Credit Agricole Group Issuer Rating Report

STABLE OUTLOOK

AA-

Overview

Scope Ratings assigns an Issuer Rating of AA- and a short term debt rating of S-1+ to Credit Agricole SA (CASA), both with Stable Outlook.

Note: The ratings were not solicited by the issuer. Both ratings and analysis are based solely on publicly available information. The issuer has participated in the process.

Highlights

- The ratings of CASA are based on the credit fundamentals of the entire Credit Agricole group; the Regional Banks are an integral part of the group's diversified business mix and earnings. With cooperative and mutual roots, the group is a market leader in France pursuing a universal banking model.
- In recent years, management has successfully de-risked and refocused on core businesses, primarily domestic and selected international retail while leveraging its size and expertise in savings products (asset management and insurance). Asset gathering businesses are attractive as they generate higher returns and provide opportunities for strengthening customer relationships.
- As detailed in the group's 2016-2020 medium-term plan, key priorities are to improve operational efficiency and to increase integration to cross-sell more products and services to customers offered by CASA and other group entities. In addition, the group aims to improve the customer experience by streamlining and digitalizing key customer journeys. These initiatives should further support and enhance earnings; increasingly important considering the continuing low interest rate environment and evolving competitive dynamics.
- We note positively that the medium-term plan continues to be underpinned by a focus on core businesses and a commitment to financial prudence.

Rating drivers (summary)

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

- Management's focus on further strengthening a leading business franchise based on a universal banking model with a dominant presence in France.
- Challenge of achieving higher returns considering low interest rates, relatively high costs and the need for investments to address changing customer behaviour and expectations.
- Reassuring capital growth and strong prudential metrics.

Ratings & Outlook

Issuer Rating	AA-
Senior unsecured debt (not MREL eligible) rating	AA-
Senior unsecured debt (MREL eligible) rating	A+
Tier 2 securities	A-
Additional Tier 1 securities rating	BBB-
Short-term debt rating	S-1+
Outlook	Stable

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Bloomberg: SCOP

Rating change drivers

Change in strategy that increases the group's risk profile. Credit Agricole has reverted to its domestic roots, achieving leadership positions in retail, bancassurance and asset gathering in France. In Italy, the group has been strengthening its regional franchise and is considered a second home market. We would view negatively aggressive expansion into riskier foreign markets or aggressive growth in global investment banking as happened during 2006-2008. In general, the group prioritises organic growth and recent M&A activity has been in line with its strategy of strengthening core business lines (e.g. Pioneer Investments, three small Italian savings banks, CACEIS) and disposing of non-core assets (e.g. Bank Saudi Fransi stake).

Reduced cohesion and clarity. The completion of the "Eureka" transaction in 3Q 2016 significantly simplified the group's structure and governance. CASA transferred its 25% stake in the Regional Banks to an entity wholly-owned by the Regional Banks and the Switch 1 mechanism was unwound. As well, changes in governance were made to facilitate management on a group level. We would view negatively moves that lead to a divergence in priorities within the group and diminish cohesion.

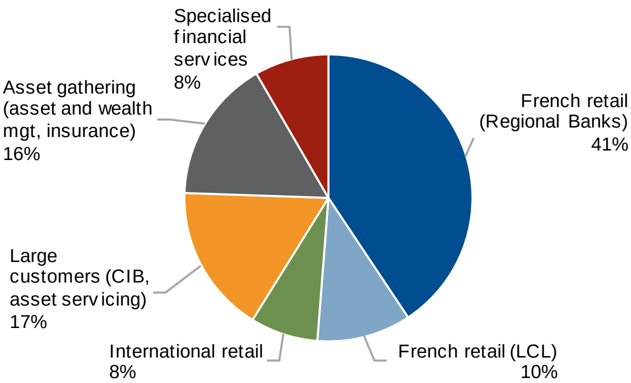
A marked and sustained improvement in profitability of the group's core domestic retail banking franchise. We believe that a sustainable improvement in profitability can be achieved only when the French economy strengthens more convincingly. After GDP growth of 2.2% in 2017, the European Commission expects GDP growth of 1.7% in 2018 and 2019.

Rating drivers (details)

Management's focus on further strengthening a leading business franchise, based on a universal banking model with a dominant presence in France.

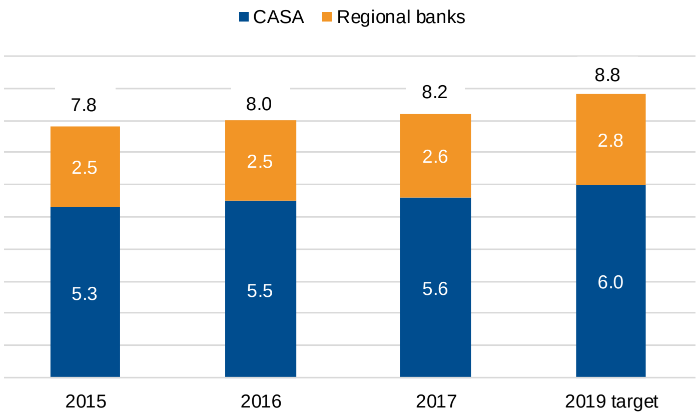
With cooperative and mutual roots, the group is a market leader in France operating under the Credit Agricole, LCL and BforBank (online universal bank) brands. Under the group's medium-term plan, "Strategic Ambition 2020", management defined the group's DNA as a "customer-focused universal bank". Fittingly, a Customer Project "driven by the digital revolution" and strengthening growth dynamics in core business lines are key priorities.

Figure 1: CA Group revenue breakdown



Notes: Data as of YE 2017. Revenues of EUR 33bn on an underlying basis and excluding the Corporate Centre. Source: Company data, Scope Ratings.

Figure 2: Revenue synergies (EUR bn)



Source: Company data, Scope Ratings.

The Customer Project entails bringing "all the expertise of a universal bank to each customer" in a multi-channel way. The group strives to be "100% human and 100% digital", providing customers with choice and flexibility in how they would like to interact with the bank. For example, the group has a target to fully digitalise its offerings by end-2019. In France, Credit Agricole is viewed as a leading digital player among traditional banks and provides a more extensive offering than pure online or neo banks.[1]

Another key objective is to increase intragroup revenue synergies by more than EUR 1bn to EUR 8.8bn in 2019 (more than 25% of business line revenue). Credit Agricole aims to distribute more products from the specialised business lines through the group's retail banking networks. At present, each Regional Bank customer with a demand deposit account is linked to nine group products on average.

In Asset Gathering (Insurance, Asset and Wealth Management), Credit Agricole plans to improve its market share by increasing synergies both within the business line and with the rest of the group, focusing on profitable growth. In July 2017, Amundi where the group holds a 70% stake acquired Pioneer Investments, Unicredit's asset management subsidiary for EUR 3.5bn. The acquisition strengthens Amundi's position as the leading European asset manager and ranks it among the world's top 10 asset managers.

Within Large Customers (CIB and Asset Servicing), the aim is to serve the business needs of the group while maintaining a low risk profile and optimising RWAs to offset the impact of new regulatory requirements. In Specialised Financial Services (Consumer Finance, Leasing & Factoring), the plan is to pursue selective growth and to further integrate the business with the group's retail banks.

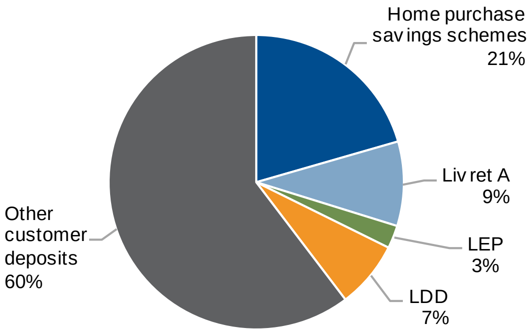
[1] D-rating survey, January 2018.

Challenge of achieving higher returns considering low interest rates, relatively high costs and the need for investments to address changing customer behaviour and expectations.

The low interest rate environment in Europe continues to weigh on margins, with the situation for French banks being particularly pronounced due to the high proportion of regulated saving schemes and accounts in the system. The government directly and indirectly sets terms on passbook accounts (Livret A, LEP, LDD) and home savings plans (PEL, CEL). We estimate that regulated schemes and accounts represent around 40% of the group's total customer deposits (LCL and Regional Banks combined).

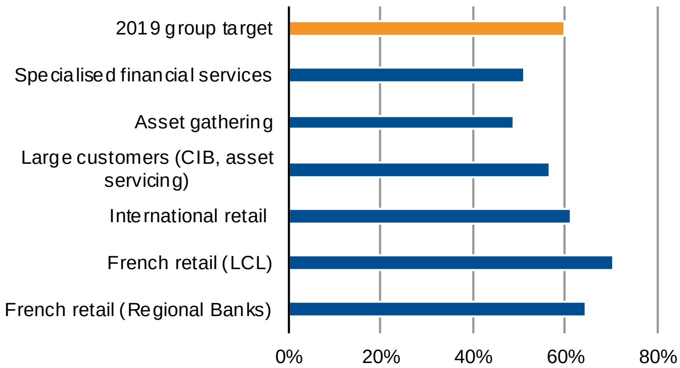
Last year, French banks margins suffered as customers renegotiated their mortgages. While high loan renegotiations no longer appear to be an issue, retail revenues may be negatively impacted by lower mortgage volumes. The 2Q 2018 Observatoire de Credit Logement report notes that demand has weakened due to rising real estate prices and declining public support for first-time buyers. As of YE 2017, mortgages comprise more than 60% of the Regional Banks' and LCL's combined domestic loan portfolio.

Figure 3: French customer assets (LCL and Regional Banks)



Notes: Data as of YE 2017. Combined customer assets of EUR511bn.
Source: Company data, Scope Ratings.

Figure 4: Cost income ratios (%)



Note: Data as of YE 2017.
Source: Company data, Scope Ratings estimates.

As detailed in the medium-term plan, the group will invest EUR 7.7bn over four years to improve industrial efficiency, another key priority of the medium-term plan. We consider this to be important as the efficiency of French banks tends to lag peers. While costs are expected to reduce in all business lines, compliance and risk systems will be strengthened and the bulk of the investment will be used for developing the various businesses and for digital transformation.

The digital transformation and branch network upgrade will require an investment of EUR 750m, of which EUR 200m will be for CASA´s French retail businesses and EUR 550m for the Regional Banks. Subsequent efficiency gains are expected to reduce the cost income ratio to about 65% for LCL and to about 55% for Cariparma in 2019.

Reassuring capital growth and strong prudential metrics.

Underpinned by solid earnings, the solvency position of the group as well as CASA are at strong levels. At 1H 2018, the fully loaded CET1 ratios of the group and CASA were 14.8% and 11.4%, respectively. These levels compare well to estimated SREP requirements in 2019 of 9.5% for the group and 8.5% for CASA; these estimates incorporate an expected 0.2% countercyclical buffer. The requirement for the group is higher as it is subject to a fully phased-in 1% G-SIB buffer. The phase-in Tier 1 leverage ratio of the group was also reassuring at 5.4% as of 1H 2018.

In its medium-term plan, management targets a fully-loaded CET1 ratio of 16% in 2019 for the group while for CASA the target is above 11%

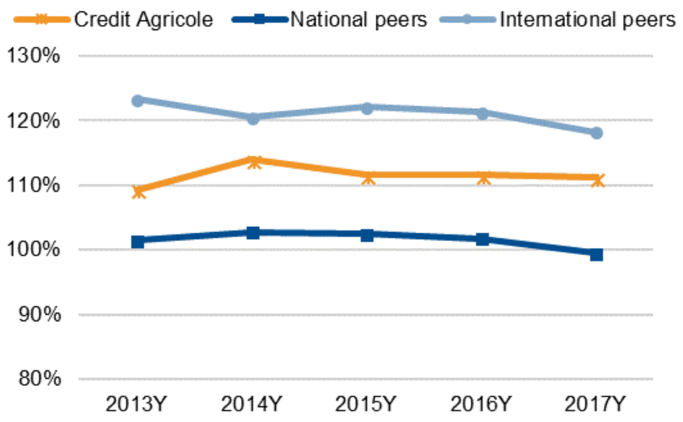
The group has successfully issued non-preferred senior debt and is well positioned against TLAC and MREL requirements. As of 1H 2018, the group's reported TLAC ratio was 21.2%, comprised of 14.8% in CET1 capital, about 1% in AT1 capital and 5.4% in senior non-preferred debt, and Tier 2 and Tier 1 securities. Meanwhile, the estimated TLAC requirement from 2022 is 21.5%, including a 2.5% capital conservation buffer and a 1% G-SIB buffer.

The group targets a TLAC ratio of 22% excluding eligible senior debt. Due to continued domestic lending growth, the group revised its guidance for TLAC debt issuance to around EUR 6bn in aggregate annually in 2018 and 2019.

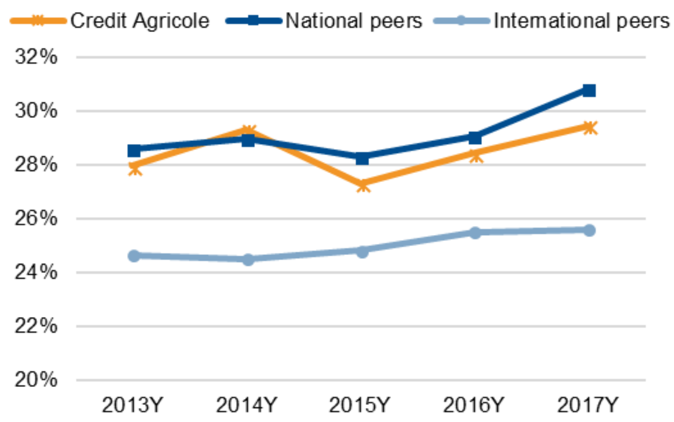
With the release of 1H 2018 results, the group communicated that they had been notified of their MREL requirement and that they met this requirement. The group's reported MREL ratio as of 30 June 2018 was approximately 13% of total liabilities and own funds or 8.2% excluding potentially eligible senior preferred debt. Management aims to keep the ratio above 8%, excluding potentially eligible senior preferred debt.

I. Appendix: Peer comparison

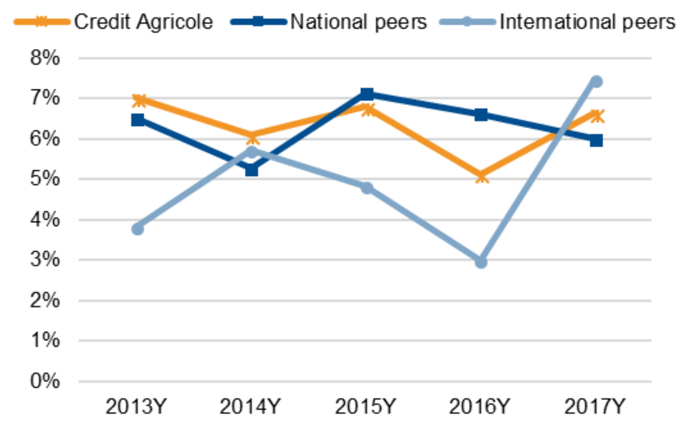
Amortised loans % Deposits



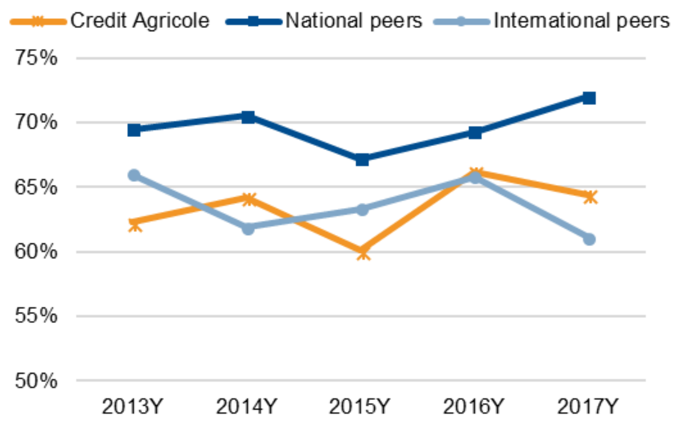
Net fees & commissions % Operating income



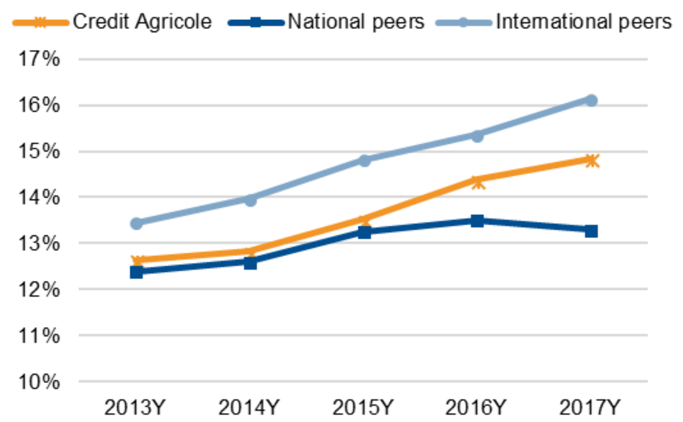
Return on average equity (%)



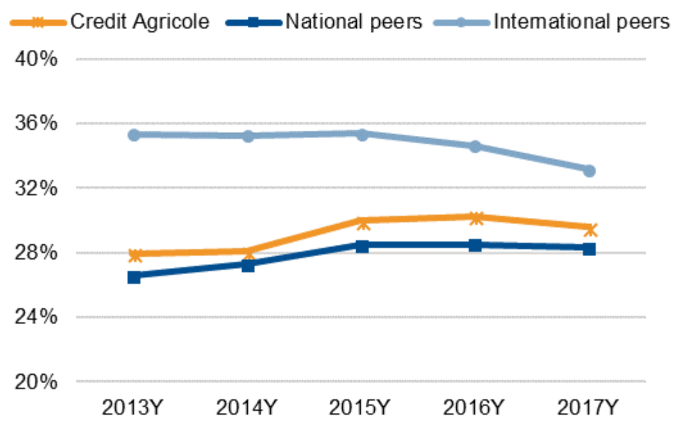
Costs % Income



Common equity tier 1 ratio (%, transitional)



Risk-weighted assets % Assets



National peers: BNP Paribas, SocGen, Crédit Agricole Group, Groupe BPCE, La Banque Postale, Credit Mutuel, HSBC France.
International peers: CA Group, RBS, BPCE, Lloyds, Rabobank, Credit Mutuel, Intesa, Commerzbank, Danske, DZ Bank, ABN AMRO, Caixabank, Handelsbanken, DNB, SEB, Swedbank, La Banque Postale, Sadabell, Bank of Ireland, UBI Banca, National Bank of Greece, AIB, Caixa Geral

Source: SNL

II. Appendix: Selected Financial Information – Credit Agricole Group

	2014Y	2015Y	2016Y	2017Y	2018H1
Balance sheet summary (EUR m)					
Assets					
Cash and interbank assets	159,555	129,340	127,361	146,193	145,766
Total securities	791,984	740,417	729,354	714,282	759,271
of which, derivatives	233,319	195,140	182,741	130,441	122,186
Net loans to customers	710,344	740,912	774,433	816,358	826,939
Other assets	100,831	88,190	91,701	86,336	92,409
Total assets	**1,762,714**	**1,698,859**	**1,722,849**	**1,763,169**	**1,824,385**
Liabilities					
Interbank liabilities	102,957	96,762	82,953	91,859	102,164
Senior debt	287,560	239,216	237,938	269,493	316,098
Derivatives	229,715	194,293	181,960	130,324	121,277
Deposits from customers	626,500	670,382	699,063	738,457	761,931
Subordinated debt	25,487	29,006	29,562	25,515	24,018
Other liabilities	398,793	371,779	388,199	399,785	390,008
Total liabilities	**1,671,012**	**1,601,438**	**1,619,675**	**1,655,433**	**1,715,496**
Ordinary equity	82,862	89,029	93,617	97,292	98,616
Equity hybrids	3,861	3,861	5,011	4,999	5,007
Minority interests	4,979	4,531	4,546	5,445	5,266
Total liabilities and equity	**1,762,714**	**1,698,859**	**1,722,849**	**1,763,169**	**1,824,385**
Core tier 1/Common equity tier 1 capital	63,507	68,846	74,949	77,398	78,817
Income statement summary (EUR m)					
Net interest income	19,516	19,983	19,136	19,677	9,187
Net fee & commission income	8,814	8,916	8,770	9,709	5,037
Net trading income	7,741	5,679	3,036	6,165	478
Other income	-5,995	-1,935	-99	-2,594	2,200
Operating income	**30,076**	**32,643**	**30,843**	**32,957**	**16,902**
Operating expense	19,318	19,616	20,412	21,222	10,913
Pre-provision income	**10,758**	**13,027**	**10,431**	**11,735**	**5,989**
Credit and other financial impairments	2,889	2,781	2,424	1,360	776
Other impairments	101	122	639	302	6
Non-recurring items	0	NA	355	397	86
Pre-tax profit	**7,768**	**9,440**	**7,723**	**10,469**	**5,293**
Discontinued operations	-7	-21	31	20	-3
Other after-tax Items	0	0	0	0	0
Income tax expense	2,478	2,988	2,582	3,479	1,501
Net profit attributable to minority interests	359	388	347	474	285
Net profit attributable to parent	**4,924**	**6,043**	**4,825**	**6,536**	**3,505**

Source: SNL

III. Appendix: Selected Financial Information – Credit Agricole Group

	2014Y	2015Y	2016Y	2017Y	2018H1
Funding and liquidity					
Net loans/deposits (%)	114.0%	111.6%	111.6%	111.2%	109.5%
Liquidity coverage ratio (%)	110.0%	100.0%	110.0%	133.3%	134.6%
Net stable funding ratio (%)	NA	NA	NA	NA	NA
Asset mix, quality and growth					
Net loans/assets (%)	40.3%	43.6%	45.0%	46.3%	45.3%
NPLs/net loans (%)	NA	NA	NA	NA	NA
Loan-loss reserves/NPLs (%)	NA	NA	NA	NA	NA
Net loan growth (%)	-0.1%	4.3%	4.5%	5.4%	2.6%
NPLs/tangible equity and reserves (%)	NA	NA	NA	NA	NA
Asset growth (%)	4.4%	-3.6%	1.4%	2.3%	6.9%
Earnings and profitability					
Net interest margin (%)	1.2%	1.2%	1.2%	1.2%	1.1%
Net interest income/average RWAs (%)	3.9%	3.9%	3.7%	3.8%	3.5%
Net interest income/operating income (%)	64.9%	61.2%	62.0%	59.7%	54.4%
Net fees & commissions/operating income (%)	29.3%	27.3%	28.4%	29.5%	29.8%
Cost/income ratio (%)	64.2%	60.1%	66.2%	64.4%	64.6%
Operating expenses/average RWAs (%)	3.9%	3.9%	4.0%	4.1%	4.1%
Pre-impairment operating profit/average RWAs (%)	2.2%	2.6%	2.0%	2.3%	2.3%
Impairment on financial assets /pre-impairment income (%)	26.9%	21.3%	23.2%	11.6%	13.0%
Loan-loss provision charges/net loans (%)	0.4%	0.3%	0.3%	0.2%	0.0%
Pre-tax profit/average RWAs (%)	1.6%	1.9%	1.5%	2.0%	2.0%
Return on average assets (%)	0.3%	0.4%	0.3%	0.4%	0.4%
Return on average RWAs (%)	1.1%	1.3%	1.0%	1.3%	1.4%
Return on average equity (%)	6.1%	6.8%	5.1%	6.6%	7.0%
Capital and risk protection					
Common equity tier 1 ratio (%, fully loaded)	13.1%	13.7%	14.5%	14.9%	14.8%
Common equity tier 1 ratio (%, transitional)	12.8%	13.5%	14.4%	14.8%	14.8%
Tier 1 capital ratio (%, transitional)	14.8%	15.3%	16.1%	16.2%	16.0%
Total capital ratio (%, transitional)	18.4%	19.3%	19.3%	18.6%	18.6%
Leverage ratio (%)	5.2%	5.7%	5.7%	5.5%	5.3%
Asset risk intensity (RWAs/total assets, %)	28.1%	30.0%	30.2%	29.6%	29.2%

Source: SNL

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