FitchRatings

Fitch Affirms Societe Generale at 'A'; Outlook Stable

Link to Fitch Ratings' Report(s): Societe Generale - Rating Action Report (https://www.fitchratings.com/site/re/10035438)

Fitch Ratings-Paris/London-21 June 2018: Fitch Ratings has affirmed Societe Generale's (SG) Long-Term Issuer Default Rating (IDR) at 'A', Short-Term IDR at 'F1' and Viability Rating (VR) at 'a'. The Outlook on SG's Long-Term IDR is Stable. Fitch has also affirmed the ratings of SG's subsidiary Compagnie Generale de Location d'Equipements (CGLE).

A full list of rating actions is available in the related Rating Action Report via the link above.

The rating actions have been taken in conjunction with Fitch's periodic review of the Global Trading and Universal Banks (GTUBs), a group of large and globally active banking groups.

KEY RATING DRIVERS

IDRS, VR AND SENIOR NON-PREFERRED DEBT

SG's IDRs, VR and senior non-preferred debt ratings reflect the bank's diversified and mostly retail-focused company profile with select strengths in euro-denominated capital markets. The ratings also factor in the bank's resilient profitability, a still fairly high stock of impaired loans and adequate capital ratios.

The business model of SG benefits from geographical, client and product diversification, drawing on the breadth of its retail and corporate banking network across France, central and Eastern Europe, Russia and Africa, as well as significant insurance, consumer finance and capital market activities. Volatile market activities accounted for a manageable 20% of group revenue in 2017, which is towards the lower end of GTUB peers' but higher than domestic peers'.

We believe SG's bancassurance model should facilitate cross-selling efforts and support the bank in achieving its revenue growth targets. Exposures to higher-risk countries have to date been well-managed and benefit from the group's focus on lower-risk client segments, for instance on large corporates in Russia.

SG's stock of impaired loans remains a rating weakness, but we expect the bank to continue reducing them to more manageable levels. At end-2017, the gross impaired loan ratio of 5% was higher than GTUB's and most domestic peers', despite a 13% yoy decline in the stock of impaired loans. The bank typically aims to fully resolve problem loans instead of writing them off at an early stage, in line with French peers. Despite the group's sound record in impaired loan recoveries, slow write-offs can result in loan impairment charges accruing through time.

SG's capital ratios are at the lower end of GTUB's and domestic peers', based on risk-weighted assets (RWAs) and leverage exposure. The group's fully-loaded Basel III common equity Tier 1 (CET1) ratio was 11.2% at end-1Q18, with a Tier 1 leverage ratio of 4.1%. We believe that high litigation and restructuring costs in 2017, while not compromising SG's targets of an 11.5% CET1 ratio by end-2018 and 12% by end-2020, have slowed progress and reduced capital flexibility, partly as a result of SG's choice to maintain its 50% dividend pay-out policy that year. An unchanged earnings generation capacity should help SG reach its capital targets.

We believe the outstanding legal case relating to alleged violations of US embargoes could result in a material fine, which introduces uncertainty to the group's capitalisation. This is partly mitigated by significant remaining legal provisions of about EUR1.2 billion euro equivalent as of June 2018 and the group's earnings. Positively, the agreements reached in June 2018 with US and French authorities to resolve investigations into interbank offered rates and transactions with Libyan counterparties remove a source of uncertainty, as existing provisions fully covered the fines.

We expect loan growth in international retail banking and insurance activities will continue to drive earnings growth, as revenue pressure in French retail banking should subside for the rest of the year. SG's operating profitability in 2017 was healthy, with operating profits on RWAs of close to 1.5%.

SG's funding profile is well-diversified by source and relies on a combination of client deposits and wholesale funding. Access to markets is well-established and diversified by investor and type of instrument. SG's liquidity buffer is covering short-term funding needs and is of good quality.

DERIVATIVE COUNTERPARTY RATING, DEPOSIT RATINGS AND SENIOR PREFERRED DEBT
SG's Derivative Counterparty Rating (DCR) and long-term senior preferred debt and

deposit ratings are one notch above the bank's Long-Term IDR because derivatives, deposits and senior preferred notes have preferential status over the bank's large buffer of qualifying junior debt (QJD) and senior non-preferred debt. Short-term deposits, rated at 'F1', are at the lower of the two short-term ratings that map to the long-term deposit rating as there is no clear liquidity enhancement at instrument level.

Rated senior debt issued by Societe Generale Acceptance N.V. and SG Option Europe, which benefits from a guarantee from SG, is rated in line with SG's senior preferred debt because Fitch expects the guaranteed notes to benefit from the protection provided by the buffer of QJD and senior non-preferred debt. This reflects Fitch's view that SG is highly likely to honour its commitment as guarantor if required, as the guarantees are unconditional, irrevocable and timely.

Fitch estimates that SG's buffer of QJD and senior non-preferred debt at end-March 2018 was equal to about 9% of risk-weighted assets (RWA), which we expect to be sufficient to recapitalise the bank after a resolution without causing losses to senior preferred creditors. We assume the regulator would intervene when the bank's CET1 capital is close to its CET1 Pillar 1 and Pillar 2 capital requirements, which together stand at 6%. We assume the regulator would then likely require the bank to be recapitalised to around 14%-15% to satisfy Pillar 1, and Pillar 2 requirement, additional Tier 1, Tier 2, capital conservation and G-SIB buffers, in addition to a buffer over these requirements.

We expect the bank to continue issuing senior non-preferred debt, which should result in a further increase of the buffer. We view this buffer as sustainable since SG will have to meet total loss absorbing capacity (TLAC) requirements as a global systematically important bank.

SUBSIDIARY
The Long- and Short-Term IDRs and Support Rating of SG's French specialist car financing subsidiary, CGLE, are based on institutional support from SG. CGLE's Long-and Short-Term IDRs are equalised with those of SG and the subsidiary's Outlook is the same as the parent's. This is because we believe this entity has a key and integral role within the group and is integrated with its parent. We do not assign a VR to CGLE as it is difficult to analyse the entity meaningfully in its own right.

SUBORDINATED DEBT AND JUNIOR SUBORDINATED DEBT
Subordinated debt and deeply subordinated debt issued by SG are all notched down from its 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 the VR for loss severity, reflecting below-average recoveries for this type of debt.

Additional Tier 1 instruments are rated five notches below the VR: two notches for loss severity to reflect the possible principal write-down, and three notches for non-performance to reflect both fully discretionary coupons and the instruments' 5.125% CET1 ratio trigger.

SUPPORT RATING AND SUPPORT RATING FLOOR

SG's Support Rating of '5' and Support Rating Floor of 'No Floor' reflect Fitch's view that senior creditors can no longer rely on receiving full extraordinary support from the French sovereign if the group becomes non-viable. The EU's Bank Recovery and Resolution Directive and the Single Resolution Mechanism for eurozone banks provide a framework for resolving banks that is likely to require senior creditors participating in losses, if necessary, instead of or ahead of a bank receiving sovereign support.

RATING SENSITIVITIES

IDRS, VR AND SENIOR NON-PREFERRED DEBT

The Stable Outlook on SG's IDR reflects our expectation that the bank will meet its stated capitalisation targets through resilient profitability, and that the stock of impaired loans will continue to decline.

A CET1 ratio materially below the 11.5% guidance for end-2018 would put ratings under pressure as well as fines that could emerge from legacy litigation if significantly above existing provisions. Ratings would also be sensitive to an inability to reduce the stock of impaired loans or to an increase in the bank's risk appetite.

Upside to the ratings is limited and would require significant improvements to the bank's franchise, capitalisation and asset quality metrics while maintaining resilient earnings and an unchanged risk appetite. A reduction in the proportion of emerging markets exposure to equity would also be positive.

DERIVATIVE COUNTERPARTY RATING, DEPOSIT RATINGS AND SENIOR PREFERRED DEBT

SG's DCR and long-term senior preferred debt and deposit ratings are notched from the bank's IDR and are therefore primarily sensitive to changes to the Long-Term IDR. The ratings would no longer be rated one notch above the Long-Term IDR if the buffer of QJD and senior non-preferred debt falls below the expected recapitalisation amount of about 8%, which we do not expect because the bank will have to meet minimum TLAC requirements.

Societe Generale Acceptance N.V. and SG Option Europe's senior debt ratings are sensitive to the same factors that drive a change in SG's senior preferred debt rating.

SUBSIDIARY
The ratings of CGLE are sensitive to changes in SG's IDRs and could also be sensitive to changes in the subsidiary's strategic importance to the rest of the group.

SUBORDINATED DEBT AND JUNIOR SUBORDINATED DEBT
Subordinated debt and deeply subordinated debt ratings are primarily sensitive to a change in SG's VR. Junior subordinated debt ratings are also sensitive to a change in Fitch's assessment of the probability of their non-performance relative to the risk captured in SG's VR.

SUPPORT RATING AND SUPPORT RATING FLOOR
An upgrade of SG's Support Rating and upward revision to the Support Rating Floor would be contingent on a positive change in the French sovereign's propensity to support the banks. While not impossible, this is highly unlikely in Fitch's view.

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Applicable Criteria

Bank Rating Criteria (pub. 23 Mar 2018)
(https://www.fitchratings.com/site/re/10023430)
Non-Bank Financial Institutions Rating Criteria (pub. 22 Mar 2018)
(https://www.fitchratings.com/site/re/10023420)

Additional Disclosures

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