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Research Update:

French Bank BPCE Outlook Revised To Positive On The Balance Sheet's Strengthening Trend; 'A/A-1' Ratings Affirmed

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Overview

- Following BPCE's strong improvement in capitalization and additional loss-absorbing capacity (ALAC), we expect management will continue building up capital and tap the senior nonpreferred market to strengthen its total loss-absorbing capacity well above regulatory requirements.
- Therefore, we are revising our outlook on BPCE and all its core and highly strategic group members to positive from stable, and affirming our long- and short-term ratings.
- The positive outlook reflects the possibility that we could revise upward our assessment of BPCE's capital and earnings and consequently our assessment of its stand-alone credit profile, or that we could factor in a second notch of ALAC support into our long-term rating.

Rating Action

On Oct. 20, 2017, S&P Global Ratings revised its outlook on French bank BPCE and its core group members, which includes notably Natixis, to positive from stable. We affirmed our 'A/A-1' long- and short-term issuer credit ratings on these entities, as well as all the ratings on their subordinated debts, senior nonpreferred notes, and hybrid capital instruments.

At the same time, we revised our outlook on BPCE's highly strategic subsidiary Crédit Foncier de France (CFF) to positive from stable, and affirmed our 'A-/A-2' long- and short-term issuer credit ratings on CFF.

Rationale

The outlook revision reflects that, following the strong improvement in capital and loss-absorbing capacity that BPCE achieved in 2016, it could further strengthen its financial profile and continue to build up capital to the point where we would raise our ratings. We believe that BPCE plans to raise its total loss-absorbing capacity (TLAC) well above regulatory requirements. We expect this trend to be also supported by the group's stable earnings, its low pay-out ratio along with its cooperative structure, recurring sales of cooperative shares, and by annual growth in S&P Global Ratings' risk-weighted assets (RWA) in the 2.0%-2.5% range in 2017 and 2018.

As part of its conservative strategy, and ahead of potentially more demanding regulation and more challenging business conditions, we believe that BPCE will make it a priority to achieve a greater TLAC buffer and positively differentiate itself from peers, notably domestic ones. Consequently, we expect that BPCE will issue significant amounts of senior nonpreferred debt in the next couple of years, following the €5.1 billion issued in 2017 year to date (of which €1.1 billion comes as part, and in advance, of the funding plan for 2018). The outlook revision acknowledges the possibility that the strengthening of the financial profile and conservativeness of financial policies could continue to the point where we would increase our long-term rating on BPCE. This could occur if, under our rating horizon, our prospective risk-adjusted capital (RAC) ratio for the group was above 10% and sustained at a level in line with a higher assessment of capital and earnings, in combination with a prospective additional loss-absorbing capacity (ALAC) ratio exceeding our 5.0% threshold for one notch of support. Alternatively, and although a longer term scenario, we could upgrade BPCE even if our assessment of capital and earnings remained unchanged, should BPCE's ALAC ratio reach our 8.0% threshold for two notches of ALAC support. The outlook also reflects our expectation that the bank will continue to demonstrate good asset quality and a prudent approach to growth.

At the current level, our ratings on BPCE are supported by the group's prominent and longstanding franchise in domestic retail banking, conservative management, stable and predictable earnings, and its strategy of strengthening its balance sheet regulatory requirements. We balance this with our view of the group's moderate growth potential in the mature French domestic banking market, the dampening effect of low interest rates on revenues, and our view of its comparatively unfavorable funding and liquidity position.

BPCE is a universal banking group with a dominant focus on retail banking in France, where it ranks No. 2, with 8,000 branches. The group's leading and stable domestic retail franchise is the primary driver of our assessment of its strong business position. We consider BPCE's business diversification to be average, and, by geography, limited in comparison with other national champions in Europe. BPCE is not a global player in corporate and investment banking, but has strong expertise in certain types of businesses and geographies, while investment solutions, in particular asset management, and specialized financial services complement its business position. We see growth in insurance and asset-gathering activities as a key component to the group's strategy.

We consider BPCE's earnings generation to be stable and predictable. We expect a low-single-digit increase in revenues in 2017, still pressured by the current low-interest-rate environment, notably as more than one-half of the group's revenues come from its French retail activities. This is mitigated, though, by dynamic growth in BPCE's loans and deposits volumes in French retail, and by the sizable and recurring contribution to net profit generated by other businesses like corporate and investment banking and asset management, which are incorporated under Natixis. We also expect that profitability will be supported by low new loan loss provisions, as a result of careful underwriting and a moderate recovery in France, where the bulk of

BPCE's exposure is concentrated.

Our assessment of BPCE's capital and earnings as adequate reflects the strengthening in the bank's capital position over the past four years, and our expectation that our projected RAC ratio will be about 10%. At end-2016, we estimated the group's RAC ratio at 9.3%, pro forma our revised new methodology (see "Risk-Adjusted Capital Framework Methodology," published July 20, 2017). We note that the impact from the revision of our methodology on BPCE's RAC ratio was marginal. The ratio at end-2016 was well above the 8.4% achieved one year earlier, with the improvement stemming mostly from strong retained earnings of above €3 billion, the generation of €1.3 billion of capital through the sale of cooperative shares in 2016, and from the absence of growth in risk exposures as measured under S&P Global Ratings' RWA.

We view BPCE's risk-management capabilities as adequate compared with peers' and the group's risk policy as conservative. We consider that the group has successfully completed most of its transition toward a reduced risk profile, and the winding down of its legacy assets.

Our central scenario factors in that the group will slightly consolidate its funding and liquidity position, from the current level that we see as somewhat below domestic peers'. At mid-2017, we estimated our stable funding ratio at 92.2% and our broad liquid assets to short-term wholesale funding ratio at 0.94x, broadly in line with the levels achieved in 2015 and 2016. We believe that the amount of retail deposits BPCE collects from regulated saving plans (mostly Livret A), and centralizes at the Caisse des Dépôts et Consignations, resulted in our funding and liquidity indicators on BPCE being weaker than peers'. We adjust our metrics because we do not see these centralized amounts as available for refinancing of the group's assets. Still, we do not see BPCE's funding and liquidity as a distinctive factor, and consider it as neutral for the ratings.

Our long-term rating on BPCE is one notch higher than the stand-alone credit profile (SACP), since we incorporate one notch of ALAC uplift. Under our revised RAC framework methodology, the insurance operations, which we expect would lie outside the scope of required bail-in capitalization, do not contribute significantly to the S&P Global Ratings' RWA used in our ALAC calculation. For this reason, we have removed the -25 percentage-point qualitative adjustment we previously applied and revised our threshold for one notch of ALAC support to 5.00% for BPCE, from 4.75% previously. For BPCE to benefit a second notch of ALAC support, the group would need to achieve an ALAC ratio of 8.00%.

We calculated that our ALAC ratio on BPCE was 5.69% of S&P Global Ratings' RWA at year-end 2016. This calculation included an impact of +0.33 percentage points from the revision of our updated methodology, mostly due to the change in our approach to insurance risks, while the rest of the difference with the 4.19% ratio that we calculated at end-2015 reflected essentially the increase in the group's total adjusted capital, which was through retained earnings and issuance of cooperative shares.

Outlook

Our positive outlook on BPCE and all its core and highly strategic subsidiaries reflects the possibility that we might raise the ratings within the next 18-24 months. This could occur if the group manages to continue to strengthen its capital and build a sizeable cushion of bail-in-able debt in resolution to a point where this strengthening would exceed our current expectations under our rating horizon. For an upgrade, our assessment of BPCE's unsupported group credit profile and our final issuer credit rating on the group would need to be reflective of levels consistent with 'A+' rated peers', in our view.

We could raise the ratings either because capital strengthens to a point where we would consider the group's capital position as strong, while additional issuance of loss-absorbing instruments continues supporting one notch of ALAC uplift, based on our projected metrics of RAC and ALAC. Alternatively, and although a longer term scenario, we could raise the ratings if the ALAC buffer achieved by BPCE was sufficient for two notches of uplift.

We could revise the outlook to stable if the group's RAC ratio and ALAC buffer appeared set to fall materially short of the levels that would lead to higher rating. This could be the case, for instance, on the back of a strong increase in risk exposures and S&P Global Ratings' RWA, or if BPCE did not issue sufficient ALAC-eligible debt in the coming years, or due to subdued or weaker-than-similarly-rated peers' retained earnings prospects.

Our positive outlook on CFF mirrors that on BPCE, as we expect CFF to remain a highly strategic subsidiary of BPCE.

Ratings Score Snapshot

	To	From
Issuer Credit Rating	A/Positive/A-1	A/Stable/A-1
SACP	a-	a-
Anchor	bbb+	bbb+
Business Position	Strong (+1)	Strong (+1)
Capital and Earnings	Adequate (0)	Adequate (0)
Risk Position	Adequate (0)	Adequate (0)
Funding and Liquidity	Average and Adequate (0)	Average and Adequate (0)
Support	(+1)	(+1)
ALAC Support	(+1)	(+1)
GRE Support	(0)	(0)
Group Support	(0)	(0)

Sovereign Support	(0)	(0)
Additional Factors	(0)	(0)

Related Criteria

- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables, Aug. 14, 2017
- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria - Financial Institutions - Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- General Criteria: National And Regional Scale Credit Ratings, Sept. 22, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Assessing Bank Branch Creditworthiness, Oct. 14, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks, March 23, 2004

Ratings List

Outlook Action; Ratings Affirmed

	To	From
BPCE		
Natixis S.A.		
Natixis Financial Products LLC		
Natixis Australia Pty Ltd.		
Natixis (New York Branch)		
BRED - Banque Populaire		
Counterparty Credit Rating	A/Positive/A-1	A/Stable/A-1
Compagnie Europeenne de Garanties et Cautions		

Counterparty Credit Rating		
Local Currency	A/Positive/--	A/Stable/--
Financial Strength Rating		
Local Currency	A/Positive/--	A/Stable/--
Credit Foncier de France		
Counterparty Credit Rating	A-/Positive/A-2	A-/Stable/A-2
Parnasse Garanties		
Counterparty Credit Rating	A/Positive/--	A/Stable/--

Ratings Affirmed	
BRED - Banque Populaire	
Certificate Of Deposit	A/A-1
Credit Foncier de France	
Certificate Of Deposit	
Foreign Currency	A-
Local Currency	A-
Natixis S.A.	
Certificate Of Deposit	
Foreign Currency	A
Local Currency	A/A-1
BPCE	
Senior Unsecured	A
Senior Unsecured	Ap
Senior Subordinated	BBB+
Subordinated	BBB
Junior Subordinated	BB+
Commercial Paper	A-1
BRED - Banque Populaire	
Subordinated	BBB
Certificate Of Deposit	A-1
Credit Foncier de France	
Senior Unsecured	A-
Natixis (New York Branch)	
Commercial Paper	A-1
Natixis S.A.	
Senior Unsecured	A
Senior Unsecured	Ap
Subordinated	BBB
Junior Subordinated	BB+
Commercial Paper	A-1

Natixis Structured Products Ltd.	
Senior Unsecured	A
Natixis US Medium-Term Note Program LLC	
Senior Unsecured	A
Senior Unsecured	Ap

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