Société Générale 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 Société Générale. The agency also assigns a rating of A+ to senior unsecured preferred debt and a rating of A to senior unsecured non-preferred debt (MREL/TLAC eligible). All ratings have a 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 Société Générale (SocGen) reflect the group's strong and well managed retail banking franchises in France and Central & Eastern Europe. Mindful of the challenges facing the retail banking industry, management is taking further action to become more efficient and to improve the client experience.
- The group's diversified universal banking business model contributes to earnings resilience although there is room for profitability to improve.
- Meaningful capital markets activities and pockets of emerging markets presence (e.g. Russia, Africa) expose the group to greater risks such as the volatility inherent in these markets and the need to ensure consistent compliance and controls across diverse geographies.
- The ratings also recognize the significant efforts the group has undertaken to reduce risks and to strengthen prudential metrics relating to capital and liquidity.

Rating drivers (summary)

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

- A diversified universal banking business underpinned by a strong franchise in its domestic market, France.
- Capital markets activities as well as pockets of emerging market presence expose the group to greater risks.
- Successful overhaul of the balance sheet in recent years, with visible improvements in solvency, funding and liquidity.

Ratings & Outlook

Issuer Rating	A+
Outlook	Stable
Senior unsecured preferred debt	A+
Senior unsecured non-preferred debt (MREL/TLAC eligible)	A
Tier 2 securities	BBB+
AT1 securities	BBB-
Short-term debt	S-1+
Covered Bonds:	
Societe Generale SCF SA Obligations Foncieres	AAA
Societe Generale SFH SA Obligations de Financement de l'Habitat	AAA

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Bloomberg: SCOP

Rating change drivers

Improvement in costs and efficiency which leads to stronger and more consistent earnings. Evolving competitive dynamics and changing customer behavior will continue to weigh on earnings, especially in the French retail banking business. A multi-year transformation plan is being implemented with the expectation that benefits will fully materialize in 2020.

A material increase in earnings volatility. The group has reshaped its capital market activities and refocused its international retail banking operations to improve earnings resilience. We would view negatively a change in strategy which materially increases the volatility of group earnings – be it from riskier capital markets activities or poor management of emerging market risks.

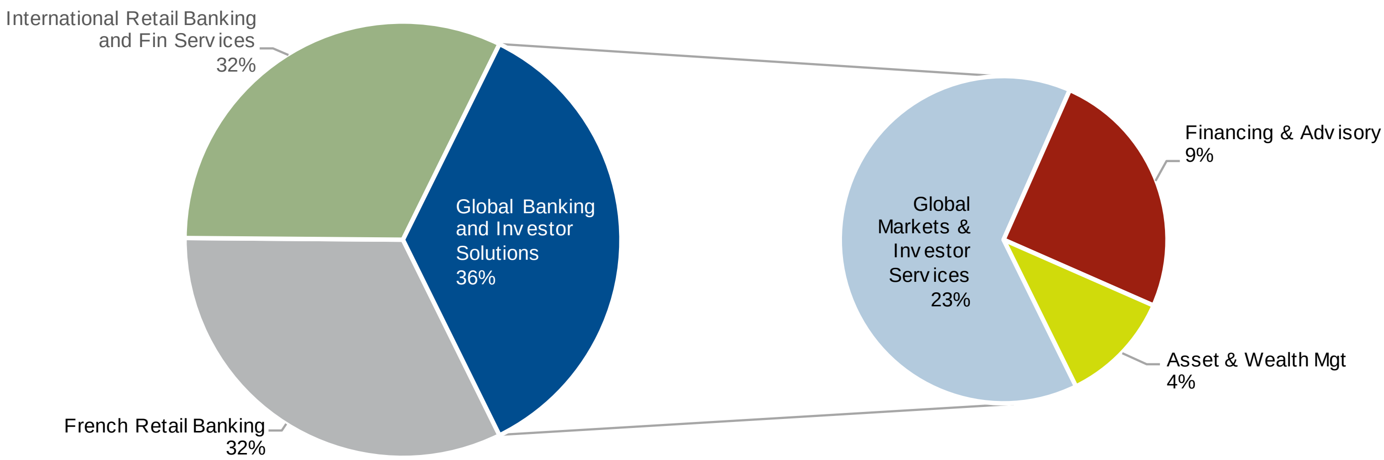
Further substantial conduct and/or legal issues which negatively impact the group's earnings, capital position and reputation. Material outstanding matters include investigations related to the manipulation of benchmark interest rates and US dollar transactions involving countries subject to US economic sanctions. As of YE 2017, the group held provisions for disputes amounting to EUR 2.3bn.

Rating drivers (details)

A diversified universal banking business underpinned by a strong franchise in its domestic market, France.

Société Générale's three core businesses – French Retail Banking, International Retail Banking and Financial Services, and Global Banking and Investor Solutions – benefit from solid market positions and provide risk and earnings diversification. The group is focusing on business-to-business (B2B) activities where relationships, expertise and an international network are valued and barriers to entry are considered higher; these account for two-thirds of group revenues. In business-to-consumer (B2C) activities efforts are directed towards the professional, high net worth and mass affluent segments. At the same time, management intends to maintain a business profile where markets activities are limited to less than 20% of group RWAs.

Figure 1: Revenues by business



Notes: Data as of end-2017. Net banking income of EUR 25.1bn excluding Corporate Centre.
Source: Company data, Scope Ratings

Cross-selling within and between each of the core businesses remains important, with the proportion of revenues stemming from group synergies steadily increasing to 30% from around 20% over the last few years. Areas of focus for synergies include insurance, private banking and commercial banking services (e.g. trade finance, cash management, payment services and factoring).

French Retail Banking (FRB) consistently accounts for about a third of group revenues. In 2017, the business generated EUR 1.0bn in group net income and a RONE of 9.1%[1]. Through its three complementary brands (Société Générale, Credit du Nord and Boursorama Banque), the group is the third largest retail bank in France. Société Générale is a national brand with about 2,000 branches targeting the wealthiest regions. Credit du Nord consists of eight regional banks and focuses on professionals and SMEs. Boursorama Banque is considered the leading online bank in France with 1.3 million customers as of YE 2017 and offers online banking, brokerage and financial information services.

[1] RONE is return on average normative equity allocated to the group's businesses. Since 2016, this is based on 11% of the businesses' risk-weighted assets.

The group is implementing a multi-year transformation plan to become more efficient as management sees a revolution occurring in retail banking – new client expectations and behaviour, new technological frontiers, and new entrants and opportunities. By 2020, the goal is to reduce the Société Générale branch network by a further 15% and the number of back-offices to 14 from 20, with a 20% reduction in staff. In addition, the group aims to automate 80% of front-to-back internal processes by 2020 (2017: 30%) and have 100% of the standard everyday banking offer online. The target cost-income ratio is less than 65% in 2020, which is still relatively high compared to other more efficient European banking systems.

Capital markets activities as well as pockets of emerging market presence expose the group to greater risks.

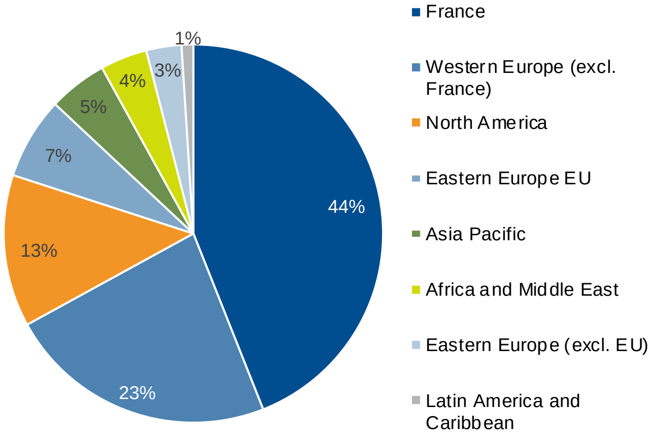
In terms of geographic presence, the group intends to maintain a balance of about 75% of revenues from mature markets and 25% from faster-growing emerging markets. While bringing diversification and growth opportunities, these faster-growing markets can also be subject to more earnings variability. As well, the group historically tended to exhibit higher non-performing loan levels compared to peers due to its long-standing presence in various emerging markets. Positively, the group has refocused and de-risked its portfolio of international retail businesses over the last few years. As of YE 2017, the commercial cost of risk for International Retail Banking & Financial Services had declined to 29bps, from 150bps in 2013.

As detailed in the 2018-2020 strategic plan, SocGen aims to consolidate leading positions in international retail markets and achieve profitable growth in emerging markets. In Central and Eastern Europe, the group holds particularly strong positions in the Czech Republic (#3 with 18.5% loan market share) and Romania (#2 with 13.1% market share). In 2017, activities in Central and Eastern Europe generated EUR 2.2bn in revenues and EUR 475m in group net income.

Russia has been considered a core market since 2006 when the group took a majority stake in Rosbank. The group maintains a nationwide presence and ranks #3 in retail lending. As of YE 2017, EAD was EUR 15.9bn (less than 2% of group EAD), with 35% being to retail and 25% to top 500 Russian and international corporates. Over the last few years, management has taken actions to mitigate the difficult operating conditions in the country, including adjusting pricing and underwriting policies, increasing ruble-denominated funding and writing off goodwill. As conditions continue to improve, profitability has been restored. In 2017, activities in Russia which also include insurance and automotive leasing generated EUR 121m in group net income.

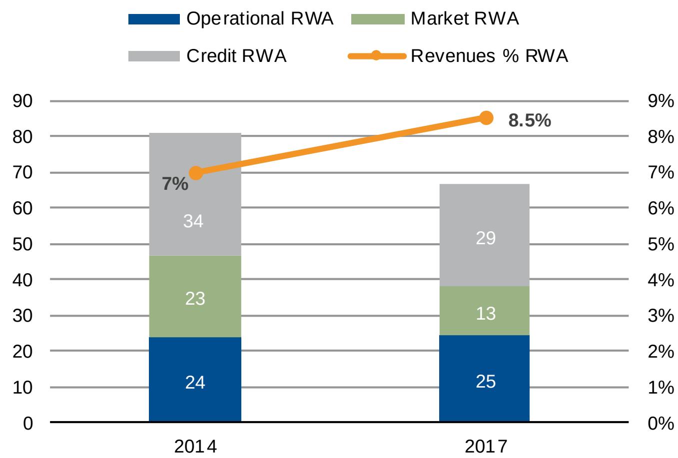
The group has been active in Africa for over 100 years and is the leading bank in French speaking Sub-Saharan Africa. Within this region, the group’s largest presence is in Morocco where it is ranked #4 in terms of loans outstanding. Other important markets include Algeria, Tunisia and Cote d’Ivoire. Of note, the group is investing in mobile and e-wallet technologies to further financial inclusion. In 2017, activities in Africa generated EUR 1.3bn in revenues and EUR 221m in group net income.

Figure 2: Geographic breakdown of credit risk (EAD)



Notes: Data as of end-2017. EAD of EUR 872bn.
Source: Company data, Scope Ratings

Figure 3: Global Markets and Investor Services RWA development



Source: Company data, Scope Ratings

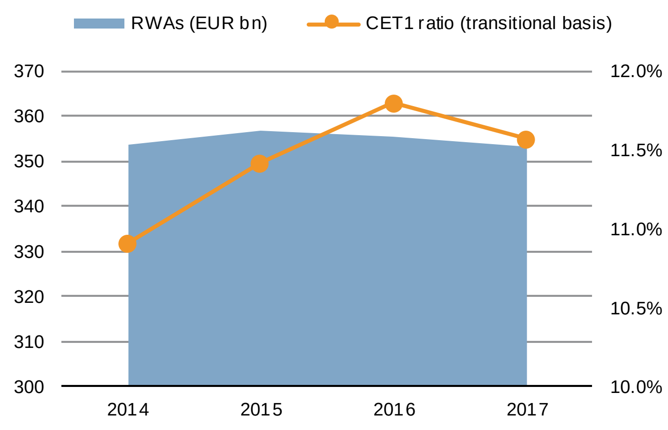
Over the years, the Global Banking and Investor Solutions (GBIS) division which includes markets, financing and advisory, transaction banking, and asset and wealth management activities has become a more consistent contributor to group earnings although the markets business continues to drive results due to its scale. As shown in Figure 3, the level of market risk has declined, and returns have improved. According to management, the group's business mix is more geared to investment and financing solutions rather than flow business (48%) compared to peers. The group maintains particular strengths in derivatives and structured products. In 2017, GBIS generated EUR 1.6bn in group net income and a RONE of nearly 11%.

Successful overhaul of the balance sheet in recent years, with visible improvements in solvency, funding and liquidity.

Since the financial crisis, the group has made significant efforts to bolster liquidity reserves, to extend the average maturity of short-term liabilities and to reduce reliance on short-term wholesale funding. For example, US money market funds accounted for USD 5.9bn of funding in 4Q 2017, compared to USD 46bn in 2Q 2011. At the same time, the group's international banking subsidiaries have become more independently self-funded. Parent company funding to these subsidiaries (excluding consumer finance) amounted to EUR 1.8bn in 4Q 2017, compared to EUR 9.2bn in 4Q 2011.

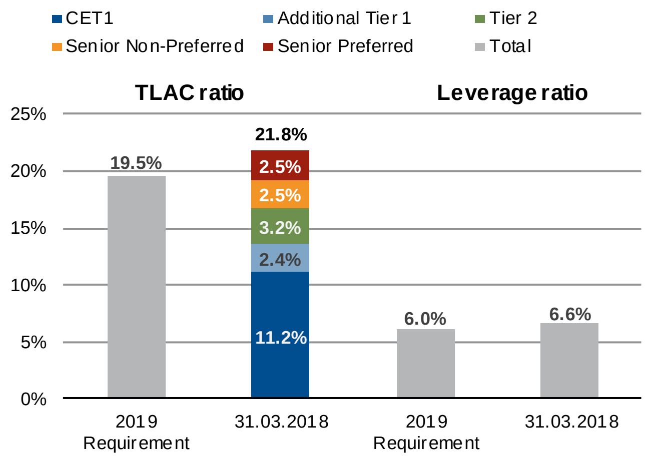
Meanwhile, we note that the group continues to be slightly more reliant on wholesale funding than peers. By our calculations, wholesale funds accounted for over 35% of total liabilities at YE 2017 while for peers the average was 30%.

Figure 4: CET1 and RWA development



Source: Company data, Scope Ratings

Figure 5: TLAC positioning



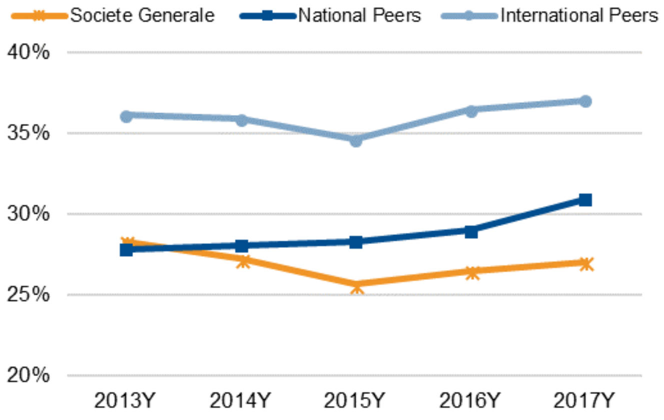
Source: Company data, Scope Ratings

The group has also materially strengthened its solvency position over the last few years and is comfortably positioned against an estimated 2019 SREP requirement of 9.6% which includes a Pillar 2 requirement of 1.5%, a G-SIB buffer of 1% and a countercyclical buffer of 0.1%. As of 1Q 2018, the group's fully loaded CET1 ratio was 11.2% and its leverage ratio was 4.1%. Management targets a CET1 ratio greater than 12% and a leverage ratio of 4-4.5% in 2020.

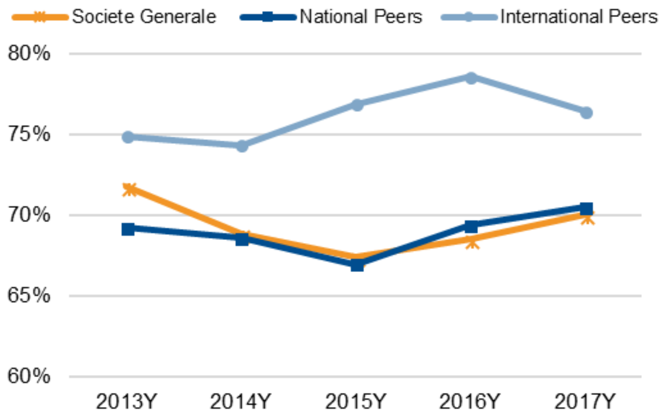
SocGen is also well positioned for expected TLAC requirements (19.5% in 2019 and 21.5% in 2022) with a TLAC ratio of 21.8%, including 2.5% of senior preferred debt as of 1Q 2018 Since the passage of the Sapin 2 law in December 2016, the group has successfully issued non-preferred senior debt. Over the 2018-2020 period, the group expects to issue annually on average about EUR 2.5bn in senior preferred and secured debt, EUR 6-7bn in senior non-preferred debt and EUR 2.5-3bn in subordinated debt (AT1/T2).

I. Appendix: Peer comparison

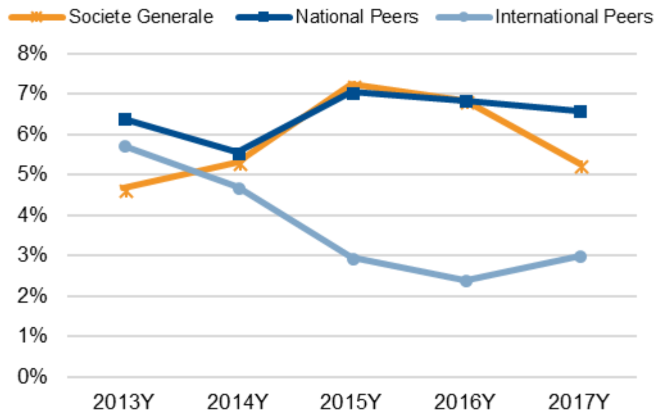
Net fees and commissions / Operating income



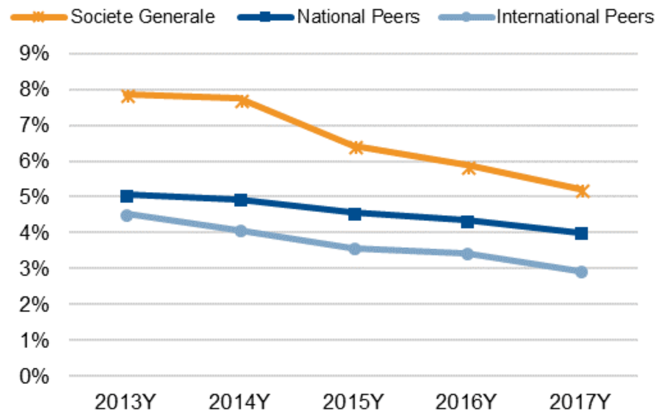
Cost-to-Income ratio (%)



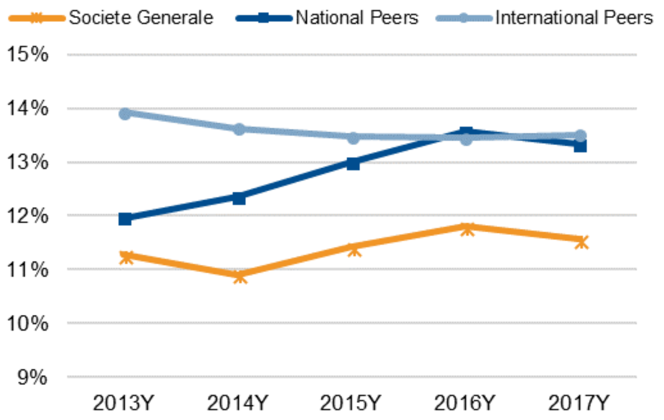
Return on average equity (ROAE, %)



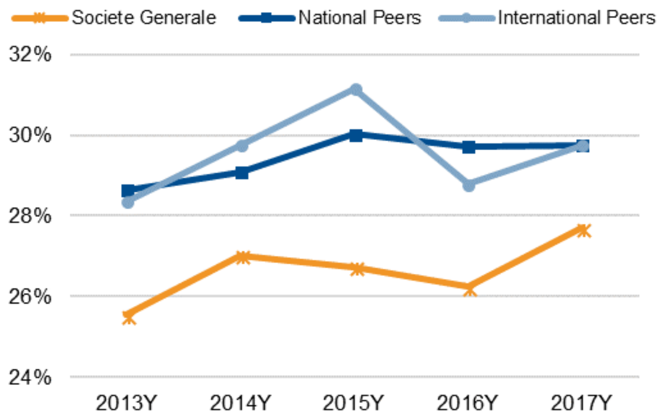
NPLs / Net Loans (%)



CET1 ratio (%, transitional basis)



Asset risk intensity (RWAs / Total assets)



National peers: BNP Paribas, Societe Generale, Credit Agricole Group, Credit Mutuel, Groupe BPCE, Banque Postale
International peers: BNP Paribas, Societe Generale, Barclays, Credit Suisse, Deutsche Bank, HSBC, UBS.
Source: SNL

II. Appendix: Selected Financial Information – Société Générale SA

	2013Y	2014Y	2015Y	2016Y	2017Y
Balance sheet summary (EUR m)					
Assets					
Cash and interbank assets	151,444	137,774	150,247	155,688	175,270
Total securities	634,469	701,434	660,066	643,105	557,126
of which, derivatives	177,185	232,587	207,590	187,182	148,754
Net loans to customers	361,276	370,367	422,278	446,105	445,650
Other assets	88,073	98,563	101,800	109,524	97,082
Total assets	**1,235,262**	**1,308,138**	**1,334,391**	**1,354,422**	**1,275,128**
Liabilities					
Interbank liabilities	94,664	95,897	102,403	87,822	94,225
Senior debt	287,278	225,813	354,423	354,429	322,185
Derivatives	179,599	236,300	207,816	191,192	155,294
Deposits from customers	344,687	349,735	379,631	421,002	410,633
Subordinated debt	7,395	8,834	13,046	14,103	13,647
Other liabilities	267,538	332,685	214,397	220,168	215,107
Total liabilities	**1,181,161**	**1,249,264**	**1,271,716**	**1,288,716**	**1,211,091**
Ordinary equity	43,933	46,160	50,265	52,273	50,807
Equity hybrids	7,075	9,069	8,772	9,680	8,566
Minority interests	3,093	3,645	3,638	3,753	4,664
Total liabilities and equity	**1,235,262**	**1,308,138**	**1,334,391**	**1,354,422**	**1,275,128**
Core tier 1/Common equity tier 1 capital	35,570	38,594	40,735	41,963	40,861
Income statement summary (EUR m)					
Net interest income	10,090	9,999	9,306	9,467	10,416
Net fee & commission income	6,507	6,475	6,678	6,699	6,823
Net trading income	4,104	4,820	7,310	6,243	5,441
Other income	2,295	2,487	2,738	2,887	2,537
Operating income	**22,996**	**23,781**	**26,032**	**25,296**	**25,217**
Operating expense	16,494	16,358	17,536	17,324	17,652
Pre-provision income	**6,502**	**7,423**	**8,496**	**7,972**	**7,565**
Credit and other financial impairments	3,505	2,628	2,487	2,049	1,052
Other impairments	76	576	61	38	5
Non-recurring items	137	135	161	422	-1,370
Pre-tax profit	**3,058**	**4,354**	**6,109**	**6,307**	**5,138**
Discontinued operations	0	0	0	0	0
Other after-tax Items	0	0	0	0	0
Income tax expense	533	1,376	1,714	1,969	1,708
Net profit attributable to minority interests	350	299	394	464	624
Net profit attributable to parent	**2,175**	**2,679**	**4,001**	**3,874**	**2,806**

Source: SNL

III. Appendix: Ratios – Société Générale SA

	2013Y	2014Y	2015Y	2016Y	2017Y
Funding and liquidity					
Net loans/deposits (%)	104.8%	105.9%	106.7%	101.3%	103.6%
Liquidity coverage ratio (%)	NA	118.0%	124.0%	142.0%	116.0%
Net stable funding ratio (%)	NA	NA	NA	NA	NA
Asset mix, quality and growth					
Net loans/assets (%)	29.2%	28.3%	31.6%	32.9%	34.9%
NPLs/Net Loans (%)	7.9%	7.7%	6.4%	5.9%	5.2%
Loan-loss reserves/NPLs (%)	58.9%	55.9%	59.0%	59.0%	56.5%
Net loan growth (%)	-4.7%	2.8%	14.0%	5.6%	-0.1%
NPLs/Tangible Equity and Reserves (%)	44.2%	41.6%	36.2%	33.8%	31.8%
Asset growth (%)	-1.2%	7.7%	2.0%	1.5%	-5.9%
Earnings and profitability					
Net interest margin (%)	0.9%	0.8%	0.7%	0.7%	0.8%
Net interest income/average RWAs (%)	3.2%	NA	2.6%	2.7%	3.0%
Net interest income/operating income (%)	43.9%	42.0%	35.7%	37.4%	41.3%
Net fees & commissions/operating income (%)	28.3%	27.2%	25.7%	26.5%	27.1%
Cost/income ratio (%)	71.7%	68.8%	67.4%	68.5%	70.0%
Operating expenses/average RWAs (%)	5.2%	NA	4.9%	4.9%	5.0%
Pre-impairment operating profit/average RWAs (%)	2.1%	NA	2.4%	2.3%	2.1%
Impairment on financial assets /pre-impairment income (%)	53.9%	35.4%	29.3%	25.7%	13.9%
Loan-loss provision charges/net loans (%)	0.8%	0.7%	0.6%	0.4%	0.2%
Pre-tax profit/average RWAs (%)	1.0%	NA	1.7%	1.8%	1.5%
Return on average assets (%)	0.2%	0.2%	0.3%	0.3%	0.3%
Return on average RWAs (%)	0.8%	NA	1.2%	1.2%	1.0%
Return on average equity (%)	4.7%	5.3%	7.2%	6.8%	5.3%
Capital and risk protection					
Common equity tier 1 ratio (%, fully loaded)	11.3%	10.1%	10.9%	11.5%	11.4%
Common equity tier 1 ratio (%, transitional)	11.3%	10.9%	11.4%	11.8%	11.6%
Tier 1 capital ratio (%, transitional)	13.4%	13.4%	14.0%	14.8%	14.0%
Total capital ratio (%, transitional)	14.7%	15.0%	16.8%	18.2%	17.2%
Leverage ratio (%)	3.5%	3.8%	3.8%	4.2%	4.3%
Asset risk intensity (RWAs/total assets, %)	25.5%	27.0%	26.7%	26.2%	27.7%
Market indicators					
Price/book (x)	0.7x	0.6x	0.7x	0.7x	0.7x
Price/tangible book (x)	0.9x	0.7x	0.8x	0.8x	0.8x
Dividend payout ratio (%)	41.7%	41.4%	44.5%	51.6%	NA

Source: SNL

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