FitchRatings

RATING ACTION COMMENTARY

Fitch Revises Societe Generale's Outlook to Positive; Affirms at 'A-'

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Fitch Ratings - Paris - 03 Jul 2023: Fitch Ratings has revised the Outlook on Societe Generale S.A.'s (SG) Long-Term Issuer Default Rating (IDR) to Positive from Stable and affirmed the IDR at 'A-' and Viability Rating (VR) at 'a-'. A full list of rating actions is below.

The Positive Outlook reflects SG's steady progress in its earnings level and stability, as seen over the last three years, and our expectation that the bank will continue to target improved earnings consistency in the medium term. The rating action also incorporates Fitch's expectation that SG will continue to execute its key strategic initiatives in French retail banking, car leasing and corporate and investment banking (CIB). We believe these will help to structurally improve the bank's earnings generation and narrow the gap with higher-rated French and global trading and universal banks (GTUB) peers.

Fitch has withdrawn Franfinance S.A.'s EUR 1 billion NEU CP programme 'F1' short-term rating as the programme has been closed, Franfinance is no longer issuing debt under the programme and there is no Fitch-rated debt outstanding under it.

KEY RATING DRIVERS

Capital, Earnings Drive Ratings: SG's ratings mainly reflect the group's adequate capitalisation and an improving execution record, which we expect to lead to more predictive and structurally higher earnings. SG's diversified business profile and moderate risk profile are relative rating strengths. Asset quality is sound following gradual improvements and SG's focus on maintaining its impaired loans ratio at adequate levels, although higher than similarly rated French and international peers.

Diversified Business Profile: SG has a diverse business profile, with strong franchises in key activities. The bank's earnings are more reliant on CIB and capital-markets businesses than most large French banks, which partly explains its more volatile performance record in the last decade, although the group is focused on improving its earnings stability.

SG is the fourth-largest retail and commercial bank in France. Its profitable retail-banking activities in the Czech Republic and Romania and its growing leasing and consumer-finance activities provide good earnings diversification. SG's execution has improved since the 2020 trough with marked progress in repositioning its CIB where it has selective leading positions, merging its two French retail banking networks and recently acquiring LeasePlan Corporation N.V.

Adequate, Improving Earnings Consistency: SG has historically been less profitable than higher-rated peers, but the execution of the merger of its French retail banking networks, the integration of LeasePlan and the CIB repositioning will improve earnings diversification and stability and cost efficiency. Fitch forecasts that SG will maintain an operating profit/risk-weighted assets (RWAs) ratio between 1.5% and 2.0% in 2023 despite temporary pressure on its domestic net interest margin and a lower level than in 2022.

We project a material rebound in SG's operating performance in 2024 as French retail banking will benefit from wider margins and cost savings while the LeasePlan acquisition will support a strong earnings contribution from car leasing.

Prudent Risk Appetite: SG has a moderate risk profile. Its risk management and controls are centralised and robust. The group applies conservative underwriting standards for home loans and consumer loans and is in line with market practice on loans to companies in France. SG tightened its risk appetite in CIB and in international retail banking. The group continues to have material exposure to traded market risks, albeit lower than most other GTUBs. SG has a sophisticated framework to manage interest rate risks and has maintained conservative interest rate sensitivities.

Moderate Asset Quality Risks: SG has a higher impaired loans ratio than higher-rated French and European peers, although it has materially improved due to more active management of its impaired loan stock and tighter underwriting standards. Fitch forecasts SG's impaired loans ratio to remain contained at between 3.0% to 3.5% in 2023 and 2024, despite moderate risks from its exposure to small and mid-sized French companies, African countries and vulnerable corporate sectors in CIB.

Fitch projects that loan impairment charges (LICs) will remain contained at close to 30bp of gross loans in 2023 and rise moderately in 2024, although they will be lower than the group's last 10-year average of around 45bp, as estimated by Fitch.

Adequate Capital Buffers: SG's capitalisation is commensurate with risks and adequate in relation to its planned growth, shareholder distributions and increased regulatory requirements. Fitch expects SG's end-March 2023 fully loaded common equity Tier 1 (CET1) ratio of 13.4% will decline in 2023-2024 but remain materially above its 12% target. This is despite the negative impact on capital from acquisitions (around 50bp), RWA inflation and shareholder distributions. We expect SG's risk-weight and leverage-based capital ratios to remain towards the low end of large European banks.

Stable Funding and Liquidity: SG has a diversified funding base and well-established market access. Customer deposits represent less than half of the bank's funding, a lower proportion than peers, and its large capital markets unit structurally leads to material short-term funding needs. However, the bank has sound liquidity, with cash and high-quality liquid assets representing about 19% of its balance sheet (excluding insurance assets) and almost 30% of its funded balance sheet at end-March 2023. This largely covers short-term financing needs, including maturing long-term debt.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

We would revise the Outlook on SG's Long-Term IDR to Stable if LICs increase more than expected while the revenue backdrop turns weaker than we forecast, in particular for French retail banking. The materialisation of execution risk on its ongoing strategic initiatives, although not our baseline scenario, could also pressure SG's ratings.

Fitch views a downgrade of SG's ratings as unlikely, as reflected in the Positive Outlook and given SG's comfortable rating headroom. However, the ratings would most likely be downgraded if the CET1 ratio drops below 11% for an extended period with no credible plan to restore it above this level, combined with sustained deterioration in the operating profit/RWAs to below 1%. We believe this could result from sharp asset quality deterioration, or from an erosion of SG's competitive position in some key franchises, which we currently do not expect.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

An upgrade of SG would most likely result from a longer record of improved earnings levels and consistency evidenced by an operating profit/ RWAs ratio sustainably above 1.6%, especially if this reflects successful execution of the restructuring in French retail banking and CIB and a longer record of robust through-the-cycle performance in its capital markets unit. We would also expect the bank to maintain a moderate risk profile and an impaired loans ratio close to or below 3%, while keeping a fully-loaded CET1 ratio consistently above 12%.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

SG's DCR, long-term senior preferred debt and deposit ratings are one notch above the Long-Term IDR because of the protection that accrues to these liabilities from the bank's buffers of subordinated and senior non-preferred debt, which we expect to exceed 10% of RWAs on a sustained basis (end-March 2023: estimated at above 16%). For the same reasons, SG's senior non-preferred debt is rated in line with the Long-Term IDR.

We also expect SG to meet its total minimum requirement for own funds and eligible liabilities (MREL) without recourse to senior preferred debt, although the introduction of full depositor preference in the EU could lead to potentially lower buffers of senior non-preferred debt over the longer term. SG's end-March 2023 MREL ratio was about 30% of RWAs, excluding senior preferred debt, which is materially above SG's 2023 total requirement of 25.4%.

Fitch rates SG's subordinated Tier 2 debt at 'BBB', two notches below the bank's VR, for loss severity, as Fitch expects recoveries to be poor for this type of debt in case of default/non-performance of the bank.

Additional Tier 1 (AT1) debt with fully discretionary coupons is rated four notches below the bank's VR, comprising two notches each for loss-severity and for non-performance risk. Our assessment is based on SG operating with comfortable CET1 capital buffers (of about 410bp at end-March 2023) above coupon-omission points and on the presence of material distributable items.

GOVERNMENT SUPPORT RATING

SG's Government Support Rating (GSR) of 'no support' ('ns') reflects Fitch's view that although possible, sovereign support cannot be relied on. In our 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.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

A downgrade of our funding and liquidity assessment for SG (currently 'a') could result in the Short-Term IDR being downgraded to 'F2', all else remaining equal.

SG's DCR, senior debt and deposit ratings are primarily sensitive to changes in SG's IDRs. We would downgrade the DCR, long-term senior preferred and senior non-preferred debt and deposit ratings by one notch if the size of the combined buffer of subordinated and senior non-preferred debt sustainably falls below 10% of RWAs, provided that we also expect the group to rely on senior preferred debt to comply with its total MREL over the medium term.

Subordinated debt and deeply subordinated debt are primarily sensitive to a change in SG's VR. In addition, the ratings on deeply subordinated AT1 instruments could be downgraded if non-performance risk increases relative to the risk captured in the bank's VR, for example if capital buffers over regulatory requirements become thin.

An upgrade of the GSR would be contingent on a positive change in the sovereign's propensity to support the bank. In Fitch's view, this is highly unlikely, although not impossible.

SUBSIDIARIES & AFFILIATES: KEY RATING DRIVERS

The Shareholder Support Ratings (SSRs) and IDRs of SG's subsidiaries, Compagnie Generale de Location d'Equipements S.A. (CGLE) and Franfinance, are based on support from SG.

CGLE's and Franfinance's IDRs are also equalised with those of SG and their Outlooks have therefore been revised to Positive from Stable, mirroring the action on SG. This is because we view both entities as having a key role within the group as providers of car financing (CGLE), and consumer finance and equipment leases (Franfinance) in France. The two subsidiaries are well-integrated within their parent and SG provides almost all of their funding.

We rate Franfinance's senior preferred debt in line with SG's. SG follows a single-point-of-entry resolution strategy and Franfinance is within its parent's resolution group. We consequently rate the long-term senior preferred debt of Franfinance one notch above the Long-Term IDR, in line with SG's, as we expect it to benefit from the protection provided by SG's buffer of subordinated and senior non-preferred debt in case of failure or resolution.

SUBSIDIARIES AND AFFILIATES: RATING SENSITIVITIES

CGLE's and Franfinance's ratings are sensitive to changes in SG's IDRs and changes in the subsidiaries' importance to the group or integration with SG.

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.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

The ratings of CGLE and Franfinance are driven by Fitch's assessment of shareholder support from SG.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance 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 the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visitwww.fitchratings.com/esg

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Societe Generale S.A.	LT IDR	A- Rating Outlook Positive	Affirmed	A- Rating Outlook Stable
	ST IDR	F1	Affirmed	F1

	Viability a- Affirmed	a-
	DCR A(dcr) Affirmed	A(dcr)
	Government Support ns Affirmed	ns
Senior preferred	LT A Affirmed	A
junior subordinated	LT BB+ Affirmed	BB+
Senior non-preferred	LT A- Affirmed	A-
subordinated	LT BBB Affirmed	BBB
long-term deposits	LT A Affirmed	A

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Rafael Quina
Senior Director
Primary Rating Analyst
+33 1 44 29 91 81
rafael.quina@fitchratings.com
Fitch Ratings Ireland Ltd
28 avenue Victor Hugo Paris 75116

Patrick Rioual
Senior Director
Secondary Rating Analyst
+33 1 44 29 91 21
patrick.rioual@fitchratings.com

Alan Adkins
Managing Director

Committee Chairperson
+44 20 3530 1702
alan.adkins@fitchratings.com

MEDIA CONTACTS

Peter Fitzpatrick
London
+44 20 3530 1103
peter.fitzpatrick@thefitchgroup.com

Additional information is available on www.fitchratings.com

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APPLICABLE CRITERIA

Bank Rating Criteria (pub. 07 Sep 2022) (including rating assumption sensitivity)

Non-Bank Financial Institutions Rating Criteria (pub. 05 May 2023) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Compagnie Generale de Location d'Equipements S.A.	EU Issued, UK Endorsed
Franfinance S.A.	EU Issued, UK Endorsed

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