Research Update:

Credit Mutuel Ratings Affirmed, Senior Nonpreferred/Hybrid Debt Upgraded On Strengthened Balance Sheet; Outlook Stable

October 16, 2019

PRIMARY CREDIT ANALYST

Nicolas Malaterre

Paris

(33) 1-4420-7324

nicolas.malaterre@spglobal.com

SECONDARY CONTACT

Sylvie Dalmaz, PhD

Paris

(33) 1-4420-6682

sylvie.dalmaz@spglobal.com

ADDITIONAL CONTACT

Financial Institutions Ratings Europe

FIG_Europe@spglobal.com

Overview

- Credit Mutuel Group (CMG) continues to strengthen its already-solid balance sheet, and we now see its capital position as a rating strength.
- Thanks to predictable earnings, supported by the contribution of insurance activities, a low risk profile, and low dividend payments, we expect its capitalization to increase further and be able to withstand likely less benign operating conditions in the years to come.
- CMG started to issue senior nonpreferred notes, but we do not expect its bail-in-able buffer to be large enough to provide additional loss absorbing capacity (ALAC) over the next two years to protect senior creditors.
- Therefore, we are raising the group stand-alone credit profile (SACP) to 'a' from 'a-', and subsequently upgrading the hybrids and senior nonpreferred notes by one notch. In addition, we are affirming the long- and short-term ratings on CMG's rated entities.
- The outlook is stable because we assume that the group will maintain a solid balance sheet and controlled risk appetite as it continues to expand its business, but also that it will report lower diversification and average profitability compared with higher-rated peers.

Rating Action

On Oct. 16, S&P Global Ratings affirmed its 'A/A-1' long-and short-term issuer credit ratings on French bank Credit Mutuel Group (CMG) and its core entities. We also affirmed our resolution counterparty credit rating (RCR). The outlook is stable

In addition, we revised the group SACP to 'a' from 'a-' and consequently raised by one notch all of our long-term ratings on the bank's hybrid capital instruments and senior nonpreferred notes.

Rationale

Today's action reflects the gradual reinforcement of CMG's balance sheet and solvency over the past years, which we expect to continue, despite a less benign environment ahead. The group will face profitability pressures in its retail and insurance businesses due to the ultra-low-interest-rate environment. But we believe that the strength of its franchises in these two segments, its predictable revenue streams and low payout ratio, resulting from its cooperative structure, allow the group to continue to build capital internally, while continuing to expand in its core business.

We expect CMG will maintain a risk-adjusted capital (RAC) ratio of or marginally above 10% in the next two years and higher levels thereafter, up from 9.7% in 2018. In our view, the pace of improvement could be slower than in previous years, due to margin pressure only partially offset by dynamic loan growth, but the upward trajectory is unlikely to change. CMG's common equity Tier 1 (CET1) ratio of 17.5% at year-end 2018 was among the strongest ratios for large European banks, with the exception of most Nordic banks.

Our capital projections capture on the following assumptions:

- An average annual increase in adjusted risk-weighted assets (RWAs) of 5.5% over 2019-2020, as credit demand remains high in the context of low interest rates and the group continues to organically expand, mainly in retail banking activities in low-risk European countries.
- Annual profits of €3.3 billion-€3.5 billion in 2019 and 2020, below the €3.5 billion achieved in 2018, a stable efficiency ratio of about 65%, and a low cost of risk.
- A low dividend payout ratio below 10%.
- A stable solvency position at the insurance businesses despite pressure from the interest-rate environment.
- No significant acquisitions.

The upward revision of the group SACP to 'a' from 'a-' also recognizes the low risk profile and stability of operating performance through the cycle. CMG is not among the strongest performers on profitability and efficiencies in a European context and does not have the geographic diversification we typically see at banks with an 'a' group SACP. This is partly due to its cooperative roots and the high share of low-risk/low-margin housing loans in the book. The group's dense French branch network weighs on its cost base, while its cost efficiencies lag other retail banking peers in several markets, for example the Nordics or the Benelux region, but are among the best of its domestic peers. In addition, its returns over the past decade, including during the 2008 financial crisis, have been stable, with a return on equity (RoE) of 6.0%-6.5%. We expect the RoE to decline marginally below 6% in 2019-2020, due to inevitable margin pressure and limited cost reduction. However, we note that lower returns pose less strategic and business model challenges to cooperative groups than for listed groups, as they typically enjoy lower cost of capital due to their capacity to issue affordable cooperative shares.

Credit Mutuel Alliance Fédérale, CMG's largest subgroup, issued its first senior nonpreferred notes earlier this year. However, we do not believe the bank will issue enough bail-in-able debt to benefit from a notch of additional loss absorbing capacity (ALAC) over the outlook horizon. The group is not subject to total loss absorbing capital rules and already has a very high level of common equity in its capital structure, so the incentive to issue senior nonpreferred debt or other subordinated instruments to meet regulatory requirements is less than for other large French banking groups. This is why the upgrade of the group SACP does not result in a parallel upgrade of the long-term rating.

Our ratings on CMG remain supported by the group's leading position and robust franchise in the French retail market and the material contribution of its insurance activities. The group has the third-largest retail banking network in France, and has built a valuable franchise in consumer finance via its subsidiary Targobank in recent years, which also provides some geographic diversity, notably in Germany. We continue to see Credit Mutuel Arkea's (CMA) exit from the group as a long and complex move from an operational perspective, although not impossible. Our central scenario remains the status quo, where CMA will continue to operate within the group alongside other members. We note that these intragroup tensions have not so far altered the group's financial performance or strategy.

CMG benefits from the low-risk nature of its core French retail banking activities and a good track record of expansion into the riskier consumer finance segment. That said, it also demonstrates lower diversity in its loan portfolio than peers. Domestic residential mortgages represent about half of CMG's total customer loans, but are naturally granular, and generated much lower losses throughout the credit cycle. We expect nonperforming loans to remain below 3% by 2020, the coverage of bad loans by reserves to remain at 65%-70%, and the cost of risk at about 25 basis points (bps), which are good metrics in our view.

Our central scenario factors in that the bank will maintain its funding and liquidity position.

Furthermore, our analysis of CMG is based on the consolidated accounts of the group, including CMA.

Outlook

The stable outlook balances our expectation that the group will maintain its solid balance sheet, asset quality and business development in retail banking and insurance against persisting pressures on profitability in a low-interest-rate environment, as for other European peers. This is less of a credit issue for cooperative groups than for listed ones, due to their generally low payout ratios and lower cost of capital. In our outlook we also assume that the existing challenges around group cohesion will not represent a structural issue, but rather an area of relative uncertainty, as has been the case so far.

Downside scenario

We could lower our ratings in the next 24 months if:

- We observed the group engaging in more rapid growth of risk assets than we anticipate, organically or via acquisitions, leading to a lower RAC ratio compared with our expectations.
- The group did not cope with the challenge of adjusting its retail banking and insurance business strategy to the evolving interest-rate environment, leading to rapidly declining margins or weaker efficiency.
- Intragroup tensions were to heighten once again, challenging the group's function, damaging its reputation, and weakening its operating performance.

Upside scenario

At this stage, we believe an upgrade is remote, because our base scenario assumes that the group will not issue sufficient bail-in-able instruments to benefit from one notch of uplift for ALAC in the next two years. Even if this were to happen in the next two years, we consider the group's lower geographic and business diversity than 'A+' rated peers and the lingering uncertainties surrounding CMA's future within the group as limiting potential rating upside.

Ratings Score Snapshot

Issuer Credit Rating: A/Stable/A-1

SACP: a

- Anchor: bbb+
- Business Position: Strong (+1)
- Capital and Earnings: Strong (+1)
- Risk Position: Adequate(0)
- Funding and Liquidity: Average and Adequate (0)

Support: 0

- ALAC Support: 0
- GRE Support: 0
- Group Support: 0
- Sovereign Support: 0

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- 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: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banks: Rating 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

Ratings List

Ratings Affirmed	
Caisse Centrale du Credit Mutuel	
Credit Industriel et Commercial	
Caisse Federale du Credit Mutuel de Maine-Anjou Basse Normandie	
Caisse Federale du Credit Mutuel Ocean	
Caisse Federale du Credit Mutuel Nord Europe	
Caisse Federale du Credit Mutuel Antilles-Guyane	
Banque Federative du Credit Mutuel	
Issuer Credit Rating	A/Stable/A-1
Resolution Counterparty Rating	A+/--/A-1
Caisse Centrale du Credit Mutuel	
Caisse Federale du Credit Mutuel de Maine-Anjou Basse Normandie	
Caisse Federale du Credit Mutuel Ocean	
Caisse Federale du Credit Mutuel Nord Europe	
Caisse Federale du Credit Mutuel Antilles-Guyane	
Banque Federative du Credit Mutuel	
Certificate Of Deposit	
Foreign Currency	A
Local Currency	A/A-1
Credit Industriel et Commercial	
Certificate Of Deposit	
Foreign Currency	A
Banque Federative du Credit Mutuel	
Senior Unsecured	A
Commercial Paper	A-1

Caisse Centrale du Credit Mutuel		
Caisse Federale du Credit Mutuel Antilles-Guyane		
Caisse Federale du Credit Mutuel Nord Europe		
Caisse Federale du Credit Mutuel Ocean		
Caisse Federale du Credit Mutuel de Maine-Anjou Basse Normandie		
Credit Industriel et Commercial		
Credit Industriel et Commercial, New York Branch		
Commercial Paper	A-1	
Upgraded		
	To	**From**
Banque Federative du Credit Mutuel		
Senior Subordinated	A-	BBB+
Subordinated	BBB+	BBB
Junior Subordinated	BBB-	BB+
Caisse Federale du Credit Mutuel Nord Europe		
Subordinated	BBB+	BBB
Junior Subordinated	BBB-	BB+