BNP Paribas SA
Issuer Rating Report

SCOPE AA- STABLE

Overview

Scope Ratings has assigned an Issuer Rating of AA- and a short-term debt rating of S-1+ to BNP Paribas (BNPP), both with Stable Outlook.

The ratings were not solicited by the issuer. Both ratings and analysis are based solely on publicly available information. The issuer does not participate in the process. For the full list of ratings, see the Ratings section at the end of this report.

Highlights

- The Issuer Rating of AA- for BNPP reflects our view that the Group, which ranks as the euro area's largest banking group by total assets, continues to preserve reassuring, stable credit fundamentals, underpinned by a relatively well-balanced universal-bank business model. Besides being one of the dominant players in the French banking market, BNPP has over the years built or acquired retail and commercial bank franchises – among them on the US West Coast, and in Italy and Belgium. Its wholesale and investment banking businesses remain substantial, but the Group has been able to reduce risk and scale back during and after the crisis without fundamentally altering its business model. BNPP's earning profile is also supported by substantial consumer finance and insurance businesses.
- BNPP displays reassuring prudential and financial metrics, with asset quality and ROAA each on an improving trend in FY17. We are also confident that internal controls and risk management, including business conduct across the group, have been reinforced in the aftermath of the financially painful settlement with US authorities in 2014. The remediation plan agreed as a result remains a key focus, but is nearing completion.

Rating drivers (summary)

The rating drivers, in decreasing order of importance in the rating assignment, are:

- A well-diversified business, with exposure to different activities and geographies.
- The Group displays stable and sustainable earnings power across economic cycles on the back of its balanced universal bank business model.
- In the face of a low-margin environment, BNPP remains committed to increasing efficiency while investing in new digital offerings.

Ratings & Outlook

Issuer Rating	AA-
Outlook	Stable
Senior unsecured debt (non-MREL/TLAC eligible)	AA-
Senior unsecured debt (MREL/TLAC eligible)	A+
Tier 2 instruments	A-
Additional Tier 1 rating instruments	BBB
Short-term debt rating	S-1+
BNP Paribas Home Loan SFH (Covered Bonds)	AAA
BNP Paribas Public Sector SCF (Covered Bonds)	AAA

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Rating change drivers

The ability of BNPP to squeeze more costs out while implementing its 2017-2020 Business Plan. The bank's successful 2014-2016 "Simple & Efficient" program achieved cumulative recurring cost savings of EUR 3.3bn by 2016 (versus EUR 2bn targeted in the initial plan). However, in the face of a low-margin environment restricting revenue growth, and added costs related to regulatory compliance, the bank's cost/income ratio has been under pressure. In 2016 it fell by 40 basis points to 67.7%, but increased again in 2017 to 69.4%. BNPP now targets a 63% cost/income ratio by 2020, on the back of a planned EUR 2.7bn in recurring cost savings. Sustained improvement in the bank's efficiency could eventually put upward pressure on the ratings.

The response of asset quality metrics to a more stressed business climate. BNPP has substantially reduced balance sheet risk since the financial crisis, especially in its corporate and investment banking business, but is currently benefiting from a benign environment regarding asset quality (with Italy standing out as the worst performer). The consumer finance business incurs high cost of risk, but this is factored into its business model, while the bank has made a conscious effort to reduce the riskiness of its consumer finance assets. Should the credit cycle turn harsher, demonstrating strong control of asset quality could be a rating positive.

Steering clear of further major compliance-related issues following the USD 8.97bn settlement with US authorities in 2014 and related temporary restrictions placed on the bank's business. After pleading guilty to laundering money for entities in US-sanctioned countries, thus paying the largest fine to date imposed on any European bank, BNPP accepted the need to completely overhaul its compliance function. It set aside EUR 250mn in 2014 and EUR 100mn in 2015 to fund its remediation plan, which appears adequate so far. BNPP has completed almost 90% of the 47 projects within the plan. BNPP has also put significant additional staff into compliance, with a 70% increase in numbers between 2014 and 2015, 25% in 2016 and a further 11% in 2017. Headcount stood at 3,770 FTEs at year-end 2017.

Rating drivers (details)

A well-diversified business, with exposure to different activities and geographies, coupled with a well-regarded digital offering.

BNPP has pursued a strategy of diversification in recent decades. This has included major bank acquisitions such as Italy's Banca Nazionale del Lavoro (BNL) in 2006 and Belgium's Fortis Bank in 2009. Bank acquisitions have met with varying degrees of success. While the BNL acquisition allowed contiguous geographical expansion, BNL has been the worst performer amongst BNPP's businesses in recent years due to asset quality issues. The Fortis acquisition has proved far more successful, with its pre-tax profit contribution growing to 8% in 2017 from 4% in 2009.

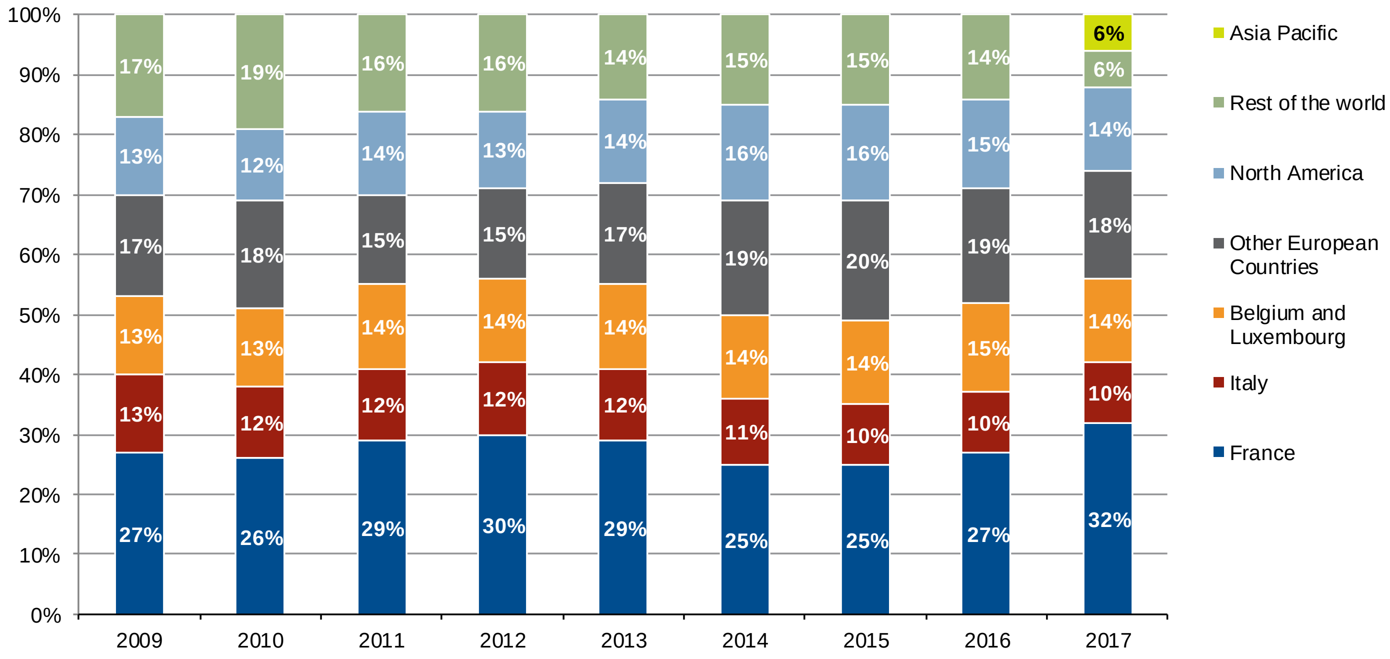
Looking ahead, the bank's strategy could include bolt-on acquisitions, but given BNPP's focus on digital expansion, appears unlikely to encompass sizeable foreign banks with legacy branch infrastructures. BNPP has exposure to a well-developed range of businesses, some of which have been performing more strongly than retail banking. In these areas acquisitions may make more sense. BNPP's vehicle leasing operations, for example, were enhanced when the bank acquired GE Capital's European fleet management arm in 2015.

BNPP's 2017-2020 strategic plan commits the Group to an ambitious program for improving its digital and mobile customer offerings and gathering a higher proportion of revenues through these additional sources. During 2017 BNPP launched Lyfpay, a universal mobile payment platform via an app, letting customers make in-store, online and peer-to-peer mobile payments as well as using store loyalty cards, coupons and special offers. BNPP recorded 38% more app visits in December 2017 (51 million) than seen a year earlier.

One of the cornerstones of the Group's digital strategy is Hello bank! Established in 2013, Hello bank! conducts banking business in France, Belgium, Italy, Germany and Austria, solely via mobile technology. It had 2.9 million customers by the end of 2017, and already generated 11% of the Group's revenues from individual clients. BNPP has also been developing digital offerings across the rest of its international retail banking network. During 2017, BNPP acquired Compte-Nickel to strengthen its digital offering in France. This company already had 800,000 accounts, and – via 2,900 tobacconists – offers an account management service (with no conditions regarding income or wealth) allowing real-time transactions, but no credit facilities.

Figure 1 shows the evolution of geographical risk diversification within the Group since 2009, with French domestic risk accounting for 32% of the total in 2017.

Figure 1: On and off balance-sheet commitments 2008-2017 -- geographical breakdown



Source: Company data, Scope Ratings

The group displays stable and sustainable earnings power across economic cycles on the back of its balanced universal bank business model.

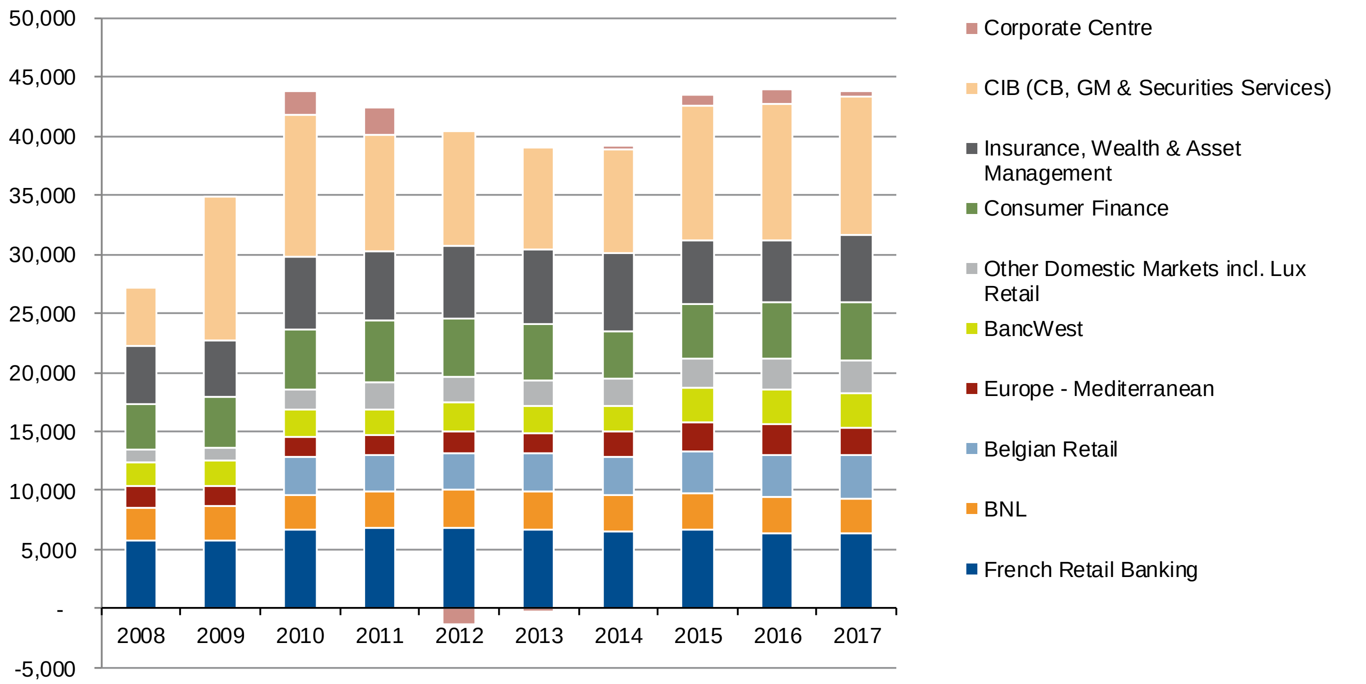
Aside from the items feeding through the corporate centre, in 2017 BNPP's European retail banking businesses in France, Belgium and Italy accounted for 30% of group revenues but only 19% of pre-tax profits. The bank in Luxembourg is excluded from these figures due to lack of separate accounting disclosure. The sub-par bottom line contribution primarily reflects the relatively inefficient French retail operation, margin pressures and provisioning costs at BNL, which continue to absorb a high proportion of the latter's operating income.

The other retail banking businesses are on a smaller scale: California-based BancWest and the Europe-Mediterranean segment (covering 14 countries including Turkey, Poland, Ukraine, Morocco, Tunisia, Algeria and sub-Saharan Africa, and operating in partnership with Bank of Nanjing in China.). These respectively accounted for 5% and 7% of 2017 revenues and 6% and 5%% of pre-tax profit.

The CIB was the second largest bottom-line contributor in 2017, with 24% of revenues and 23% of pre-tax profit. Its share of pre-tax profit fallen from over one third before the financial crisis. The decline over time in CIB revenues is understandable in light of risk reduction and scaling back of activities in several areas, and we do not view this as a negative trend. We consider that the business has performed well enough since the losses experienced in Global Markets in 2010. The strength of the corporate banking business helps BNPP to stack up relatively well versus other European peers in terms of the scale of its revenue base.

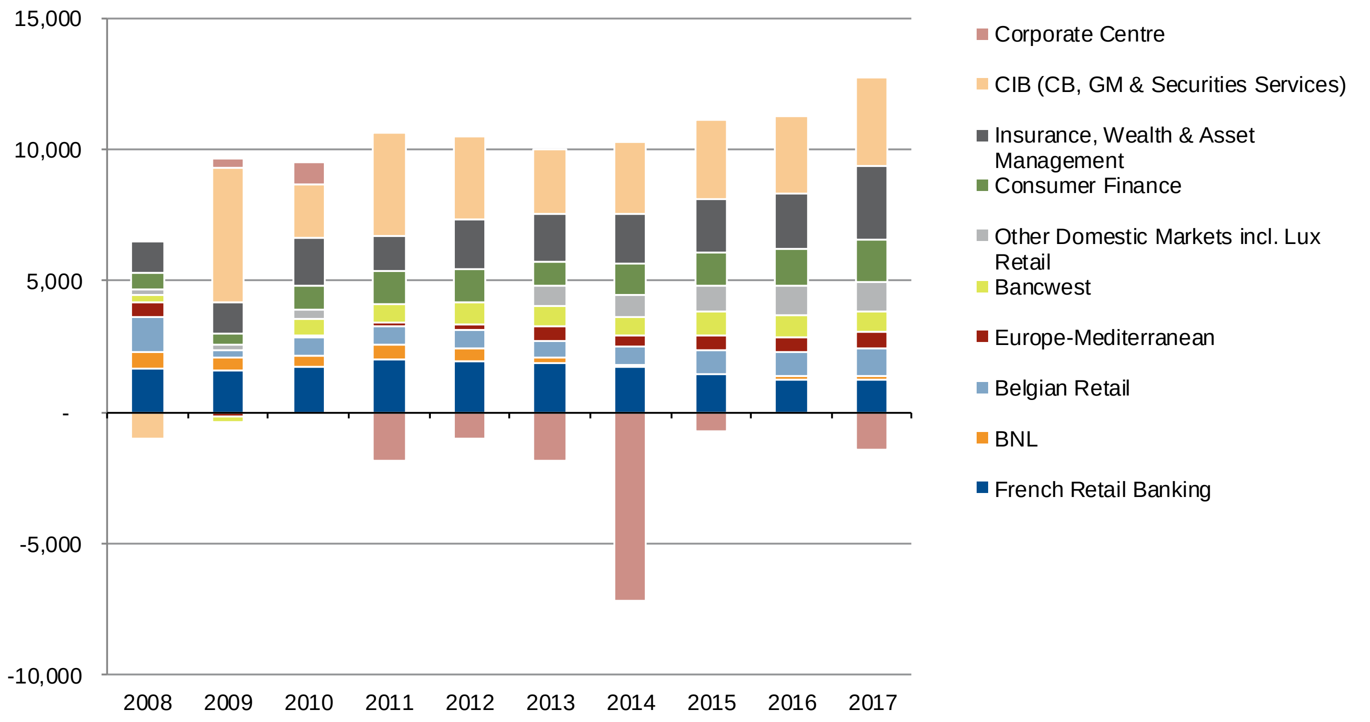
Wealth and Asset Management and Insurance represented 18% of total 2017 pre-tax profit and BNPP Personal Finance (consumer finance) 13%, based on 13% and 11% revenue shares respectively. In terms of long-term earnings growth, the consumer finance business (BNP Paribas Personal Finance) has stood out over the period since the financial crisis, helping to hedge against pressures in the retail banking businesses. The insurance business (marketed through both the retail banking and consumer finance platforms) has also proved to be a solid and substantial performer, as have the Group's equipment and vehicle leasing businesses.

Figure 2: BNPP revenue mix 2008-2017 (EUR mn)



Source: Company data, Scope Ratings

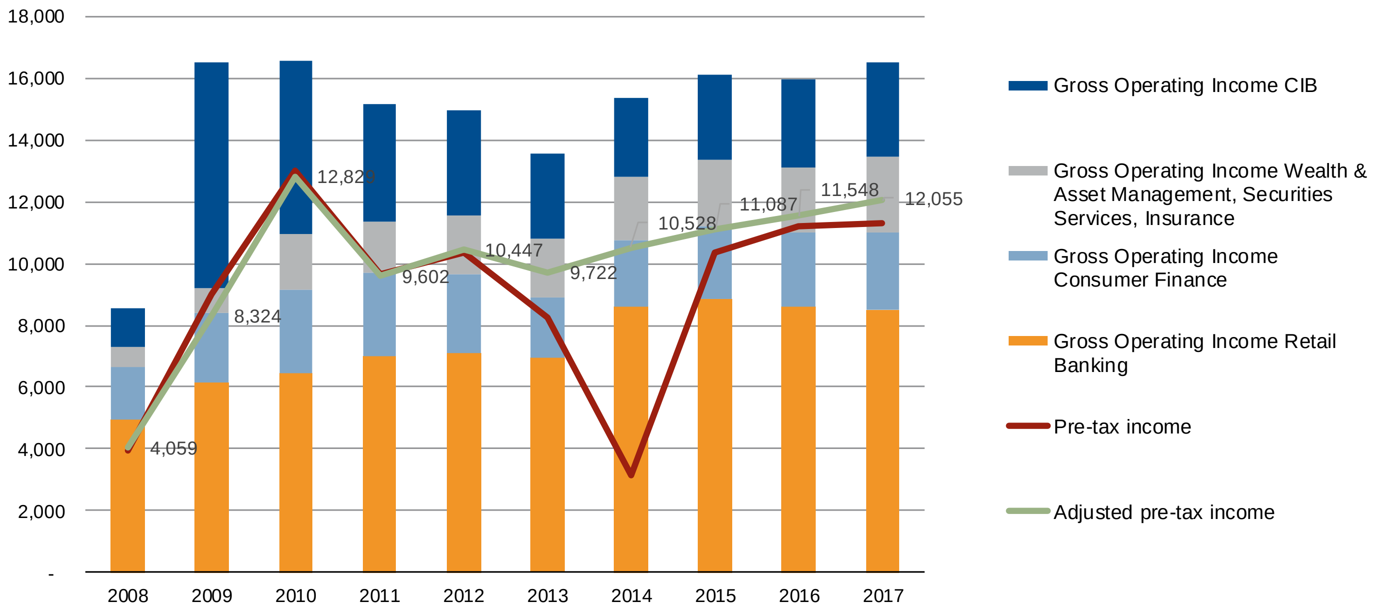
Figure 3: BNP Paribas pre-tax profit mix 2008-2017 (EUR mn)



Source: Company data, Scope Ratings

Figure 4, compiled after adjusting divisional profitability for one-off items, shows that the earnings contribution from retail businesses remains both important and relatively stable and sustainable. The consumer finance business (BNP Paribas Personal Finance) is accounted for within BNPP' retail businesses, but in terms of gross operating income it weighs similarly to both to the Wealth and Asset Management/Securities Services/Insurance businesses and the CIB, while contributing a growing level of pre-tax profit, which since 2016 has exceeded that generated by the French retail banking business.

Figure 4: BNPP's adjusted gross operating income breakdown and pre-tax income, 2008-2017 (EUR mn)



Source: Company data, Scope Ratings

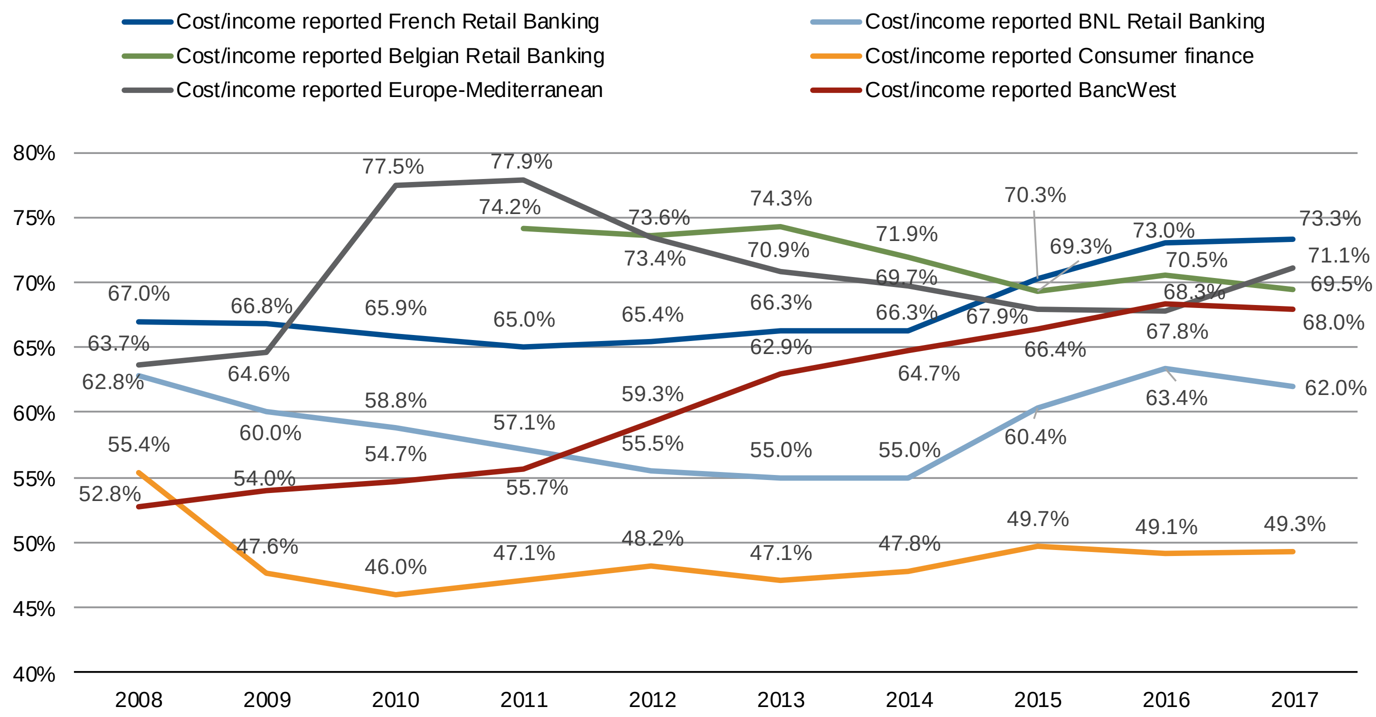
Commitment to increasing efficiency and streamlining operations while investing in new digital and mobile customer offerings designed to improve the customer experience.

In recent years BNPP has delivered significant cost savings contributing to efficiency, while at the same time seeing increased regulatory compliance costs and investing in the Group's digital offerings. The cost/income ratio remains relatively high compared with many European peers.

In February 2017 BNPP unveiled its 2017-2020 business plan. This sets out the bank's aims to continue transforming its customer-facing mobile banking and digital platforms across each business line and in all geographies. From 2020 onwards BNPP seeks to generate EUR 2.7bn in recurrent annual savings. Before this, given that the plan involves upfront investment and development in addition to streamlining of processes, BNPP estimated incurring EUR3 bn in transformation costs between 2017 and 2019, offsetting this with around EUR3.4bn in planned cost savings during the same period. In 2017 transformation costs were EUR 856 mn, with EUR 533 mn in recurring cost savings.

We believe that a strategic focus on higher efficiency remains vital given the low-growth and low-margin environment in which banks must operate, especially in France, which still suffers from significant rigidity in its labour market. As demonstrated in Figure 5 below, the French retail banking network has the weakest cost/income ratio amongst BNPP's main retail businesses (73.3% in FY17), with BancWest and the Belgian network not far behind. Notably, efficiency has also been worsening in some of the Group's other retail operations.

Figure 5: Divisional cost/income ratios of main retail businesses (%)

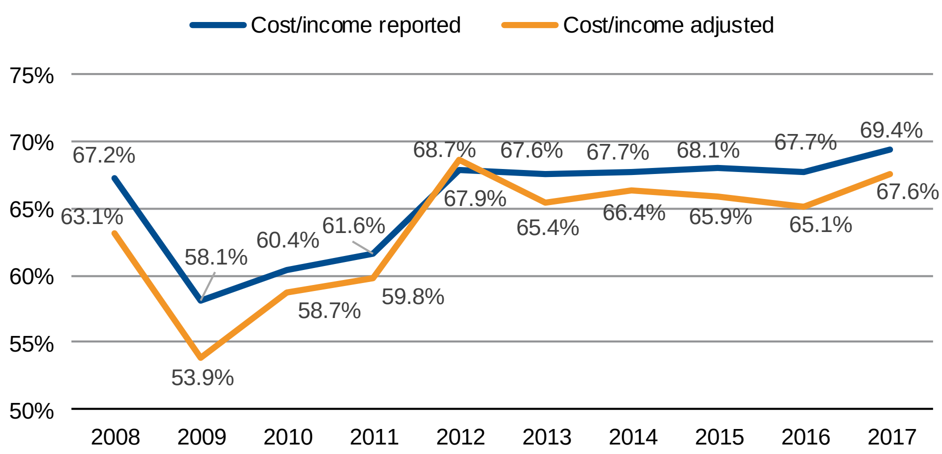


Source: Company data, Scope Ratings estimates

In this respect, BNPP's commitment to further cost reductions remains an important rating driver. BNPP is targeting a cost/income ratio of 63% in 2020, versus 69.4% in 2017 (deteriorating from 67.7% in 2016). Even in light of the significant cost savings achieved to date, BNPP has incurred one-off business transformation costs, while compliance expenses have increased.

Adjusting the reported figures to take account of one-off items reveals that the underlying cost/income ratio is lower than the reported one, as demonstrated in Figure 6.

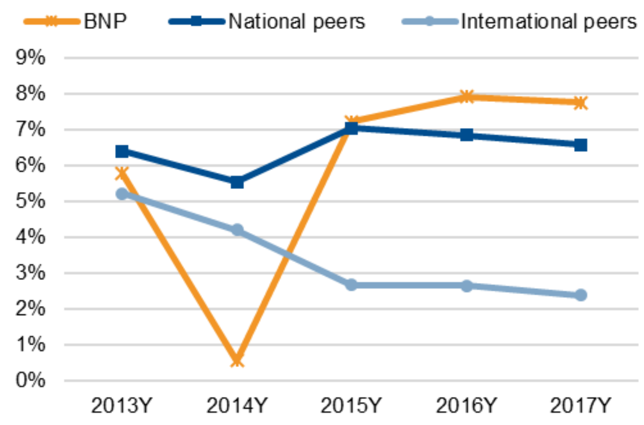
Figure 6: Cost/ Income Ratio of BNPP adjusted vs. reported (%)



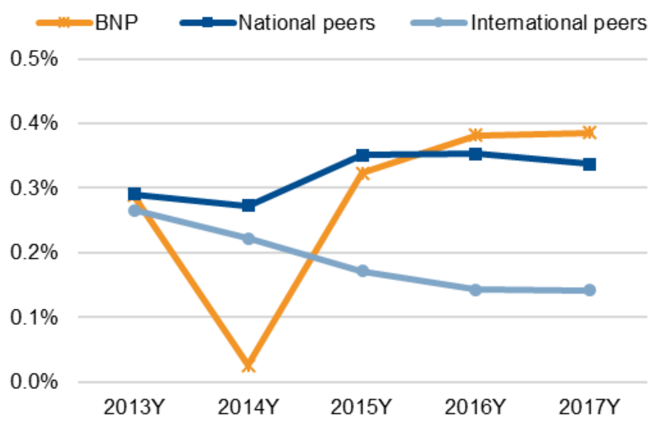
Source: Company data, Scope Ratings estimates

I. Appendix: Peer comparison

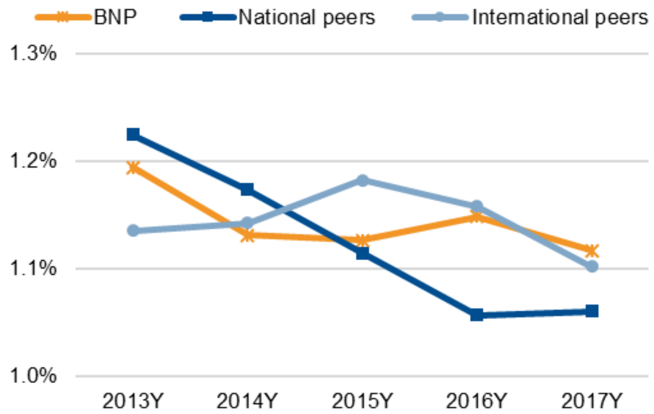
Return on average equity (ROAE, %)



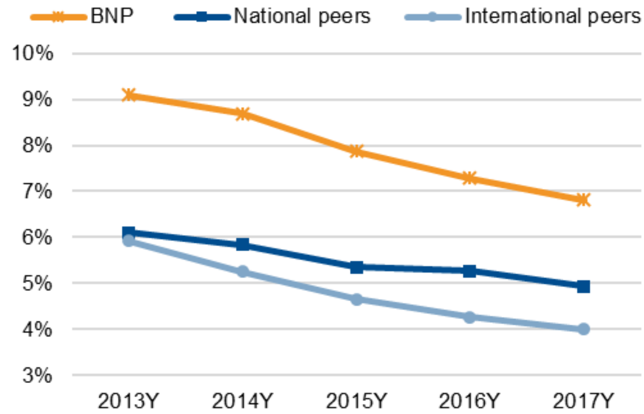
Return on average assets (ROAA, %)



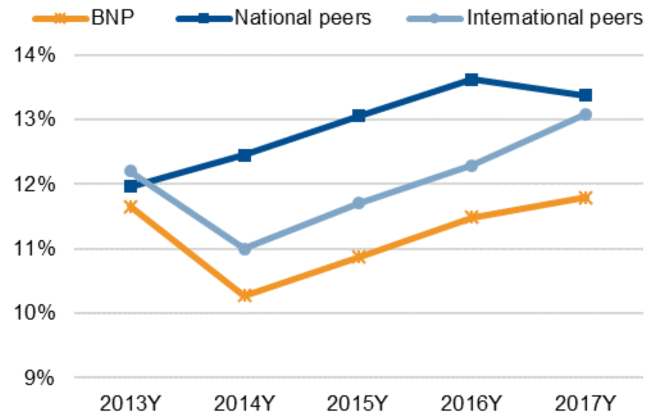
Net Interest Margin (%)



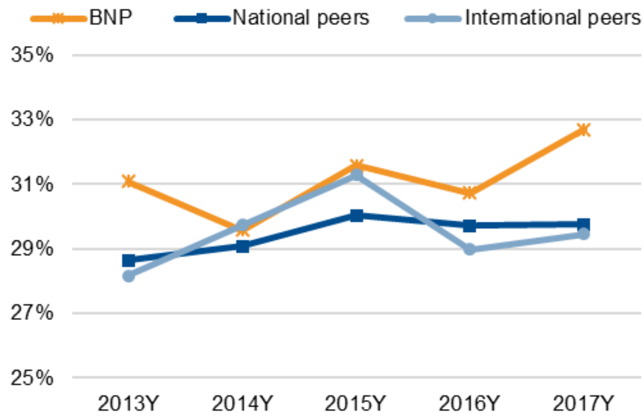
Impaired & Delinquent Loans / Loans (%)



CET 1 Ratio (Fully-Loaded, %)



Risk-weighted Assets / Assets (%)



Source: SNL, Scope Ratings

*National peers: BNP Paribas, SocGen, Credit Agricole Group, Credit Mutuel Group, Groupe BPCE and La Banque Postale (Note: 2017 figures do not include Credit Mutuel Group).

**Cross-border peers: BNP Paribas, SocGen, HSBC, Barclays, Deutsche Bank, UBS and Credit Suisse.

II. Appendix: Selected Financial Information – BNP Paribas Group

	2013Y	2014Y	2015Y	2016Y	2017Y
Balance sheet summary (EUR m)					
Assets					
Cash and interbank assets	151,553	160,821	177,974	207,811	224,116
Total securities	896,579	1,099,325	973,825	987,597	841,901
of which, derivatives	313,492	437,867	359,242	350,959	247,050
Net loans to customers	617,646	658,351	682,963	712,819	729,533
Other assets	134,361	159,261	159,431	168,732	164,702
Total assets	**1,800,139**	**2,077,758**	**1,994,193**	**2,076,959**	**1,960,252**
Liabilities					
Interbank liabilities	85,682	92,032	86,531	75,893	77,974
Senior debt	423,157	439,889	367,954	389,692	372,908
Derivatives	310,294	438,008	350,842	342,568	246,073
Deposits from customers	557,903	641,549	700,309	765,953	766,890
Subordinated debt	13,641	15,486	17,926	19,386	16,787
Other liabilities	318,300	357,105	370,554	378,247	372,411
Total liabilities	**1,708,977**	**1,984,069**	**1,894,116**	**1,971,739**	**1,853,043**
Ordinary equity	80,977	82,869	88,414	92,235	93,811
Equity hybrids	6,614	6,589	7,855	8,430	8,172
Minority interests	3,571	4,231	3,808	4,555	5,226
Total liabilities and equity	**1,800,139**	**2,077,758**	**1,994,193**	**2,076,959**	**1,960,252**
Core tier 1/Common equity tier 1 capital	65,243	64,519	69,562	74,075	76,135
Income statement summary (EUR m)					
Net interest income	20,596	20,319	22,553	22,376	21,774
Net fee & commission income	7,178	7,388	7,615	7,202	7,454
Net trading income	5,938	6,276	7,292	7,568	7,725
Other income	5,680	5,656	7,396	6,665	7,170
Operating income	**39,392**	**39,639**	**44,856**	**43,811**	**44,123**
Operating expense	26,126	26,409	29,261	29,394	29,936
Pre-provision income	**13,266**	**13,230**	**15,595**	**14,417**	**14,187**
Credit and other financial impairments	4,282	3,908	4,113	3,633	3,218
Other impairments	298	373	1,003	171	225
Non-recurring items	-497	-5,799	-100	597	566
Pre-tax profit	**8,189**	**3,150**	**10,379**	**11,210**	**11,310**
Discontinued operations	0	0	0	0	0
Other after-tax Items	0	0	0	0	0
Income tax expense	2,750	2,643	3,335	3,095	3,103
Net profit attributable to minority interests	607	350	350	413	448
Net profit attributable to parent	**4,832**	**157**	**6,694**	**7,702**	**7,759**

III. Appendix: Ratios – BNP Paribas Group

	2013Y	2014Y	2015Y	2016Y	2017Y
Funding and liquidity					
Net loans/deposits (%)	110.6%	102.5%	97.5%	93.0%	94.9%
Liquidity coverage ratio (%)	NA	113.6%	124.4%	122.3%	121.0%
Net stable funding ratio (%)	NA	NA	NA	NA	NA
Asset mix, quality and growth					
Net loans/assets (%)	34.3%	31.7%	34.2%	34.3%	37.2%
Impaired & delinquent loans/loans (%)	9.1%	8.7%	7.9%	7.3%	6.8%
Loan-loss reserves/impaired loans (%)	58.6%	61.6%	63.5%	64.7%	65.8%
Net loan growth (%)	-2.2%	7.4%	3.7%	4.4%	2.3%
Impaired loans/tangible equity & reserves (%)	43.2%	40.2%	36.6%	35.2%	31.5%
Asset growth (%)	-5.6%	14.8%	-4.0%	4.2%	-5.6%
Earnings and profitability					
Net interest margin (%)	1.2%	1.1%	1.1%	1.1%	1.1%
Net interest income/average RWAs (%)	3.7%	3.3%	3.6%	3.5%	3.4%
Net interest income/operating income (%)	52.3%	51.3%	50.3%	51.1%	49.3%
Net fees & commissions/operating income (%)	18.2%	18.6%	17.0%	16.4%	16.9%
Cost/income ratio (%)	66.3%	66.6%	65.2%	67.1%	67.8%
Operating expenses/average RWAs (%)	4.7%	4.3%	4.6%	4.7%	4.7%
Pre-impairment operating profit/average RWAs (%)	2.4%	2.2%	2.5%	2.3%	2.2%
Impairment on financial assets /pre-impairment income (%)	32.3%	29.5%	26.4%	25.2%	22.7%
Loan-loss provision charges/net loans (%)	0.6%	0.6%	0.5%	0.5%	0.4%
Pre-tax profit/average RWAs (%)	1.5%	0.5%	1.6%	1.8%	1.8%
Return on average assets (%)	0.3%	0.0%	0.3%	0.4%	0.4%
Return on average RWAs (%)	1.0%	0.1%	1.1%	1.3%	1.3%
Return on average equity (%)	5.8%	0.6%	7.2%	7.9%	7.8%
Capital and risk protection					
Common equity tier 1 ratio (%, fully loaded)	11.7%	10.3%	10.9%	11.5%	11.8%
Common equity tier 1 ratio (%, transitional)	11.7%	10.5%	11.0%	11.6%	11.9%
Tier 1 capital ratio (%, transitional)	12.8%	11.5%	12.2%	12.9%	13.2%
Total capital ratio (%, transitional)	14.3%	12.6%	13.6%	14.5%	14.8%
Leverage ratio (%)	3.7%	3.6%	4.0%	4.4%	4.6%
Asset risk intensity (RWAs/total assets, %)	31.1%	29.6%	31.6%	30.7%	32.7%
Market indicators					
Price/book (x)	0.9x	0.7x	0.7x	0.8x	0.8x
Price/tangible book (x)	1.0x	0.9x	0.9x	1.0x	1.0x
Dividend payout ratio (%)	40.8%	NM	45.0%	45.0%	49.9%

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