MOODY'S
INVESTORS SERVICE

ISSUER COMMENT
06 NOVEMBER 2014

ANALYST CONTACTS

Alessandro Roccati 4420-7772-1603
*Senior Vice President*
alessandro.roccati@moodys.com

Andrea Usai 4420-7772-1058
*VP-Sr Credit Officer*
andrea.usai@moodys.com

Riccardo M Rinaldini 4420-7772-1689
*Associate Analyst*
riccardom.rinaldini@moodys.com

Laurie Mayers 4420-7772-5582
*Associate Managing Director*
laurie.mayers@moodys.com

Société Générale

# SG Third Quarter 2014 Results Commentary

(All comparisons are year over year unless otherwise noted)

In Q3 2014, Société Générale (SG; A2 negative, C- negative/baa2) reported group net income of EUR836 million compared with EUR534 the same period the previous year. This resulted in an annualised pre-tax return of 145 basis points on reported CRDIV risk-weighted assets of EUR353 billion, equivalent to an annualised return on equity of around 7% (Moody's calculations).

We view these results as credit neutral for bondholders. Operating trends showed higher revenues and a lower cost of credit. Capital also improved; however, tail risks (EUR4.8 billion equity and intra-group funding) continue to stem from SG's exposure to Russia (Baa2 negative) due to the country's weak macro conditions and the impact of the US and EU sanctions. Positively, the Group's wholesale funding decreased, due to a reduction of the short-term component whilst liquidity remains ample.

At operating level, revenue growth outpaced operating cost growth and credit provisions decreased to 58bps from 69bps of customer loans. Management stated that the bank aims to reach an agreement with the US authorities over the US sanctions investigations by end-2015. SG has outstanding collective litigation reserves of EUR900 million and didn't book any litigation provision in the quarter.

SG's regulatory capital position and leverage were in line with its global peers that have large capital markets activities: the firm's fully-applied Basel 3 Common Equity Tier 1 (CET1) ratio increased to 10.4% in the quarter and its Basel 3 Tier 1 leverage ratio was 3.8%. As we expected, SG successfully passed the ECB's comprehensive assessment, which consisted of a supervisory judgement on key risks, an asset quality review and a stress test prior to the introduction of the euro area single supervisory mechanism. The outcome of the asset quality review was an adjustment of -22bps on SG's CET1 ratio at end-2013: -20bps for credit risk and -2bps for market risk. SG's transitional CET1 ratio under stress was 10.6% in the base case and 8.1% in the adverse scenario, above the respective minimum requirements of 8.0% and 5.5%. Key drivers of CET1 ratio deterioration in the adverse scenario were cumulative impairment losses on financial and non-financial assets in the banking book, mainly on its corporate exposures.

Positively, the firm's funding profile improved in line with the business plan targets: short-term wholesale funding, including long-term debt maturing within the next 12 months, decreased to EUR94 billion at end-September 2014 from EUR124 billion at end-2013 and the loans-to-deposit ratio decreased to 100% at the same date from

104% at end-2013. However, SG's reliance on confidence-sensitive wholesale funding remains elevated: EUR204 billion, or around 32% of its funded balance sheet at end-September 2014. We view SG's liquidity reserves to be in line with most of its international peers. At end-September 2014, SG reported a LCR > 100% under current Basel 3 assumptions, with a EUR144 billion liquidity buffer covering 153% of EUR94 billion short-term funding, inclusive of the long-term debt maturing within the next 12 months.

Despite moderate improvements over the quarter, SG's asset quality remains lower than that of its large domestic peers due to its exposure to Eastern Europe and Russia and its larger presence in the mid-corporate French market: EUR28 billion problem loans were equal to 6.0% of gross customer loans, higher than other domestic peers .

Performance by main divisions:

The Global Banking and Investor Solutions division (43% of SG's division profits and including the Global Markets, Financing and Advisory, Asset and Wealth Management and Securities Services and Brokerage), reported EUR445 million net income driven by a good performance of the financing and advisory division. Global Markets, SG's investment banking division, recorded a 18% increase in net income driven by lower operating expenses and cost of risk that more than offset the weak performance of the equities business (-25%) owing to low volatility and low volumes in flow products. The FICC business recorded a moderate increase in revenues driven by the good performance of structured products in Asia and forex. The Financing and Advisory division recorded a strong net income of EUR151 million, due to high revenues in natural resources and infrastructure. However, weaker revenues in the private banking segment (-4%) and overall higher operating expenses (+10%) meant that Asset and Wealth Management results were weaker than the same quarter the previous year.

French retail banking (around 29% of SG's division profits), reported a net income of EUR305 million. Amidst the low interest-rate environment and weak demand for new financing, revenues decreased by 3% despite solid growth in deposits (+5%). Whilst operating expenses remained broadly stable, the cost of credit decreased to 51 bps due a reduction of business customers provisions.

The International Retail Banking and Financial Services division (around 28% of SG's division profits) recorded EUR296 million net income. The Financial Services and Insurance subdivision performed well, posting a 9% increase in reported net income driven by EUR1.1 billion net inflow in insurance. In International Retail, operating expenses declined in line with revenues (-2%, net of movements in the foreign-currency exchange rates) and the cost of risk was broadly unchanged at 128 bps. We continue to view SG's exposures to Russia as a credit risk due to the potential volatility of the economy in the country, following recent sanctions from the US and the EU. SG Russia posted a net income of EUR16 million in the quarter and at end-October 2014, SG showed EUR3.2 billion of equity exposures and EUR1.6 billion of intercompany funding (EUR1 billion senior unsecured and EUR0.6 billion of subordinated debt) towards its Russian subsidiaries. Under our central scenario, we view that the anticipated slowdown in Russia should not affect SG's aggregate credit profile; under an adverse scenario, a marked deterioration in business conditions would impair SG's profits and could increase tail risks from its Russian operations.

SG's long-term deposit and debt ratings are A2, the short-term rating is Prime-1, and the bank's standalone BCA is baa2. The senior debt and deposit ratings benefit from three notches of uplift from the standalone BCA, reflecting our current expectation of a very high probability of government support for the bank. The outlook on SG's long-term debt and deposit ratings is negative reflecting the recent adoption of the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism (SRM) regulation in the EU and the implication of these developments for the reduction or elimination of support in SG's long term debt and deposit ratings.