FitchRatings

Fitch Upgrades Groupe BPCE to 'A+'; Stable Outlook

Link to Fitch Ratings' Report(s): Groupe BPCE - Rating Action Report (https://www.fitchratings.com/site/re/10054403)

Fitch Ratings-Paris/London-04 December 2018: Fitch Ratings has upgraded Groupe BPCE's (GBPCE) Long-Term Issuer Default Rating (IDR) to 'A+' from 'A' and Viability Rating (VR) to 'a+' from 'a'. The Outlook on the Long-Term IDR is Stable. The Short-Term IDR has been affirmed at 'F1'.

Fitch has also upgraded the Long-Term IDRs of GBPCE's main entities: BPCE S.A., the Banques Populaires (BPs), the Caisses d'Epargne et de Prevoyance (CEPs), Natixis S.A., Credit Foncier de France S.A. (CFF) and Banque Palatine.

A full list of rating actions is in the related Rating Action Report available at www.fitchratings.com or by clicking the link above.

KEY RATING DRIVERS
IDRS, VR AND SENIOR DEBT
GBPCE's upgrade reflects improving capital ratios, new targets set under the 2018-2020 strategic plan and the recent acceleration of the execution of the bank's strategy since the nomination of a new group CEO in June 2018. This includes the integration of CFF's retail activities into the BPs and CEPs, the transfer of factoring, leasing, consumer finance, securities services and guarantees to BPCE S.A. from Natixis S.A. to improve synergies with the regional banks and the sale of non-core African subsidiaries.

The ratings reflect the group's strong and diversified company profile focused on French retail and commercial banking, fairly low risk appetite and sound asset quality as well as strengthening capitalisation and adequate liquidity.

GBPCE mainly operates in France, where it is the second-largest player in retail and commercial banking. GBPCE has a universal bancassurance business model and a significant global franchise in asset management. The group's strategy is to expand its market positions primarily through organic growth and revenue synergies from additional cross-selling between group entities. Acquisitions will concentrate on asset and wealth management.

GBPCE has a modest risk appetite. Its loan portfolio is mainly concentrated in France and close to half consists of low-risk housing loans. An additional 10% is with the French public sector. However, the bank's underwriting standards for professionals and corporate are average compared with French peers, although they are progressively being tightened. In corporate and investment banking, the bank has an originate-to-distribute model and market risk is modest.

The impaired loans to gross loans ratio of GBPCE was 3.5% at end-June 2018, above our 3.0% benchmark for a 'a' asset quality score in France, and is not declining as quickly as peers. However, like other French banks, GBPCE's policy is to retain impaired loans on balance sheet until they are fully resolved, which tends to inflate the ratio. The loan loss allowances on impaired loans ratio of slightly below 60% is moderate compared with French peers and leaves the group partially reliant on collateral valuation and realisation.

GBPCE's retail and commercial banking revenue is affected by the low-interest-rate environment, but the group has been able to generate recurring and acceptable earnings. Average pre-tax profit of close to EUR6 billion per year over the past four years provides the group with significant capacity to absorb shocks. The development of insurance and asset management provides GBPCE with a growing source of non-interest income. Cost efficiency is below the best French peers with a cost-to-income ratio of about 70%, but should benefit from investments in digitalisation and successive mergers of regional banks.

Capitalisation is solid and has improved from internal capital generation and regular issuance of cooperative shares. The group has set a new common equity Tier 1 (CET1) ratio target of above or equal to 15.5% in its 2020 strategic plan. The group's fully loaded CET1 ratio was 15.6% at end-September 2018 (15.4% pro forma of already announced transactions) and the Fitch Core Capital (FCC) ratio was in the same range. The group's capitalisation is supported by a contained dividend payout ratio. The regulatory leverage ratio was satisfactory at 5.1% at end-September 2018.

GBPCE benefits from the strong deposit franchise of its regional banks but its two largest subsidiaries (Natixis and CFF) are mostly wholesale funded. As a result, about half of total funding consists of deposits, a lower share than other French cooperative peers. GBPCE's market funding is diversified in terms of products and currencies. Central bank deposits and high-quality liquid assets represent 12% of the balance sheet excluding insurance assets at end-June 2018 and cover wholesale funding maturing over the next 12 months.

GBPCE's 'F1' rating is the lower of the two possible Short-Term IDRs mapping to a 'A+' Long-Term IDR because we do not view its liquidity as exceptionally strong compared with similarly rated banks globally.

Preferred and non-preferred senior debt ratings are aligned because the group's buffers of qualifying junior debt and non-preferred senior debt (in combination around 7% of risk-weighted assets at end-1H18) are not sufficient to justify uplift to the preferred senior debt ratings under our criteria.

AFFILIATED ENTITIES

GBPCE is a cooperative banking group bound by a legally established cross-support mechanism comprising its 14 BPs, 15 CEPs, its central body BPCE S.A., and many affiliates, the largest being Natixis, CFF and Banque Palatine. The group publishes consolidated accounts and the affiliated entities to BPCE S.A. share a common strategy and coordinated marketing activities. Risk management is also centralised. We consequently assign group ratings in accordance with Annex 4 of our Bank Rating Criteria and have the same IDRs for all these entities.

Fitch has upgraded the Long-Term IDR, affirmed the Short-Term IDR and withdrawn the ratings of Credit Maritime Mutuel because we do not consider these ratings relevant to our coverage. This issuer is not a legal entity and the local banks affiliated to it have now almost all merged into a BP.

Natixis S.A. has some debt guaranteed by Caisse des Depots et Consignations (AA/Stable), a special agency controlled by the French state. The ratings of these securities are aligned with the long-term rating of Caisse des Depots et Consignations and have been affirmed.

The rating of negotiable European commercial paper (NEU CP) issued under Natixis Factor's, Natixis Lease's, Natixis Lease Immo's, Natixis Bail's and Cicobail S.A.'s NEU CP programmes guaranteed by Natixis S.A. are aligned with its 'F1' Short-Term IDR. This reflects Fitch's view that Natixis S.A. is highly likely to honour its commitment as guarantor if required, as the guarantees are unconditional, irrevocable and timely. The issuing entities are part of Natixis S.A.'s leasing and factoring arm.

DERIVATIVE COUNTERPARTY RATINGS

Fitch has upgraded the Derivative Counterparty Ratings (DCRs) of BPCE S.A. and Natixis S.A. to 'A+ (dcr)'. They are notable derivative counterparties within GBPCE. The DCRs are at the same level as

BPCE S.A.'s and Natixis S.A.'s preferred senior debt ratings. Derivative counterparties in France have no preferential status over other preferred senior obligations in a resolution scenario.

SUPPORT RATING AND SUPPORT RATING FLOOR
GBPCE's Support Rating (SR) of '5' and Support Rating Floor (SRF) of 'No Floor' reflect Fitch's view that although possible, sovereign support cannot be relied upon. In Fitch's view, legislative, regulatory and policy initiatives (including the implementation of the EU's Bank Recovery and Resolution Directive) have substantially reduced the likelihood of sovereign support for EU commercial banks in general, implying that senior creditors would probably be required to participate in losses, if necessary, instead of, or ahead of, the bank receiving sovereign support.

SUBORDINATED AND JUNIOR SUBORDINATED DEBT
Subordinated debt issued by BPCE S.A. and Natixis S.A. and deeply subordinated debt issued by BPCE S.A. are all notched down from GBPCE's VR in accordance with Fitch's assessment of each instrument's respective non-performance and relative loss severity risk profiles.

We rate subordinated Tier 2 debt one notch below GBPCE's VR to reflect below-average recoveries for this type of debt. Legacy deeply subordinated Tier 1 securities are rated four notches below GBPCE's VR to reflect the high loss severity risk of these securities (two notches from the VR) as well as a higher risk of non-performance (an additional two notches) relative to the group's VR.

RATING SENSITIVITIES
IDRS, VR AND SENIOR DEBT
The Stable Outlook on GBPCE's Long-Term IDR reflects Fitch expectation that the group will maintain its fairly low risk appetite, strong capitalisation and continue to improve its profitability. Fitch also expects the bank to more actively reduce its stock of impaired loans, to maintain strict liquidity policies and to continue its strong execution of the 2020 strategic plan.

GBCPE's ratings are primarily sensitive to a deviation from the current capital trajectory and liquidity policies and/or increase in risk appetite. Upside potential is limited and would be contingent on a significant franchise expansion or demonstration of exceptionally strong and stable financial metrics, in particular a materially lower stock of impaired loans, higher profitability, further improvement in capitalisation and a track record of exceptionally strong liquidity.

GBPCE's preferred senior debt could be upgraded to one notch above the group's Long-Term IDR if the buffer of qualifying junior debt plus non-preferred senior debt became sufficient to protect preferred senior creditors from default in case of failure (Fitch estimates a required buffer of around 9% of risk-weighted assets). GBPCE's qualifying junior debt and non-preferred senior debt buffer was around 7% of risk-weighted assets at end-June 2018.

AFFILIATED ENTITIES
The affiliated entities' IDRs will continue to move in tandem with those of GBPCE unless there is a change in the affiliation status, which Fitch views as very unlikely.

The long-term ratings of Natixis S.A.'s guaranteed debt is sensitive to rating actions on the guarantor, Caisse des Depots et Consignations, and ultimately on the French sovereign.

The ratings of the debt issued by Natixis Factor, Natixis Lease, Natixis Lease Immo, Natixis Bail and Cicobail S.A. and guaranteed by Natixis S.A. are primarily sensitive to a change in Natixis S.A.' Short-Term IDR.

DCRs
Under French law, derivative counterparties rank pari passu with preferred senior creditors, meaning that BPCE S.A.'s and Natixis S.A.'s DCRs are sensitive to the same factors as the preferred senior debt rating of BPCE S.A. and Natixis S.A.. They are currently aligned with the banks' Long-Term

IDRs and are primarily sensitive to changes to these.

SR AND SRF
An upgrade of GBPCE's SR and upward revision of the SRF would be contingent on a positive change in the French sovereign's propensity to support its banks. While not impossible, this is highly unlikely in Fitch's view.

SUBORDINATED AND JUNIOR SUBORDINATED DEBT
The ratings of the subordinated debt issued by BPCE S.A. and Natixis S.A. and the deeply subordinated debt issued by BPCE S.A. are primarily sensitive to a change in GBPCE's VR. The ratings of the legacy deeply subordinated Tier 1 securities are also sensitive to a change in Fitch's assessment of the probability of their non-performance relative to the risk captured in GBPCE's VR.

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Applicable Criteria
Bank Rating Criteria (pub. 12 Oct 2018) (https://www.fitchratings.com/site/re/10044408)
Non-Bank Financial Institutions Rating Criteria (pub. 12 Oct 2018) (https://www.fitchratings.com/site/re/10044407)

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