12 Nov 2020 | Affirmation

Fitch Affirms Credit Mutuel Alliance Federale at 'A+'; Outlook Negative

Fitch Ratings-Paris-12 November 2020:

Fitch Ratings has affirmed Credit Mutuel Alliance Federale's (CM Alliance Federale) Long-Term Issuer Default Rating (IDR) at 'A+' with a Negative Outlook and Viability Rating (VR) at 'a+'.

Fitch has also affirmed the ratings of Banque Federative du Credit Mutuel S.A. (BFCM) and Credit Industriel et Commercial S.A. (CIC).

The rating actions reflect Fitch's view that the bank's ratings have sufficient headroom to absorb moderately large pressure on asset quality and profitability mainly due to the bank's solid capitalisation profile.

The Negative Outlook reflects downside risks to our base case, as pressure on the ratings would increase if the downturn is deeper or more prolonged than we currently expect. Fitch expects France's GDP to contract by 10.5% in 2020 before growing by 5.4% in 2021.

Key Rating Drivers

IDRs, VR

CM Alliance Federale's ratings reflect its stable and diversified business model, fairly low risk appetite and sound asset quality. They also reflect its resilient profitability, strong capitalisation and adequate liquidity.

CM Alliance Federale comprises 13 of the 18 regional federations of local banks of the wider Credit Mutuel (CM) group and accounts for about 80% of CM group's revenue, total assets and equity. Fitch rates CM Alliance Federale on a standalone basis as its large size would make it difficult for other CM group members to support it, despite the legally-based mutual solidarity between them. We consider the risk of CM Alliance Federale having to provide extraordinary support to other CM group members, as possible but remote and this does not negatively affect the ratings. The probability of such an event is low in our opinion, given other CM group members' sound credit profiles.

The central institution of CM Alliance Federale, Caisse Federale de Credit Mutuel (CFdeCM) and its affiliated local banks are linked by a contractual mutual support mechanism. They publish consolidated accounts and share a common strategy, brand and joint marketing activities. Risk management is also centralised. The entities forming CM Alliance Federale are considered as a single unit by banking supervisors, in addition to supervision at CM group level. We consequently assign group ratings to CM Alliance Federale, in accordance with Annex 4 of our Bank Rating Criteria.

CM Alliance Federale is the third-largest retail and commercial bank in France and has well-established life and non-life insurance franchises. It generates most of its revenue domestically. Outside of France it is mainly active in Germany, where it offers consumer finance, leasing and factoring. The bank's strategy is well articulated and its cooperative status supports its low risk appetite.

About half of CM Alliance Federale's loan portfolio comprises low-risk housing loans. Higher risk consumer finance loans account for about 10% of the portfolio and benefit from a sound risk-return profile. The group is conservative in its lending to professionals and SMEs.

CM Alliance Federale maintained healthy asset quality metrics in 1H20, with an impaired/gross loans ratio of 3.1% and high coverage of impaired loans by loan loss allowances, at about 72%. We expect loan performance to deteriorate further in the coming 12-18 months and the impaired loans ratio to peak at around 4% by end-2021 under our baseline assumptions. At end-June 2020, the bank had deferred about EUR3.5 billion in loan payments until end-September 2020. We expect further deferrals will be granted to support businesses in particularly exposed sectors (restaurants, hotels, tourism for example) as France enters its second lockdown.

CM Alliance Federale has strong recurring profitability, generally commensurate with a low risk appetite. It has repeatedly had stronger operating efficiency than peers, despite its de-centralised structure and large branch network, and continued to demonstrate strong cost control during 1H20. However, the bank's 1H20 operating profitability was burdened by high loan impairment charges at about 50bp of average gross loans, mainly reflecting the bank's conservative classification of loans in sensitive sectors to Stage 2. The bank's insurance and capital markets activities weighed on performance over the half-year, whereas retail and commercial banking networks were supportive with sustained loan production.

Capitalisation is a key rating strength for CM Alliance Federale and compares favourably with most of its French and European banking peers. This is owing to the bank's low risk appetite, prudent capital planning and limited payouts to cooperative shareholders. CM Alliance Federale has a strong buffer over its regulatory capital requirements - the bank's Common Equity Tier 1 (CET1) capital of 17.1% at end-June 2020 exceeded its regulatory requirement by a wide margin. In conjunction with the bank's strong pre-impairment profits, this provides ample cushion against asset quality shocks. Nonetheless, given the downside risks to our base case forecasts, we believe that our assessment and rating of the bank's capitalisation are sensitive to risk-weighted assets (RWA) inflation from weaker creditworthiness of the bank's counterparties.

CM Alliance Federale benefits from a large and stable deposit base, originating mainly from its domestic branch networks. The bank's liquidity improved markedly in 1H20, owing to strong deposit inflows during the half year. This is partly due to households building precautionary savings and corporates drawing liquidity lines and holding onto state-guaranteed loan proceeds to strengthen their liquidity position. CM Alliance Federale's liquidity also benefited from a higher buffer of cash, central bank placements and high-quality liquid assets (HQLA), which totaled about 20% of group assets, excluding insurance assets.

A more permanent and structural improvement in the group's liquidity profile would lead to a change in our 'a' score for funding and liquidity to 'a+', in line with the VR. The 'a' score for funding and liquidity results in a Short-Term IDR of 'F1', which is the lower of the two possible Short-Term IDRs mapping to a 'A+' Long-Term IDR.

SUBSIDIARIES

Fitch has common VRs for CM Alliance Federale, BFCM and CIC. BFCM made up 80% of CM Alliance Federale's consolidated assets at end-June 2020 (the other 20% relate to the local CM banks). It is the group's main issuing vehicle on the financial markets and it coordinates the group's subsidiaries. CIC is owned by BFCM and accounts for about 45% of group assets. It is one of the group's two retail and commercial networks in France and hosts the group's modest corporate and investment banking activities.

BFCM and CIC are highly integrated within CM Alliance Federale in terms of management, systems, capital and liquidity. This means that the subsidiaries' and group's credit profiles cannot be separated. As of September 2020, BFCM also officially became part of CM group's solidarity mechanism.

SUPPORT RATINGS AND SUPPORT RATING FLOORS

CM Alliance Federale's, BFCM's and CIC's Support Ratings (SR) of '5' and Support Rating Floors (SRF) of 'No Floor' reflect Fitch's view that although possible, sovereign support cannot be relied upon. Legislative, regulatory and policy initiatives, including the implementation of the EU's Bank Recovery and Resolution Directive, have substantially reduced the likelihood of sovereign support for EU commercial banks in general, in our view. This implies that senior creditors would probably be required to participate in losses, if necessary, instead of, or ahead of, the bank receiving sovereign support, despite CM's systemic importance.

SENIOR PREFERRED DEBT

Fitch has affirmed BFCM's and CIC's senior preferred long- and short-term debt ratings at 'AA-' and 'F1+', respectively. These are one notch above the Long- and Short-Term IDRs of BFCM and CIC to reflect the protection that will accrue to senior preferred debt from debt and equity resolution buffers. This is because Fitch expects CM Alliance Federale to fill its total minimum requirement for own funds and eligible liabilities (MREL) without recourse to senior preferred debt within up to the next five years.

DERIVATIVE COUNTERPARTY RATING AND DEPOSIT RATINGS

Fitch has affirmed BFCM's Derivative Counterparty Rating (DCR) at 'AA-(dcr)', in line with equally ranking senior preferred debt. Fitch has also affirmed BFCM's and CIC's long- and short-term deposit ratings at 'AA-' and 'F1+' as deposits rank pari passu with senior preferred debt and derivatives claims in France.

SENIOR NON-PREFERRED DEBT

BFCM's senior non-preferred long-term debt rating is in line with BFCM's Long-Term IDR. Fitch views the probability of default on the senior non-preferred notes as the same as that of the bank.

SUBORDINATED AND JUNIOR SUBORDINATED DEBT

Subordinated debt and deeply subordinated debt issued by BFCM are notched down from CM Alliance Federale's 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 two notches below CM Alliance Federale's VR to reflect below average recoveries for this type of debt arising from subordination in case of a non-viability event. Legacy deeply subordinated Tier 1 securities are rated four notches below CM Alliance Federale's VR to reflect the high loss severity risk of these securities (two notches from the VR) as well as a higher risk of non-performance (an additional two notches) relative to the bank's VR.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

CM Alliance Federale's ratings would likely be downgraded on a combination of a pronounced and sustained deterioration in impaired loans associated with a lower coverage ratio, a sustained reduction of the bank's operating profitability/RWA ratio below 1.5% and deterioration in the CET1 ratio significantly below 16%.

Although currently not expected, a weakening in the creditworthiness of other CM group members could also negatively affect CM Alliance Federale's ratings.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

The Outlook on the Long-Term IDR could be revised to Stable if the economy continues to perform in line with our base case, therefore keeping the negative pressure on asset quality, earnings and capital in line with our current assessment.

In the event CM Alliance Federale is able to withstand rating pressure arising from the pandemic, the most likely trigger for an upgrade would be a significant franchise expansion or demonstration of even stronger or stable financial metrics. We consider that given its currently high rating, an upgrade is unlikely in the current operating environment.

SUBSIDIARIES

BFCM's and CIC's ratings are sensitive to changes in the ratings of CM Alliance Federale and changes to BFCM's and CIC's role and integration within the group, which we do not expect.

SRs AND SRFs

An upgrade of CM Alliance Federale's, BFCM's and CIC's SRs and upward revision of the SRFs would be contingent on a positive change in the French sovereign's propensity to support its banks. While not impossible, this is highly unlikely, in Fitch's view.

DERIVATIVE COUNTERPARTY RATING, DEPOSIT RATINGS AND SENIOR DEBT

Senior preferred and senior non-preferred debt, deposit ratings and DCRs of the abovementioned entities of the group could be downgraded if CM Alliance Federale's Long-Term IDR is downgraded or if Fitch no longer expects CM Alliance Federale to meet its resolution buffer requirements with only senior non-preferred debt and more junior instruments within three to five years.

SUBORDINATED AND JUNIOR SUBORDINATED DEBT

The ratings of the subordinated debt and deeply subordinated debt issued by BFCM are primarily sensitive to a change in CM Alliance Federale's VR.

Best/Worst Case Rating Scenario

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579]

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING
The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

Credit Mutuel Alliance Federale; Long Term Issuer Default Rating; Affirmed; A+; Rating Outlook Negative
; Short Term Issuer Default Rating; Affirmed; F1
; Viability Rating; Affirmed; a+
; Support Rating; Affirmed; 5
; Support Rating Floor; Affirmed; NF
Banque Federative du Credit Mutuel S.A.; Long Term Issuer Default Rating; Affirmed; A+; Rating Outlook Negative
; Short Term Issuer Default Rating; Affirmed; F1
; Viability Rating; Affirmed; a+
; Support Rating; Affirmed; 5
; Support Rating Floor; Affirmed; NF
; Derivative Counterparty Rating; Affirmed; AA-(dcr)

----junior subordinated; Long Term Rating; Affirmed; BBB
----Senior non-preferred; Long Term Rating; Affirmed; A+
----subordinated; Long Term Rating; Affirmed; A-
----long-term deposits; Long Term Rating; Affirmed; AA-
----Senior preferred; Long Term Rating; Affirmed; AA-
----short-term deposits; Short Term Rating; Affirmed; F1+
----Senior preferred; Short Term Rating; Affirmed; F1+
Credit Industriel et Commercial S.A.; Long Term Issuer Default Rating; Affirmed; A+; Rating Outlook Negative
; Short Term Issuer Default Rating; Affirmed; F1
; Viability Rating; Affirmed; a+
; Support Rating; Affirmed; 5
; Support Rating Floor; Affirmed; NF
----long-term deposits; Long Term Rating; Affirmed; AA-
----Senior preferred; Long Term Rating; Affirmed; AA-
----short-term deposits; Short Term Rating; Affirmed; F1+
----Senior preferred; Short Term Rating; Affirmed; F1+

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Additional information is available on www.fitchratings.com

Applicable Criteria

Bank Rating Criteria (pub. 28 Feb 2020) (including rating assumption sensitivity)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Status

Endorsement Policy

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