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Fitch Revises Societe Generale's Outlook to Stable; Affirms at 'A-'

Fitch Ratings - Paris - 16 Oct 2024: Fitch Ratings has revised the Outlook on Societe Generale S.A.'s (SG) Long-Term Issuer Default Rating (IDR) to Stable from Positive and affirmed the IDR at 'A-' and Viability Rating (VR) at 'a-'.

The Outlook revision on SG's Long-Term IDR follows Fitch's revision to Negative of the Outlook on France's sovereign Long-Term IDR on 11 October 2024 (see Fitch Revises France's Outlook to Negative; Affirms at 'AA-' at www.fitchratings.com) and the subsequent revision to negative of the outlook on the operating environment (OE) for French banks. The latter is assessed at 'aa-' and is capped at the sovereign rating, and would be downgraded should the sovereign be downgraded. Fitch believes the downward pressure on the French sovereign and on the OE offsets upside rating potential in the near term.

We still believe SG's strategic initiatives should nonetheless structurally improve its performance, as it plans to address the bank's main long-standing weaknesses and could lead to a gradual catch-up with its higher-rated French peers in the medium term.

A full list of rating actions is below.

Key Rating Drivers

Capital, Earnings Drive Ratings: SG's ratings mainly reflect the group's adequate capitalisation and improving execution, which Fitch expects to lead to more predictable and structurally higher earnings over the 2023-2026 strategic plan. SG's diversified business profile and tightened risk appetite are rating strengths. Asset quality is sound, following gradual improvements and SG's focus on reducing its impaired loans ratio, although this remains higher than most similarly rated European peers'.

Diversified Business Profile: The bank has a diverse business profile, with strong franchises in key activities. Its earnings are more reliant on corporate and investment banking (CIB) businesses than most large French banks. This partly explains its more volatile performance over the past decade, although it is focusing on improving its earnings stability.

SG is the fourth-largest retail and commercial bank in France. Its profitable activities in the Czech Republic and Romania, and its growing car leasing business provide good earnings diversification, and the group's execution has generally improved since 2020.

Prudent Risk Appetite: SG has a moderate risk profile, with centralised and robust risk management and controls. It applies conservative underwriting standards for home and consumer loans, and is in line with market practice for corporate loans in France. It has tightened its risk appetite in CIB and international retail banking. Its exposure to traded market risks is material, but lower than at most global trading and universal banks. Recent hedging losses in French retail banking have led SG to strengthen its interest rate risk management.

Moderate Asset-Quality Risks: The bank's impaired loans ratio is slightly above higher-rated European peers'. Although it has materially improved due to more active impaired loan management and tighter underwriting standards, Fitch forecasts the ratio to remain slightly above 3% over the next two years. The disposal of higher-risk African subsidiaries should nonetheless benefit SG's asset quality from 2025. We project loan impairment charges will remain at 25bp-30bp over 2024-2026**.**

Slowly Improving Underlying Profitability: SG has historically been less profitable than higher-rated peers. Fitch forecasts that SG's operating profit/risk-weighted assets (RWAs) ratio will gradually recover to close to 2% in 2025, above its long-term average but still below most large European peers. This is notably due to a slower-than-expected recovery in domestic interest margins added to risks from a weakening OE. However, SG's stronger execution and the disappearance of one-off items that clouded 2023 and 1H24 results should support the bank's profitability rebound in the medium term.

Adequate Capital Buffers: The bank's capitalisation is sound, commensurate with its risk profile, and adequate in relation to its planned growth, shareholder distributions and increased regulatory requirements. Its direct exposure to the French sovereign remains limited, relative to the size of its capital. Fitch expects SG's common equity Tier 1 (CET1) ratio (end-June 2024: 13.1%) to remain in 13%-13.5% by end-2026. Despite further impacts from the Basel III endgame regime and shareholder distributions, our expectation is supported by SG's focus on capital build-up, assets disposals, and gradually recovering internal capital-generation capacity.

Stable Funding and Liquidity: SG has a diversified funding base and well-established market access. Customer deposits represent less than half the bank's funding, a lower proportion than peers', and its large capital markets unit leads to material structural short-term funding needs. However, the bank has a sound liquidity buffer, with cash and high-quality liquid assets covering short-term financing needs, including maturing long-term debt.

Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/ Downgrade

SG retains sufficient rating headroom to withstand a one-notch downgrade of the French sovereign to 'A+' or of the OE score for French banks to 'a+' from 'aa-'.

However, its ratings could come under pressure if the OE deteriorated more significantly than we expect, for instance due to a larger than anticipated effect of a more restrictive fiscal policy on the economic environment or structurally higher risks from the already high private-sector indebtedness.

For this to be rating negative, it would have to result in SG's CET1 ratio dropping below 12% for an extended period with no credible plan to restore it above this level, combined with sustained deterioration in the operating profit/RWAs ratio towards 1%. We believe this could result from sharp asset-quality deterioration or from an erosion of SG's competitive position in some key franchises, which we do not expect.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/ Upgrade

In the event of a stabilisation of the OE at the current level, an upgrade would most likely result from an operating profit/RWAs ratio sustainably close to 2%, especially if this reflects good progress on the execution of SG's strategic plan. If the OE was downgraded to 'a+', the upgrade would be contingent to a longer record of improved earnings comfortably above 2%.

In both cases, we would also expect the bank to maintain a moderate risk profile and an impaired loans ratio close to 3% or lower, while keeping a fully loaded CET1 ratio consistently at or above 13%.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

Short-Term IDR

SG's Short-Term IDR of 'F1' is the higher of two options that map to a 'A-' Long-Term IDR, reflecting our 'a' assessment for funding and liquidity.

Derivative Counterparty Rating, Deposit Ratings and Senior Debt

SG's Derivative Counterparty Rating (DCR), and long-term senior preferred debt and deposit ratings are one notch above the Long-Term IDR due to the protection accruing to these liabilities from the bank's buffers of subordinated and senior non-preferred debt, which we expect to continue to exceed 10% of RWAs on a sustained basis (end-June 2024: 16.5%-17%). For the same reasons, SG's senior non-preferred debt is rated in line with the Long-Term IDR.

We also expect SG to meet its total minimum requirement for own funds and eligible liabilities (MREL) without recourse to senior preferred debt, although the introduction of full depositor preference in the EU could lead to lower buffers of senior non-preferred debt over the longer term. SG's end-June 2024 MREL ratio equalled 28.3% of RWAs, excluding senior preferred debt, which is above SG's total requirement of 27.6%.

Subordinated Debt and Junior Subordinated Debt

Fitch rates SG's subordinated Tier 2 debt at 'BBB', two notches below the bank's VR, for loss severity, as Fitch expects recoveries to be poor for this type of debt in case of default/non-performance of the bank.

Additional Tier 1 (AT1) debt with fully discretionary coupons is rated four notches below the bank's VR, comprising two notches each for loss-severity and for non-performance risk. Our assessment is based on SG operating with comfortable buffers above coupon-omission points, and on the presence of material distributable items. SG's 4.2% leverage ratio at end-June 2024 is the binding constraint for maximum distributable amounts, with around 60bp over the 3.6% requirement, which we view as sufficient, as it is equivalent to around EUR9 billion.

Government Support Rating

SG's Government Support Rating (GSR) of 'no support' reflects Fitch's view that, although possible, sovereign support cannot be relied upon. In our view, 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.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

Rating Sensitivities

A downgrade of our funding and liquidity assessment for SG (currently 'a') could result in the Short-Term IDR being downgraded to 'F2', all else remaining equal.

SG's DCR, senior debt, and deposit ratings are primarily sensitive to changes in SG's IDRs. We would downgrade the DCR, long-term senior preferred and senior non-preferred debt and deposit ratings by one notch if the combined buffer of subordinated and senior non-preferred debt durably falls below 10% of RWAs - provided that we also expect the group to rely on senior preferred debt to comply with its total MREL over the medium term.

Subordinated debt and deeply subordinated debt are primarily sensitive to a change in SG's VR. In addition, the ratings on deeply subordinated AT1 instruments could be downgraded if non-performance risk increases relative to the risk captured in the bank's VR, for example if capital buffers over regulatory requirements are eroded.

An upward revision of the GSR would be contingent on a positive change in the sovereign's propensity to support the bank. In Fitch's view, this is highly unlikely.

SUBSIDIARIES & AFFILIATES: KEY RATING DRIVERS

The Shareholder Support Ratings and IDRs of SG's subsidiaries, Compagnie Generale de Location d'Equipements S.A. (CGLE) and Franfinance S.A., are based on support from SG.

CGLE and Franfinance's IDRs are equalised with those of SG. This is because we view both entities as having a key role within the group, as providers of car and boat financing (CGLE), and consumer finance and equipment leases (Franfinance) in France. The subsidiaries are well-integrated within the group and SG provides almost all of their funding.

We rate CGLE's short-term senior preferred debt in line with CGLE's Short-Term IDR.

SUBSIDIARIES AND AFFILIATES: RATING SENSITIVITIES

CGLE and Franfinance's ratings are sensitive to changes in SG's IDRs and changes in the subsidiaries' importance to the group or to their integration with SG.

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.

Public Ratings with Credit Linkage to other ratings

The ratings of CGLE and Franfinance are driven by Fitch's assessment of shareholder support from SG.

ESG Considerations

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Societe Generale S.A.	LT IDR	A-	Affirmed		A-
	ST IDR	F1	Affirmed		F1
	Viability	a-	Affirmed		a-

ENTITY/DEBT	RATING			RECOVERY	PRIOR
	DCR	A(dcr)	Affirmed		A(dcr)
	Government Support	ns	Affirmed		ns
• Senior preferred	LT	A	Affirmed		A
• junior subordinated	LT	BB+	Affirmed		BB+
• Senior non-preferred	LT	A-	Affirmed		A-
• subordinated	LT	BBB	Affirmed		BBB
• long-term deposits	LT	A	Affirmed		A
• Senior preferred	ST	F1	Affirmed		F1
• short-term deposits	ST	F1	Affirmed		F1
Compagnie Generale de Location	LT IDR	A-	Affirmed		A-

ENTITY/DEBT	RATING			RECOVERY	PRIOR
d'Equipements S.A.					
	ST IDR	F1	Affirmed		F1
	Shareholder Support	a-	Affirmed		a-
• Senior preferred	ST	F1	Affirmed		F1
Franfinance S.A.	LT IDR	A-	Affirmed		A-
	ST IDR	F1	Affirmed		F1
	Shareholder Support	a-	Affirmed		a-

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Bank Rating Criteria (pub.15 Mar 2024) (including rating assumption sensitivity)

Non-Bank Financial Institutions Rating Criteria (pub.17 Jan 2024) (including rating assumption sensitivity)

Additional Disclosures

Solicitation Status

Endorsement Status

Compagnie Generale de Location d'Equipements S.A.	EU Issued, UK Endorsed
Franfinance S.A.	EU Issued, UK Endorsed

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