ISSUER COMMENT

BPCE Raises Capital Adequacy Ratio Target to 18%, a Credit Positive

From Credit Outlook

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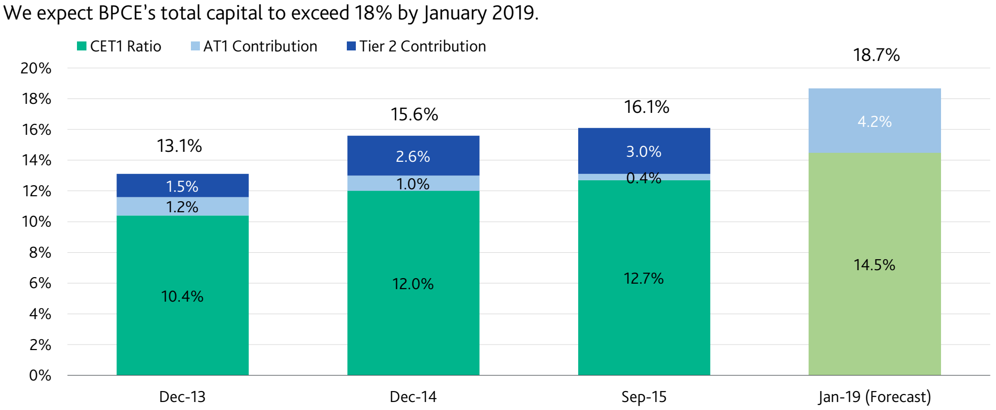
Last Thursday, the French bank BPCE (A2 stable, baa2[1]) announced that it had revised upward its total capital ratio target to 18% by early 2019. The increase is credit positive because it will allow the bank to meet its future total loss-absorbing capacity (TLAC) requirements using capital only, which will better protect senior creditors from losses in a bank resolution. Additionally, BPCE will become one of France's best capitalized banks, alongside Groupe Crédit Agricole, which also aims to have its TLAC composed of only capital instruments and no senior debt.

BPCE's total capital ratio is currently 16.1% of its risk-weighted assets (RWAs), up from 15.6% as of December 2014. This improvement was mainly the result of growth in the bank's common equity Tier 1 (CET1) capital to 12.7% of RWAs from 12.0% and additional Tier 2 instruments to 3.0% of RWAs from 2.6%. BPCE's RWAs total €390-€400 billion, and have remained stable and closely managed.

The bank will meet the new target primarily through its capacity to generate CET1: BPCE plans to increase its CET1 ratio by 60 basis points each year until 1 January 2019, or 180 basis points in total. This goal seems reasonable given that BPCE's average earnings contribution to Tier 1 ratio has been 71 basis points per year since 2010. Additionally, BPCE plans to issue €1.5-€3.5 billion of Tier 2 debt annually, subject to market conditions. These new Tier 2 issues, existing Tier 2 maturing and calls on Additional Tier 1 capital would result in a net increase of €3 billion of subordinated debt by 2019, which seems achievable and will be reflected, when issued, in our loss-given-failure analysis. Assuming stable RWAs under this scenario, BPCE's total capital would exceed 18% by 2019 (see exhibit).

BPCE's Growth of Its Total Capital Ratio, December 2013-January 2019

We expect BPCE's total capital to exceed 18% by January 2019.



Sources: BPCE and Moody's Investors Service estimates

[1] The bank ratings shown in this report are BPCE's senior unsecured debt rating and adjusted baseline credit assessment.

The TLAC framework aims to ensure that global systemically important banks such as BPCE generate sufficient capital from eligible TLAC liabilities to ensure the maintenance of critical functions during and immediately following a resolution of a failed bank without the need for a bailout and assuming that shareholders will not be able to increase equity. Eligible liabilities include capital and subordinated debt, but can also include bail-in-able senior debt up to 2.5% of a bank's RWAs. We expect that the minimum TLAC requirement, which the Financial Stability Board will publish in mid-November, will be set at 16%-20% of RWAs. With a capital ratio in excess of 18%, BPCE will be able to meet TLAC requirements without including any senior debt in eligible liabilities, a credit positive for senior debtholders.

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