Banque Fédérative du Crédit Mutuel SA
Issuer Rating Report

A+ STABLE

Overview

Scope Ratings assigns an Issuer Rating of A+ and a short-term debt rating of S-1+ to Banque Fédérative du Crédit Mutuel SA (BFCM), 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 has not participated in the process.

Highlights

- The ratings are based on the overall stability and predictability of the Crédit Mutuel Alliance Fédérale (CMAF), the dominant grouping within the Crédit Mutuel Group (CM), one of France's large retail banking and financial services networks. CMAF's reassuring credit fundamentals are also a key driver for the ratings at their current high level. We have assigned ratings to BFCM as it has been delegated capital markets functions for CMAF, which represents the major part of the CM group.
- Scope's ratings also consider existing challenges to the entire CM group's operational and strategic cohesion, in the form of Crédit Mutuel Arkea's strategic evolution as it attempts to break away from the rest of the group. However, this forms a relatively small part of the overall CM Group compared to CMAF, and although its potential exit from the Group represents an area of uncertainty, we do not see its activities or potential exit from the CM Group as representing an existential threat to CMAF. BFCM does not benefit directly from the type of solidarity mechanism that exists between CMAF's mutual banks within their groupings. However, we consider it improbable that the CMAF grouping would fail to support its treasury and capital markets vehicle in need.

Rating drivers (summary)

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

- A cohesive structure for CMAF within the CM Group, largely unaffected by the attempts of the operationally independent Crédit Mutuel Arkéa to break away from CM
- CMAF is the likely first line of defence should BFCM ever require support from the Group
- Low-risk balance sheet, reassuring prudential metrics and adequate profitability

Ratings & Outlook

Issuer Rating	A+
Outlook	Stable
Senior unsecured debt rating (non-MREL/TLAC eligible)	A+
Senior unsecured debt rating (MREL/TLAC eligible)	A
Tier 2 instruments rating	BBB+
Short-term debt rating	S-1+

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Bloomberg: SCOP

Rating change drivers

As is the case for French and European peers, CM faces the challenge of excess capacity, as technology advances and customers seek alternative ways of accessing banking services. We consider CMAF to be technologically aware and focused on relevant development. Financial metrics and the franchise strength in relation to evolving customer habits could be enhanced by CMAF further positioning itself at the leading edge of technology. Credit ratings could also be positively affected, especially if this leads to lower costs and supports revenues on a recurring basis.

CMAF's operations are primarily domestic, thus potential negative macro trends in France could harm the group's recurring profitability on a more structural basis.

Rating drivers (details)

A cohesive structure for CMAF within the CM Group, largely unaffected by the attempts of the operationally independent Crédit Mutuel Arkéa to break away from CM

We view the CM Group as being fairly decentralized; more so than other French mutualist bank groups. Below the top level the Group divides into the following segments:

- The grouping previously named Crédit Mutuel-CM11 Group (CM-C11) announced in November 2018 that it would rename itself Crédit Mutuel Alliance Fédérale (CMAF). It is made up of a mutual banking division and Strasbourg-based BFCM and its non-mutual subsidiaries. These two arms are complementary and interconnected. The mutual banking division (also referred to as the regulatory perimeter) comprises 11 regional banking federations plus 1,357 Caisses de Crédit Mutuel (local co-operative banks belonging to their respective federations), and the Caisse Fédérale de Crédit Mutuel (CF de CM), collectively owned by its members. CF de CM co-ordinates services required by the mutual network banks and centralizes and allocates the deposits they gather. It owns 93% of BFCM, with a further 5.1% owned by the member banks. The BFCM Group is principally made up of CIC (a regional bank in Ile de France and head of its own banking network) and subsidiaries operating in insurance, finance, electronic banking and IT, whose products are extensively sold by the member banks. BFCM acts as the central funding arm for the whole of the CMAF grouping and is also responsible for relationships with large corporates and public sector customers.

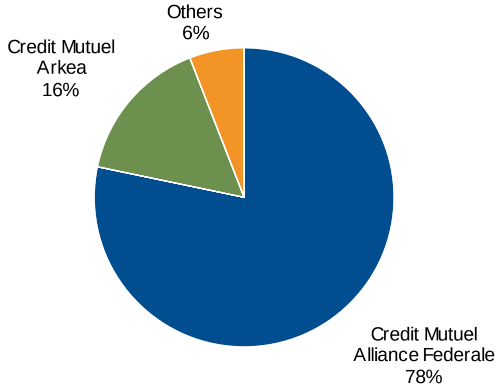
- Crédit Mutuel de Bretagne (by far the principal partner), Crédit Mutuel du Sud-Ouest and Crédit Mutuel Massif Central created Crédit Mutuel Arkéa in 2002, built on the same principles but on an inherently smaller geographic scale. Following member banks' approvals taken at EGMs during 2018, Crédit Mutuel Massif Central is expected to join CF de CM and thus become part of CMAF with effect from the start of 2020.

- The remainder of the banking group is comprised of four smaller unaffiliated regional federations.

- At national level The Confédération Nationale du Crédit Mutuel (CNCM) is responsible for ensuring the coherence of its network, and the proper functioning of the institutions affiliated to it. It is CM's central body in relation to the French Monetary and Financial Code. All the regional federations are associated with it. CNCM represents CM to the public authorities and to the ECB as supervisor. The General Court of the European Union has, in a recent decision, found that Crédit Mutuel is a group united around its central body, rejecting in December 2018 an appeal filed by CM Arkéa, which disputed the establishment by the ECB of consolidated prudential supervision through the CNCM.

As seen in Figure 1, CMAF represents 78% of the group's assets with Crédit Mutuel Arkéa accounting for a further 16%.

Figure 1: Breakdown of total CM group assets – year-end 2018



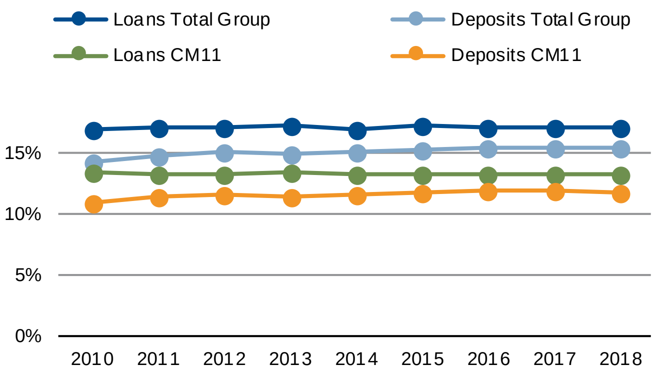
Source: Company data, Scope Ratings

We do not consider the relative decentralization of CM to be a credit weakness for CMAF. First, it is a historical reality and the group has performed well over the years within this structure. Second, we, we consider Crédit Mutuel Arkea's moves as creating internal uncertainties for CM but not a challenge to the integrity of CMAF, which has its own conservative risk culture and distinct strategy.

CMAF's business displays several reassuring characteristics:

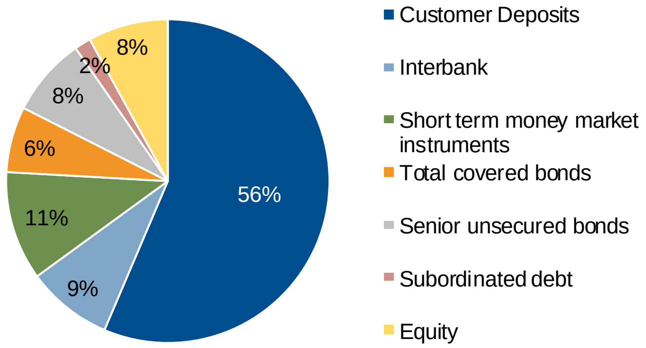
- Predominantly a retail bank, CMAF represents a significant market share of loans and deposits in France (Figure 2). The Group is primarily deposit-funded, and the remainder of its funding is well diversified.

Figure 2: CM11 & Total Group loan and deposit market shares



Source: Company data, Scope Ratings

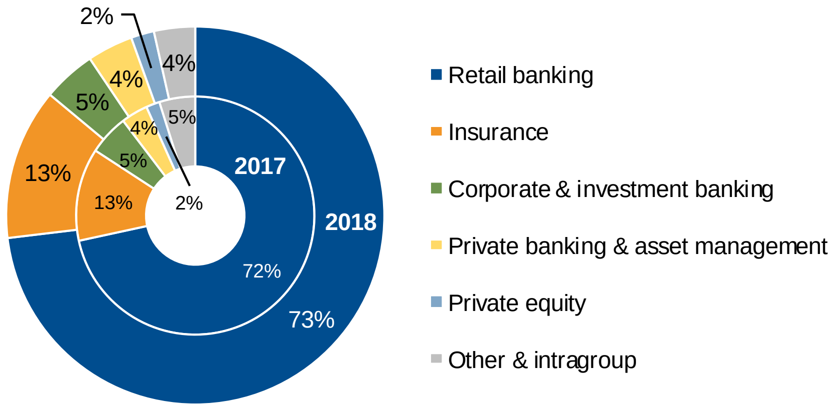
Figure 3: Crédit Mutuel Alliance Federale funding split, year-end 2018 (EUR bn)



Source: Company data, Scope Ratings

- Although the Group is predominantly domestically focused (with 77% of net revenues originating in France in FY18), within this we consider the business mix to be well balanced (see Figure 4). The retail banking business encompasses the local cooperative banks, the CIC network, Banque Européene du Crédit Mutuel (servicing corporates and real estate professionals). CIC Iberbanco, Targobank in Spain and Germany, the Cofidis Participations Group (consumer credit, payments and other banking services), Banque Casino (joint venture offering financing solutions for online retailers) and many specialized businesses which have their products marketed through the branch networks. These latter include equipment leasing, hire purchase, real estate leasing factoring, asset management, employee savings and real estate sales and management.

Figure 4: Crédit Mutuel Alliance Federale revenue breakdown (2018 versus 2017)



Source: Company data, Scope Ratings

A key competitive advantage of CMAF versus other French peers has been its proven technology leadership; most evident in electronic and digital banking. During the last three years, CMAF has implemented its digital transformation plan “2018 Customer Member Priority Plan”. This covered over 200 projects and introduced many new functionalities for mobile applications and remote banking. Consumer lending is just one example: some 85% of consumer loan applications are now made via mobile phones. CMAF offers the ‘Avantoo’ service to customers, which combines an offer for its physical banking network, its mobile internet bank and a telephone subscription. CMAF has also been making very active use of artificial intelligence – for example the virtual assistant Watson in analyzing email traffic – and thus helping to formulate responses to customers.

In November 2018 CMAF announced its 2019-2023 strategic plan, *ensemble#nouveaumonde*. This continues to place technology at the centre of the group’s priorities along with customer relations and employee engagement. It also sets out several financial targets and ESG-related objectives.

CMAF is the likely first line of defence should BFCM ever require support from the Group

The CMAF group has its own mutual support system, in the form of a federal support mechanism under Article R.515-1 of the French Financial and Monetary Code. The liquidity and solvency of the local banks are guaranteed due to their association with the Caisse Fédérale de Crédit Mutuel (CF de CM). A collective banking license has been issued for CF de CM and its member banks. All contribute to a mutual guarantee fund based on their respective asset size and net revenues. This would act as the first line of defence, should member banks need support.

We also note that at the top level of the CM hierarchy, the Caisse Centrale du Crédit Mutuel (CCCM) manages treasury operations for the group and organizes CM’s mutual financial support mechanism. As required by Article L511-31 of the French Monetary and Financial Code, CM’s mutual support system is designed to continuously ensure the liquidity and solvency of all member banks affiliated with CNCM (Confédération Nationale du Crédit Mutuel) and that of the network as a whole. It may, therefore, take actions deemed necessary to protect regional groupings within the network.

As BFCM is the unsecured funding vehicle for CMAF, and owned by its member banks, we consider that there is a high level of vested interest from members of the CMAF

Group – also by far the largest regional grouping within CM – to ensure its ongoing viability. Further, Articles 7&8 of EU Regulation 575/2013 regarding consolidated prudential supervision and the mechanism provided for in Article L.511-42 of the French Monetary and Financial Code provide for the CMAF Group to support its subsidiaries.

Elsewhere within the CM group mutual support mechanisms exist at regional level, but crucially the member banks do not directly benefit from BFCM's activities. Crédit Mutuel Arkea's most recent (2018) Annual Registration document notes its ongoing dispute with CNCM of its administrative, technical and financial supervision. In the previous year's document it also noted that 'additional mechanisms' (calls for contributions, in other words) would require a decision on its part. Such a decision, by implication, were it to be on behalf of another regional group within CM, might not be forthcoming (or perhaps not in a timely enough manner).

Low-risk balance sheet, reassuring prudential metrics and adequate profitability

Prior to the financial crisis, CM was one of the few large European banking groups, and among the very few in France, which was not involved in the excessive risk-leverage spiral that brought many peers into difficulties and subsequently necessitated some form of external support. Thus, the group's overall balance sheet continues to have a low risk profile, and its financial and prudential metrics compare well to those of French peers (see Figure 5).

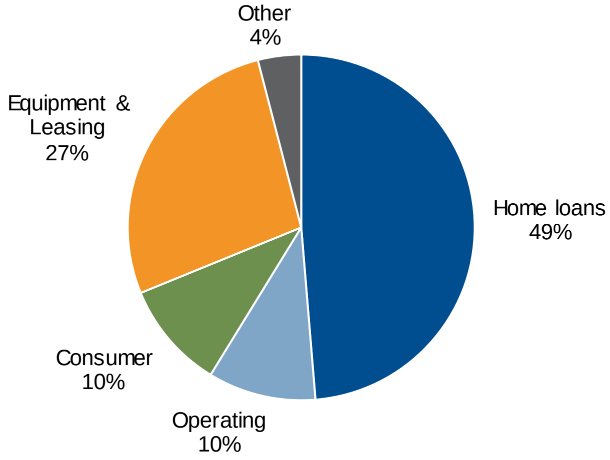
Figure 5: Prudential and financial metrics for CMF and the five largest French banking groups (year-end 2018)

	Crédit Mutuel Alliance Federale	Crédit Mutuel Group	Groupe BPCE	BNP Paribas	Société Générale	Crédit Agricole Group
Total Assets (EUR bn)	667.4	852.6	1,273.93	2,040.84	1,309.43	1,854.76
Common Equity Tier 1 Ratio (transitional)	16.60%	17.53%	15.84%	11.78%	11.00%	14.95%
Total Capital Ratio (transitional)	19.70%	20.52%	19.59%	15.02%	16.60%	18.70%
Common Equity Tier 1 Ratio (fully loaded)	16.60%	NA	15.50%	11.77%	10.94%	14.95%
Total Capital Ratio (fully loaded)	19.70%	NA	19.20%	15.01%	16.50%	18.31%
Tier 1 Leverage Ratio	6.00%	6.60%	5.28%	4.50%	4.20%	5.30%
Loan loss provisions (LLP)/Average gross customer loans	0.24%	0.21%	0.18%	0.34%	0.24%	0.01%
ROAE	6.86%	6.64%	5.34%	7.62%	7.10%	6.75%
ROAA	0.45%	0.43%	0.30%	0.37%	0.35%	0.41%
Cost/income ratio	61.93%	64.66%	72.79%	70.93%	70.18%	64.47%
Credit costs/Pre-impairment Operating Profit	16.88%	15.95%	19.64%	21.97%	14.09%	14.81%

Source: Company info, SNL

Within this, CMAF is a leading player in the French mortgage market, issuing covered bonds through its specialised subsidiary Crédit Mutuel-CIC Home Loan SFH. At 2018, home loans represented just under half of the loan portfolio (see Figure 6). Credit costs are in line with those seen across major peers in the industry.

Figure 6: Sector breakdown of CMAF group loans by customer type – FY 2018



Source: Company data, Scope Ratings

In 2018 CMAF revenues increased 0.4% YoY to EUR 14bn, due to strong sales performance within retail banking and insurance businesses. Revenues revenues grew by 2.5% and 3.3%, respectively, in line with the 2019-2023 strategic plan target of +3% growth.

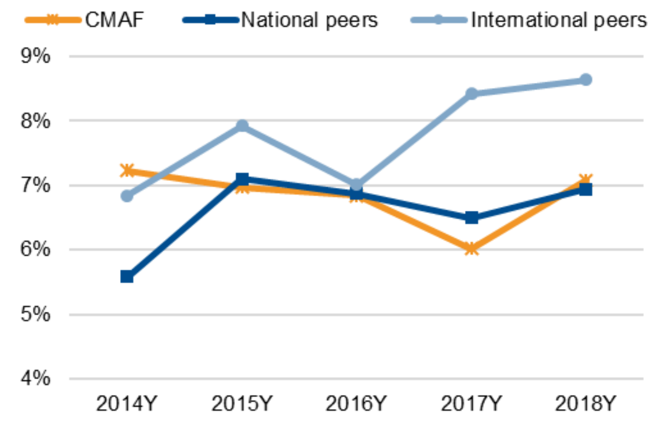
Net income was approximately EUR 3bn (+23.3% YoY). Growth was mainly driven by higher revenues and lower corporate income tax (-18.6%). CMAF's 2018 return on equity stood at 7.16%.

The CMAF YE18 CET1 ratio stood at 16.6% (YE17: 16.5%). Going forward, we expect CMAF to maintain its reassuring balance-sheet fundamentals, despite the challenges it faces in maintaining profitability against a sluggish French economy over the next few years (1.4-1.5% GDP growth is forecast between 2019 and 2021 according to Banque de France projections) and very low interest rates.

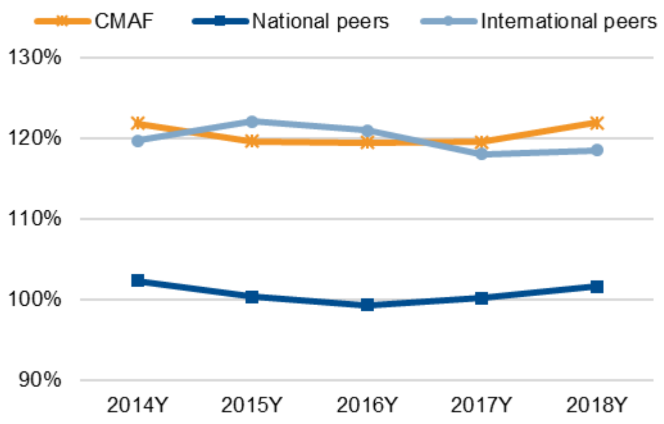
As of YE18, CMAF's Liquidity Coverage Ratio stood at 131.2% while the loan to deposit ratio was 121.9%%. High Quality Liquid Assets (HQLA) held amounted to EUR 79.2bn as of 2018 year-end. Taken together with the growth in the proportion of deposit funding in recent years and the covered bond programme, which represents a stable funding source, we consider CMAF's liquidity to be strong.

I. Appendix: Peer comparison

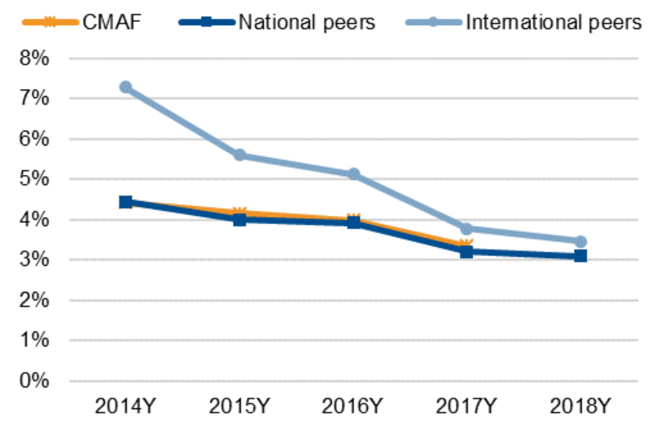
Return on average equity (%)



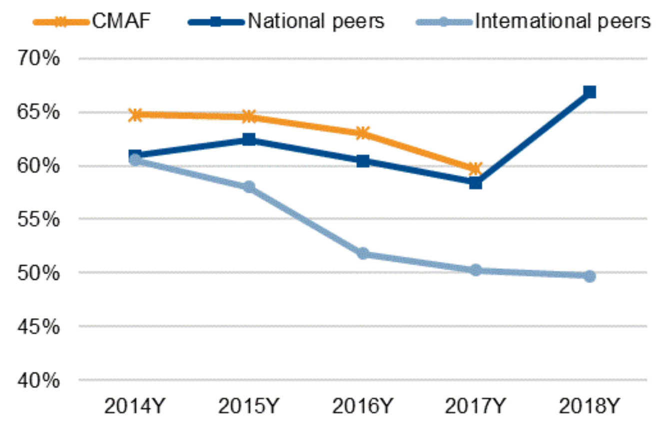
Net loans/deposits (%)



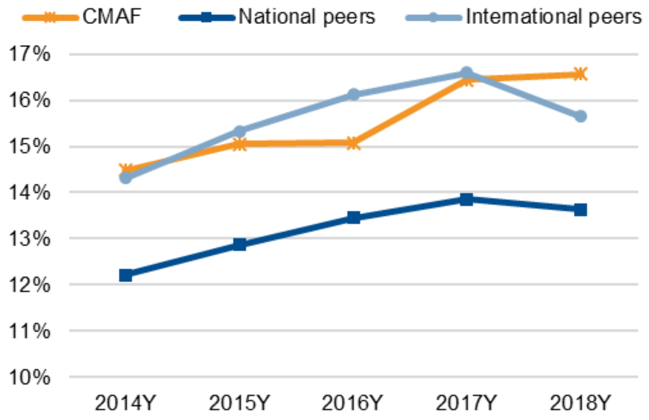
Problem loans/Gross customer loans (%)



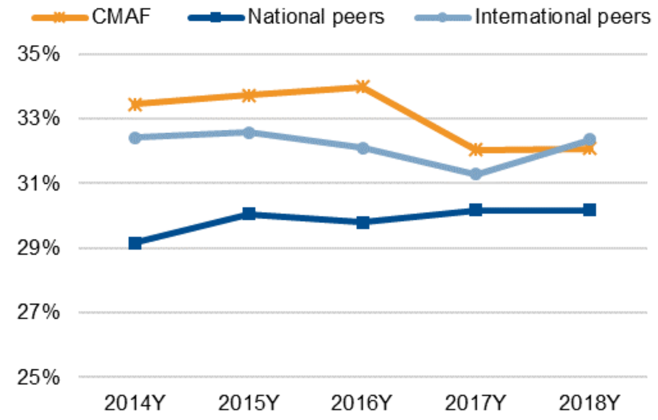
Loan-loss reserves/problem loans (%)



Common equity tier 1 ratio (%, transitional)



Asset risk intensity (RWAs / total assets,%)



National peers: BNP Paribas, Societe Generale, Credit Agricole Group, Groupe BPCE, Credit Mutuel Group, La Banque Postale.

Cross-border peers: Credit Agricole, BPCE, La Banque Postale, Credit Mutuel Group, Lloyds, RBS, ABN Amro, Rabobank, Intesa, Commerzbank, Danske Bank, Caixabank, Bankia, Handelsbanken, SEB, Swedbank, DNB, Bank of Ireland, AIB.

Source: SNL, Scope Ratings

II. Appendix: Selected Financial Information – Crédit Mutuel Alliance Federale

	2014Y	2015Y	2016Y	2017Y	2018Y
Balance sheet summary (EUR m)					
Assets					
Cash and interbank assets	77,397	81,328	98,738	94,658	100,864
Total securities	149,243	155,523	151,338	150,065	52,571
of which, derivatives	10,524	8,997	9,024	6,698	7,111
Net loans to customers	287,224	304,136	329,958	344,942	370,886
Other assets	29,871	29,866	29,722	29,534	143,043
Total assets	**543,735**	**570,853**	**609,756**	**619,199**	**667,364**
Liabilities					
Interbank liabilities	37,271	43,990	49,209	44,175	53,985
Senior debt	105,672	105,396	112,458	112,431	119,680
Derivatives	9,800	8,405	8,236	5,978	5,529
Deposits from customers	235,831	254,370	276,194	288,532	304,319
Subordinated debt	6,486	6,088	6,710	7,725	7,224
Other liabilities	NA	NA	NA	NA	NA
Total liabilities	**508,879**	**533,720**	**570,169**	**578,209**	**623,769**
Ordinary equity	32,235	34,308	36,474	38,600	40,289
Equity hybrids	0	0	0	0	0
Minority interests	2,621	2,825	3,113	2,390	3,306
Total liabilities and equity	**543,735**	**570,853**	**609,756**	**619,199**	**667,364**
Core tier 1/Common equity tier 1 capital	26,332	28,968	31,227	32,611	35,438
Income statement summary (EUR m)					
Net interest income	5,619	5,561	5,552	5,713	6,209
Net fee & commission income	2,851	3,157	3,256	3,511	3,613
Net trading income	605	1,119	1,609	1,259	809
Other income	2,974	3,034	2,762	3,195	3,550
Operating income	**12,049**	**12,871**	**13,179**	**13,678**	**14,181**
Operating expense	7,537	7,886	8,107	8,448	8,714
Pre-provision income	**4,512**	**4,985**	**5,072**	**5,231**	**5,468**
Credit and other financial impairments	866	809	823	858	903
Other impairments	36	104	286	40	1
Non-recurring items	NA	NA	NA	NA	NA
Pre-tax profit	**3,610**	**4,072**	**3,963**	**4,334**	**4,563**
Discontinued operations	0	-23	44	22	0
Other after-tax Items	0	0	0	0	0
Income tax expense	1,195	1,539	1,383	1,929	1,569
Net profit attributable to minority interests	235	256	214	219	298
Net profit attributable to parent	**2,179**	**2,254**	**2,410**	**2,208**	**2,695**

Source: SNL, Scope Ratings

III. Appendix: Ratios – Crédit Mutuel Alliance Federale

	2014Y	2015Y	2016Y	2017Y	2018Y
Funding and liquidity					
Net loans/ Deposits (%)	121.8%	119.6%	119.5%	119.6%	121.9%
Liquidity coverage ratio (%)	109.0%	140.0%	140.3%	130.9%	131.2%
Net stable funding ratio (%)	NA	NA	NA	NA	NA
Asset mix, quality and growth					
Net loans/ Assets (%)	52.8%	53.3%	54.1%	55.7%	55.6%
Problem Loans/ Gross Customer Loans (%)	4.4%	4.2%	4.0%	3.3%	3.1%
Loan Loss Reserves/ Problem Loans (%)	64.8%	64.6%	63.0%	59.7%	70.0%
Net loan growth (%)	4.7%	5.9%	8.5%	4.5%	7.5%
Problem Loans/ Tangible Equity & Reserves (%)	34.0%	31.9%	31.2%	27.2%	24.7%
Asset growth (%)	6.8%	5.0%	6.8%	1.5%	7.8%
Earnings and profitability					
Net interest margin (%)	1.1%	1.1%	1.0%	1.0%	1.1%
Net interest income/ Average RWAs (%)	NA	3.0%	2.8%	2.8%	3.0%
Net interest income/ Operating income (%)	46.6%	43.2%	42.1%	41.8%	43.8%
Net fees & commissions/ Operating income (%)	23.7%	24.5%	24.7%	25.7%	25.5%
Cost/ Income ratio (%)	62.6%	61.3%	61.5%	61.8%	61.4%
Operating expenses/ Average RWAs (%)	NA	4.2%	4.1%	4.2%	4.2%
Pre-impairment operating profit/ Average RWAs (%)	NA	2.7%	2.5%	2.6%	2.7%
Impairment on financial assets / Pre-impairment income (%)	0.2%	0.2%	0.1%	0.1%	0.2%
Loan Loss Provision/ Avg Gross Loans (%)	0.3%	0.3%	0.3%	0.2%	0.2%
Pre-tax profit/ Average RWAs (%)	NA	2.2%	2.0%	2.1%	2.2%
Return on average assets (%)	0.5%	0.5%	0.4%	0.4%	0.5%
Return on average RWAs (%)	NA	1.3%	1.3%	1.2%	1.5%
Return on average equity (%)	7.2%	7.0%	6.8%	6.0%	7.1%
Capital and risk protection					
Common equity tier 1 ratio (%, fully loaded)	14.4%	NA	15.0%	16.5%	16.6%
Common equity tier 1 ratio (%, transitional)	14.5%	15.0%	15.1%	16.4%	16.6%
Tier 1 capital ratio (%, transitional)	15.4%	15.8%	15.7%	17.0%	17.0%
Total capital ratio (%, transitional)	17.9%	18.2%	18.5%	20.3%	19.7%
Leverage ratio (%)	6.1%	5.7%	5.7%	6.1%	6.4%
Asset risk intensity (RWAs/ Total assets, %)	33.4%	33.7%	34.0%	32.0%	32.1%
Market indicators					
Price/book (x)	NA	NA	NA	NA	NA
Price/tangible book (x)	NA	NA	NA	NA	NA
Dividend payout ratio (%)	NA	NA	NA	NA	NA

Source: SNL, Scope Ratings

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