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Research Update:

French Bank Societe Generale 'A/A-1' Ratings Affirmed; Outlook Remains Positive On Loss Absorption Buildup

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Overview

- Societe Generale's (SG's) medium-term financing plan, which aims to build up a sizable buffer of bail-in-able debt to protect senior creditors and strengthen its balance sheet, is on track.
- However, operating conditions have become more challenging for European banks than we forecast a year ago, with rising pressure on revenue and the need to further adjust costs.
- We are affirming our ratings on SG, its rated subsidiaries, and debt.
- The positive outlook reflects the possibility that a steady additional loss-absorbing capacity (ALAC) build up could result in a higher rating if the bank also manages to strengthen its risk-adjusted profitability, reducing the gap with 'A+' rated peers.

Rating Action

On Oct. 17, 2019, S&P Global Ratings affirmed its 'A/A-1' long- and short-term issuer credit ratings on France-based bank Societe Generale (SG) and its core banking entities.

We also affirmed our 'A+/A-1' long- and short-term resolution counterparty ratings on the group entities operating in countries where there is an effective resolution regime and that would be part of a bank resolution strategy.

In addition, we maintained the positive outlooks on all the group's core subsidiaries (see ratings list below for full details). In particular, we affirmed our ratings on the insurance company Sogécap, and maintained a stable outlook.

We affirmed all the issue ratings on senior debt, subordinated, and hybrid capital instruments.

Rationale

Today's affirmation balances the various initiatives the bank is taking to strengthen its balance sheet, which are credit positive, with the much tougher operating environment we now expect for banks in at least the next two-to-three years. Therefore, we are maintaining the positive outlook initially assigned back in October 2018.

SG is gradually building up a large buffer of bail-in-able debt to meet regulatory and ALAC requirements, providing greater protection to holders of senior debt. By 2020, we expect the bank to build up a cushion of such instruments that would make it eligible to benefit from a second notch of uplift--thereby exceeding 8% of S&P Global Ratings' risk-weighted assets (RWAs). We estimate that SG's ALAC buffer will be above 7% at year-end 2019 and exceed the 8% mark by year-end 2020, thanks to the regular issuance of senior nonpreferred debt instruments. Since year-end 2016, SG has issued about €20 billion of senior nonpreferred debt and it has announced that it intends to issue €6 billion-€7 billion annually to comply with total loss-absorbing capacity requirements. We therefore believe the contemplated trajectory is credible. A second notch of ALAC uplift would leave the issue ratings on hybrid debt unchanged because we notch them from the 'a-' unsupported group credit profile.

Before considering any upgrade to 'A+', we will also consider the strength of SG's business model in an environment we expect to be less benign in the years to come. In 2020, we will assess the progress made again, and whether the bank is capable of improving its profitability, which still lags that of higher-rated peers. We will also see if it can maintain a lower risk profile than previously, especially in its investment-banking activities. We believe the bank's goal to control downward pressure on revenue in a lower-for-longer interest rate environment in Western Europe, combined with an expected slowdown of economic growth, is ambitious and will prove challenging to execute. The same applies to the ambition to control cost efficiency, while transforming the group's business model, especially in French retail and corporate and investment banking activities.

We expect cost efficiency to be supported by increased revenue synergies through greater leverage of the group's structure. In this context, achieving a return on tangible equity in the 9%-10% range by year-end 2020, a reduced level from the previous goal of 11.5%, looks ambitious. We noted the downward revision of this medium-term objective in February 2019, but do not assume further changes to the group's financial targets. Any other downward revision of the group's objectives, similar to the moderately lower profitability targets and narrower spectrum of key strategic targets announced in February, would in our view signal a more difficult adaptation of SG's business model. This would likely lead us to reconsider the possibility of any rating upgrade.

Since October 2018, we have monitored progress made in executing the strategy toward 2020. Although balance-sheet metrics, ALAC, and capital build up are well on track, other goals related to the shore up of profitability are proving more difficult to reach due to the changing cycle. One of the measures we will be looking at is SG's capacity to improve its cost-to-income ratio toward 65% by 2020, compared with a high 70% in 2018 and above this mark in first-half 2019. Avoiding the erosion of revenue and adjusting the cost base are the biggest challenges we see.

Indeed, we believe that persistent low interest rates will continue to affect SG's net interest margin in its domestic activities, similar to other French banks. We expect group income to be in the €3.5 billion-€3.8 billion range on average in 2019-2020, lower than our 2018 forecast of above €4 billion. Underlying profit remains relatively resilient but the unfavorable environment is exerting pressure. The group continues to execute its strategy to lend in segments that offer higher yields than French mortgages, while preserving asset quality. We also expect more synergies with specialized subsidiaries like Societe Generale Assurances and ALD, in France and abroad. In addition, we will monitor to what extent the bank manages to improve its insurance earnings contribution and cross selling, which in our view is below the level of French peers.

SG's business model is strong and diverse from a geographic and business standpoint, but somewhat more fragmented in our view than many other large universal and international banking groups. We note the ongoing refocus on activities that display higher growth potential. SG has executed a number of divestments and portfolio management actions, which we expect will continue incrementally in the coming quarters without fundamentally altering future franchise development.

We affirmed our ratings on Sogécap, the group insurance subsidiary, and maintained a stable outlook as insurance activities are outside the scope of a bank resolution, in our view.

Outlook

The positive outlook on SG reflects the possibility of raising our long-term ratings to 'A+' in the next two years. This upgrade could happen if the group continues to steadily build a buffer of loss-absorbing instruments to protect senior creditors in a resolution, while it sustainably enhances its core profitability, reducing the gap with 'A+' rated peers.

Upside scenario

Given the amount of debt already issued and SG's funding plans for the next year, we believe it is on track to build a bail-in-able debt buffer of at least 8% of our RWAs by 2020. This could allow us to incorporate a second notch of ALAC support in our long-term issuer credit ratings, likely toward the end of our two-year outlook horizon, around mid-2020. However, we would also need to observe improving profitability and efficiency in the next 12 months under the medium-term strategic targets, closing the gap with 'A+' rated peers. In particular, we would like to see SG's return on average common equity converge toward 8%-9% by 2020, and our measure of noninterest expense to operating revenue reduce toward 65%, from above 70% at mid-year 2019, with our risk-adjusted capital (RAC) ratio in the 8.5%-9.0% range.

Downside scenario

We could revise our outlook to stable if:

- The gradual ALAC buffer buildup falls short of our expectations, for instance, because of the more rapid growth of our RWAs, or lower core capital generation due to unexpected one-off negative items, like an unexpected litigation cost; or
- The bank fails to structurally improve its core profitability and cost base as indicated, and narrow the gap with 'A+' rated peers.

Ratings Score Snapshot

Issuer Credit Rating	A/Positive/A-1
SACP	a-

Anchor	bbb+
Business Position	Strong (+1)
Capital & Earnings	Adequate (0)
Risk Position	Adequate (0)
Funding and Liquidity	Average and Adequate (0)
Support	(+1)
ALAC Support	(+1)
GRE Support	(0)
Group Support	(0)
Sovereign Support	(0)
Additional factors	(0)

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- Criteria - Financial Institutions - General: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- Criteria | Financial Institutions | Banks: Assessing Bank Branch Creditworthiness, Oct. 14, 2013
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria | Financial Institutions | Banks: Commercial Paper I: Banks, March 23, 2004

Related Research

- EMEA Financial Institutions Monitor 4Q2019, Oct 11, 2019
- Bail-In Debt Remodels Risk Profile Of Bank Funding In Europe And North America, Sept. 26, 2019
- Societe Generale, March 15, 2019

Ratings List

*************** Societe Generale **************	
Ratings Affirmed	
Societe Generale	
Societe Generale Bank & Trust	
Societe Generale (New York Branch)	
SG Americas Securities LLC	
Franfinance	
Credit du Nord S.A.	
Issuer Credit Rating	A/Positive/A-1
Societe Generale	
Societe Generale Bank & Trust	
Societe Generale (New York Branch)	
Franfinance	
Credit du Nord S.A.	
Resolution Counterparty Rating	A+/--/A-1
Societe Generale	
Credit du Nord S.A.	
Franfinance	
Certificate Of Deposit	A/A-1
Sogecap S.A.	
Issuer Credit Rating	
Local Currency	A-/Stable/--
Financial Strength Rating	
Local Currency	A-/Stable/--
Societe Generale	
Senior Unsecured	A
Senior Unsecured	Ap
Senior Subordinated	BBB+
Subordinated	BBB

*************** Societe Generale *************	
Ratings Affirmed	
Junior Subordinated	BB+
Junior Subordinated	BBB-
Commercial Paper	A
Commercial Paper	A-1
Sogecap S.A.	
Subordinated	BBB
Credit du Nord S.A.	
Senior Unsecured	A
Commercial Paper	A-1
Franfinance	
Commercial Paper	A-1
SG Issuer	
Resolution Counterparty Liability	A+
Senior Unsecured	A
Senior Unsecured	Ap
Short-Term Debt	A-1
SG Structured Products Inc.	
Senior Unsecured	A
Senior Unsecured	Ap
SGA Societe Generale Acceptance N.V.	
Senior Unsecured	A
Societe Generale (Canada)	
Commercial Paper	A-1
Commercial Paper (Canada Scale)	A-1(MID)
Societe Generale Effekten GmbH	
Senior Unsecured	A
Societe Generale N.A. Inc.	
Commercial Paper	A-1

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.