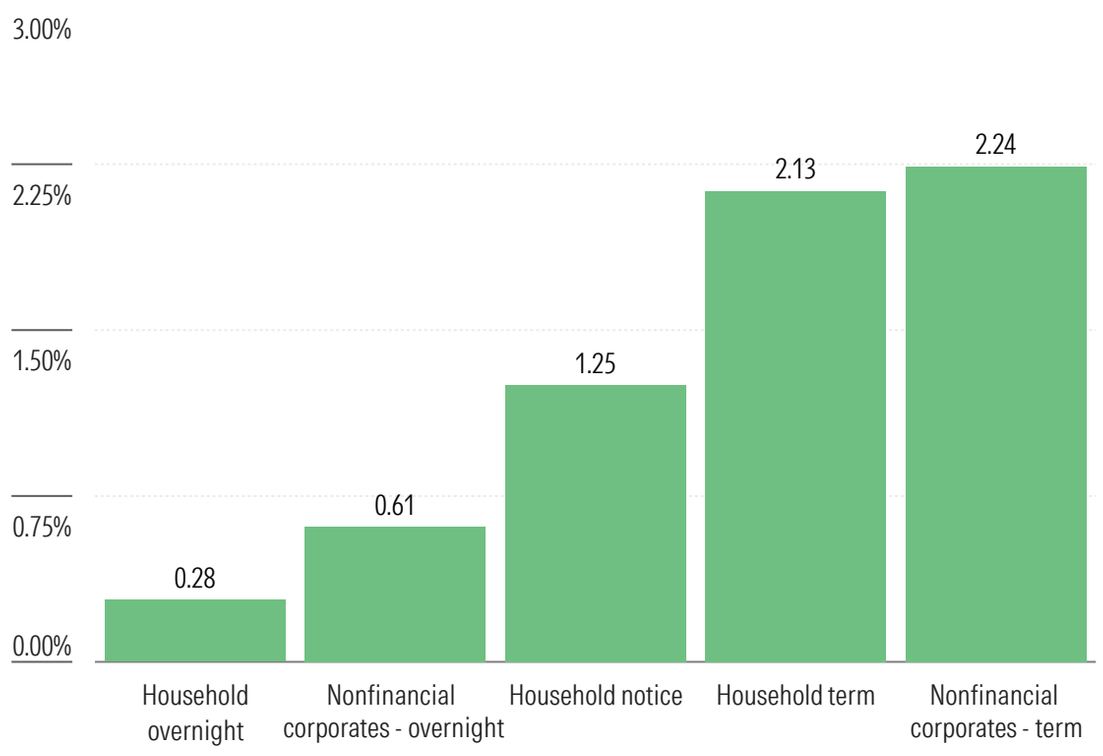
Deposit Mix of Euro Area Banks

Cheap overnight deposits historically made up a smaller portion of overall deposits.



Current Average Interest Paid on New Deposits by Euro Area Banks

Overnight deposits offer much greater liability margins for European banks.

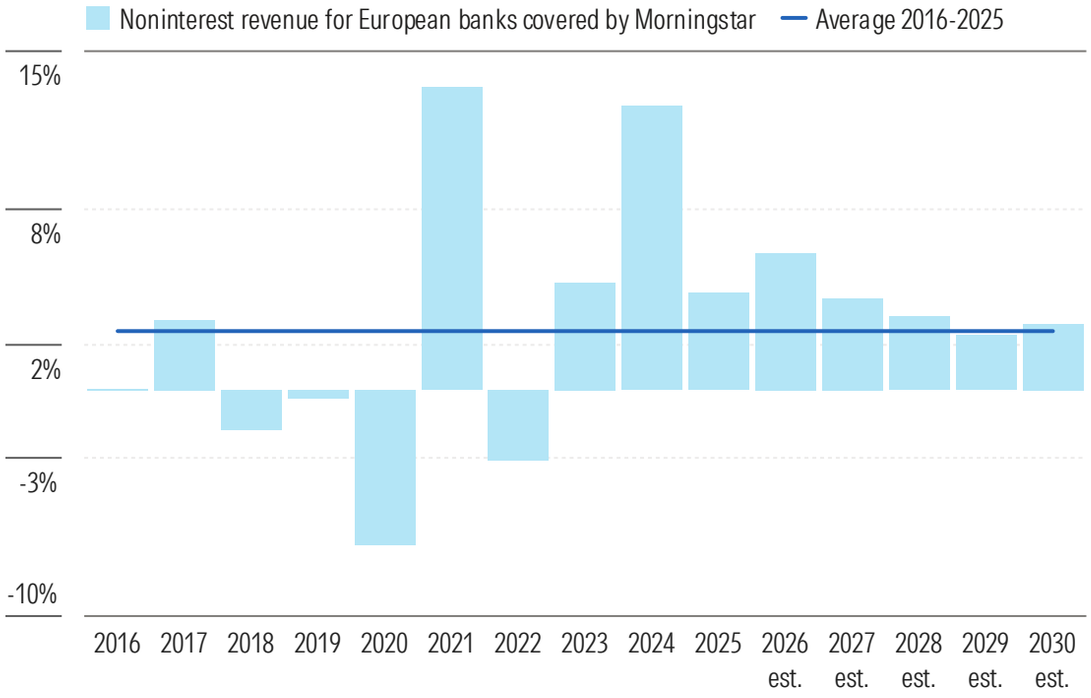


Source: Morningstar, European Central Bank. Data as of August 2026.

Noninterest Revenue: Wide Divergence in Contribution and Growth Prospects

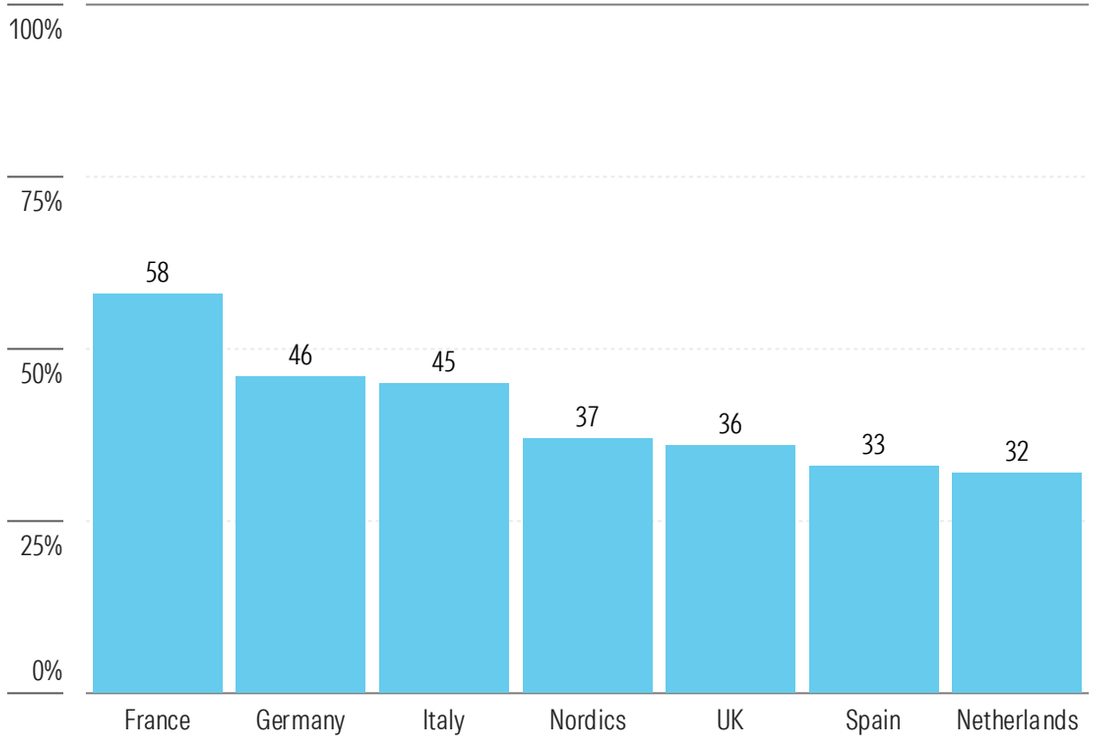
Noninterest revenue is a wide-ranging line item that reflects the bulk of revenue from the nonspread-based businesses of European banks. We expect modest growth on average, but this hides a wide divergence in outcomes for the respective banks that we cover. We expect the secular decline of investment banking for European banks to continue, while the outlook for banks with material asset and wealth management operations is better. We see less competition from fintech firms in payments and transactional banking.

We Expect Noninterest Revenue Growth To Increase by 4% per Year



Contribution to Revenue From Noninterest Revenue, 2027 Morningstar Estimate

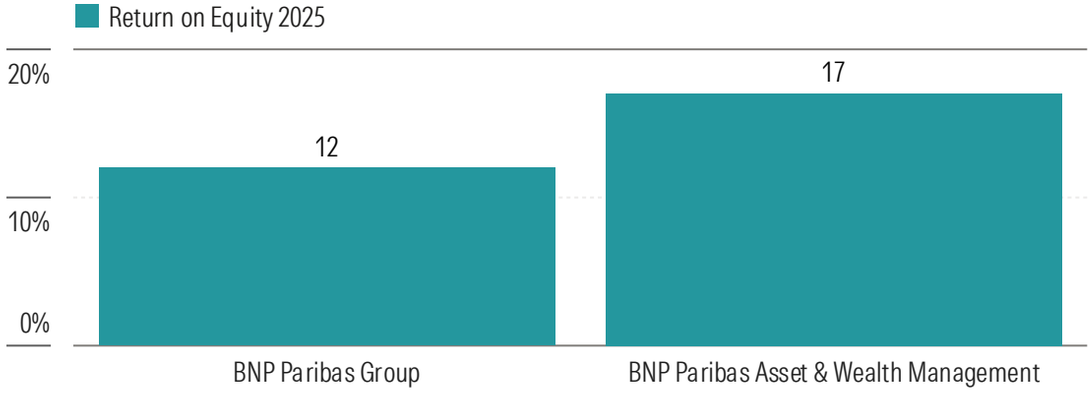
On average, we expect that NIR will constitute 41% of European banks' 2027 revenue.



Source: Morningstar, company data of European banks covered. Data as of September 2026.

Pressure Will Remain in Investment Banking, While Opportunities Exist in Investment and Transactional Products

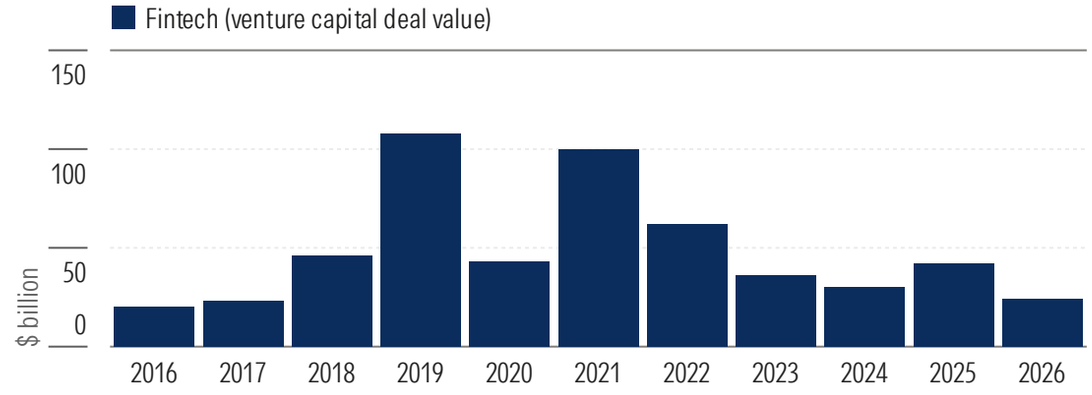
BNP Illustrates Profitability of Investment Products



Managing Clients' Money Generates Attractive Returns

We expect healthy fee growth from European banks' asset and wealth management operations. Their low capital intensity makes these businesses an attractive counterweight to capital-intensive lending and deposit-taking. Many European banks intend to invest in this space. In some jurisdictions, notably Italy and France, captive distribution remains the norm, and banks can leverage their client base to distribute their own investment products.

Lower Fintech Investment = Less Competition



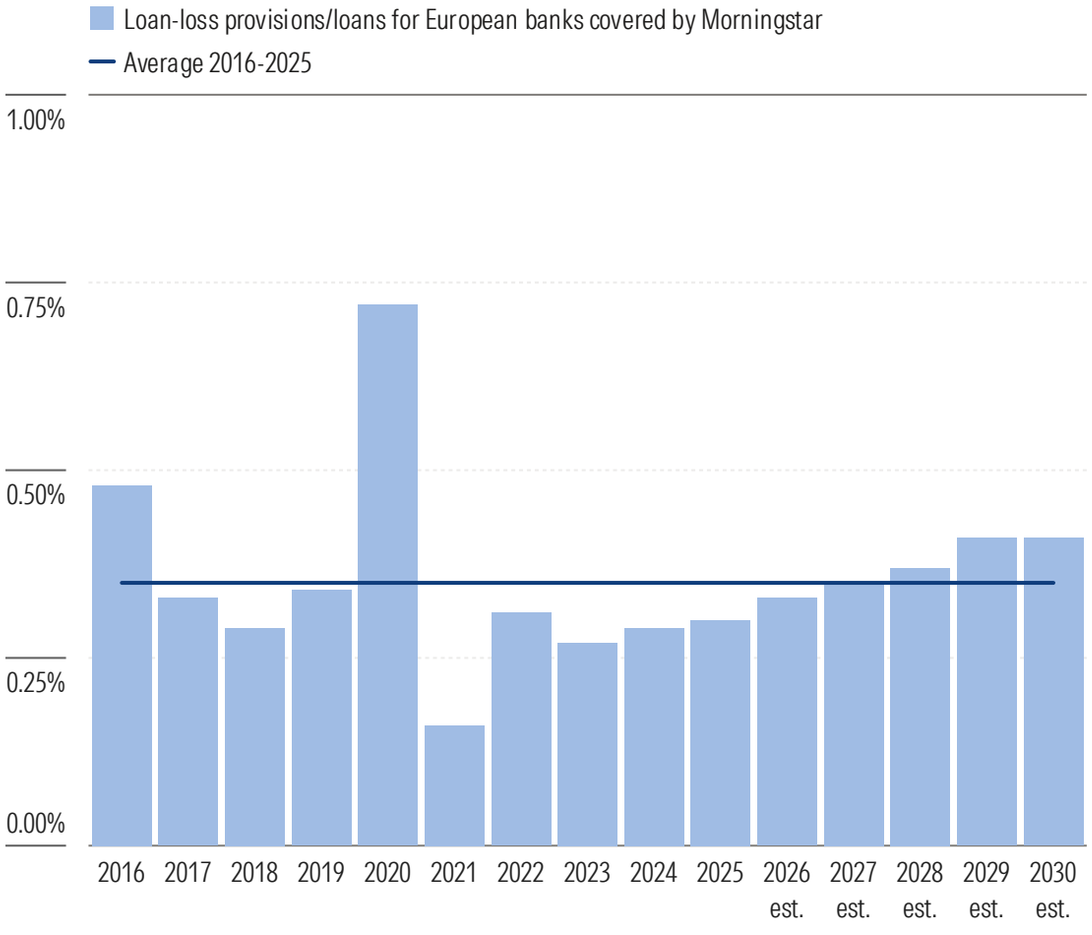
Less Fintech Funding Creates Opportunities

Financial technology rivals have competed aggressively for market share in many areas of banking, especially in payments and basic transactional banking. However, funding for fintech firms has dried up as the age of ultracheap money is seemingly over. This creates the opportunity for banks to claw back some market share. The pricing of some products was also depressed as cash-flush fintech firms offered cutthroat prices to gain market share.

Source: Morningstar, BNP company data, PitchBook: Fintech report Q2 2026.

We Expect a Moderate Increase in Loan-Loss Provisions, but We Think Credit Quality Has Improved

We Think Credit Loss Ratio Should Normalize to Long-Run Average



Loan-Loss Provisions Still Most Volatile Line Item

The provisions that a bank needs to raise against the loans that it anticipates will go bad are the most cyclical element of European banks' income statements. They are typically closely correlated to the state of the economy. After preemptively raising significant provisions during the pandemic, the credit loss ratio of European banks is currently lower than what we view as a midcycle level. Given the current inflationary pressures and sharply higher interest rates, we have been surprised by the resilience of European households and firms.

Well-Seasoned Mortgage Loan Books Should Provide Some Protection

Low loan growth means that European banks' loan books now have more older vintages than before. The material increase in European house prices means borrowers have built up significant equity.

Firms' and Households' Balance Sheets Have Improved

In most European countries, low loan growth has seen households and firms deleveraging, placing them in a better position to weather an economic downturn.

Commercial Real Estate a Concern

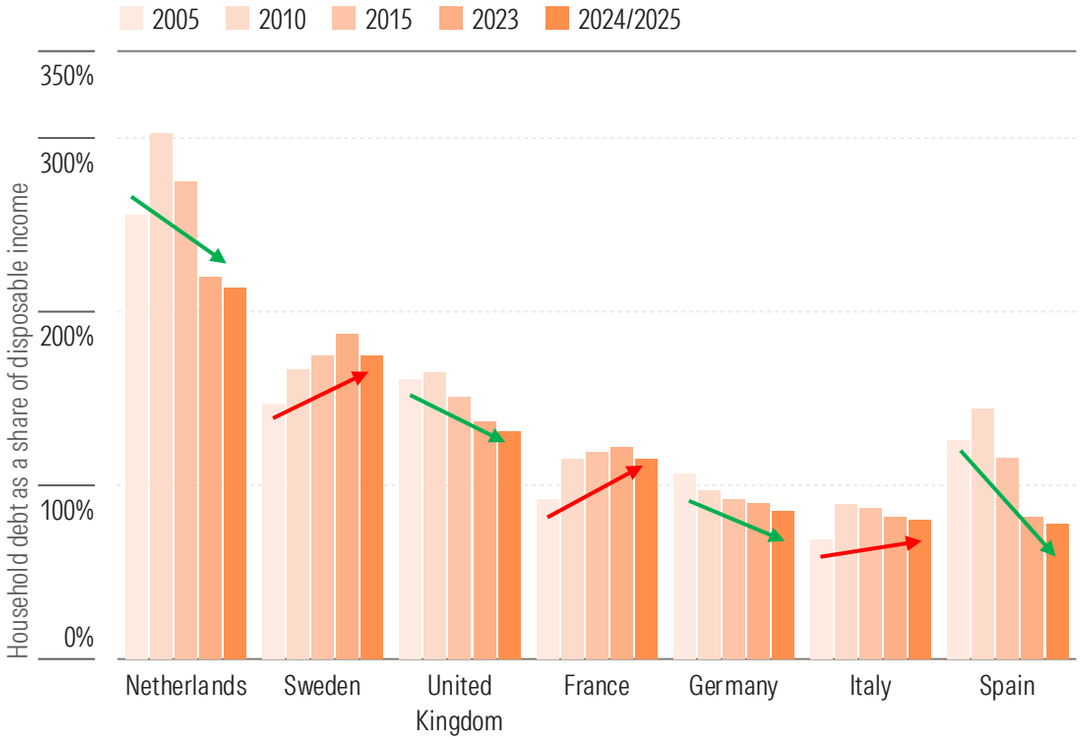
We are concerned about some pockets of weakness in European banks' corporate loan books, especially real portfolios, where structural fundamental changes, high gearing levels, and substantially higher refinancing costs create a lethal cocktail.

Source: Morningstar, company data of European banks covered. Data as of September 2026.

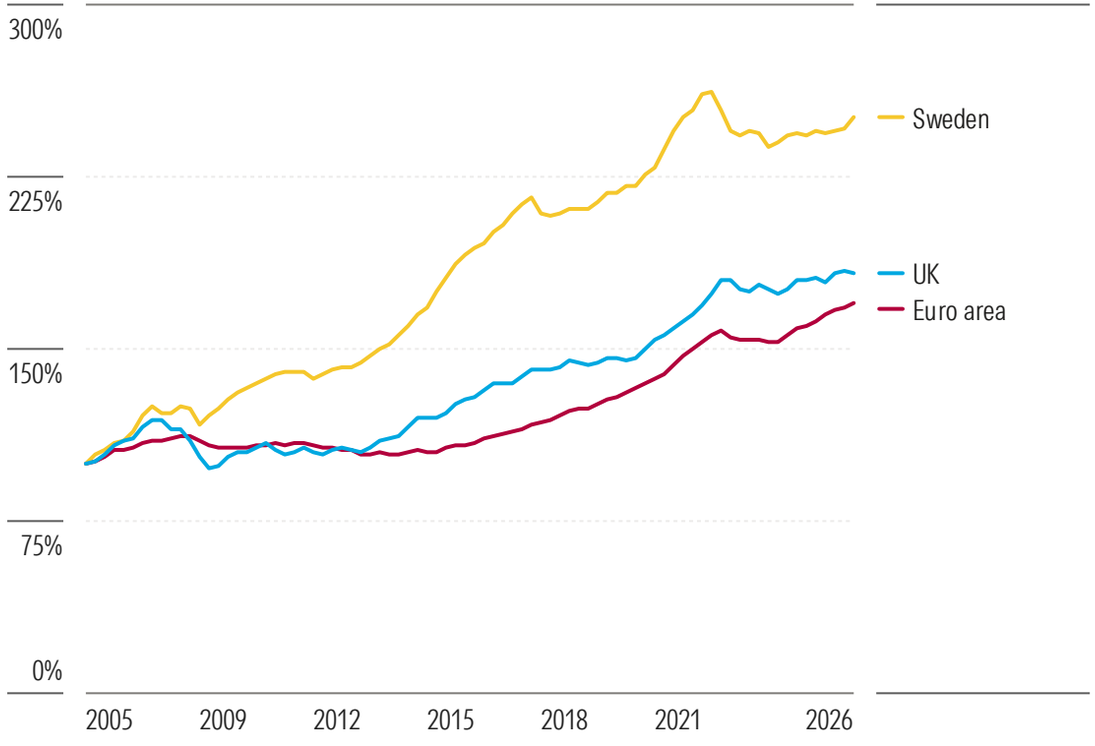
European Households' Financial Position Has Improved, and Seasoned Mortgage Books Provide Protection

Except for Sweden and to a lesser extent France, European households owe less in relation to their disposable income than two decades ago. An increasing share of European household debt has a fixed interest rate, which shelters households. House price bubbles have often led to a credit crisis. Low loan growth, however, means that lending books now consist of older loans than previously. Many homeowners would have built up substantial equity and should be able to weather larger house price declines than before.

Household Debt to Disposable Income



European House Prices (2005 = 100)



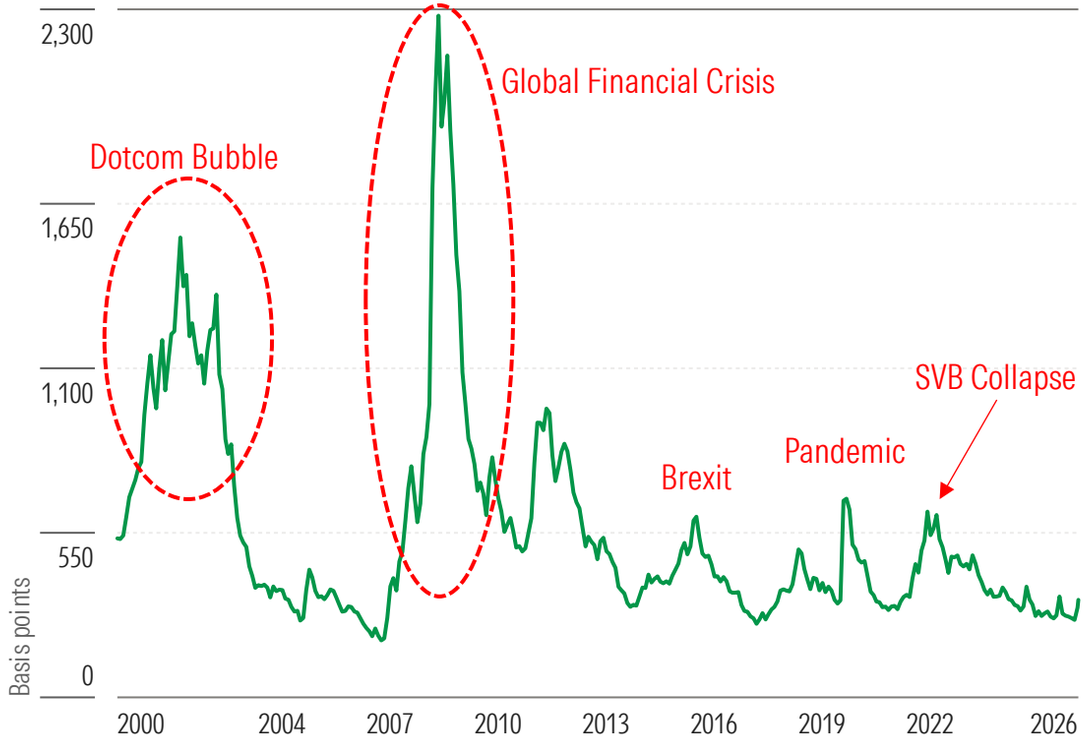
Source: Morningstar, OECD – data for Germany, Italy, Netherlands, Sweden as of 2025, rest – as of 2024. Bank for International Settlements - data as of March 2026.

Corporate Balance Sheets Are Stronger, but Higher Interest Rates Will Bite

Lower debt-service ratios than before should protect European firms against higher interest rates and inflationary cost pressures. We look at the credit spreads of high-yield issuers as a proxy for the weaker parts of European banks' loan books. Spreads remain above prepandemic levels, which indicates that there are still concerns about the asset quality of weaker issuers. We remain more concerned about corporate credit quality than household lending. We think some firms splurged on cheap credit, which is not reflected in broad data sets.

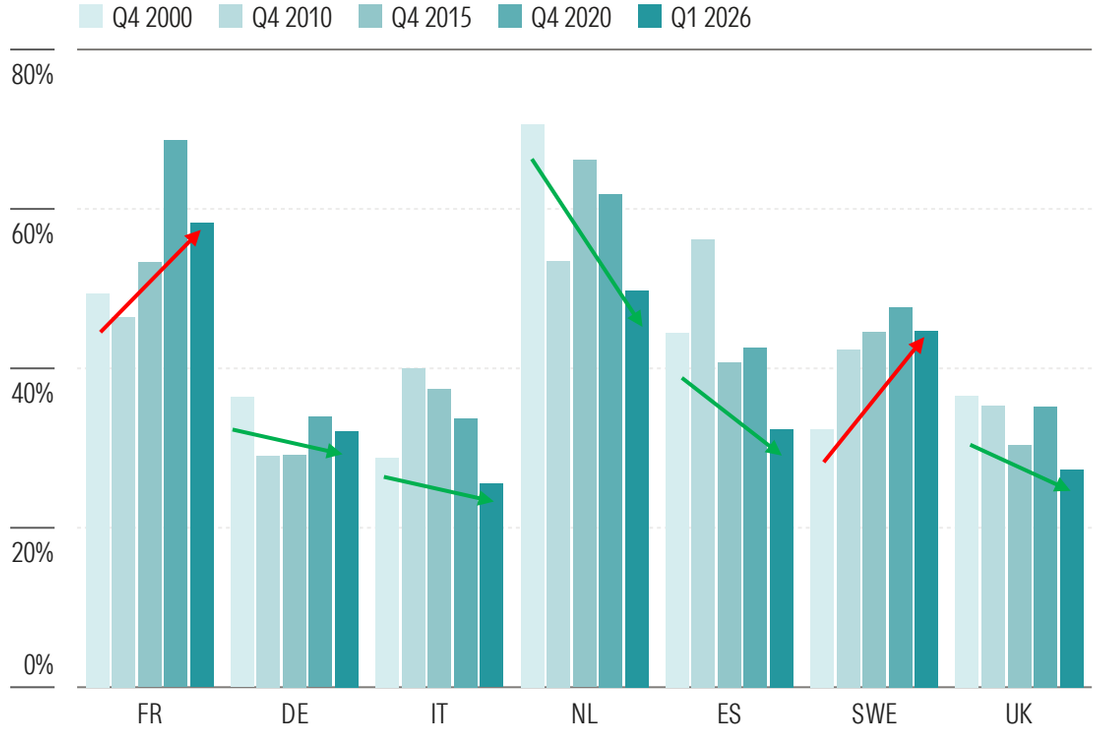
High-Yield Credit Not Showing Signs of Distress

Option-adjusted spread ICE BofA ML Euro Area High Yield Bond Index.



Most European Firms' Balance Sheets Have Improved

Debt-service ratio of nonfinancial corporations.

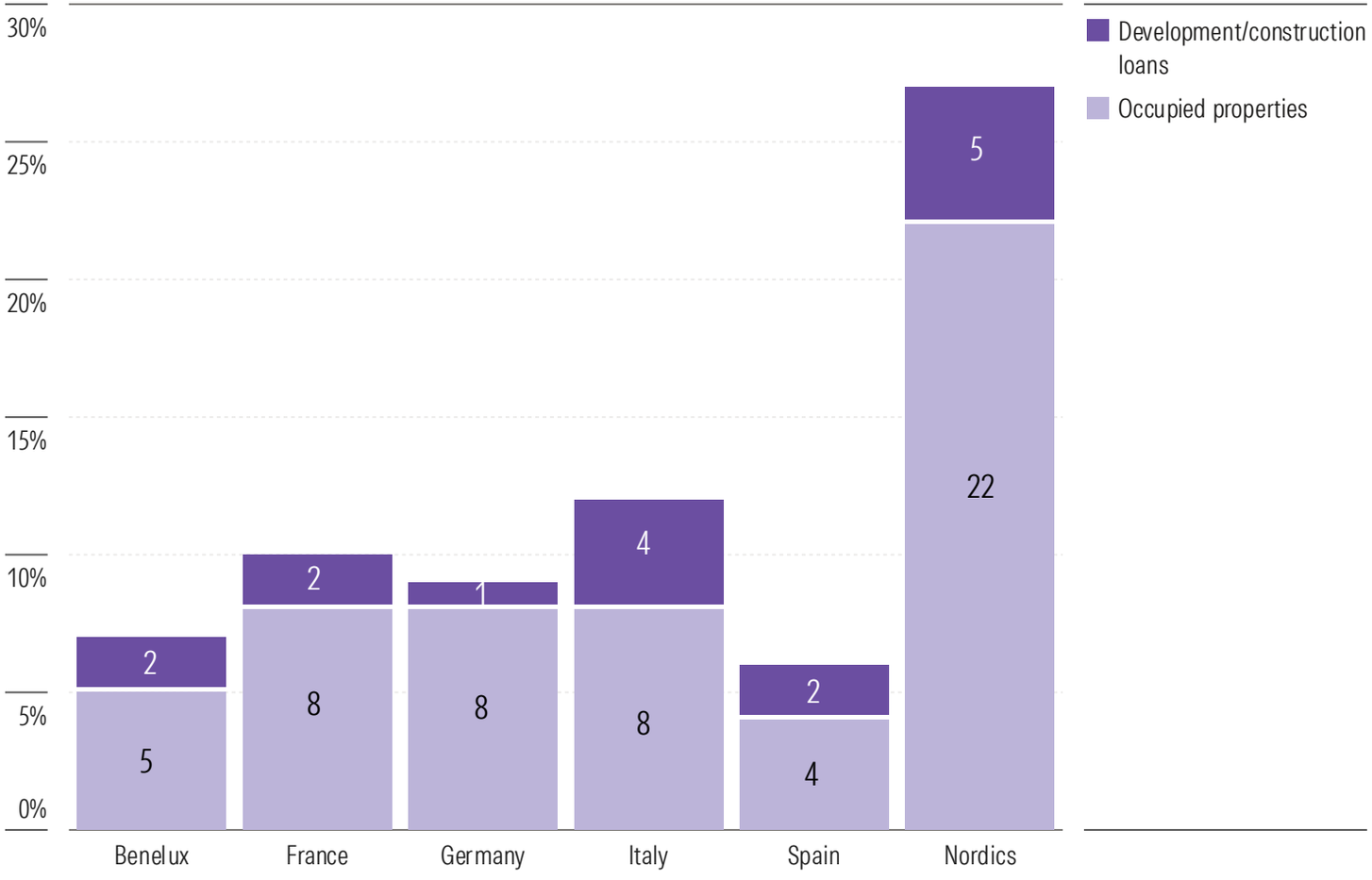


Source: Morningstar, Bank for International Settlements – data of as March 2026, ICE/Bank of America Merrill Lynch (FRED) - data as of Oct.. 8, 2026.
Option-adjusted spread = spread above the swap rate for similar tenors, adjusted for embedded options. Debt-service ratio = (principal repayment + interest expense)/(net income).

See Important Disclosures at the end of this report.

Health of Commercial Real Estate Loan Book Is Our Key Credit Quality Concern

European Banks Have Meaningful Exposure to Commercial Real Estate



One of the lasting impacts of the covid-19 pandemic has been a shift toward working from home and digital shopping.

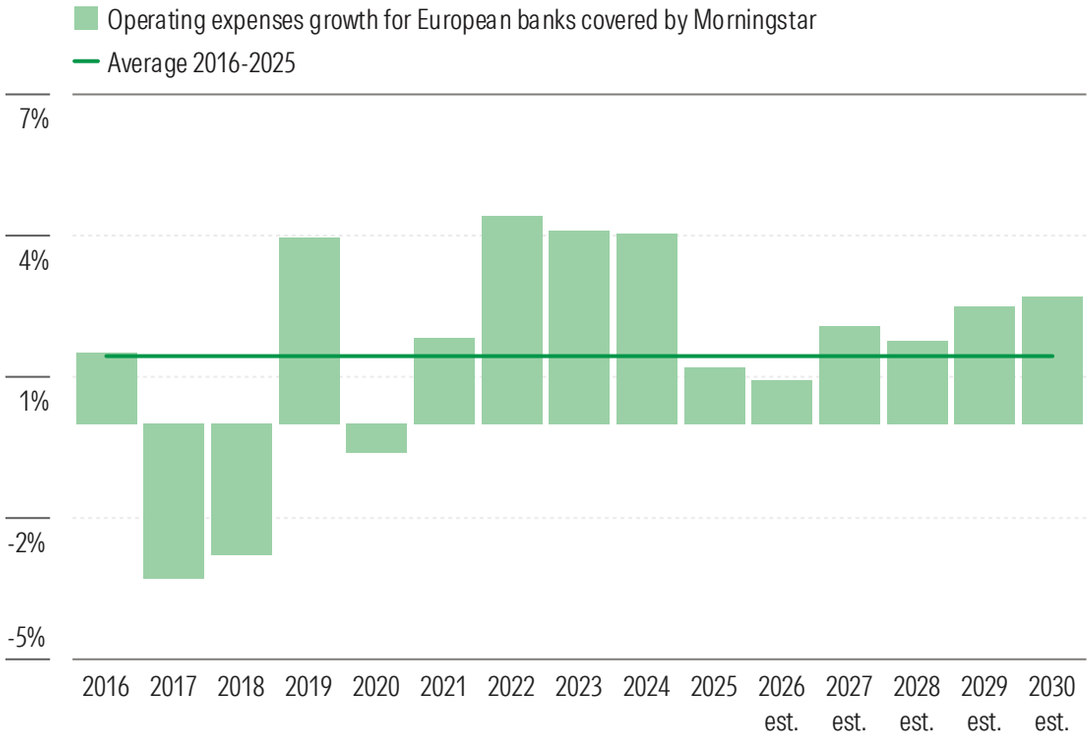
Elevated vacancy levels remain in office and retail properties. Many properties are also poorly equipped to deal with the energy transition and will need expensive remodeling. High spreads on the bonds of real estate issuers reflect credit quality concerns.

European banks have a sizable exposure to commercial real estate, although there are significant differences in the composition of lending books by sector and quality.

Source: Company data. Data as of 2023.

We Think Investors Underappreciate European Banks' Improvement in Efficiency

We See Higher-Cost Growth Due to Higher Variable Compensation and Inflation



The increased use of digital technology has supported flat cost growth on average for the European banks we cover. We expect some inflationary pressure on costs while improved profitability will also lead to higher bonus payments.

Depressed NIMs Previously Obscured Improved Efficiency of European Banks



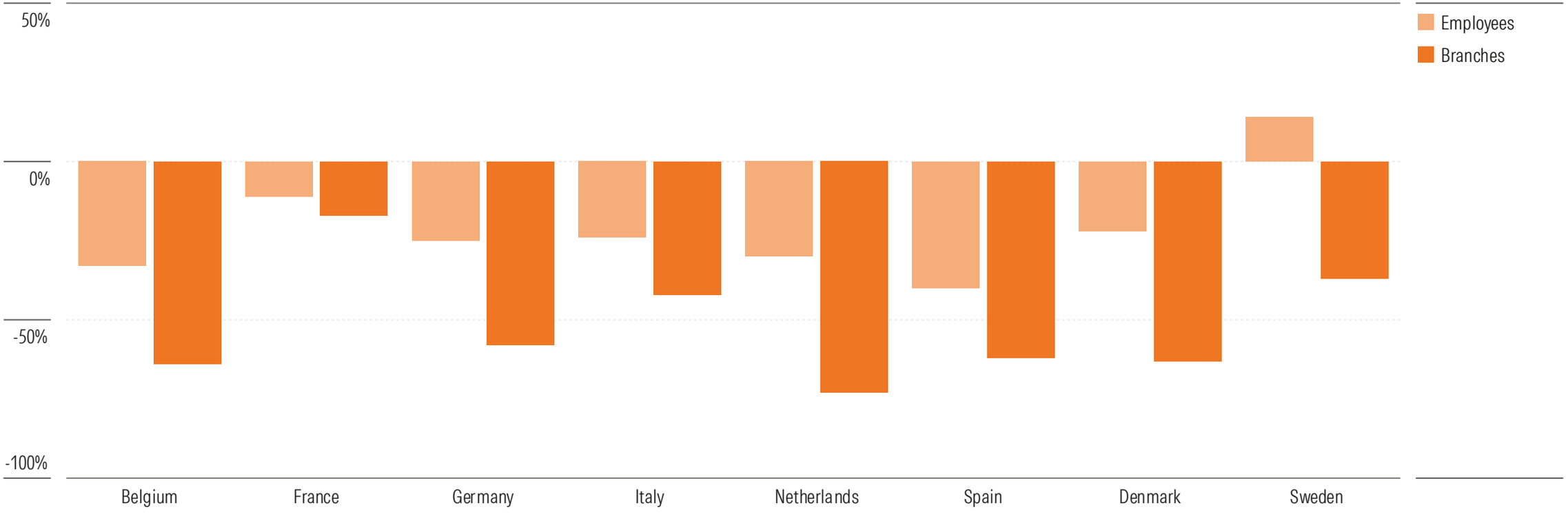
In the short term, the bulk of costs are fixed, which makes European banks highly operationally geared. Any improvement in revenue is therefore meaningfully amplified on the bottom line.

Source: Morningstar, company data of European banks covered. Data as of September 2026.

Higher Regulatory and Compliance Costs Have Consumed Much of the Material Improvement in Efficiency

Digitalization has allowed banks in most European countries to materially reduce their number of branch networks and employees. Increased consolidation of banks also played a role. This has created a lasting improvement in efficiency.

Change in Bank Employees and Branches, 2007-25



Source: Morningstar, European Central Bank. Data as of December 2025.

ESG Snapshot

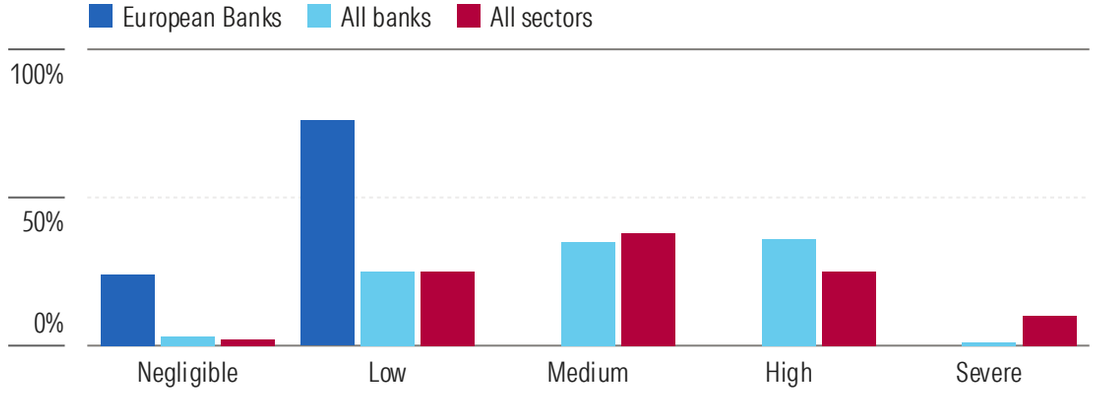
Data privacy and security and product governance are key considerations in European banks' ESG ratings.

Summary of Sustainalytics' ESG Ratings and Sources

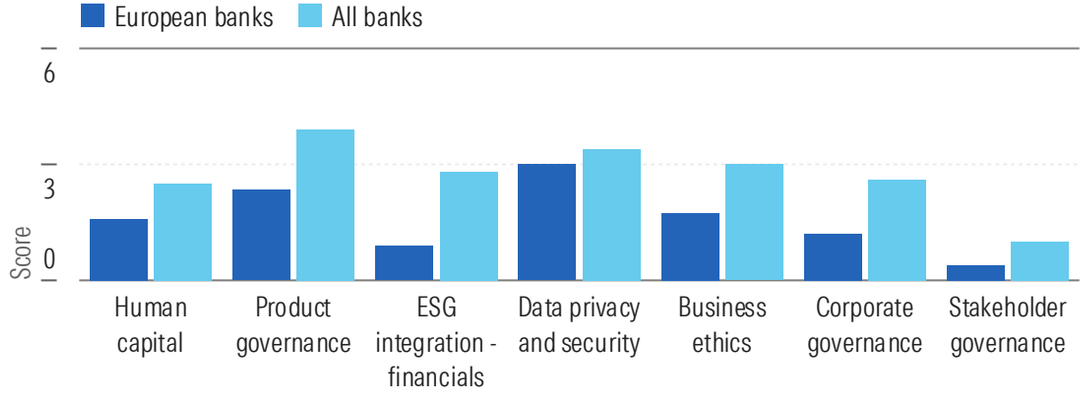
All European banks have a Negligible or Low ESG Risk Rating, which is better than the distribution of ratings across the overall Morningstar Sustainalytics universe. The largest drivers of European banks' ESG scores are data privacy and security, product governance, human capital, and ESG integration.

- Data privacy and security: Banks are moving their products and services into an online and mobile environment, which introduces risks around data privacy and security. Investments in secure systems preventing cyberattacks and nonmalicious exposures of sensitive data are crucial.
- Product governance: High competitive pressures as well as broad and complex product offerings paired with high regulatory scrutiny can result in misselling of products. Regulators are dialing up checks for greenwashing practices, potentially resulting in fines and investigations.
- Human capital: Banks face increasing pressure in attracting and retaining top talent, as private equity and tech firms compete for the same talent pool. Regulation also puts increasing emphasis on workforce gender equality, as issues such as pay gaps and diversity are in focus.
- ESG integration: Banks face pressures to align lending practices with ESG considerations, reducing exposure to controversial industries.

Distribution of ESG Risk Ratings for European Banks and All Industries



Top ESG Risk Rating Scores by Material ESG Issue



Source: Morningstar Sustainalytics. Data as of October 2026.

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