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Research Update:

France-Based Societe Generale 'A/A-1' Ratings Affirmed On Capital Improvement; Outlook Negative

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Overview

- France-based Société Générale's capital position has strongly improved since 2012.
- Because we see less of a chance that the banking group will fall short of our capital and earnings expectations, we have removed this consideration from our outlook.
- We are affirming our 'A/A-1' ratings on Société Générale.
- The outlook remains negative because we are considering removing government support from the ratings by the end of 2015.

Rating Action

On July 18, 2014, Standard & Poor's Ratings Services affirmed its 'A/A-1' long- and short-term counterparty credit ratings on France-based Société Générale. We also affirmed our 'A/A-1' ratings on the group's core subsidiaries Crédit du Nord S.A. (including its regional banks), Franfinance, Komercni Banka A.S., SG Americas Securities LLC, and Société Générale Bank & Trust. (See the Ratings List below for details).

The outlook remains negative.

Rationale

The affirmation reflects our view that our risk-adjusted capital (RAC) ratio for Société Générale group, before benefits for diversification, will exceed 8% by end-2014. As of Dec. 31, 2013, the ratio stood at 7.6%, ahead of our previous expectations. This strong improvement from the 6.7% we calculated at year-end 2012 has resulted primarily from deleveraging measures, notably the bank's reduced exposure to securitizations. We also note that the group raised $3 billion in hybrid debt in 2013, as well as $1.5 billion and €1 billion in the first half of 2014, all in the form of additional Tier 1 instruments.

Société Générale's capital position is commensurate with our "adequate" assessment of its capital and earnings. We expect that in 2014 and 2015 the group will maintain or improve its capital ratios at or above the current level, that is, well above 7%, supported by sound profits and helped by contained low single-digit growth in Standard & Poor's risk-weighted assets. Because we see less of a chance that the banking group will fall short of our capital and earnings expectations, we have removed this consideration from our outlook.

Our expectations for the group's earnings capacity are that it will remain at least stable in 2014 and will strongly increase in 2015, supported by single-digit growth in revenues and a material reduction in expenses, as called for by the bank's strategic plan that it announced on May 13, 2014. We do not rule out the possibility of a hit to profitability from litigation charges in 2014 and 2015, after the €846 million charge in 2013. This amount comprised €446 million to resolve Euribor litigation with the European Commission and a new €400 million unassigned litigation reserve (on top of the creation of a litigation reserve totaling €300 million, posted in 2012). Also supporting our view of the group's capital management is its plan to achieve a Tier 1 ratio at or above 12.5% at the end of 2016 under full implementation of Basel III (that is, not incorporating phase-in arrangements), from 11.8% at end-2013.

Following strongly improved funding and liquidity since 2011, we expect the group will consolidate its position in 2014 and 2015, in alignment with global peers. At the end of 2013, our short-term measure of broad liquid assets to short-term wholesale funding was close to 1.1x and our long-term stable funding ratio stood at 93% (for definitions of these metrics, see "Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions," published on July 17, 2013).

Société Générale's stand-alone credit profile (SACP) finds support from its well-established position in its core markets. The bank combines a stable and successful retail banking operation in France with a sustainable and profitable franchise in corporate and investment banking (CIB), and a growing international retail banking business. The SACP also reflects our view of the bank's well-managed and refocused balance sheet. We note that the group has no exposure to Ukraine. Its exposure at default (EAD) to East European countries outside the EU was 5% of the group's total at end-2013. With about €13 billion in loans outstanding from retail banking and financial services activities, the group's exposure to Russia accounted for a limited 3 percentage points. In our view, this is a manageable risk given the group's risk diversification and financial profile.

We currently consider that Société Générale is of "high" systemic importance to France, which we view as "supportive" of private-sector commercial banks. As a result, and in line with our criteria, the 'A' long-term rating on the bank stands one notch above our assessment of the SACP at 'a-'.

Outlook

The negative outlook indicates that we may lower our ratings on the bank by year-end 2015 if we believe that the likelihood has risen that senior unsecured creditors may incur losses if the bank fails. Specifically, we may lower the long-term rating by one notch if we considered that extraordinary government support is less predictable under the new EU legislative framework (see "Credit FAQ: The Rating Impact Of Resolution Regimes For European Banks," published on April 29, 2014, on RatingsDirect). The potential reduction of extraordinary government support would have no impact on our ratings on Société Générale's subordinated debt. Indeed, we have long believed that subordinated creditors would not receive extraordinary government support in a stress scenario and already rate these instruments by notching down from the SACP.

The negative outlook also reflects the possibility that the group will not consolidate its funding and liquidity profile as we expect it will.

We could revise the outlook to stable if we observed a sustainable improvement in the group's funding and liquidity profile. In addition, we would need to consider that potential extraordinary government support for the bank's senior unsecured creditors was unchanged in practice, despite the introduction of bail-in powers and international efforts to increase banks' resolvability. A revision to stable might also follow if we believed that any steps Société Générale might take, which would provide substantial additional flexibility to absorb losses while a going concern, fully offset increased bail-in risks.

Ratings Score Snapshot

Issuer Credit Rating	A/Negative/A-1
SACP	a-
Anchor	bbb+
Business Position	Strong (+1)
Capital and Earnings	Adequate (0)
Risk Position	Adequate (0)
Funding and Liquidity	Average and Adequate (0)
Support	+1
GRE Support	0
Group Support	0
Sovereign Support	+1
Additional Factors	0

Related Criteria And Research

Related Criteria

- Group Rating Methodology, Nov. 19, 2013
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Assigning "Intermediate" Equity Content To "Tier 2" Bank Hybrid Capital

Instruments, July 16, 2013
- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Hybrid Capital Methodology And Assumptions, Nov. 1, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Credit FAQ: Treatment Of Banks' Insurance Subsidiaries In The Risk-Adjusted Capital Framework, May 23, 2014
- Ratings On France-Based Société Générale Affirmed At 'A/A-1' After Government Support Review; Outlook Remains Negative, April 30, 2014
- Société Générale, July 9, 2013

Ratings List

Ratings Affirmed

Societe Generale
Societe Generale Bank & Trust
SG Americas Securities LLC
Komercni Banka A.S.
Franfinance
Credit du Nord S.A.
Banque Tarneaud S.A.
Banque Rhone Alpes S.A.
Banque Kolb S.A.

Counterparty Credit Rating   A/Negative/A-1

NB: This ratings list does not include all affected ratings.

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