BPCE SA
Issuer Rating Report

AA- STABLE

Overview

Scope Ratings has assigned an Issuer Rating of AA- and a short-term debt rating of S-1+ to BPCE SA, both with Stable Outlook.

The ratings were not solicited by the issuer. Both ratings and analysis are based solely on publicly available information. The issuer has not participated in the rating process.

Highlights

- The Issuer Rating of AA- for BPCE SA reflects our view that Groupe BPCE, for which it acts as the central institution, continues to preserve reassuring, stable and predictable credit fundamentals, underpinned by a low-risk business model focused predominantly on domestic retail banking. Wholesale and investment banking business is less important for Groupe BPCE compared to more internationally focused domestic peers. As of 1H18, Groupe BPCE ranks as the eighth largest banking group in the euro area and the fourth largest in France by total assets.

Rating drivers (summary)

The rating drivers, in decreasing order of importance in the rating assignment, are:

- A stable franchise with strong links to the communities served, combined with a low-risk business model, anchored mostly by domestic retail banking and financial services. Post-crisis, the investment bank Natixis has been de-risked and scaled down and now primarily provides specialised products for the Group's clients.
- Balancing revenue pressure against efficiency and the need to invest upfront in a digital banking model. Overall profitability of the Group's two large retail networks (the Banques Populaires and Caisses d'Epargne) is modest and remains vulnerable to sluggish economic conditions in France. Nevertheless, Groupe BPCE continues moving towards better intragroup revenue and cost synergies, which is a positive and necessary strategy, and has also announced significant cost control measures as part of its plan to transform its retail banking platforms and organisational structure.
- Groupe BPCE displays solid capital adequacy measures compared to domestic peers. The Group is considered a Global Systemically Important Bank (G-SIB), so must comply with Total Loss-Absorbing Capacity (TLAC) standards mandated by the Financial Stability Board.

Ratings & Outlook

Issuer Rating	AA-
Outlook	Stable
Senior unsecured debt (non-MREL/TLAC eligible)	AA-
Senior unsecured debt (MREL/TLAC eligible)	A+
Tier 2 instruments	A-
Short term debt rating	S-1+

Lead Analyst

Jennifer Ray
j.ray@scoperatings.com

Associate

Alvaro Dominguez Alcalde
a.dominguez@scoperatings.com

Team Leader

Sam Theodore
s.theodore@scoperatings.com

Scope Ratings GmbH

Suite 301
2 Angel Square
London EC1V 1NY

Phone +44 20 3457 0444

Headquarters

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: SCOP

Rating change drivers

Any negative macro-economic or political trends in France could hurt Groupe BPCE's recurring profitability (especially given its relative dependence on French retail business to generate revenues).

Many large branch-based retail banks are experiencing significant challenges with respect to their future strategies due to technology advances, and from changing customer behaviour. Investment in digital offerings is considered necessary but expensive, and a focus on cost efficiency is crucial. The inability of the Group to reduce capacity and costs to adjust to an evolving landscape could in time be negative for the credit.

A material restructuring of the Group in the direction of reducing excess capacity and significantly lowering costs could eventually help the ratings upward. Groupe BPCE is taking steps to simplify its organisational structure and merge some of its regional banks. Also during 2018 it announced that mortgage asset generation previously conducted via Crédit Foncier (CFF) will transfer to other Group banks during 1H19. The Group is also planning to transfer retail banking activities housed within Natixis to various retail banks within the Group. Major recurring cost savings appear some way off. Under its current strategic plan the Group seeks to lower its cost/income ratio assisted by targeted recurring cost savings of EUR 1bn by the end of 2020; however, in the near term it will be investing significantly in its digital offerings.

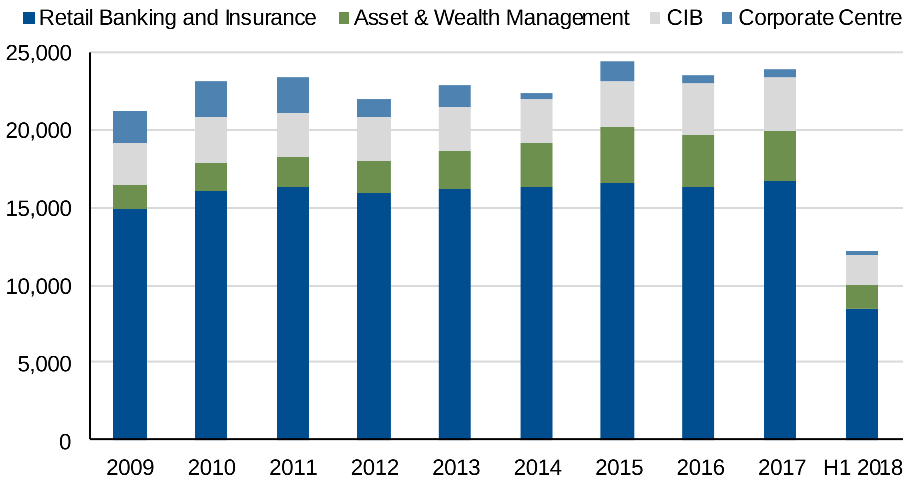
Rating drivers (details)

Stable franchise with strong links to the communities served, combined with a low-risk business model

The 2009 in-market mega-merger between the Banque Populaire (BP) and the Caisses d'Epargne (CE) networks – each already with a very substantial retail footprint across France – was to some extent designed to financially shore up the troubled investment bank, Natixis. The two networks own equal shares in BPCE SA, the Group's central institution. The transaction proved very positive, combining the forces of the strong domestic retail franchises of BP and CE, and also leading to the restructuring of Natixis and reduction of its risk profile, partly through BPCE SA's guarantee on its toxic assets.

Based on 3Q17 Banque de France data, within France the Group has a 21.6% share of on-balance sheet customer deposits & savings, and 21.1% in customer loans, second only to Credit Agricole-LCL. Groupe BPCE has a 26.4% market share of home loans.

Figure 1: Revenue structure of Groupe BPCE 2009-H1 2018 (EURm))



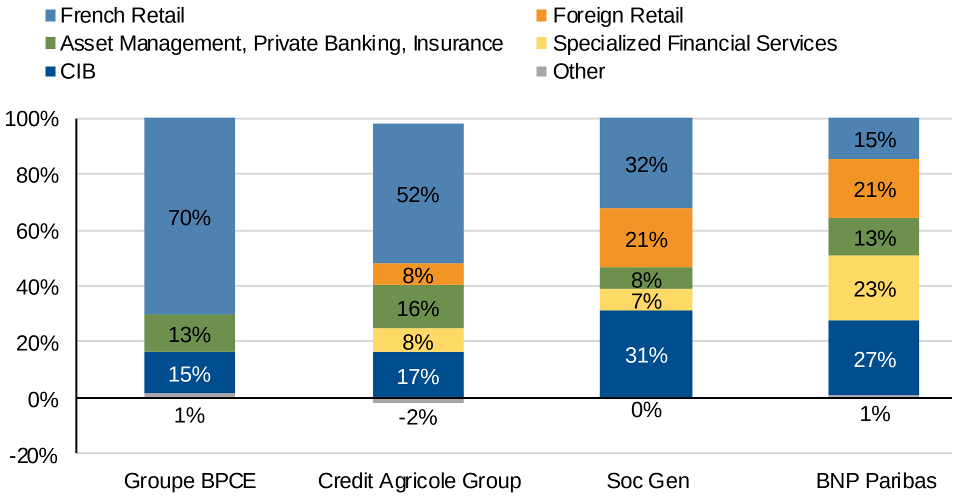
Source: Scope Ratings research, Company data

The Group has three main business lines, dominated by the Retail Banking and Insurance segment., which accounted for 70% of FY17 revenues. This included 14 BP and 15 CE (down from 16 at YE17, following the June 2018 merger between two CE that created the new Caisse d'Epargne Grand Est Europe). The BP and CE franchises – each with a co-operative shareholding structure – underpin the group's position in the French retail market. CdE is a well-established brand in France focused on household savings,and ranks first in serving French local authorities. Along with individual customers BP specialises in servicing small- and medium-sized companies and self-employed professionals. Other companies within this business segment include Crédit Foncier de France (Issuer Rating AA- with Stable Outlook), a large mortgage lending specialist which currently accounts for most of the Group's real estate financing business, Banque Palatine, formerly San Paolo Bank (France), servicing upper-market corporate and retail clients, and BPCE International. Groupe BPCE's non-controlling interest in CNP Assurances is also included within this segment.

The second strand comprises Natixis, 71.03% owned by BPCE SA, with the remaining shares listed. It has three core business divisions: Corporate and Investment Banking (CIB), Asset and Wealth Management (including Insurance) and Specialized Financial Services (including factoring, leasing, consumer credit, sureties and financial guarantees and payments. Except for the payments business, most of Natixis' retail banking activities will be transferred via sale to BPCE SA, with the transaction expected to close in 1Q19.

The retail franchise strength, especially after restructuring Natixis, means that the Group benefits from a low-risk business model compared with peers, as shown in Figure 2.

Figure 2: Revenue structure of four large French banks (year-end 2017)



Source: Scope Ratings research, Company data

The regional co-operative roots of the BP and CE networks have predisposed the banks to maintaining a modest risk appetite compared to more internationally focused peers, as evidenced in Figure 3 below. Retail mortgages account for 45.7% of loans, and their secured nature has helped to restrict provisioning needs throughout the economic cycle.

Figure 3 Asset quality metrics for French G-SIBs (year-end 2017)

	Groupe BPCE	BNP Paribas	Société Générale	Credit Agricole Group
Gross NPLs/Total Loans	3.31%	5.89%	4.91%	3.08%
NPLs/Tangible Equity and Reserves	29.57%	36.04%	30.01%	23.45%
Coverage Ratio	51.39%	57.57%	59.93%	78.84%
Loan Loss Provisions/Average Loans	0.20%	0.39%	0.22%	0.16%

Source: Company Reports, SNL

Wholesale and investment banking businesses remain a materially less significant part of the Group's consolidated revenues, especially compared to BNP Paribas and Société Générale. In general, large banking groups with extensive wholesale and investment banking businesses have been down-scaling these activities, against the backdrop of more restrictive regulations and reduced market opportunities. For Groupe BPCE, this was more the result of a forced reduction of risk during the crisis and thus ahead of the curve compared to peers. In light of the Group's traditional retail-bank culture, we do not expect Natixis to materially increase its risk profile in the foreseeable future. We note that the Group has some ambitions in the international retail market, although it says that investment amounts will be limited, and it will focus on products and services for expatriates and cross-border commuters, as well as developing related trade finance business. Natixis has been shifting its capital allocation to lower risk activities, primarily insurance – where the Group has ambitions to be a full-fledged bancassurer – and asset management, in which Natixis would like to position itself as a global player.

The above characteristics underpin the low-risk business model of Groupe BPCE, a key driver for our high credit ratings.

Balancing revenue pressure against efficiency and the need to invest upfront in a digital banking model

In 2017, on a year-to-year basis, operating expenses grew 2.6% (+EUR 426mn) while revenues dropped 1.8% (EUR -438mn) bringing the gross operating income down by 11.5% (EUR -864mn). Operating expenses rose due to additional impacts from Group transformation and restructuring. The modest decrease in revenue was largely the result of exceptional FY16 revenue growth due to a EUR 831 mn capital gain from the disposal of the Group's stake in Visa Europe. Excluding this, revenues rose 1.7%).. FY17 ROAE was 4.8%, down from 6.9% in 2016.

The Group's has been targeting intra-group synergies in recent years, for example cross-selling of Natixis' products via the retail banking networks. As indicated above, it has recently been announced that many of Natixis' retail banking products will be sold to the retail banks within the Group, to create greater efficiencies. In the case of its insurance lines, the Group has created a single platform servicing both retail networks. Continuing these efforts should help support profitability but we are cautious about the weighty challenges that lie ahead, with the need to address excess capacity brought forward by technology advances and the consequent changes in customer behaviour.

Like peers, Groupe BPCE faces a balancing act in the face of revenue pressure in the low interest rate environment and sluggish domestic GDP growth, all against the backdrop of France's history of labour market rigidity (which may in time improve considering the enactment of some reforms during 2018 under President Macron), BPCE's Group's overall FY17 cost/income ratio of 72.1% was slightly weaker than the 69% reported in FY16 and 68.1% in FY15. Thus, the Group must continue paring back costs to try and at least maintain efficiency. At the same time Groupe BPCE recognises a need to invest in a banking model aimed at an ever more digitally aware customer base. The Group has been ramping up its digital retail offerings. For example, it acquired the German online fintech bank Fidor Bank AG in 2016. In addition to its permanent customer base Fidor Bank offers a proprietary 'white label' banking product, which allows corporate customers to offer digital banking services using their name and marketing platforms, serviced through Fidor's technological architecture and using its banking licence. Partnerships include O2 Banking, a mobile-only bank account offered by Telefónica.

Groupe BPCE has completed two strategic plans (2010-2013 and 2014-2017). In November 2017 the Group launched its 2018-2020 strategic plan: TEC 2020 (Transformation Digitale Engagement Croissance). The 2014-2017 plan had focused on boosting market share in loans, building up savings and deposits, establishing an integrated insurance platform, and growing Natixis' international profile, especially in the CIB. It also initiated the Group's digital transformation. A separate plan was launched in early 2017 to streamline the Group's retail banking operations and improve service quality – and this also included a digital action plan for the Group's clients.

The TEC 2020 plan continues the Group's focus on digital transformation. The Group targets 10% of products and services being purchased via digital channels on completion of the plan in 2020, with 90% of customers using the Group's digital portals. To achieve these objectives, digital transformation investments will be increased to EUR 600M per year. The Group intends to develop common interfaces across all its brands, invest heavily in data analytics to assist with risk management and customisation of solutions, and to improve efficiency by sharing management platforms across the Group.

Figure 4 compares the performance of the Group's domestic commercial banking and insurance activities (primarily the BP and CE retail banks) with that of other French retail banking networks. Groupe BPCE's retail banking profitability has improved in recent years, and the cost/income ratio had fallen to to 68.9% in 2017, compared to 71.0% in 2009 when the Group was created. However, revenue growth is a challenge – in 2017 French retail revenues dropped 0.5% year-on-year due to declining net interest income in a persistently low interest rate environment. Cost of risk was 20bps in 2017. We believe that in time there is room for the retail networks' profitability to improve to levels closer to that of the regional banks within the Credit Agricole Group. The target cost/income ratio under TEC 2020 is circa 64% for Retail Banking and Insurance, 68% for Asset and Wealth Management, and 60% for Corporate and Investment Banking. Cost cuts of EUR 1bn on a recurring basis are targeted.

Figure 4: Profitability of French retail divisions (year-end 2017)

	Groupe BPCE	BNP Paribas	Société Générale	La Banque Postale	CA-Reg Banks	CA-LCL
Total revenues (EURm)	16,673	6,352	8,131	5,320	13,277	3,447
Gross operating income (EURm)	5,183	1,695	2,023	1,068	4,746	1,005
Cost of risk (EURm)	1,106	331	567	192	218	204
Pre-tax profit (EURm)	4,096	1,366	1,495	1,138	4,529	807
Cost-income ratio (%)	68.90%	73.30%	75.12%	81.80%	64.57%	70.83%
Cost of risk vs. pre-provision operating profit (%)	27.00%	24.23%	38.94%	21.92%	4.81%	25.28%

Solid capital metrics including TLAC measures

As of YE17 Groupe BPCE had the highest CET1 ratio amongst large French banks, comfortably above the ECB's 2018 SREP requirement of 8.63% (phased in basis).

Figure 5: Capital metrics for four French G-SIBs (year-end 2017)

	Groupe BPCE	BNP Paribas	Société Générale	Credit Agricole Group
Common Equity Tier 1 Ratio (transitional)	15.30%	11.90%	11.60%	14.84%
Total Capital Ratio (transitional)	19.20%	14.80%	17.20%	18.63%

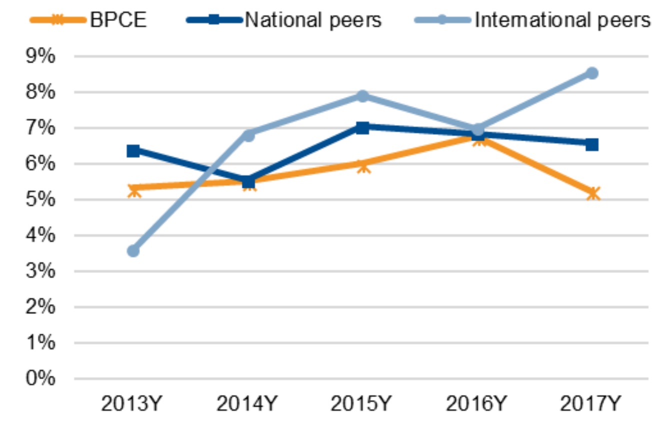
Source: Company Reports

Groupe BPCE needs to comply with the TLAC requirements laid down by the Financial Stability Board ('FSB'). The Group dropped out of the G-SIB list in November 2017, but was re-added in November 2018. The FSB specified that total TLAC-eligible instruments must equal a minimum 16.0% of risk-weighted assets (RWAs), with an initial target date of 1st January 2019. On top of this the Group must maintain a 2.5% capital conservation buffer, taking the total TLAC requirement to 18.5% of RWAs. In its TEC 2020 strategic plan the Group set itself a target TLAC ratio of above 21.5% from 2019. Excluding the CRR/CRD IV phase-in measures, Groupe BPCE's TLAC ratio reached 20.8% at 2017 year- end and 21.6% as of end-June 2018 – thus in excess of its target.

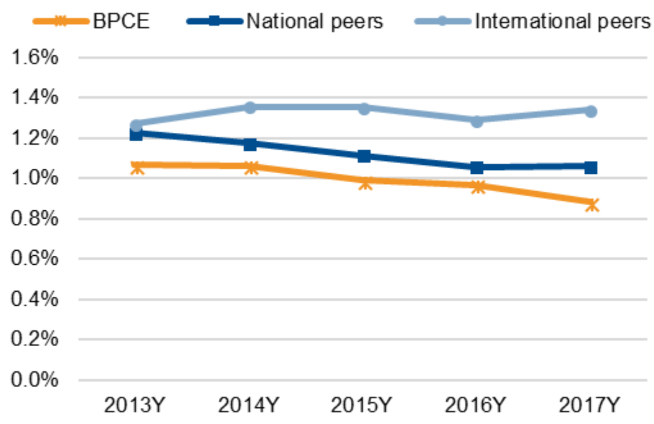
The Group intends to meet TLAC requirements without recourse to preferred senior debt. Scope views this as readily achievable given the solid capital position and moderate amounts the bank expects to issue in non-preferred senior debt, amounting to EUR 4bn to EUR5bn annually, compared to EUR 23bn in total funding raised for 2017.

I. Appendix: Peer comparison

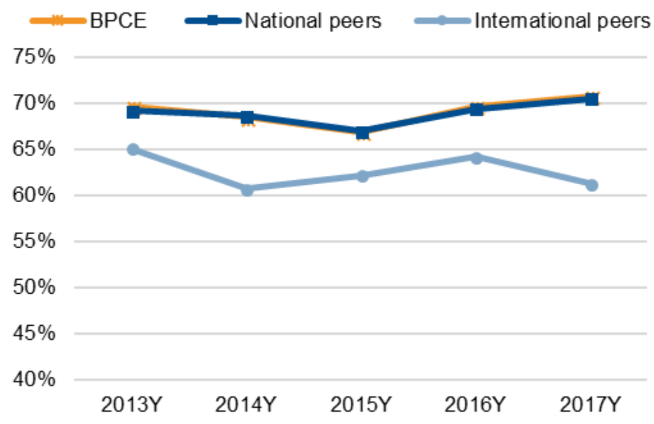
Return on Average Equity (%)



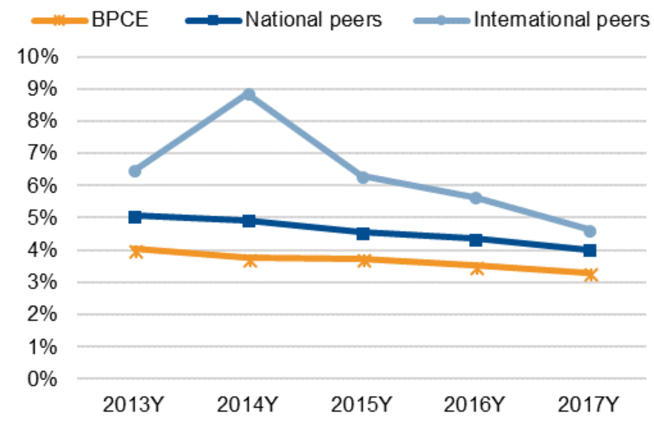
Net Interest Margin (%)



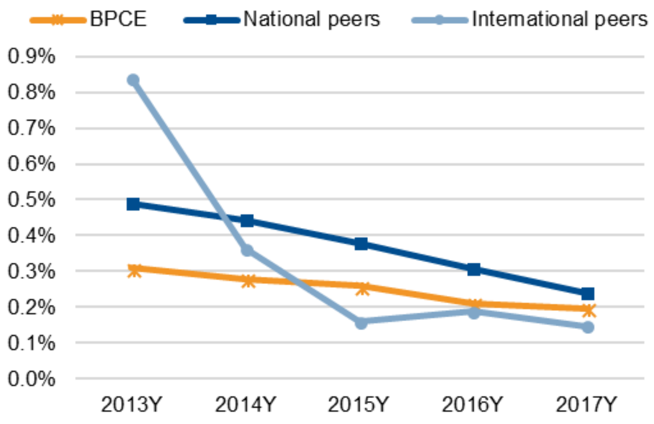
Cost/Income Ratio (%)



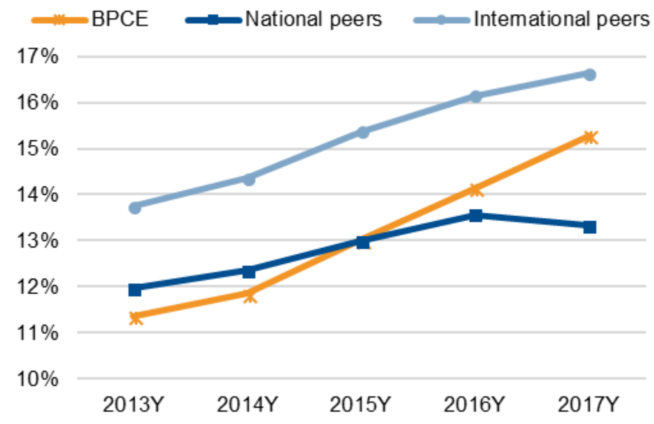
NPLs/Net Loans (%)



Loan Provision/Avg Loans at Amortised Cost (%)



CET1 ratio (%, transitional basis)



*National peers: BNP Paribas, Societe Generale, Credit Agricole Group, Groupe BPCE, Credit Mutuel Group, La Banque Postale.
**Cross-border peers:, Credit Mutuel Group, UBI, Banco Popolare,.
** Cross-border peers based on business model : Credit Agricole, BPCE, La Banque Postale, Credit Mutuel Group, Lloyds, RBS, ABN Amro, Rabobank, Intesa, Commerzbank, Danske Bank, Caixabank, Bankia, Handelsbanken, SEB, Swedbank, DNB, Bank of Ireland, AIB
Note: Credit Mutuel not included in 2016 peer groups..
Source: SNL, Scope Ratings

II. Appendix: Selected Financial Information - Groupe BPCE

	2014Y	2015Y	2016Y	2017Y	2018H1
Balance sheet summary (EUR m)					
Assets					
Cash and interbank assets	183,125	167,480	181,022	186,951	186,787
Total securities	342,593	294,453	294,647	287,589	213,346
of which, derivatives	92,737	76,968	75,614	62,773	62,089
Net loans to customers	621,518	627,238	677,380	703,236	727,124
Other assets	76,062	77,364	82,191	82,074	159,750
Total assets	**1,223,298**	**1,166,535**	**1,235,240**	**1,259,850**	**1,287,007**
Liabilities					
Interbank liabilities	85,752	77,067	87,211	92,238	90,894
Senior debt	342,274	286,588	289,259	274,617	343,158
Derivatives	88,700	74,624	71,149	62,762	62,794
Deposits from customers	473,845	499,741	531,781	569,890	523,605
Subordinated debt	15,700	18,234	20,216	17,513	17,232
Other liabilities	154,349	145,088	166,488	171,629	178,477
Total liabilities	**1,160,620**	**1,101,342**	**1,166,104**	**1,188,649**	**1,216,160**
Ordinary equity	52,004	56,237	60,232	63,346	63,427
Equity hybrids	3,286	1,395	1,230	683	683
Minority interests	7,388	7,561	7,674	7,172	6,737
Total liabilities and equity	**1,223,298**	**1,166,535**	**1,235,240**	**1,259,850**	**1,287,007**
Core tier 1/Common equity tier 1 capital	46,587	50,957	55,303	59,042	60,472
Income statement summary (EUR m)					
Net interest income	11,542	11,059	10,904	10,232	4,412
Net fee & commission income	8,121	9,159	8,781	9,451	4,626
Net trading income	2,170	2,999	2,805	3,784	1,428
Other income	1,834	1,084	1,446	703	1,917
Operating income	**23,667**	**24,301**	**23,936**	**24,170**	**12,383**
Operating expense	16,200	16,248	16,673	17,099	8,841
Pre-provision income	**7,467**	**8,053**	**7,263**	**7,071**	**3,542**
Credit and other financial impairments	2,006	1,911	1,543	1,445	576
Other impairments	52	19	154	85	NA
Non-recurring items	-130	0	804	-25	0
Pre-tax profit	**5,279**	**6,123**	**6,370**	**5,516**	**2,966**
Discontinued operations	0	0	0	0	0
Other after-tax Items	0	0	0	0	0
Income tax expense	1,913	2,323	1,882	1,811	927
Net profit attributable to minority interests	459	558	500	681	396
Net profit attributable to parent	**2,907**	**3,242**	**3,988**	**3,024**	**1,643**

Source: SNL, Scope Ratings

III. Appendix: Ratios – Groupe BPCE

	2014Y	2015Y	2016Y	2017Y	2018H1
Funding and liquidity					
Net loans/deposits (%)	129.0%	123.6%	125.4%	121.6%	122.8%
Liquidity coverage ratio (%)	NA	NA	120.0%	126.4%	110.0%
Net stable funding ratio (%)	NA	NA	NA	NA	NA
Asset mix, quality and growth					
Net loans/assets (%)	50.8%	53.8%	54.8%	55.8%	56.5%
NPLs/net loans (%)	3.8%	3.7%	3.5%	3.3%	3.5%
Loan-loss reserves/NPLs (%)	53.6%	53.3%	52.4%	51.4%	56.9%
Net loan growth (%)	7.3%	0.9%	8.0%	3.8%	6.8%
NPLs/tangible equity and reserves (%)	32.6%	32.1%	30.8%	29.6%	29.1%
Asset growth (%)	8.8%	-4.6%	5.9%	2.0%	4.3%
Earnings and profitability					
Net interest margin (%)	1.1%	1.0%	1.0%	0.9%	0.8%
Net interest income/average RWAs (%)	NA	2.8%	2.8%	2.6%	2.3%
Net interest income/operating income (%)	48.8%	45.5%	45.6%	42.3%	35.6%
Net fees & commissions/operating income (%)	34.3%	37.7%	36.7%	39.1%	37.4%
Cost/income ratio (%)	68.5%	66.9%	69.7%	70.7%	71.4%
Operating expenses/average RWAs (%)	NA	4.1%	4.3%	4.4%	4.5%
Pre-impairment operating profit/average RWAs (%)	NA	2.0%	1.9%	1.8%	1.8%
Impairment on financial assets /pre-impairment income (%)	26.9%	23.7%	21.2%	20.4%	16.3%
Loan-loss provision charges/net loans (%)	0.3%	0.3%	0.2%	0.2%	0.2%
Pre-tax profit/average RWAs (%)	NA	1.6%	1.6%	1.4%	1.5%
Return on average assets (%)	0.3%	0.3%	0.4%	0.3%	0.3%
Return on average RWAs (%)	NA	1.0%	1.2%	0.9%	1.0%
Return on average equity (%)	5.5%	6.0%	6.8%	5.2%	5.8%
Capital and risk protection					
Common equity tier 1 ratio (%, fully loaded)	11.7%	12.9%	14.2%	15.4%	15.2%
Common equity tier 1 ratio (%, transitional)	11.9%	13.0%	14.1%	15.3%	15.3%
Tier 1 capital ratio (%, transitional)	12.7%	13.3%	14.5%	15.4%	15.4%
Total capital ratio (%, transitional)	15.4%	16.8%	18.5%	19.2%	19.1%
Leverage ratio (%)	4.5%	4.5%	4.9%	5.1%	5.0%
Asset risk intensity (RWAs/total assets, %)	32.1%	33.6%	31.7%	30.7%	30.7%
Market indicators					
Price/book (x)	NA	NA	NA	NA	NA
Price/tangible book (x)	NA	NA	NA	NA	NA
Dividend payout ratio (%)	NA	NA	NA	NA	NA

Source: SNL, Scope Ratings

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

1 Cour du Havre
F-75008 Paris

Phone +33 1 8288 5557

London

Suite 301
2 Angel Square
London EC1V 1NY

Phone +44 20 3457 0444

Madrid

Paseo de la Castellana 95
Edificio Torre Europa
E-28046 Madrid

Phone +34 914 186 973

Milan

Via Paleocapa 7
IT-20121 Milan

Phone +39 02 30315 814

Oslo

Haakon VII's gate 6
N-0161 Oslo

Phone +47 21 62 31 42

info@scoperatings.com
www.scoperatings.com

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