France
Special Report

State Support Measures for French Banks

Effective Measures Sustain Some Ratings

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Overview

- French government measures announced in October 2008 to support the country's banking system appear to be working effectively, but none of the major French banks is currently heavily dependent on refinancing or solvency schemes for survival.
- The government support schemes, combined with the French sovereign's high rating, provide Fitch Ratings with sufficient comfort to assign 'A+' Support Rating Floors to the country's top six banks.
- France's best-performing banks (BNP Paribas, Crédit Agricole and Banque Fédérative du Crédit Mutuel) are rated above their Support Rating Floors, with their Long-Term (LT) Issuer Default Ratings (IDRs) still driven by their acceptable intrinsic financial strength. Société Générale is also rated above the Support Rating Floor, but pressure on this bank's ratings is mounting, reflecting continued weak investment banking results and an international franchise focused on Central and Eastern Europe (CEE) and Russia.
- Although the current crisis has taken its toll on French banks (with a negative impact on 2007/2008 results at the country's top six banks of around EUR32bn), all banks have managed to replace capital by issuing common equity or Tier 1 capital qualifying instruments; the government has played a key role in supplying capital to the banks since end-2008, but nationalisation is not on the cards. Tier 1 capital adequacy ratios (CARs) at the leading French banks are still above 8%.
- Natixis (A+/Outlook Stable) is France's most troubled bank. Fitch considers the current merger of its strategic shareholders to be largely government-inspired. The government's close oversight of the merged entity, which is intended to be up and running by end-June 2009, is viewed positively for creditors by Fitch.
- Fitch considers the most problematic areas for French banks in 2009 to be continued writedowns on structured assets, low market appetite for structured products, mounting pressure for banks with large exposures in CEE and Russia and large unsecured consumer loan portfolios. Fitch does not expect retail mortgages, which are problematic in certain other European countries, to perform badly in France.
- While the French state's direct ownership of French banks is minimal, its influence over the sector is increasing. French banks accessing state support must comply with certain ethical standards and agree to expand lending to the real economy. The government's determination to resolve problems at Natixis is, in Fitch's opinion, reflected in government-influenced appointment of key senior management.

State Support Schemes for French Banks

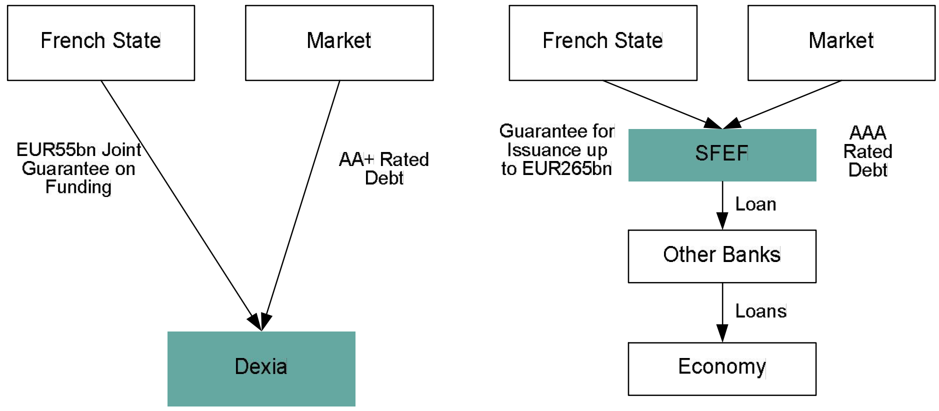
Measures unveiled in October 2008 by the French government to support the banking system focus on two key areas: liquidity support through the provision of state-guaranteed refinancing help, and solvency support, through the availability of Tier 1 capital instruments.

Two companies have been created in conjunction with the schemes:

The Société de Financement de l'Economie Française (SFEF), which is 34%-owned by the French state, with the balance being held by seven leading French banks, provides liquidity support. SFEF can issue up to EUR265bn of term debt (maximum maturity five years), guaranteed by the French state and therefore 'AAA' rated, and this can be onlent to the country's banks, pro rata according to their market shares. (Exceptions were made for captive auto financing vehicles, which can apply for amounts in excess of their natural market shares, but this is part of a government package to support the automotive industry as a whole.) Debt must be issued before end-2009 and the cost to the banks is around 4% per year. At end-March 2009, only EUR34bn in funds (of EUR265bn available) had been issued by SFEF.

The mechanism works as shown below:

Sovereign Support Scheme: Refinancing



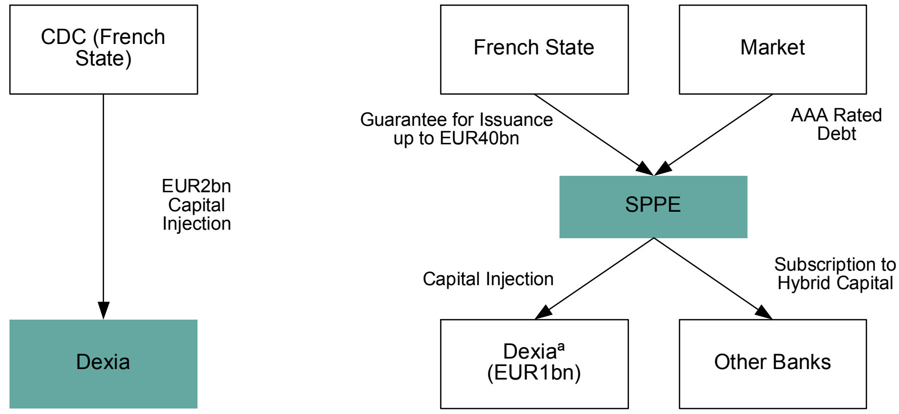
Source: Fitch

The state has also issued guarantees in respect of Dexia's obligations (a maximum EUR55bn) in conjunction with the rescue package organised for that banking group.

The Société de Prises de Participations de l'Etat (SPPE), which is fully owned by the French state, has earmarked EUR40bn of funds available for injecting, as Tier 1 capital, into troubled French banks (along the lines of Dexia), or into those banks which the government considers are not sufficiently well capitalised to continue to support the development of the real economy. In December 2008, EUR10.5bn was made available for the country's top six banks, in the form of Tier 1 capital instruments, supplemented at end-January 2009 by a further EUR10.5bn earmarked for the same banks which must be taken up by end-August 2009.

Banks can accept funds from SPPE in the form of Tier 1 capital qualifying as subordinated debt or preference shares. Pricing of the subordinated debt is calculated using a formula which takes into account the state's cost of funding plus 300bp plus a measure of the borrower's risk, based on its historic CDS spreads. December 2008 issues of these subordinated debt instruments were priced at around 8% per year. BNP Paribas (BNPP, rated 'AA'/Outlook Negative) is, to date, the sole issuer of preference shares, taken up by SPPE. BNPP's prefs are remunerated according to a sliding scale formula, linked to, and always higher than, the dividends paid on ordinary shares (for BNPP this is 7.65% for 2009 rising to a ceiling of 14.8%). If dividends are not paid on ordinary shares, no coupon will be paid out on these preference shares.

Sovereign Support Scheme: Hybrids/Capital



[a] Or other banks if necessary
Source: Fitch

Book equity in France's banking system, at end-February 2009, stood at EUR420bn. Even if all of SPPE's funds were injected into the banking system, the French state's holding would equate to less than 10% of system equity, which is considered modest. (The currently very low share price for many quoted banks means that some banks are trading below net asset value. This should be taken into account when considering control as measured as a percentage of system equity). There is no talk of widespread nationalisation of the country's major banks, as is happening in several other countries.

No French bank at present is totally dependent on SFEF or SPPE for continuing its operations.

Support Scheme Conditions

President Nicolas Sarkozy's bank support schemes come with conditions: banks receiving state funds are required to extend new lending to France (mainly to individuals, SMEs and local authorities) at 3%-4% per year (at current levels, this translates into EUR75bn of new lending annually). Senior management must also agree to abide by some 'ethical' standards: bonuses must be renounced and the granting of stock options is prohibited. In addition, the government must be kept regularly informed of lending progress at the banks.

What do the Support Schemes Mean for the Banks' Ratings?

Fitch has not changed any of the ratings assigned to the six banks because they received capital funds from SPPE or liquidity from SFEF.

Funds obtained from the support schemes are fairly expensive, to the extent that a banks' reliance on such support reduces its ability to generate healthy profits. Pressure on the Individual Ratings could mount, though this has not been noted to date.

The most important effect of the support schemes affecting ratings assigned by Fitch to large French banks is in the Support Rating Floors assigned to the country's leading banks. For Fitch, the fact that France, as a highly rated sovereign ('AAA'/Outlook Stable), has demonstrated its ability and willingness to support the country's top private sector systemically important banks has enabled the agency to feel reassured that the LT IDRs of these banks will not fall below the 'A+' level (provided factors underpinning such support remain unaltered). This is considered a high rating for a financial institution in current markets.

A number of leading French banks are rated 'A+' or higher, based on their intrinsic financial strength (see list of major bank ratings at end of this report) but the LT IDRs of some entities (notably Groupe Caisse d'Epargne (GCE), Groupe Banque Populaire (GBP) and Natixis) are at their current levels due to their ability to rely on state support schemes.

Wider Government Economic Stimulation Measures

Measures aimed at stimulating the economy have also been introduced. In November 2008, a EUR20bn fund, which was fully controlled by Caisse des Dépôts et Consignations (CDC), a 'AAA'-rated financial institution owned by the French state, was established to take stakes in strategic French companies. Efforts to kick-start the economy include acceleration of public spending, particularly in the construction sector (social housing receives EUR1.5bn and EUR8bn credit guarantees are extended for private and public sector projects), tax breaks for small companies hiring new staff (EUR1.2bn), credit for financing arms of auto makers (EUR1bn) and accelerated payment of tax rebates and credits (EUR11.4bn). In January 2009, further amounts (of up to EUR6bn) were set aside to support the automotive industry in the form of loan guarantees and subsidised loans, while conditions for banks to access funds from SFEF were eased (the range of acceptable collateral was broadened), specifically to benefit the banking arms of Renault and PSA Peugeot Citroën. The government is also contemplating providing additional credit guarantees to the manufacturing sector or direct loans. In addition, tax cuts and extra welfare payments totalling EUR2.7bn, unveiled in mid-February 2009 and directed towards low-income households, are intended to appease mounting social unrest and extend some help to ordinary households.

The measures taken by the government are aimed at supporting the economy (rather than the banks themselves), to date, but there is no tangible evidence that they are working. French businesses and consumers, as elsewhere in Europe, are finding it harder to access credit as banks and investors store up liquidity. More time is needed before Fitch is able to determine whether policies introduced to date prove adequate or sufficient.

State Involvement in France's Banking System

The French state, which is so prevalent in many sectors of France's economy, has a very limited presence in the country's banking system, in terms of direct ownership. A publicly owned 35% stake in GCE's central body, the government's last equity stake of any significance in the country's banking system, was sold in 2006. As a result of the support schemes (BNPP opted to take up state capital support in the form of non-voting, non-convertible preference shares) the French state now holds around 17% of BNPP. The government is not represented on BNPP's board.

Currently, only La Banque Postale (LBP, rated 'AA-'/Outlook Stable) remains in the hands of the government, as it is 100%-owned by France's La Poste, the state-owned national post office. LBP, though a very modest issuer in the capital markets, controls a 10% retail share of deposits in France and serves 29 million customers; it is therefore an important domestic bank. The French state also owns two highly specialised financial institutions, both of which are 'AAA' rated. These are CDC, France's largest institutional investor, and Agence Française de Developpement which lends mainly to developing countries.

Nevertheless, Fitch considers that the government's 'hold' over the banking system in France is firm. The local regulator, the Commission Bancaire (CB), has a reputation for being tough and does not favour the soft touch approach previously adopted by certain other regulators. The CB often demands CARs that are far higher than the prudential minimum for all its banks, even the large ones, and supplements regular inspections with ad-hoc visits to oversee areas of particular concern. Most recently, it has completed a review of Natixis' structured asset portfolios and has visited various banks where exposure to the real estate markets is considered high.

As for many of the world's leading economies, the French state is very keen to ensure that its banking system is performing well; numerous public statements of support have been voiced since the onset of the current crisis by the country's leading figures (the President of the Republic himself, the Minister of Finance and the President of the Central Bank).

Groupe Caisse d'Epargne/Groupe Banque Populaire/ Natixis – a Special Case

Natixis is by far France's worst-performing major bank (with an Individual Rating of 'E'). Its strategic shareholders (each with a 35% stake), GCE and GBP, have recapitalised the bank throughout 2008 (EUR5.6bn), but problems persist and the possibility of additional recapitalisation remains high. GCE and GBP are merging, under a timetable which envisages this being achieved by end-June 2009. Fitch believes that this merger, which will create a commercial banking group controlling some 20% of retail deposits in France ('New Group'), is largely government-inspired, as regulators are keen to address problems at Natixis and ensure that GCE and GBP can focus on stimulating growth in the real economy (GCE holds a 17% stake in the country's housing loans and GBP is by far France's largest lender to the SME sector).

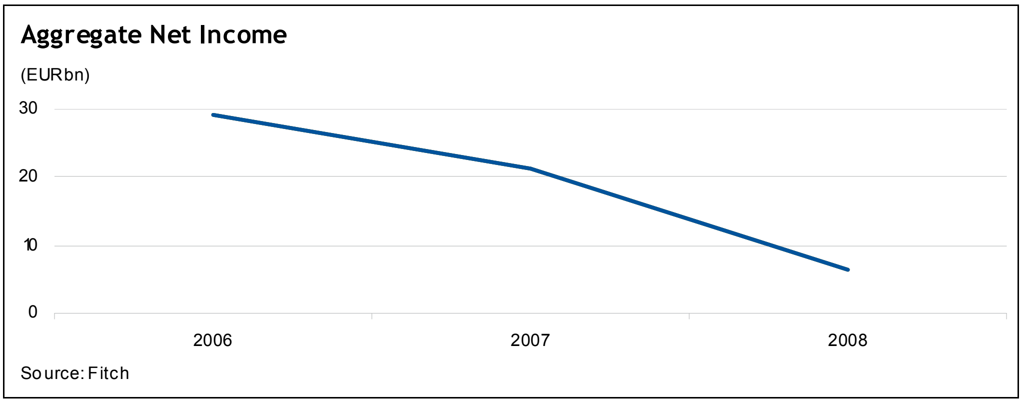
New Group's executive chairman, M François Pérol, was previously a special economic advisor to President Nicolas Sarkozy. In Fitch's view, this indicates just how determined the French state is to address New Group's problems. It is the only example, to date, of the French government's involvement in influencing senior management at any of the French banks that receive state support.

In addition, the ability of GCE, GBP and Natixis to access any further funds from SFEF or SPPE is conditional on New Group going ahead. No such conditions are applied to other leading French banks. In addition to the amounts earmarked by SPPE for GCE and GBP in the January 2009 offering (EUR2bn), the French state will subscribe a further EUR3bn of preference shares to be issued by New Group. Depending on New Group's performance, such shares may be converted into preference shares with voting rights, which means up to 20% of the voting rights in New Group could end up in the state's hands.

Impact of the Crisis on Leading French Banks

Only three French banks reported net losses in 2008, and unsurprisingly, these are the names involved in the creation of New Group, dragged down by Natixis' very poor performance (it reported a EUR2.7bn net loss in 2008). Nevertheless, all large French banks have suffered as a result of the current crisis, with results severely affected, mainly by the poor performance of the corporate and investment banking (CIB) units, spilling through to weak results at the asset management division and spiralling impairment charges. This is illustrated in the tables below.

All Six Leading Banks Have Been Affected



Fall in 2008 Revenue Focused on CIB and Asset Management

	(%)
Domestic retail banking	-1
International retail banking & financial services	+14
CIB	-42
Asset Management/Insurance./Private Banking]	-16

Source: Fitch

Spiralling Impairment Charges

	(EURbn)
2006	3.4
2007	6.5
2008	17.3

Source: Fitch

Securities writedowns, counterparty failures, fraud-related losses and other 'crisis-related' negative impacts totalled around EUR32bn at the country's top six banks in 2007–2008. All such banks successfully managed to raise additional capital to compensate for the losses, as illustrated in the table below.

Negative Financial Impact Versus Capital/Hybrid Issuance

(EURbn)	Pre-tax impact of the crisis in 2007/08 (A)	Post-tax impact of the crisis[b] in 2007/08 (B)	Capital/ hybrid issuance in 2008 (C)	Issuance minus impact of the crisis (B + C)	Capital/ hybrid issuance planned for 2009 (D)	Total impact on tier1 capital so far (B + C + D)
Natixis	-6.7	-4.7	6.5[a]	1.8	n.a.	n.a.
GCE	-5.9	-4.1	1.9	-2.2	n.a.	n.a.
GBP	-3.6	-2.5	1.0	-1.5	n.a.	n.a.
GCE + GBP + Natixis	-11.5	-8.0	3.8	-4.2	5.0	0.8
CA	-9.3	-6.5	6.9	0.4	0.0	+0.4
BNP	-6.0	-4.2	3.9	-0.3	2.6	+2.3
SG	-4.3	-3.0	4.1[c]	1.1[c]	1.7	+2.8[c]
CMCEE	-1.2	-0.8	1.9	1.1	0.0	1.1
Total	-32.3	-22.5	20.6	-1.9	9.3	7.4

[a] Of which EUR5.6bn subscribed to by GCE and GBP
[b] Assuming a 30% tax rate
[c] Excluding a EUR5.5bn capital increase following the Kerviel fraud
Source: Fitch

Outlook – Trouble Spots and Mitigants

For additional information on the Outlook for Leading French banks see 'Major French Banks' Semi-Annual Review and Outlook' dated 16 April 2009 and available at www.fitchresearch.com.

Reduced Asset Quality

This is likely to be felt across the board, but those banks most exposed to consumer finance (CA, SG and BNPP), credit risk in Central and Eastern Europe (CEE) and Russia (notably SG, but also CA and BNPP) and large wholesale banking business (CA, SG, BNPP and Natixis) are expected to be the worst hit. Loan quality indicators in Q408 already showed a sharp deterioration for the country's leading banks and given the poor global economic prospects, these trends are expected to deteriorate further. Low levels of impaired loans (hovering at around 3% of average loans during the positive cycle years of the mid-2000s), were clearly unsustainable. Fitch expects impairments to materially exceed historic averages, with impairment charges for the leading banks potentially doubling in 2009.

Troubled Investment Banking Performance

Given current investor risk aversion, tight liquidity and weak issuance volumes, Fitch is pessimistic about the ability of the CIB divisions in the country's leading banks to pick up in the short term. Those banks most focused on financing and fixed income (CA's Calyon and BNPP are best placed) are expected to perform better. SG's strong focus on the equities markets does not bode well for the immediate future. An overhaul and rethinking of CIB business will probably be required, as demand for some products (notably structured finance) is not expected to return quickly but, to date, no French bank has announced a full-blown strategic rethink of these businesses. Fitch considers that Natixis is effectively being wound down in many areas. Writedowns of toxic assets, which are still high at some French banks (notably Natixis where EUR31bn of such assets have been identified for disposal), are expected to continue, with monoline exposures causing additional problems.

Refinancing Pressure

All large French banks are dependent, to some extent on the wholesale markets for funding, although pressure is not too severe as all large players have access to good, stable retail deposits (Natixis is an exception but GCE and GBP, in turn, are able to count on such deposits). BNPP boasts the best loans/deposits ratio (119% at end-2008) but the search for cheap, retail funding is increasing at all banks. The banks' overseas subsidiaries are, at times, dependent on funding from the parent. In the case of SG's CEE/Russian networks, only one entity, Czech Republic's Komercni Banca, has a loans/deposits ratio of below 100%.

Solvency Issues

CARs at the country's top banks were all above 8% (Tier 1) at end-2008, although pressure is likely to mount in the medium term. Fitch is most pessimistic about prospects for those banks with still substantial structured assets (BNPP, SG and Natixis) as market value volatility in these portfolios can produce very sudden, substantial writedowns. However, the weak economic situation means losses in some areas of the banks' loan books may also contribute to capital pressure. With markets spurning financial sector investment and the hybrid markets virtually closed, turning to the government for additional equity appears to be one of the few options available for banks globally, if required.

Housing Market/Real Estate Sector

Although falling real estate values are generating considerable nervousness in many European countries (notably Spain), Fitch considers that this remains less of a threat to large French banks. House prices fell by between 5% - 10% in 2008 (but averages vary considerably by region) and general consensus points to a further maximum fall of 15% for 2009. Nevertheless, the retail mortgage market in France enjoys some positive characteristics: average loan-to-vale (LTV) ratios are just 60% (although 2006/2007 LTV ratios rose to 90%), the majority of retail housing loans are extended at fixed rates, generating stable repayment instalments and there are few second home loans in France and products such as equity release mortgages are not generally offered by French banks. In addition, the average French consumer is far less indebted than some of his European counterparts (household indebtedness at 72% of household income, compared with 170% for his UK counterpart). Although unemployment is rising steeply (2.4 million unemployed at end-February 2009), Fitch believes defaults of home loans will be low in France.

Exposures to real estate developers, an area where several French banks were caught out in the late 1990s, represented just 2% of total lending in France at end-2008. Although many banks are signalling that the construction sector is increasingly problematic, at least the banks are not overly concentrated in this area in France.

Weaker Profitability

Performance indicators achieved by the country's leading banks in 2008 were weak. Fitch believes that 2009 ratios will continue to be well below the pre-crisis highs. Nevertheless, Fitch is less pessimistic about CA, where investment banking problems appear to have been dealt with most swiftly and the sheer size of the group's equity (around EUR69bn) helps absorb losses (for example at its Greek subsidiary, Emporiki Bank of Greece, or from deteriorating consumer portfolios in Poland). The ratings and Outlooks assigned to leading French banks are shown in the table below.

Ratings Assigned by Fitch to Major French Banks

	LT IDR/Outlook	ST IDR	LT Rating Hybrids/Prefs	Individual Rating	Support Rating	Support Rating Floor
BNP Paribas	AA/Negative	F1+	AA-	B	1	A+
Crédit Agricole	AA-/Stable	F1+	A+	B	1	A+
Société Générale	AA-/Negative	F1+	A+	B/C	1	A+
Banque Fédérative du Crédit Mutuel	AA-/Stable	F1+	A+	n.a.	1	A+
Groupe Caisse d'Epargne	A+/Stable	F1+	BB+/negative watch	C/D	1	A+
Natixis	A+/Stable	F1+	BB+/negative watch	E	1	n.a.
Groupe Banque Populaire[a]	A+/Stable	F1+	BB+/negative watch	C/D	1	A+

[a] Did not participate in the rating process
Source: Fitch