Research Update:

Societe Generale Outlook To Negative On Profitability Challenges; Ratings Affirmed; Hybrid And Sub Debt Downgraded

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Overview

- Société Générale's (SG's) unexpected earnings loss in first-quarter 2020, beyond the setbacks from the COVID-19 pandemic, confirms the profitability challenges the bank continues to face, especially in its investment banking activities.
- We believe the bank may have to further adjust its business model to restore the risk-adjusted profitability and revenue resilience of its investment banking division.
- Positively, SG's creditworthiness benefits from the group's continual build-up of an already substantial buffer of additional loss absorbing capacity (ALAC), mainly through senior nonpreferred debt issuance, and enhances the protection of its senior bondholders.
- We are revising the outlook on SG to negative from stable, and affirming the ratings at 'A/A-1' on the group, including its core banking subsidiaries.
- Our view of SG's weakened group stand-alone credit profile (SACP), which we have revised downward to 'bbb+' from 'a-', leads us to lower the issuer credit ratings by one notch on the core insurance subsidiary Sogecap, and the issue ratings on the group's hybrid and subordinated debt instruments, including the senior nonpreferred debt, as they are all rated from the group SACP.
- The negative outlook reflects the uncertainty in the economic and operating environment and our view of the related risks for the bank's own intrinsic strength, especially in terms of asset quality, and its ability to preserve a sufficiently high buffer of bail-inable debt.

Rating Action

On May 15, 2020, S&P Global Ratings revised to negative from stable the outlook on French bank Société Générale (SG) and the core banking subsidiaries, including Czech bank Komercni Banka. We affirmed the long- and short-term ratings at 'A/A-1'.

At the same time, we lowered by one notch the issue ratings on the group's subordinated (including senior nonpreferred) and hybrid debt.

We also lowered to 'BBB+' from 'A-' the issuer credit rating on the group's core insurance subsidiary Sogecap S.A. The outlook is negative.

Rationale

Today's rating actions follow a review of SG's first-quarter 2020 performance, published late April, and resulting comparison of the stability of the revenue streams with other large European banks. SG's profitability has been under pressure for some time, and the challenging economic conditions amid the COVID-19 pandemic and the turbulent capital market environment have exacerbated the existing weaknesses.

SG posted an unexpected €326 million net loss in first-quarter 2020. This is because the bank had to set aside more provisions, and its revenues were hit by the weak performance of its corporate and investment banking (CIB) division. Indeed, the group reported a drop in quarterly revenue of almost 17% against first-quarter 2019, but the revenues contracted in a more pronounced way, by almost 43%, in the CIB division. This stemmed from a collapse in equities revenue (essentially structured products) amid intense market volatility in the second half of March 2020, and it was only partially offset by the better performance in fixed income. In our view, the investment bank has struggled to deliver relatively stable risk-adjusted earnings and the sensitivity of group revenue to capital market swings has persisted more than we had anticipated. The group's other businesses are performing relatively well, but not enough to make up for the poor performance in the still sizable CIB division. This reflects some limitations in diversification benefits by businesses and in the group's overall revenue stream.

We consequently now consider SG's business position to be adequate, instead of strong previously, in line with that of large global banks like Barclays or Credit Suisse. We understand that management intends to remedy this by further repositioning the group's presence in CIB activities to generate additional cost savings over time. The right-sizing of the equities division, which historically was one of the bank's main strengths in the capital markets and a solid earnings contributor, remains a challenge for management given the higher-than-before capital requirement and intense competition from U.S. banks. The flagging performance in the equities segment contrasts with what many other European banks or U.S. banks delivered in the same quarter.

Our revised expectations incorporate a rise in the group's cost of risk of about 70 basis points (bps) from the 25 bps increase in 2019, as we believe that the bank--similar to its peers--will have to continue to create provisions, notably in the most risky and volatile sectors, including transportation, energy, tourism and leisure, and leveraged finance. We expect some rebound in 2021, but its return on equity should still be well below the pre-crisis level of about 5%-6%. Positively, we expect the group's balance sheet to stay solid. Its risk-adjusted capital should stay above 8% in the next two years on average, thanks to dividend retention. SG's common equity tier 1 ratio stood at 12.6% at end-March 2020, and the bank commits to keeping a 200-250 bps buffer over the regulatory requirement.

Because of the downward revision of the group SACP to 'bbb+' from 'a-', we are lowering the issue ratings on the group's subordinated and hybrid instruments by one notch.

At the same time, we believe that the build-up of large buffers of bail-inable debt upholds the group's overall credit quality. In March 2020, we estimate that SG's ALAC ratio stands above 8% of S&P Global Ratings' risk-weighted assets (RWAs). This level makes the bank eligible for a second notch of uplift above its 'bbb+' group SACP, as per our rating approach. SG benefits from its established presence in the wholesale market. By mid-April, it already executed about 45% of its 2020 funding plan. The stock of senior nonpreferred instruments was close to €22 billion at end-2019, and SG has since made additional issuances of approximately €5.6 billion. In our opinion, issuing over the remainder of the year could be more difficult and there may be delays compared with our expectations. Relative to other French banks, SG has issued one of the largest amounts of senior nonpreferred instruments as a proportion of S&P Global Ratings RWAs to date. The substantial stock of bail-inable buffers supports the affirmation of the 'A' long-term rating.

The ratings and outlook on Komercni Banka move in tandem with that of the group, since it is a core banking subsidiary. The downgrade of Sogecap reflects our view that the heightened pressure on SG's intrinsic creditworthiness (evidenced by the lower group SACP) implies a lower capacity to provide extraordinary support if needed. As a nonbanking entity, Sogecap falls outside the bank resolution perimeter and our 'BBB+' long-term rating on the insurer is aligned with the group SACP, not with the group credit profile, which includes ALAC support.

Outlook

Société Générale

The negative outlook on SG and its core bank subsidiaries reflects that the recessionary economic environment in France and the eurozone in 2020 could trigger a more pronounced deterioration in asset quality than we forecast, or prolonged profitability pressure. The outlook also reflects the difficulties SG may encounter in a more volatile market environment to maintain a buffer of bail-inable securities in excess of 8% of S&P Global Ratings' RWAs, since this is the condition to maintain a two-notch ALAC uplift above the 'bbb+' group SACP.

Downside scenario

We could lower the ratings in the next 12-24 months in the absence of sound profitability prospects for 2021 and beyond. This could happen if credit losses remain almost as elevated as in 2020, or if the group cannot sustainably improve its efficiency ratio in line at least with historic standards. Rating pressure also stems from the negative trends in France's economic and industry risks--which are to some extent common with other French banks--and which could give way to a greater-than-forecast erosion in asset quality.

Downward pressure could also come from difficulties in issuing a sufficient quantity of senior nonpreferred debt (that is, 8% of S&P Global Ratings' RWAs), if access to capital markets proves volatile and difficult, or if RWA inflation proves stronger than we expected, notably in case of further market volatility.

Upside scenario

A revision of the outlook to stable in the next 12-24 months would first hinge on easing economic and operating conditions for banks in France, SG's main market, in 2021. It would also assume the repositioning of investment banking activities is short and efficient, versus a costly, multi-year process. A stable outlook would also require that we see more limited risk that the ALAC buffer could drop below 8% of S&P Global Ratings' RWAs.

Sogecap

The negative outlook on Sogecap reflects our view that in case of a deterioration in SG's intrinsic creditworthiness over the next 24 months--implying weakened capacity to support its subsidiary if needed--we would lower our long-term issuer credit and insurer financial strength ratings on Sogecap.

We expect Sogecap will remain a core subsidiary of SG. Sogecap contributes indirectly to the revenue of French retail networks that distribute its insurance products. We understand SG intends to develop its franchise in this sector, increasing intragroup synergies in revenue through its bancassurance model.

We would revise the outlook to stable if pressure on SG's group SACP diminished thanks to improving operating conditions in countries where it is present, particularly France.

Ratings Score Snapshot

Societe Generale Ratings Score Snapshot

	To	From
Issuer Credit Rating	A/Negative/A-1	A/Stable/A-1
SACP	bbb+	a-
Anchor	bbb+	bbb+
Business Position	Adequate (0)	Strong (+1)
Capital and Earnings	Adequate (0)	Adequate (0)
Risk Position	Adequate (0)	Adequate (0)
Funding and Liquidity	Average and Adequate (0)	Average and Adequate (0)
Support	(+2)	(+1)
ALAC Support	(+2)	(+1)
GRE Support	0	0
Group Support	0	0
Sovereign Support	0	0
Additional Factors	0	0

SACP--Stand-alone credit profile. ALAC--Additional loss-absorbing capacity. GRE--Government-related entity.

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

- Societe Generale 'A/A-1' Ratings Affirmed Despite Heightening Earnings Pressure; Outlook Remains Stable, April 23, 2020
- Negative Rating Actions Taken On Various French Banks On Deepening COVID-19 Downside Risks, April 23, 2020
- Europe's AT1 Market Faces The COVID-19 Test: Bend, Not Break, April 22, 2020
- How COVID-19 Is Affecting Bank Ratings, April 22, 2020
- Economic Research: Europe Braces For A Deeper Recession In 2020, April 20, 2020
- Societe Generale Outlook To Stable As Profitability Prospects Falter In The Face Of COVID-19; 'A/A-1' Ratings Affirmed, April 3, 2020
- Societe Generale, Jan. 14, 2020

Ratings List

Ratings List Table

Downgraded

	To	From
Sogecap S.A.		
Issuer Credit Rating		

Ratings List Table (cont.)

Local Currency	BBB+/Negative/--	A-/Negative/--
Financial Strength Rating		
Local Currency	BBB+/Negative/--	A-/Negative/--
Societe Generale		
Senior Subordinated	BBB	BBB+
Subordinated	BBB-	BBB
Junior Subordinated	BB	BB+
Junior Subordinated	BB+	BBB-
Sogecap S.A.		
Subordinated	BBB-	BBB
Ratings Affirmed		
Societe Generale		
Societe Generale Bank & Trust		
Societe Generale (New York Branch)		
Komercni Banka A.S.		
Franfinance		
Credit du Nord S.A.		
Resolution Counterparty Rating	A+/--/A-1	
Societe Generale		
Credit du Nord S.A.		
Certificate Of Deposit		
Foreign Currency	A	
Local Currency	A/A-1	
SG Americas Securities LLC		
Resolution Counterparty Rating	A/--/A-1	
Societe Generale		
Senior Unsecured	A	
Senior Unsecured	Ap	
Commercial Paper	A	
Commercial Paper	A-1	
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	

Ratings List Table (cont.)

Senior Unsecured	Ap	
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	A-1(MID)	
Societe Generale Effekten GmbH		
Senior Unsecured	A	
Societe Generale N.A. Inc.		
Commercial Paper	A-1	
Ratings Affirmed; Outlook Action		
	To	**From**
Societe Generale		
Societe Generale Bank & Trust		
Societe Generale (New York Branch)		
SG Americas Securities LLC		
Komercni Banka A.S.		
Franfinance		
Credit du Nord S.A.		
Issuer Credit Rating	A/Negative/A-1	A/Stable/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. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 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.