

Research Update:

BPCE Outlook Revised To Negative On France's Rising Economic Risks; 'A/A-1' Ratings Affirmed

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Table Of Contents

Overview

Rating Action

Rationale

Outlook

Ratings Score Snapshot

Related Criteria And Research

Ratings List

Research Update:

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Overview

- The economic risks under which French banks, including BPCE, operate have increased in our view, leaving them moderately more exposed to the potential of a lengthier recession in the eurozone.
- We are revising our outlook on BPCE to negative from stable and affirming our 'A/A-1' long- and short-term ratings.
- The negative outlook on BPCE factors in the possibility that an increase in France's banking industry risks, and a potential one-notch lowering of the sovereign ratings could occur before the bank has delivered a sufficient and sustainable increase in its capital position, or improved its risk position enough to cushion any negative impact on its creditworthiness.

Rating Action

As previously announced on Oct. 25, 2012, Standard & Poor's Ratings Services revised to negative from stable its outlook on BPCE and BPCE's core subsidiaries, Natixis S.A., BRED-Banque Populaire, and Compagnie Européenne de Garanties et Cautions. At the same time, we affirmed our 'A/A-1' long- and short-term counterparty credit ratings on BPCE, Natixis S.A., and BRED-Banque Populaire, and our 'A' long-term counterparty credit rating on Compagnie Européenne de Garanties et Cautions.

Rationale

The outlook revision reflects our view that BPCE's capital and earnings remain a negative rating factor and are not therefore able to compensate for increased risks in the bank's economic and operating environment. The bank is making ongoing efforts to improve its regulatory capital ratios, which are also reflected in our risk-adjusted capital (RAC) ratios. Measures taken include retaining earnings, selling new cooperative shares, and disposing of assets such as Foncia, Eurosic, and legacy assets. However, in our view, the rising economic risks in the bank's domestic market and the more protracted recession in the eurozone offset some of the benefits of these improvements. We consider that the pace of capital improvement is not yet fast enough for BPCE to reach a RAC ratio of 7% over our projected horizon. Nevertheless, if the improving trend continues, BPCE's risk position keeps getting better, and the economic and operating environment does not deteriorate more than we expect BPCE's stand-alone creditworthiness will be supported.

We base our ratings on BPCE on Groupe BPCE's "strong" business position, "moderate" capital and earnings, "adequate" risk position, "average" funding, and "adequate" liquidity, as our criteria define these terms. The ratings also reflect our view of Groupe BPCE's "high" systemic importance in France, which we assess as "supportive" toward its banking system. We assess Groupe BPCE's stand-alone credit profile (SACP) at 'a-'.

Our bank criteria use our BICRA methodology and our economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. Our 'a-' anchor for a commercial bank operating only in the Republic of France (AA+/Negative/A-1+) is based on an economic risk score of '3' and an industry risk score of '2', on a scale of 1-10 ('1' is the lowest risk and '10' is the highest). BPCE's weighted economic risk score stands at around '3', reflecting Groupe BPCE's dominant share of assets in its domestic market. Trends in domestic banking industry risks are negative in our view, as detailed in "Various Rating Actions Taken On French Banks Due To Rising Economic Risks," published Oct. 25, 2012. A revision of the industry risk score of France to '3' from '2' would push BPCE's anchor down to 'bbb+' from 'a-'.

Groupe BPCE's business position is "strong," in our opinion. It is a universal banking group with a strong focus on retail banking in France, where it ranks second. The bank's prominent, longstanding, and stable domestic retail franchise is the main factor behind our "strong" assessment of the group's business position. We view the group's earnings as quite predictable. In our opinion, a prudent and risk-averse management team implements Groupe BPCE's cohesive strategy built around its core franchises. BPCE's management has refocused some of its subsidiaries in business areas where they are well-anchored. It has also identified subsidiaries that do not entirely fit in its two main business lines (like Coface and Nexity, managed by the group as equity participations). The group has already demonstrated its ability to seize opportunities to dispose of noncore assets and parts of Natixis' workout portfolio. In our view, this lends some credibility to the group's announcement that it foresees more asset disposals.

Our "moderate" assessment of Groupe BPCE's capital and earnings is based on our projected risk-adjusted capital (RAC) ratio before diversification for the group increasing in a range of 6% to 6.5% in the next 18 to 24 months from 5.3% as of Dec. 31, 2011. These projections do not take into account potential sales of noncore assets, which could translate into new sources of capital. The adverse effects of weaker economic growth in France have been taken into account in our base-case scenario. In line with industry trends, the group's capital policy calls for further increasing of its capital ratios and we believe, under our base-case scenario, that the group is on track to achieve its target during the Basel III transition period. The group targets a common equity tier 1 ratio of above 9% at year-end 2013. We understand that Groupe BPCE will continue to manage its balance sheet tightly as it prepares for Basel III. We also see limited dividend payout ratios, new sales of cooperative shares, as well as divestments from noncore assets, as potential additional sources of capital for the group. We take the view that, while

adequate, Groupe BPCE's retained earnings in 2012 and 2013 will stand below its underlying capabilities.

Our assessment of Groupe BPCE's risk position as "adequate" factors in a reasonable appetite for growth, oriented toward selected areas of expertise, and what we view as the group's adequate risk management capabilities. Positive trends are noticeable. It has successfully implemented de-risking measures and repositioned itself around a tightened business scope. We consider that Groupe BPCE has a good track record in credit risk management in its core lending business of retail banking. The group's domestic loan book is of good quality, in our opinion. Prospective total cost of credit risk is expected to trend below domestic peers. Risks embedded in its legacy asset portfolio have also been declining, although remaining an area of scrutiny, in particular for *Crédit Foncier de France (CFF, A-/Stable/A-2)*. Groupe BPCE's exposure to South European countries remains manageable in our view in light of its earnings capacity.

Groupe BPCE's funding is "average" and its liquidity position "adequate," in our opinion. The group relies on confidence-sensitive wholesale funding. It is therefore sensitive to a prolonged disruption in the funding markets. Groupe BPCE's loan-to-deposit ratio compares unfavorably with those of peers. Its major funding imbalances arise from wholesale-funded subsidiaries *Natixis* and *CFF*, and from the centralization of most of its regulated *Livret A* savings plan deposits at French state institution, *Caisse des Depots et Consignations (AA+/Negative/A-1+)*, making these centralized deposits unavailable for funding. We believe the group's ability to repackage mortgage loans into covered bonds, raise funds throughout its large retail banking networks, and its loyal deposit base, should mitigate these vulnerabilities. The group also recently revised down its liquidity and funding needs. At the time of writing, it had completed 94% of its medium- and long-term funding plan with average maturity increasing to almost seven years. The rebalancing of the funding model toward long-term liabilities is currently underway. In our view, the *Livret A* reform is adding some specific pressure for BPCE in reaching this objective, but at this stage we consider it to be manageable. Groupe BPCE's access to European Central Bank funding facilities remains opportunistic, in our view. Liquidity reserves were strengthened in the past quarters, covering short-term wholesale funding needs, according to the bank's own estimates.

Our long-term rating on Groupe BPCE is one notch higher than the SACP, reflecting its "high" systemic importance in France and our assessment of the French government as "supportive" of its banking system.

Outlook

The negative outlook on BPCE factors in the possibility that the intensification of the difficulties in the operating environment for French banks, and any potential lowering of the sovereign ratings by one notch could occur before the bank has delivered a sufficient and sustainable increase in its capital position or improved its risk position to cushion any negative

impact on its creditworthiness. If they materialized, these concerns would lead to a downgrade of BPCE's long-term and short-term ratings by one notch.

We note that, under our criteria, if all other factors remained the same, we would not automatically downgrade BPCE if we were to lower the ratings on France. We would, however, reassess our opinion of the French banking system to include the underlying reasons for the downgrade and their potential impact on the bank's SACP.

We might revise the outlook on BPCE's long-term rating to stable if, all other factors being equal, we believed that the group's transition toward a reduction in risks and increasing capitalization could counterbalance negative pressures on the bank's issuer credit rating. This positive trend could potentially counterbalance concerns over France's banking sector industry risks, and the potential lowering of the ratings on France. This could happen if we believed there would be no serious deterioration in the French and eurozone economic and operating environments in the foreseeable future.

Ratings Score Snapshot

Issuer Credit Rating	A/Negative/A-1
SACP	a-
Anchor	a-
Business position	Strong (+1)
Capital and earnings	Moderate (-1)
Risk position	Adequate (0)
Funding and liquidity	Average and adequate (0)
Support	+1
GRE Support	0
Group Support	0
Sovereign Support	+1
Additional Factors	0

Related Criteria And Research

- French Bank BPCE And Core Subsidiaries Lowered To 'A' After Sovereign Downgrade; Outlook Stable, Jan. 23, 2012
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Group Rating Methodology And Assumptions, Nov. 9, 2011
- Bank Hybrid Methodology And Assumptions, Nov. 1 2011
- Bank Capital Methodology And Assumptions, Dec. 10, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed; Outlook Action

	To	From
BPCE Natixis S.A. BRED - Banque Populaire Counterparty Credit Rating	A/Negative/A-1	A/Stable/A-1
Compagnie Européenne de Garanties et Cautions Counterparty Credit Rating	A/Negative/--	A/Stable/--

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