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Published every Monday and Thursday morning, Moody's Credit Outlook informs our research clients of the credit implications of current events.

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BPCE

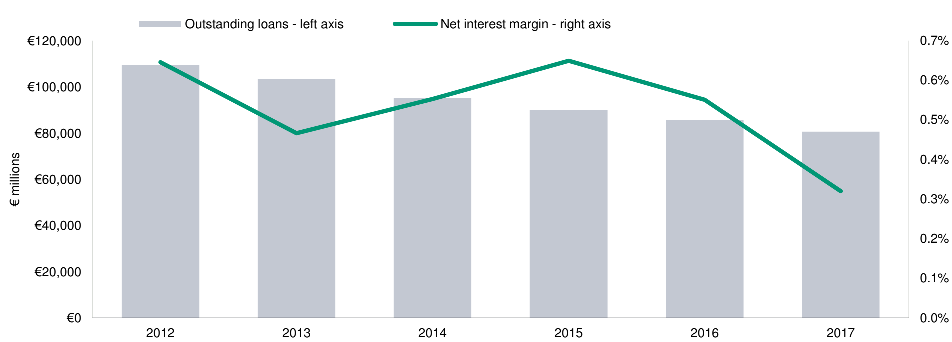
Groupe BPCE would benefit from integration of Credit Foncier de France's activities into its retail networks

From Credit Outlook

Last Tuesday, BPCE (A1/A1 stable, ba1[1]) announced that the activities of its large real estate financing subsidiary, Credit Foncier de France (CFF, A1/A1 stable, b1 direction uncertain), will be carried out by the group's other subsidiaries and retail networks, while CFF's outstanding assets will be managed by CFF until their maturity. This scenario discontinues CFF as a brand and is credit positive for BPCE owing to CFF's high fixed costs and margin pressure in an environment in which pure real-estate financing is no longer viable because of the high reliance on market funding and the non-provision of customer services. The project was approved by BPCE's supervisory board and CFF's board of directors and has been presented to union organisations representing CFF's employees.

As of December 2017, CFF had a consolidated balance sheet of €114 billion, including a loan book of €80 billion. The current low interest rate environment has strained CFF's business model, which specialises in social housing for individuals and real estate for professionals and investors. As Exhibit 1 shows, CFF's net interest margin fell to 32 basis points of gross loans in 2017 from 65 basis points in 2012 and its net banking income declined 23% over the same period. The declines reflect high early repayments (14.8% of mortgage loans to individuals in 2017 versus 11.4% in 2016) and increasing mortgage refinancings (6.2% in 2017 versus 2.4% in 2016) at lower interest rates.

Exhibit 1
CFF's net interest margin is constrained by a decreasing loan portfolio and low interest rates
Outstanding loans and net interest margin as a percentage of gross loans



Sources: Company reports and Moody's Investors Service

Even though CFF has reduced costs, it has not been sufficient to offset margin pressure: operating expenses were a high 84% of its net banking income in 2017 and averaged 76%

between 2012 and 2017. Even though CFF reduced its cost of risk in absolute terms in 2017, impairment charges still absorbed 99% of the lender's pre-provision income in 2017.

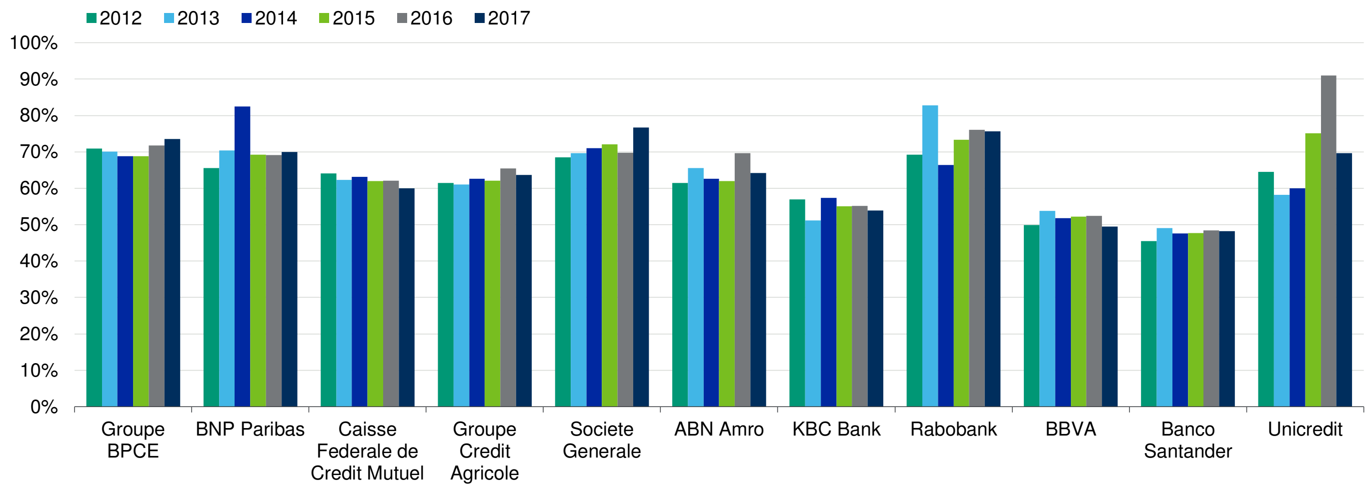
Additionally, CFF's leverage ratio was weak at 3.9% as of December 2017 because of the low risk weight of its large retail and public-sector exposures. CFF's capitalization, as measured by its Basel III transitional phase-in Common Equity Tier 1 ratio, was also relatively low at 10.3%, considering the risks in the loan book and the significant sector and borrower concentrations. CFF has a particularly large exposure to the Italian government (€2.9 billion, or 85% of its international sovereign exposures as of December 2017). Its structurally low earnings-generation capacity limits its ability to improve its solvency and leverage on a standalone basis, which weighs on BPCE group.

BPCE intends to have the group's different entities write new loan production, taking over from CFF. Assets currently on CFF's balance sheet will be managed by CFF until their maturity and CFF will cease to be an active commercial entity. This project would eventually benefit BPCE's financial profile and efficiency, which has lagged most peers for many years (see Exhibit 2) partly because of CFF's limited earning-generation capacity and the significant size of the group's historical networks.

Exhibit 2

BPCE's efficiency is weaker than most of its peers

Cost-to-income ratio as a percentage of net banking income



Sources: Company reports and Moody's Investors Service

BPCE will retain CFF's covered bond financing vehicle, Compagnie de Financement Foncier, which is very active in the markets and has €63 billion of outstanding Aaa-rated covered bonds backed mainly by CFF-originated residential mortgage assets and BPCE-originated public-sector loans. BPCE's decision on CFF is credit neutral for the covered bonds because CFF, which has a long-term Counterparty Risk Assessment of Aa3(cr), will continue to sponsor the covered bond programme and provide multiple services including servicing activities to Compagnie de Financement Foncier. Compagnie de Financement Foncier and the covered bonds will also continue to benefit from BPCE group's strong internal solidarity mechanism which is enshrined in French law. Over the longer term, the share of public sector loans (38% as of fourth-quarter 2017) will increase, which is likely to improve the overall credit quality of the cover pool.

Endnotes

1 The bank ratings shown in this report are the bank's deposit rating, senior unsecured debt rating and Baseline Credit Assessment.

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