FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Groupe BPCE at 'A+'; Negative Outlook

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Fitch Ratings - Paris - 24 Sep 2020: Fitch Ratings has affirmed Groupe BPCE's (GBPCE) Long-Term Issuer Default Rating (IDR) at 'A+' and Viability Rating (VR) at 'a+' and removed them from Rating Watch Negative (RWN). A Negative Outlook was assigned to the Long-Term IDR.

Fitch has also affirmed 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 S.A.

A full list of rating actions is displayed below.

The affirmation and removal from RWN reflect Fitch's updated assessment that GBPCE's ratings have sufficient headroom, due mainly to the group's solid capitalisation profile, to absorb pressure on asset quality and profitability under our baseline expectations for the economies where it operates.

The Negative Outlook on the Long-Term IDR reflects downside risks from a potentially greater-than-expected or more permanent deterioration in asset quality, or delays to the recovery of profitability towards an operating profit/risk-weighted asset (RWA) of about 1.5%. A slowdown of the currently observed economic recovery due to further containment measures taken as a result of a resurgence of the virus would exacerbate these downside risks.

KEY RATING DRIVERS

IDRS AND VR

The ratings of GBPCE reflect its strong franchise and diversified model, strong solvency and capital metrics and a focus on generally low-risk businesses. Asset quality and profitability are rating weaknesses relative to other 'A+' rated peers' and we expect increased pressure on both in the near term as a result of the economic fallout from the coronavirus pandemic.

GBPCE mainly operates in France, where it ranks as the second-largest domestic player in retail and commercial banking. GBPCE has a universal bancassurance business model. It operates the two large distribution networks of the BPs and the CEPs in France. Its partially listed subsidiary Natixis is a niche player in corporate and investment banking (CIB), but is a significant global player in asset management, through its 24 affiliates.

GBPCE's common equity Tier 1 (CET1) ratio is a key rating strength. At end-June 2020, the ratio was 15.6% adjusted for the temporary increase in RWAs generated by the two-month waiting period for the guarantee activation of state-guaranteed loans (a 25bp positive impact). GBPCE has established a long record of maintaining its capital metrics well above regulatory requirements and we expect the CET1 ratio to remain in line with the group's target of at least 15.5% at end-2020.

GBPCE had more than 600bp of excess capital above its CET1 Supervisory Requirement and Evaluation Process requirement at end-June 2020, one of the largest buffers among large European banks. The group's capitalisation is supported by a contained dividend pay-out ratio and regular issuance of cooperative member shares. Its regulatory leverage ratio was satisfactory at 4.9% at end-June 2020.

GBPCE's impaired loan ratio is currently broadly in line with other French cooperative banks'. It was resilient through the cycle as it peaked at a moderate 4.1% at end-2013 before gradually declining to about 3% at end-2019. The stock of Stage 3 loans increased by EUR1.8 billion in 1H20 (or 9% compared with end-2019), mainly coming from specific segments of Natixis' loan portfolio.

We expect GBPCE's asset quality to deteriorate in the next 18 months, but not materially higher than a stage 3 loans ratio of 4% by end-2021. GBPCE has significant exposure to industries that have been specifically impacted by the lockdown measures and resulting economic recession. The group has exposure to sectors such as aviation, tourism/hotels/catering (EUR13.4 billion of gross exposure) and wholesale and non-food retail trade (EUR16.1 billion) or automobile distribution (EUR9.9 billion).

Companies in the oil and gas sector are also suffering from lower commodity prices and Natixis's net exposure at default amounted to EUR10 billion at end-June 2020.

We expect that lending to professionals and to SMEs (about 20% of consolidated loans to customers) will be more vulnerable than other parts of GBPCE's loan book in the downturn and show signs of manageable deterioration by 2021, when government support measures gradually start to be phased out. Residential home loans and exposure to local authorities (about 55% of customer loans) have traditionally performed well through the cycle, and we do not expect a material weakening, despite a likely increase in the unemployment rate in France. Most borrowers in stable employment to which banks traditionally lend have seen their remuneration broadly maintained during lockdown, which is supportive for asset quality.

GBPCE's structural profitability has been broadly stable but moderate (10-year average operating profit/RWA of about 1.4%), partly reflecting a low risk appetite and limited market pressure on profitability given the group's cooperative structure, but also lower cost efficiency than peers'. The development of insurance and asset management supports a significant share of revenue coming from non-interest income, which make GBPCE less vulnerable to the prolonged period of low interest rates than some other European cooperative banking groups.

GPBCE's operating profitability will materially decline in 2020 compared with previous years after a weak 1H20. However, we expect a gradual recovery in 2H20, which could result in an operating profit/RWA ratio of around 0.5% for 2020. GBPCE's net income in 1H20 was impacted by higher loan impairment charges (LICs, about 42bp in 1H20, broadly in line with the group's guidance for 2020). Profitability was also affected by the poor performance of Natixis' equity derivatives business, which mainly suffered from the cancellation of already announced 2019 dividends from companies.

Consequently, we expect that GBPCE's profitability will be weaker than previously anticipated, at least until end-2021. We expect the bank will only return to an operating profit/RWA closer to 1.5% during 2022 on renewed revenue growth, realised cost savings and the normalising LICs. To reach profitability levels more in line with that of similarly rated peers, further significant cost savings while continuing to grow its revenue organically are key.

GBPCE benefits from the strong deposit franchise of its regional banks in France, but only about half of total funding consists of deposits as its two largest subsidiaries (Natixis and CFF) are mostly wholesale-funded. GBPCE's market funding is diversified by instrument, currency and investor base. GBPCE maintains a comfortable liquidity buffer (EUR319 billion at end-June 2020), which covers wholesale and interbank funding maturing over the next 12 months. High-quality liquid assets amounted to about 17% of total assets.

GBPCE's 'F1' Short-Term IDR is the lower of two options mapping to an 'A+' Long-Term IDR due to Fitch's funding and liquidity assessment of 'a' for the group.

SENIOR DEBT

Fitch rates the senior preferred debt of GBPCE group entities in line with their IDRs (A+/Negative/F1). This is because GBPCE is expected to use senior preferred debt to meet its minimum requirement for own funds and eligible liabilities (MREL) over the medium term, and buffers of subordinated and senior non-preferred debt are unlikely to exceed 10% of RWAs on a sustained basis. GBPCE's management has not committed to comply with its total MREL requirement without using senior preferred debt.

Consequently, senior non-preferred notes issued by BPCE S.A. are rated 'A' or one notch below the central body's Long-Term IDR to reflect the risk of below-average recoveries on these instruments.

SUBORDINATED DEBT

Fitch rates GBPCE's and Natixis' subordinated Tier 2 debt two notches below GBPCE's VR, which is the baseline notching for these instruments. This is because of loss severity, as we expect recoveries to be poor for this type of debt in case of default/non-performance of the bank. GBPCE does not meet the conditions outlined in our Bank Rating Criteria to rate its Tier 2 debt only one notch below the VR.

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 entities affiliated 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.

The ratings of the negotiable European commercial paper (NEU CP) programmes of BPCE Factor S.A., BPCE Lease S.A., BPCE Lease Immo S.A., BPCE Bail S.A. and Cicobail S.A., guaranteed by BPCE S.A., are aligned with its 'F1' Short-Term IDR. This reflects Fitch's view that BPCE 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 GBPCE's leasing and factoring activities.

DERIVATIVE COUNTERPARTY RATINGS

Fitch has affirmed the Derivative Counterparty Ratings (DCRs) of BPCE S.A. and Natixis at 'A+(dcr)'. They are notable derivative counterparties within GBPCE. The DCRs are at the same level as BPCE S.A.'s and Natixis's senior preferred debt ratings. Derivative counterparties in France have no preferential status over other preferred senior obligations in a resolution.

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. 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 or ahead of, the bank receiving sovereign support, despite GBPCE's systemic importance.

RATING SENSITIVITIES

IDRS AND VR

Factors that could, individually or collectively, lead to negative rating action/downgrade:

The ratings are primarily sensitive to the extent and the duration of the weakening of the bank's financial profile as a result of the pandemic shock to the economy. We would likely downgrade GBPCE's Long-Term IDR and VR if its asset quality deteriorates faster than expected, meaning that the impaired loans ratio would remain above 4% for an extended period, or in the case of setbacks to our expectation of an improved operating profit/RWA to levels close to 1.5% by 2022. In such an event, we would also consider whether its CET1 ratio remains commensurate with its credit risk profile.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

The Outlook on the Long-Term IDR could be revised to Stable in the event of a lower-than-expected impact on GBPCE's asset quality and earnings, followed by a quicker recovery to profitability towards the group's longer-term average levels, and if the impaired loans ratio resumes its firm downward trajectory.

In the event GBPCE withstands rating pressure arising from the economic fallout, an upgrade of the VR and the Long-Term IDR would be unlikely as it would require a significant and sustainable improvement in franchise, operating profitability and asset quality while maintaining a low risk appetite and solid capitalisation metrics compared with other 'A+' rated peers.

SENIOR DEBT

Senior preferred and senior non-preferred debt issued by BPCE S.A. and other group entities could be upgraded by one notch, if we expect GBPCE to comply with its total MREL requirement without using senior preferred debt or if the group explicitly targets a capital and funding structure where the buffer of senior non-preferred and subordinated instruments would sustainably exceed 10% of RWAs.

SUBORDINATED DEBT

The ratings of the subordinated debt issued by BPCE S.A. and Natixis are primarily sensitive to a change in GBPCE's VR.

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 we do not expect.

The programme ratings of BPCE Factor S.A., BPCE Lease S.A., BPCE Lease Immo S.A., BPCE Bail S.A. and Cicobail S.A., guaranteed by BPCE S.A., are primarily sensitive to a change in BPCE S.A.'s Short-Term IDR.

DCRs

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

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.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579]

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or to the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Caisse d'Epargne et de Prevoyance Grand Est Europe	LT IDR	A+ Rating Outlook Negative	Affirmed	A+ Rating Watch Negative

ENTITY/DEBT	RATING			PRIOR
	ST IDR	F1	Affirmed	F1
Caisse d'Epargne et de Prevoyance Loire Drome Ardeche	LT IDR	A+ Rating Outlook Negative	Affirmed	A+ Rating Watch Negative

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Rafael Quina
Director
Primary Rating Analyst
+33 1 44 29 91 81
Fitch Ratings Ireland Limited
60 rue de Monceau Paris 75008

Julien Grandjean
Associate Director
Secondary Rating Analyst
+33 1 44 29 91 41

Claudia Nelson
Senior Director
Committee Chairperson
+44 20 3530 1191

MEDIA CONTACTS

Louisa Williams
London
+44 20 3530 2452
louisa.williams@thefitchgroup.com

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

Bank Rating Criteria (pub. 28 Feb 2020) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Banque Palatine S.A.	EU Issued
Banque Populaire Alsace-Lorraine- Champagne	EU Issued
Banque Populaire Aquitaine Centre Atlantique (BPACA)	EU Issued
Banque Populaire Auvergne Rhone Alpes	EU Issued
Banque Populaire Bourgogne, Franche-Comte	EU Issued
Banque Populaire du Nord	EU Issued
Banque Populaire du Sud	EU Issued
Banque Populaire Grand Ouest	EU Issued
Banque Populaire Mediterranee	EU Issued
Banque Populaire Occitane	EU Issued
Banque Populaire Rives de Paris	EU Issued
Banque Populaire Val de France	EU Issued
BPCE Bail S.A.	EU Issued
BPCE Factor S.A.	EU Issued
BPCE Lease Immo S.A.	EU Issued
BPCE Lease S.A.	EU Issued
BPCE S.A.	EU Issued
BRED Banque Populaire	EU Issued
Caisse d'Epargne CEPAC	EU Issued
Caisse d'Epargne et de Prevoyance Aquitaine Poitou Charentes	EU Issued
Caisse d'Epargne et de Prevoyance Bretagne-Pays de Loire	EU Issued
Caisse d'Epargne et de Prevoyance Cote d'Azur	EU Issued

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