Bank Risk Monitor

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French banks prove resilient to the sluggish French economy

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Key messages

The tendency of the analyst, investor and media community when looking at the financial performance of banks is to point to the correlation between economic growth and bank results in terms of both revenue generation and bad debt charges.

A weaker economy usually slows down credit demand, and therefore has a direct impact on lending revenues. However, net interest income is not the only area of banks' revenues which is usually affected. Commissions, fees and trading gains are all penalized by lower levels of activity as volumes decline.

A weaker economic environment usually has a negative impact on a bank's loan book, harming asset quality. Negative or sluggish economic growth usually leads to higher levels of non-performing loans and bad debt charges. As a result, as the cycle deteriorates, the profitability of banks tends to decline.

For French banks, we point to a visible correlation between their profitability indicators and the country's GDP growth rate. This would be true for other banking systems as well, but such correlation should not be overstated.

What may be equally relevant is linking GDP growth with bank revenue rise and also with trends in banks' cost of risk (defined as bad debt charges to loan book). Despite a very weak performance of the domestic economy in 2012 and 2013, French banks managed to produce an acceptable, middle-of-the-range revenue performance in 2013. In this context we note that the extensive deleveraging the large French banks went through in 2012 had more to do with the funding crisis than with sensitivity to GDP trends. French banks were also able to display acceptable asset quality metrics which were thus only modestly correlated with the GDP growth sluggishness.

These trends can in our view be explained by two factors. First, the structure of the French banks' domestic loan book is relatively low-risk and dominated by residential mortgages and long-term corporate loans. The risk profile of the French mortgage market has historically been very low (see below) and consumer lending remains highly regulated and tightly protected.

Second, we believe that the French banks learned a lot of lessons from the earlier large banking crisis of the early 1990s which was triggered by rapid deregulation, a major bubble-bursting property crisis, the first post-war credit crunch and ultimately the collapse of one of the largest banks in the country, Crédit Lyonnais.

During the earlier crisis the French banks fought for their survival using the following avenues:

1/ Continuous cost reduction in the domestic retail network thanks to a favourable demographic structure ("age pyramid") and an overhaul in social regulation for bank personnel;

2/ Sustained domestic consolidation between 1996 and 2009;

3/ Non profit-driven entities, such as mutualist and cooperative banks, abiding by market principles and avoiding aggressive pricing competition – unlike what occurred in other European countries with respect to mutualist groups;

4/ Intense effort of diversification abroad which started in 1999 and remains in place today.

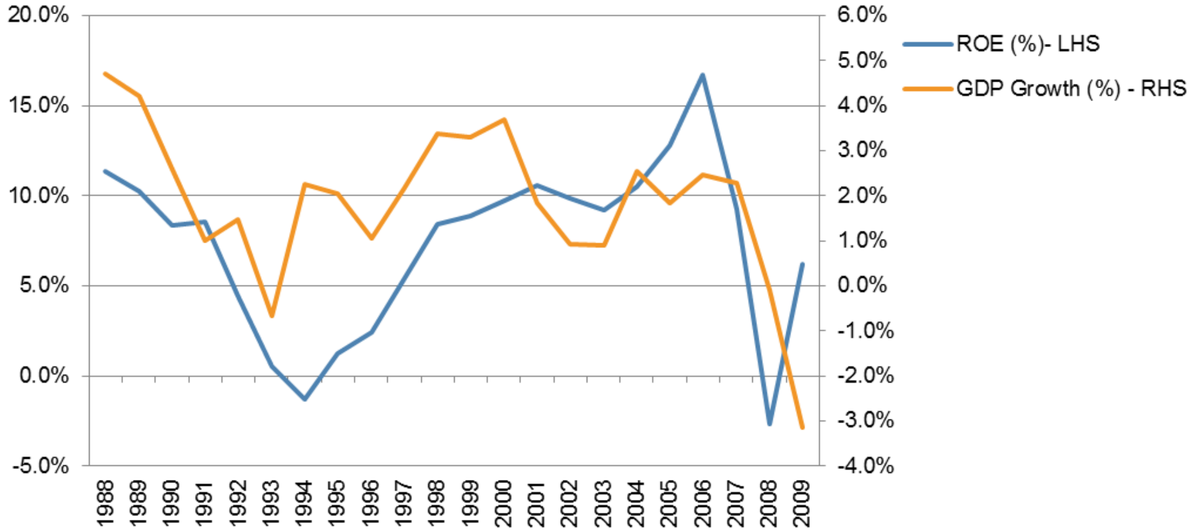
In this report Scope focuses on BNP Paribas as an example of successful diversification away from the uncertainties of the French economy.

Compared to 20 years ago French banks display less dependence on the volatility of the French economy, as evidenced by the relative resilience of their bad debt charge levels during 2012 and 2013 (arguably two of the worst years experienced by the French economy over the last 20 years). In the case of domestic pure plays like BPCE, Crédit Mutuel or Crédit Agricole, we believe that the overall prudential and institutional framework of the French banking system offers adequate protection against the effects of a severe economic deterioration, thus mitigating the impact of the inherent GDP growth-bank revenues correlation.

Analyzing the correlation between banks and the French economy

French banks are not immune to the relationship between GDP growth and their profitability, as demonstrated by Chart 1 (ended in 2009 as the OECD no longer provides such data). This chart gives a good view over several cycles of the relationship between economic growth and the profitability of French banks.

Chart 1: ROE vs GDP Growth – French banks 1988-2009

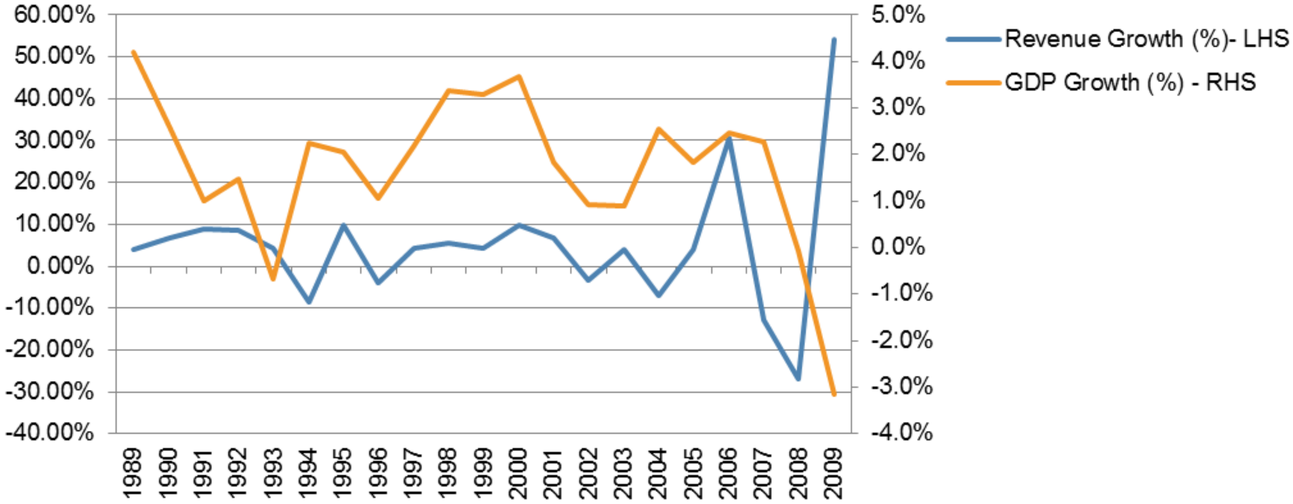


Source: OECD

As we can see there is a rather strong correlation between GDP growth and the profitability of the French banking sector. It is interesting to note that in the recent past French banks went through a major "hunger march" in profitability terms between 1988 and 1995 that can only be compared with the crisis years (between 2007 and 2012). But it can be argued that the financial crisis was a global phenomenon while the 1988-1995 events were more French-specific. We believe that the early 1990s crisis served as a catalyst for the French banking sector, and these particular years (as well as the years immediately afterwards) were the years during which the sector engaged into structural reform in order to "never again" experience the weight of such a crisis – directly linked to GDP growth falling (1988-1993), then to interest rates going up unexpectedly (1994) and lastly to the credit crunch hitting the banks hard (1995) – as a delayed response to GDP growth contracting.

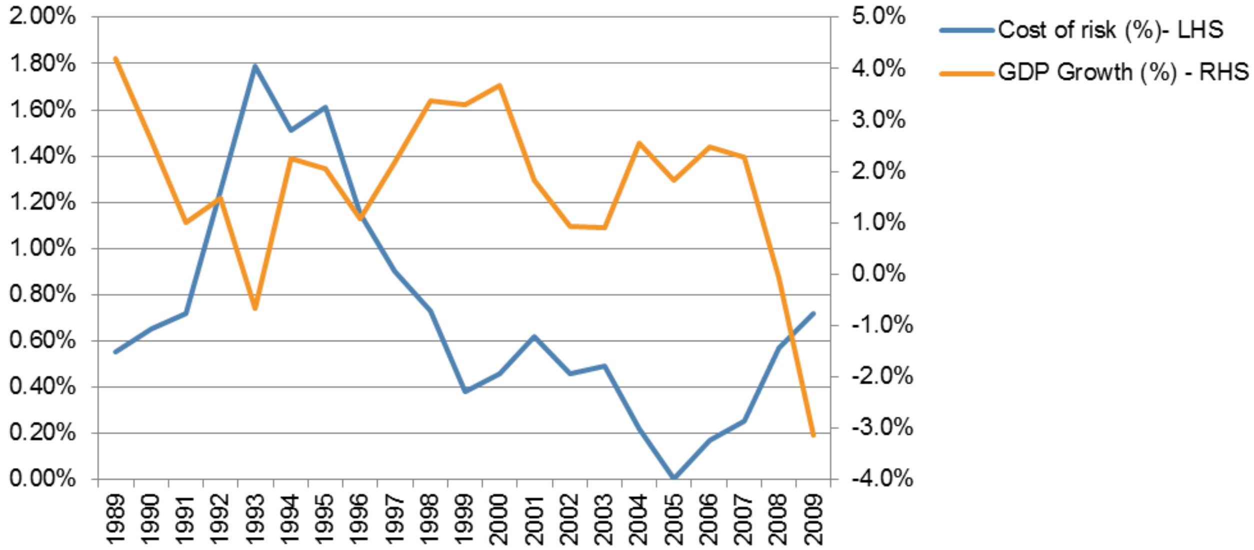
We note that in this context the revenue growth (Chart 2) correlates better with GDP growth than the bad debt charge (Chart 3).

Chart 2: Revenue growth vs GDP Growth French banks



Source: OECD

Chart 3: Bad debt charge vs GDP Growth (%)



Source: OECD

Chart 3 shows that, that while the inverted correlation between bad debt charge and GDP growth was strong between 1989 and 1999, it started to break after this. It means that as the economy started to slow down again from 2000 to 2003, the cost of risk of French banks kept falling. It had reached very low levels by 2005, so an increase after this was normal but as the level of economic activity started to completely collapse (2007-2009), the cost of risk increased but in a much more “orderly” fashion, peaking at 72bps in 2009, a very far cry from the levels seen in 1993-1995 (from 1.5% to 1.8%). Do more recent data (this time taken at individual banks level) confirm the relative disconnect between French banks’ performance indicators and France’s economic activity trends? This is what the next section will try and answer.

French banks asset quality metrics vs. French economic growth: reducing the dependency

Table 1 below shows the average operating income growth of the 18 Scope-rated banks between 2006 and 2013. We pay particular attention to 2012 and 2013, the two most challenging years for the French economy in recent memory.

Table 1: Operating income growth of the 18 Scope-rated banks (in %)

	2006Y	2007Y	2008Y	2009Y	2010Y	2011Y	2012Y	2013Y
Barclays Plc	24.53%	6.47%	-8.04%	37.60%	8.03%	-0.88%	-20.27%	12.13%
RBS	8.48%	6.47%	-18.47%	41.54%	-9.50%	-6.29%	-28.87%	11.59%
Credit Suisse	26.99%	1.60%	-81.11%	348.77%	-6.58%	-17.12%	-8.43%	8.68%
UBS	17.40%	-32.24%	-87.59%	520.10%	29.15%	-12.46%	-8.49%	8.50%
ING Bank	5.95%	1.94%	-0.88%	5.68%	16.74%	-3.71%	-13.89%	3.88%
Groupe BPCE						**-0.86%**	**-5.31%**	**2.98%**
HSBC	13.69%	21.64%	4.78%	-19.04%	3.73%	6.85%	-13.78%	1.16%
Credit Mutuel Group	**12.60%**	**-2.23%**	**-15.41%**	**52.17%**	**8.48%**	**-4.48%**	**1.77%**	**0.84%**
BNP Paribas SA	**27.15%**	**11.19%**	**-12.11%**	**46.30%**	**9.36%**	**-3.81%**	**-6.84%**	**-1.05%**
Societe Generale	**16.81%**	**-1.67%**	**2.30%**	**4.21%**	**13.62%**	**-2.68%**	**-9.89%**	**-1.96%**
Credit Agricole Group	**13.23%**	**0.26%**	**-2.29%**	**7.63%**	**5.05%**	**17.99%**	**-19.20%**	**-2.06%**
BBVA	20.35%	15.85%	4.41%	8.90%	-1.61%	-1.49%	9.31%	-2.27%
KBC	15.32%	0.84%	-50.40%	-4.66%	80.68%	-12.80%	6.67%	-2.79%
Rabobank	7.33%	10.69%	10.56%	1.37%	2.17%	-0.24%	7.16%	-4.38%
Commerzbank	26.89%	-3.78%	-22.22%	60.64%	18.92%	-22.78%	1.65%	-4.49%
Deutsche Bank	10.97%	8.67%	-51.00%	92.13%	5.36%	11.39%	-2.46%	-5.60%
Santander	16.21%	8.06%	16.96%	30.13%	3.75%	2.50%	1.52%	-8.42%
Lloyds	5.35%	-3.58%	-7.79%	128.18%	10.40%	-16.35%	-1.37%	-9.94%
AVERAGE	**15.84%**	**2.95%**	**-18.72%**	**80.10%**	**11.63%**	**-3.74%**	**-6.15%**	**0.38%**

Source: SNL, Scope Ratings

Interestingly, the operating income growth of French banks has been below average in generally buoyant years (such as 2006 and 2009 – the latter showing rebound from crisis write-downs in 2008) while French banks performed reassuringly well (and therefore showed their defensive qualities) in 2008 and to a lesser extent, 2013. The French economy had outperformed the OECD peer group in 2008, while it hadn't in 2013.

Despite this, French banks show an acceptable "middle-of-the-range" position in 2013. Nowhere nearly as good as the rebound experienced by some UK banks and the two large Swiss banks, but better than the two German banks, some Benelux banks, one UK bank and one Spanish bank.

In 2012, the deleveraging of French banks mirrored their lack of performance in revenue growth and the poor performance of the French economy. But here we believe that the disappointing revenue growth had more to do with the funding problems that surfaced with the Euro-area crisis in 2011 than with a particularly strong correlation with the economy. It is likely that the deleveraging had a negative impact on credit growth and therefore that the bank's self-imposed lending restrictions had an impact on the economy. It is a case of the banking sector contributing to the weak environment rather than the weaker environment impacting banks.

Below we look at the cost of risk (defined as bad debt charges % loans).

Table 2: Cost of risk of 18 Scope-rated banks

	2005Y	2006Y	2007Y	2008Y	2009Y	2010Y	2011Y	2012Y	2013Y
Santander	0.89%	1.29%	1.22%	1.63%	2.83%	2.57%	2.41%	3.04%	2.70%
RBS	0.41%	0.42%	0.30%	0.94%	1.72%	1.40%	1.33%	1.00%	1.71%
BBVA	0.45%	0.76%	0.68%	0.76%	1.34%	1.16%	1.03%	1.92%	1.43%
KBC	0.02%	0.15%	0.19%	1.40%	1.40%	0.97%	1.01%	0.81%	1.34%
Barclays Plc	0.57%	0.75%	0.83%	1.25%	1.72%	1.26%	1.24%	0.74%	0.68%
Commerzbank	0.35%	0.40%	0.16%	0.63%	1.28%	0.71%	0.42%	0.54%	0.68%
BNP Paribas SA	**0.20%**	**0.22%**	**0.38%**	**1.19%**	**1.38%**	**0.69%**	**0.51%**	**0.57%**	**0.62%**
Societe Generale	**0.20%**	**0.26%**	**0.32%**	**0.93%**	**1.97%**	**1.09%**	**0.90%**	**1.02%**	**0.62%**
Rabobank	0.17%	0.13%	0.20%	0.45%	0.45%	0.28%	0.34%	0.49%	0.55%
Credit Agricole Group	**0.32%**	**0.30%**	**0.53%**	**0.80%**	**0.96%**	**0.68%**	**1.26%**	**0.63%**	**0.54%**
HSBC	0.98%	1.19%	1.66%	2.37%	2.55%	1.35%	1.17%	0.80%	0.53%
Lloyds	0.74%	0.85%	0.90%	1.33%	3.78%	1.72%	1.34%	0.90%	0.51%
Deutsche Bank	0.23%	0.15%	0.30%	0.60%	1.16%	0.37%	0.42%	0.38%	0.51%
ING Bank		0.04%	0.03%	0.56%	0.72%	0.31%	0.38%	0.36%	0.40%
Groupe BPCE					**0.89%**	**0.37%**	**0.39%**	**0.44%**	**0.37%**
Credit Mutuel Group	**0.11%**	**0.11%**	**0.08%**	**0.64%**	**0.75%**	**0.49%**	**0.52%**	**0.34%**	**0.35%**
Credit Suisse	-0.07%	-0.06%	0.11%	0.35%	0.22%	-0.04%	0.08%	0.07%	0.07%
UBS	-0.11%	-0.04%	0.09%	1.00%	0.76%	0.05%	0.05%	0.04%	0.06%
AVERAGE	**0.34%**	**0.41%**	**0.47%**	**0.99%**	**1.44%**	**0.86%**	**0.82%**	**0.78%**	**0.76%**

Source: SNL, Scope Ratings

Table 2 shows the following:

- The mostly domestic banks (Credit Mutuel, BPCE, and Crédit Agricole since 2013) have shown a cost of risk materially lower than European peers over a long period of time, therefore showing a lower dependency on the woes of domestic GDP.

- French banks as a whole have generally shown a better-than-average cost of risk and also higher trend stability. Explained by the differing business models, geographies and specific macro conditions, over 2005-2013 some banks in the table show repeated instances of cost of risk exceeding 1%: HSBC six years out of nine, Lloyds four years, RBS five years, BBVA five years, and KBC four years. By comparison French banks have shown a higher degree of resilience. SocGen has shown on average a higher cost of risk but this can be explained by its emerging markets exposure, in particular Russia, while the high levels for BNP Paribas in 2009 had a lot to do with the first-time integration of Fortis.

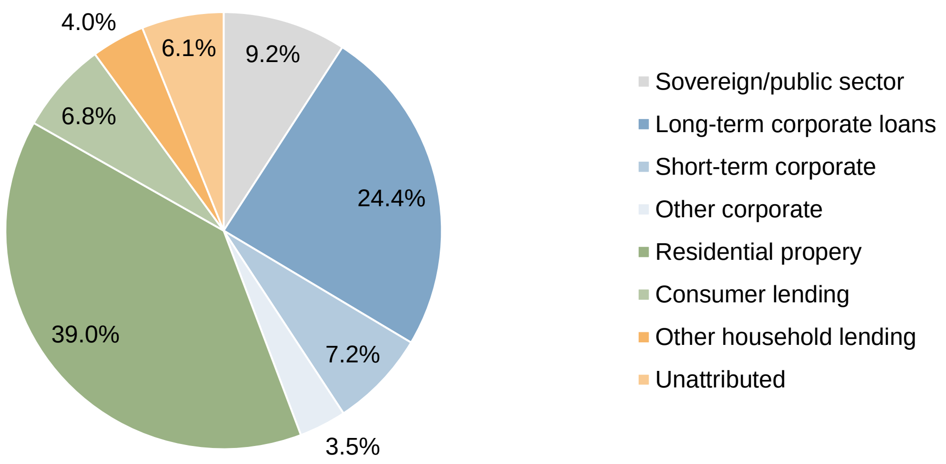
On top of the expected linking to market conditions, we believe that there are several specific factors explaining the build-up of resilient fundamentals by French banks over the years.

Specific factors explaining the resilience of French banks' fundamentals – irrespective of economic conditions

The structure of French banks' domestic loan book is inherently low-risk

Chart 4 looks at the structure of the French banking sector to try and explain the relative resilience of French banks' cost of risk versus peers – pretty much irrespective of the economic conditions. The chart presents the total loan outstanding of the French domestic sector to French residents in December 2013. To put the numbers into context, the total loans analysed here represent EUR 2,328bn.

Chart 4: Structure of the French banking sector loan book to French residents (YE 2013, in %)



Source: Banque de France

More than 50% of the domestic loan book of French banks is based on products that could be considered of a lesser risk than average, mainly residential mortgages (39% of total) and long-term corporate loans (24%). Add to this the weight of sovereign/public sector (9%) and it could be argued that almost three-quarters of the French banks' domestic loan book are only moderately risky. Conversely, short-term treasury loans to businesses and consumer loans represent each 7% of the total.

The French residential property market is low-risk, in our view.

This structure does not make French banks immune to a deteriorating economic environment and at first sight it seems that French banks could be very sensitive to a property bubble, considering their large exposure to property loans. However, the way the market is structured offers a good degree of protection, in our opinion.

The following observations are extracted from Crédit Agricole's April 2014 debt presentation and the ACP (French bank regulatory authority) report on housing loans in 2012 (dated July 2013):

According to the largest French bank by market share, the French property market has not experienced a bubble or excessive risk-taking as seen in the US, the UK, Ireland or Spain up to 2007. The 2008-2009 recession put an end to the boom and since then the housing sector has been undergoing a correction, with cumulative declines in prices of 15% in the UK, 35% in Spain and 55% in Ireland. France was not impacted by these developments. Prices continued to rise in 2010-2011 while in 2012-2013 the cumulative decline in prices remained at a very modest -4%. In 2014, this limited decline should continue according to Crédit Agricole, with sales stabilising at a modest level and existing house prices going down by 3%. The reason for this modest market adjustment is clearly due to a bad economic environment but these numbers are not very significant and should clearly not be a source of concern, in our opinion.

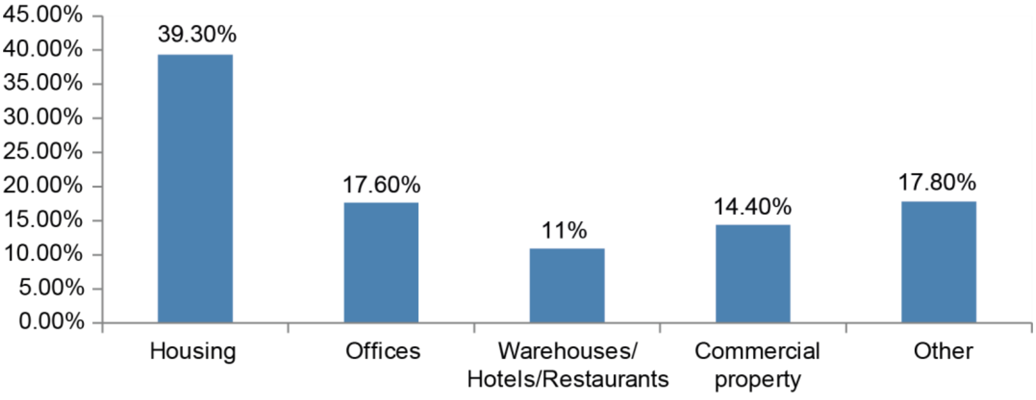
More importantly, the lending practices in France enhance borrower solvency.

- In France, the granting of a housing loan is based on the borrower's ability to repay and not on the value and quality of the asset. The ratio of repayments to income must not significantly exceed one third of the borrower's income.
- Most housing loans are amortizing, with constant repayments. They usually have a fixed rate to maturity (92% in 2012 for new loans). Almost all floating rates are capped, which is much more predictable for the borrower's finance.
- The average initial maturity of new housing loans stood at 19.8 years in 2012. The average effective duration fluctuated between 11 and 13 years from 2005 to 2012.
- Mortgage equity withdrawal mechanisms are highly regulated and rarely used.
- Specific to France, an important security often attached to residential property loans is a Crédit Logement guarantee. The borrower pays a guarantee to Crédit Logement and the monies join a guarantee fund that usually helps repaying the guarantee at the end of the loan. The guarantee is expressed as a percentage of borrowed capital (usually 1.5%) and therefore is indirectly linked to the borrower's repayment capacity, and not the value of the asset.
- Consequently the risk profile of the French residential housing market is very low and the NPL ratio stood at 1.47% in 2012.

However, property crises can also come from property developers and dealers, and not only household. The exposure of French banks to property developers and dealers stood at EUR 182bn in 2012 (no 2013 data were available at the time of writing) according to the ACP report on property finance in France (dated July 2013), down 3% versus 2011. Within that number, 67% was effective loans, 5% equity stakes in property projects and 28% off-balance sheet products (undrawn credit lines and guarantees). Within that total 66% of the loans were in France and 34% abroad (the latter being essentially split between Italy, Belgium and the US – an unsurprising breakdown considering the foreign presence of French banks abroad). This means that as a percentage of the EUR 2.3trn of loan outstandings to French residents, about EUR 80bn go to French property professionals, or less than 3.5% of total outstandings. More importantly, the largest portion of loans to property professionals is linked to the residential market, as shown in Chart 5.

Therefore it is fair to say that the asset quality risk attached to the property market in France, whether residential or professional, is reasonably limited.

Chart 5: Breakdown of loans to property professionals, by type of product (2012)



Source: Annual survey of the SGACP (2012)

The French consumer credit market is also well-protected.

Consumer credit in France has also proven to be extremely resilient across the cycles. This is in our view due to two major factors:

- First, the expertise of the major consumer credit players in France: Cetelem (BNP Paribas), Sofinco (Credit Agricole) and Cofidis (Crédit Mutuel) who have been running credit scoring models for several decades;
- The active input of French lawmakers, who have regularly voted measures to avoid overindebtedness and protect fragile borrowers (particularly so since 2010).

The lessons of the 1990 crisis have been effective

In many ways, the DNA of current French banks' management is still heavily ingrained in the lessons of the difficult years of the early 1990s banking crisis. We note the severity of the Euro-crisis of 2011-2012 which had a damaging impact on French banks' funding and liquidity and which consequently triggered very aggressive deleveraging plans. But that particular time period had less bearing with the French banks' dependency on French GDP variations.

1988-1995: a series of unfortunate events

It is difficult to assess a precise chronology of the events that befell the French banking sector between 1988 and 1995 as a lot of the events described below appeared roughly at the same time. However, they give a good idea as to the challenges to which the French banks were exposed, and which they spent the next two decades trying to avoid replicating:

1987: Termination of annual "credit ceilings" traditionally fixed by the French governments to limit/regulate the circulation of credit; this deregulation means that all French banks can grant any loan to any client. This creates a lot of competitive pressure on the "specialised financial institutions" since their traditional public missions now become obsolete (all other banks can do them without restrictions).

1988-1991: as a result of the above, massive credit growth in the French economy; some institutions start to diversify in higher-margins, riskier activities (commercial property)

1991: the French government removes its guarantee on the long-term debt of Specialised financial institutions creating huge margin pressure on the traditional business of these banks (long-term corporate loans, state-aided housing loans, loans to local authorities);

1992-1995: the economic crisis starts to hurt property prices and reveals the large exposure of French banks to this sector;

1994: surprise increase of short-term interest rates by the Fed which adds to the woes of the sector despite the start of the economic recovery;

1994-1995: the property crisis expands to the corporate sector. Provisions move to record highs and banks, also undercapitalized, stop lending.

1994: collapse of Crédit Lyonnais.

1995: beginning of serious financial difficulties of the large specialised financial institutions which have to restructure and consolidate. That year, the French banking sector experiences its first credit crunch since WWII.

Measures taken by French banks to "disconnect" from French GDP exposure

Since the bulk of the French banks were privatized between 1986 and 1994, they had the opportunity to take specific measures to fight the vast problems of the French economy. The main aspects were:

Cost reduction in the French retail networks.

Even if revenues declined faster than costs between 1991 and 1995, French banks nonetheless launched a material cost reduction effort in their network, under the premise that at some point GDP growth would resume, loan growth would pick up, and revenues would start materialising. In many ways, this cost reduction strategy in the middle of non-existent revenue growth is the one followed by many banks these days, based on the idea that when revenues pick up even slightly the impact on the bottom line will be notable. This is what happened to French banks, from 1996 in particular, and this phenomenon has been pursued to this day. This cost reduction was made easier by two developments. First we point to the positive demographic structure of bank employees, all hired in the 1970s when the banks branched out, and who started to be eligible for pre-retirement in the 1990s. Second, a significant amendment occurred to the social regulation regarding bank employees, who were no longer assimilated with civil servants. The January 2000 collective agreement gave the banks full responsibility over salary increases while it enabled them to use performance evaluation for the professional assessment of bank employees (versus assessment based on seniority only as was the case under the previous regime).

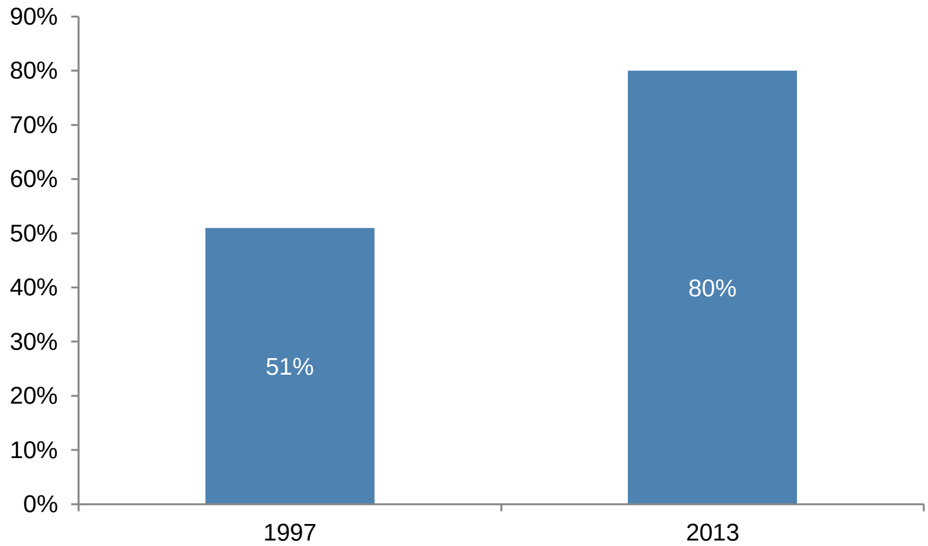
Domestic consolidation

Between 1994 and 2009, the French banking sector went through significant consolidation which reshaped the sector. Interestingly, the bulk of the consolidation took place in the aftermath of the early 1990s crisis. We can identify only one significant transaction linked to the recent financial crisis (the creation of BPCE).

We point to the most important steps in this multi-year consolidation process:

- Crédit Mutuel buying CIC in 1998 ;
- Banque Nationale de Paris buying Paribas in 1999-2000 to create BNP Paribas ;
- Crédit Agricole buying Crédit Lyonnais in 2003 ;
- Banque Populaire merging with Caisses d'Epargne to create BPCE in 2009.

Chart 6: Loan market shares of Top 5 banking groups, 1997 and 2013



Source: Banque de France, Scope Ratings estimates

As a consequence of the factors above, the domestic retail profitability of the large French banks has materially improved over the years

Table 3 gives a snapshot of the domestic retail profitability of four large French banks (please note that LCL is owned by Crédit Agricole but is reported separately from the regional banks of Crédit Agricole).

Table 3: Profitability indicators of five large French networks (YE 2013)

	BP+CE	BNPP	SocGen	Reg Bks CA	LCL
Total revenues (EUR mn)	13,387	6,726	8,235	14,873	3,811
Cost-income ratio (%)	65.5%	65.3%	64.0%	54.0%	66.0%
Cost of risks (%)	0.34%	0.24%	0.66%	0.26%	0.34%
Estimated post-tax ROE (%)	8%	17%	13%	25%	22%
Net profits (EUR mn)	2,072	1,278	1,164	3,666	599

Source: Company data, Scope Ratings estimates

Table 3 shows the progress made by the French banking sector over a 20-year period (considering that a majority of branch networks above were loss-making in the mid-1990s). As we can see, the banks post double-digit ROEs in France (except for BPCE which is the most recently formed of these networks and which needs to catch up on efficiency gains and customer intensity). Interestingly enough (and validating some of our conclusions above), the cost of risks of the French networks remains very low (except for Societe Generale, due to the fact that the non-performing loan coverage ratio was increased in 2013). But considering the state of the French economy, a cost of risk of 37bps on average is a very satisfactory performance, in our opinion.

Competitive distorsions have been gradually subsiding as the mutualist sector became more "market-conscious".

The cooperative and mutualist sector has always represented a significant proportion of French banks' market shares. Comparable to the Sparkassen and Raiffeisen sectors in Germany, mutualist banks (BPCE, Crédit Agricole, Crédit Mutuel, and also Banque Postale), which on aggregate represented over 60% of bank lending in France, had less competitive profitability objectives. After a period of market share gains that followed the deregulation of the 1980s and 1990s, French mutualist groups started to "normalize" their market behaviour (which was very price-driven in the 1990s). Two factors can explain this: first, they realized that if they wanted to fund their growth then making losses was not an option since access to the equity market was impossible (due to the capital structure of these banks). Second, both the-then Banque Populaire Group (now part of BPCE) and Crédit Agricole did IPO one of their subsidiaries (Natixis and Crédit Agricole SA respectively). By introducing a market-oriented entity in their organization, the two largest mutualist banks in France had to introduce market-friendly management in their modus operandi which we overall view as a positive – even if the lessons of capitalism were learned the hard way by both organizations. We nonetheless believe that these experiences will prove fruitful for both entities in the future.

French banks reduced their dependency to GDP growth by diversifying abroad.

Once the domestic market was fully consolidated it was important for French banks to complete their diversification away from France by expanding in other countries. Every bank pursued some sort of international strategy from 1999 onwards.

- **Société Générale** expanded internationally from 2000 especially in the emerging Europe regions – notably the Czech Republic and Romania – as well as more recently in Russia.
- **BNP Paribas** expanded its Californian strategy in the US by purchasing banks on the West Coast even before its merger with Paribas. From 2002 onwards, BNP Paribas bought large banks in in Italy (BNL) and in Belgium (Fortis).
- **Crédit Agricole** followed suit by large acquisitions in Italy and in Greece.
- **Crédit Mutuel** chose Germany and Spain.

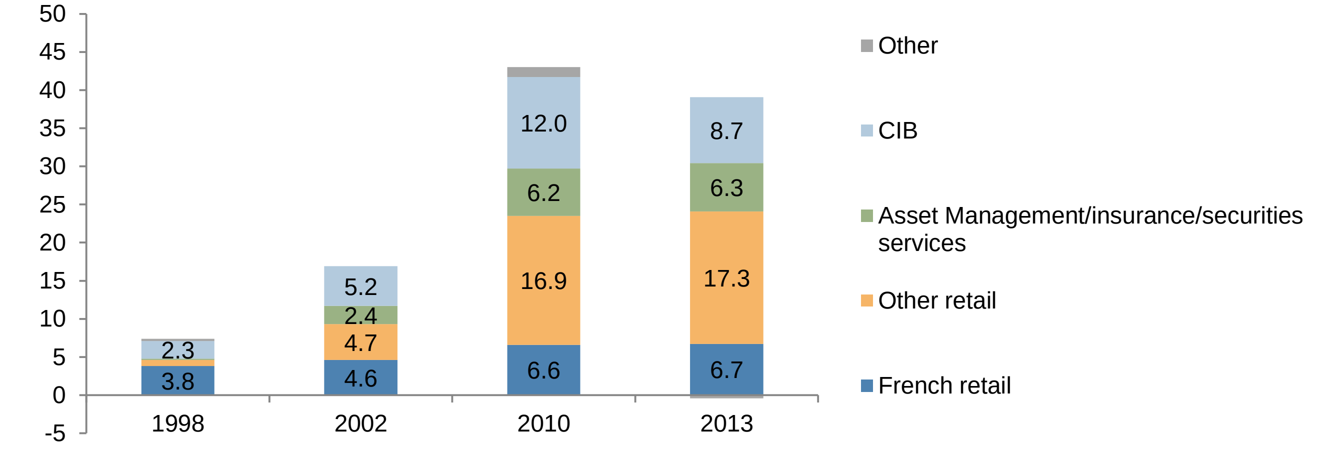
In France, only BPCE did not build a retail network outside France among the French banks rated by Scope – but it built a significant US asset management business through its listed subsidiary Natixis.

How to limit the damage of a weak French economy: the example of BNP Paribas.

Charts 7 and 8 present the typical development undertaken by BNP Paribas from 1998 onwards, from the moment the bank was still Banque Nationale de Paris.

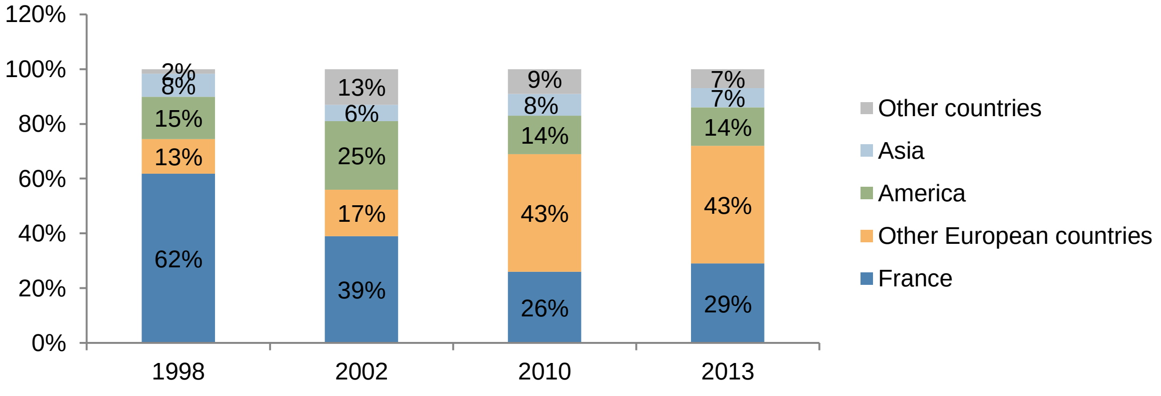
Chart 7 presents the diversification of the bank in revenue terms while Chart 8 looks at the evolving geographic diversification of the bank's loan book.

Chart 7: Revenue breakdown of BNP Paribas 1998-2013 (EUR bn)



Source: Company data, Scope Ratings estimates

Chart 8: Geographic breakdown of the loan book BNP Paribas 1998-2013 (%)



Source: Company data, Scope Ratings estimates

BNP Paribas's strength as a bank has always been its diversification, visible first and foremost at the **business line** level. Prior to its privatization in the 1990s, the old Banque Nationale de Paris was essentially a French domestic retail business with traditional commercial banking operations and one subsidiary in the US – Bank of the West. Its merger with Paribas brought additional expertise in corporate and investment banking, as well as in personal finance, asset management, and securities services. Chart 7 above examines these trends by looking at the pre-tax earnings mix of the company in 1997, 2002 (post BNP Paribas merger), 2010 (post BNL and Fortis acquisitions) and 2013.

As seen in Chart 7, the different retail businesses of BNP Paribas experienced a quantum leap in 2002, with the addition of Paribas' old Compagnie Bancaire business, and in 2006 and 2009 with the addition of the BNL and Fortis networks. Together, all retail banking operations represent between 55% and 62% of BNPP's revenue mix over the cycle, while the weight of Corporate & Investment Banking (CIB) has traditionally been limited to 25-30%. It is interesting to see that the typically non-French retail business (split between Belgium, Luxembourg, Italy, the US and selected emerging markets) now represents 45% of the bank's revenues versus less than 11% in 1998 (and this was mostly the US). French retail (and direct dependency to the country's GDP) now represents 17% of the bank's revenues (versus 51% back in 1998).

BNP Paribas's business mix is also well-diversified at **geographic** level. This diversification comes in our view as a direct consequence of the crisis 20 years ago. At the time, the old Banque Nationale de Paris managed to maintain acceptable financial fundamentals thanks to the earnings contribution of its subsidiary Bank of the West in the United States. This positive experience with diversification probably shaped the resolutely European strategy launched by BNP Paribas from 2000. Looking in Chart 8 at the geographic breakdown of the loan book for the same period as for Chart 7, we can see that the company's risk base is extremely well-diversified geographically.

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