

Special Report

Major French Banks Semi-Annual Review and Outlook

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Summary

The trend of regular growth in major French banks' bottom line results came to an end in 2007, when a 27% fall in reported net income was recorded by the eight largest banking groups on an aggregated basis – Credit Agricole (CA), BNP Paribas (BNPP), Societe Generale (SG), Credit Mutuel Centre Est Europe (CMCEE), Groupe Caisse d'Epargne (GCE), Groupe Banque Populaire (GBP), Natixis and La Banque Postale (LBP). This strong turnaround at most banks was due to the impact of the financial crisis, and the necessary subprime-related write-downs/provisions since H207 (EUR11.8bn in total) in the banks' respective corporate and investment banking (CIB) and asset management (AM) divisions. In one particular case, the fall in net income was also attributable to a massive fraud-related proprietary trading loss. Only two groups (CMCEE and LBP) have not been significantly impacted by the US subprime crisis. Only four banks managed to increase operating income in 2007, and the worst performers lost up to 14% of their revenue compared with 2006. A breakdown of 2007 revenue disclosed a saturated domestic retail market, the volatility of CIB revenue and successful diversification into foreign markets and in activities generating more recurring revenue. Cost to income ratios deteriorated very significantly and, in some cases, exceeded 100% in H207. Three groups, namely BNPP, CMCEE and LBP, were particularly resilient in this unfavourable environment, with BNPP and LBP posting a 6% and 9% rise in net income in 2007, respectively, and CMCEE maintaining its cost to income ratio below 60%.

Those French banks that have been hit by the crisis are expected to be hit again in 2008 as the crisis is not over. Moreover, the loss of revenue in CIB divisions due to the distressed activity in structured finance is likely to pose a problem for certain banks. In addition, Fitch does not forecast any upturn in domestic retail banking for 2008. On the other hand, non-structured CIB activities continue to perform well, credit defaults remain very low, and international retail banking and specialised financial services show regular and strong growth. As a whole, assuming there is a similar impact from the crisis in full year 2008 as there was in H207 (which is a conservative assumption unless the financial conditions of the monoline insurers deteriorate very significantly), combined operating income and operating profit for the eight largest French banks could fall by about 2% and 10% respectively in 2008. However, there exist a number of specific issues that could influence these forecasts significantly, such as the "post-fraud" life at SG, the fortunes of the monoline insurer CIFG, and possible M&A activity.

The Economic Environment

French economic growth slumped to only 0.3% in Q407. Consumer confidence has fallen very sharply since summer 2007 to its lowest level since surveys were first published in the late 1980s. Global financial turmoil and rising living costs are important factors underpinning the erosion of consumer sentiment. Growth in consumer spending, traditionally at around 2.6% each year, declined to 0.5% in Q407 and retail sales have weakened further in the opening months of 2008, with sales recording a small decline in February. With the exception of the labour market, supply side indicators have also been sluggish with industrial production weakening at the end of 2007 and export growth remaining at just 2.6% in 2007. French exporters appear to be less well placed than their German counterparts in terms of coping with the appreciation of the euro and net trade continues to detract from growth. Despite this unfavourable environment, French banks pursued

their growth in retail banking throughout the year, and asset quality remained robust.

The market environment has changed considerably since Q307 due to the US subprime crisis. French banks were not left unscathed, recording a total of EUR11.8bn (pre-tax) subprime related write-downs/provisions in 2007. This mostly took the form of heavy write-downs/provisions on asset-backed securities (ABS)/collateralised debt obligation (CDO) and monoline exposure. In addition, funding costs increased as liquidity became scarced in the market. The EUR11.8bn charge was split as follows: CA – EUR4.1bn; SG – EUR2.9bn; Natixis – EUR2.3bn; BNPP – EUR1.3bn; GCE and GBP – EUR0.5bn each excluding Natixis (or EUR1.3bn each including Natixis); and CMCEE – EUR0.2bn.

Despite the charges, banks holding 65% of deposits in France continue to be rated 'AA-' or higher and all large French banks enjoy solid retail franchises. At the same time, solid capital ratios facilitate loss absorption and write-downs. However, many of France's leading banks (with the notable exception of CMCEE and LBP) have, over the years, developed sizeable CIB activities and have branched out into the structured finance markets. Moreover, the structured finance contagion has spilled over into the cooperative banking groups via Calyon, controlled by CA, and Natixis, where majority control is split equally between GCE and GBP. Being rather late entrants into the structured markets, Calyon and Natixis do not necessarily hold the best assets and management was not necessarily well placed to fully understand the risks involved. In addition, all large French banking groups (again with the notable exception of CMCEE and LBP) are large players in AM activities, which are indirectly affected by the financial crisis, especially as French asset managers were sizeable providers of "enhanced", or "dynamic" funds invested in structured products.

General Trends for 2007 (See Tables 5 and 6)

After a very solid H107 performance, in line with the strong results posted in 2006, most French banks were hit hard by the financial crisis in H207. Some banks even reported net losses in their CIB units, and AM divisions were also affected. This led to falling operating profits and to rising cost/income ratios. At the same time, funding costs rose due to the depressed interbank market. Of the eight largest French banks, only BNPP managed to increase operating income significantly in 2007, and, at this level, growth did not reach 10% for any bank. Only three other banks managed to increase operating income in 2007: CA (by 2% on the back of external growth), LBP (by 2%) and CMCEE (by a very modest 0.4%). The worst performers were Natixis and GCE, which both reported a 14% decline. The main reason behind this strong turnaround compared with 2006 is the heavy impact of provisions/write-downs on CDOs and monoline exposure for French banks in H207. In fact, all banks that publish interim figures (CMCEE and LBP do not) saw their revenue fall in H207. While BNPP and CA limited this fall to 17%-22%, SG, GCE and GBP posted a 30%-35% decline. The fall at GCE and GBP was primarily due to the 50% fall in revenue at Natixis. Faced with dwindling operating revenues, all banks excluding LBP reported a deterioration of their cost to income ratios and a fall in operating profit in 2007 compared with 2006, and in H207 compared with H107. It should be noted that GCE, GBP and Natixis posted pre-provision operating losses (and thus cost to income ratios above 100%) in H207. This had not happened to any large French bank in the last decade and highlights the exceptionally strong impact of the financial crisis on some banks' performance. Only BNPP and LBP increased their net income in 2007, and no bank that publishes interim figures managed to increase its net income in H207 compared with H107. The largest fall in net income in both 2007 and H207 was recorded at SG which suffered, in addition to the financial crisis, from exceptionally high fraudulent losses in its CIB division.

If the eight banks are aggregated, operating income was stable at EUR112bn in 2007 despite the EUR12bn impact of the crisis, and the trend varied tremendously between the different business lines: 0% growth in domestic retail banking, 29% growth in international retail banking and specialised financial services, a 23% decline in CIB and 21% growth in AM/insurance/private banking. These trends would appear to highlight that the country's retail market is saturated, the volatility of CIB revenue and the successful diversification into foreign markets and in activities generating more recurring revenue. However, the combined net income reported by France's eight leading banks in 2007 fell by a very sizeable 27% on comparative results for 2006 (or 18% excluding the fraud at SG).

Bank by Bank Results for 2007 (See Tables 5 and 6)

Societe Generale (SG)

SG's 2007 results were marked by poor results posted by the CIB division, long the group's star performer, and by a massive fraud-related proprietary trading loss. Net income for 2007 declined by 72%. Fitch's comprehensive income, which includes changes in value of available-for-sale (AFS) instruments, declined by 102% and was negative (-EUR105m). While the bank reported a strong first half (with published net income up 14%, at EUR3.5bn), the third and fourth quarters were affected by the impact of the crisis (EUR2.6bn write-downs in the CIB business line plus EUR276m compensation charges in AM) and by a devastating EUR4.9bn trading loss due to a fraud in its proprietary equity division. Backdating the fraud losses sustained in January 2008 to 2007 results has given rise to much accounting controversy. From a fiscal point of view, this fraud resulted in a EUR2.2bn differed tax asset. In Q407, SG posted its worst quarterly performance ever, with a EUR3.2bn net loss. The crisis mostly impacted the group's operating income, which fell by 4%. At the same time, non-interest expenses rose by 4% and the group's cost to income ratio deteriorated to 68% (2006: 62%). The EUR4.9bn exceptional pre-tax loss resulting from the fraud was only partially offset by EUR1bn capital gains realised on the sale of equity participations, and net exceptional items totalled -EUR3.9bn. SG's Tier 1 ratio fell to 6.6% due to the fraud but will be restored to 8% (despite the acquisition of Rosbank) owing to a rights issue which raised EUR5.5bn in March 2008.

BNP Paribas (BNPP)

BNPP managed to increase published net income by 6% to EUR8.3bn despite the financial crisis, its best annual performance ever. While BNPP posted a strong H107, with published net income up 20%, it sent worrying signs to the market in August 2007 when it suspended trading in three of its funds for valuation considerations. However, the funds were re-opened three weeks later and the real negative impact of the crisis materialised in Q407. As a whole, provisions/write-downs directly related to the subprime fallout totalled EUR1.3bn for the full year 2007 and were split as follows: EUR851m depreciation/write-downs on CDOs/LBOs/monolines and EUR424m impairment charges in CIB (US residential construction sector) and BancWest (including subprime securities). Operating income was up 9% and increased in all business lines, including in CIB. However, the 3% fall in revenue from domestic retail banking in H207 is not very promising. At the same time, non-interest expenses were up 10% and, according to Fitch's calculations, BNPP's cost to income ratio deteriorated to 62.5% in 2007 from 61.7% in 2006. The rise in loan impairment charges to EUR1.5bn from EUR810m reflected the impairment charges at BancWest mentioned above, as well as higher activity and deteriorating credit risk at Cetelem (mostly relating to the Spanish market). It should be noted that the 2007 results include EUR1bn pre-tax capital gains realised by BNP Paribas Capital, against EUR287m in 2006. Fitch's comprehensive income, which includes changes in value of AFS instruments, dropped by 17% to EUR6.4bn. The bank's Tier 1 (Basel I) ratio reached a satisfactory 7.3% at end-2007.

Natixis

Natixis, created in November 2006 but combining the businesses of Natexis Banques Populaires, Ixis CIB, plus selected businesses from GCE, published a disappointing EUR1.2bn net income for 2007, against EUR1.6bn in H107 and EUR2.2bn in 2006. This sharp decline in profitability is linked to the revenue mix at Natixis (CIB activities, which generated 43% of Natixis's operating income before the financial crisis, were hit hard by the crisis and posted a 48% drop in operating income and a EUR177m net loss in 2007. Operating income in the structured business line fell from EUR536m in 2006 to -EUR535m in 2007 and operating income on proprietary trading fell from EUR437m in 2006 to a EUR295m loss in 2007) and to the troubles encountered by CIFG, Natixis's monoline insurer. On the other hand, the bank's other activities (AM, project finance and brokerage) continued to perform reasonably well (these posted a 13% increase in operating income) and profits from equity-accounted associates (ie, profits from Natixis's 20% stake in the regional banks of GCE and GBP) were stable, at EUR672m.

Excluding CIFG, the crisis led to a total of EUR1.4bn write-downs/provisions in Natixis's results (of which EUR1.2bn was deducted from operating income and EUR138m was written as a general provision), split as follows: EUR949m write-downs on subprime exposure (loans pending securitization, RMBS and ABS CDOs) and EUR409m provisions against monolines insurers that have granted credit enhancements to its assets. Moreover, the crisis generated about EUR0.5bn in trading losses or loss of revenue in the structured business line. Despite Natixis's efforts to reduce the cost base and achieve cost/revenue synergies well ahead of expectations, the cost to income ratio deteriorated to 85%. Excluding general provisions, loan loss provisions remained very low, at only EUR54m, or four basis points of weighted assets. In addition to the EUR1.4bn and EUR0.5bn impacts mentioned above, Natixis depreciated fully its participation in CIFG (EUR369m after tax) when it sold CIFG to GCE and GBP in December 2007. This depreciation charge on CIFG and EUR125m restructuring charges at Natixis were offset in Natixis's accounts by the EUR232m capital gain realised on the sale of Natixis's headquarters in Paris and EUR234m gains on the restructuring of the AM business. Natixis's Tier 1 ratio remained satisfactory, at 8.3%. It should be noted that, had GCE and GBP not bought CIFG and had Natixis had to provide itself USD1.5bn (EUR970m – fully written down) to CIFG, its net income for 2007 would have been minimal.

Groupe Caisse d'Epargne (GCE)

GCE's 2007 performance was heavily impacted by Natixis's (34.7% held) results and by the acquisition of a 50% stake (consequently fully written-down) in CIFG from Natixis. The group posted a EUR1.4bn net income excluding minorities, against EUR1.5bn in H107. The negative impact of the crisis (c. EUR1bn after tax, of which EUR0.78bn related to Natixis/CIFG) was only partially offset by positive exceptional items (EUR580m after tax). Regarding Natixis, the write-downs/provisions on subprime exposure were proportionally recorded in GCE's accounts (i.e. EUR320m after tax). Regarding CIFG, firstly the depreciation of the stake in CIFG recorded by Natixis was proportionally recorded in GCE's accounts (i.e. EUR210m pre-tax) and, secondly, the USD750m capital increase provided by GCE to CIFG was fully written down (i.e. EUR490m pre-tax). The combined negative impact of CIFG on GCE was thus EUR700m pre-tax, or EUR460m after-tax. In addition, the group's retail activities had a difficult year, with operating income down 4.6%, net income down 26% and a stable, but still high, 71.6% cost to income ratio. At 84% in 2007, GCE's cost to income ratio was very poor and is not a true reflexion of the group's recurring cost efficiency. On the positive side, the group recorded a number of positive exceptional items (notably some capital gains on the sale of participations in SanPaolo IMI and Veolia), and the recently acquired equity accounted real estate company, Nexity (40% controlled), saw its net income jump by 24%.

It should also be noted that GCE would have been hit much harder by the troubles at CIBG and IXIS CIB if Natixis had not been created from the merger of Natixis Banques Populaires and IXIS CIB in 2006. GCE's Tier 1 ratio remained unchanged in H207 at 8.7%. However, Fitch has already warned that the capital ratios of GCE and GBP are somewhat flattering, given that Natixis is proportionately consolidated into their accounts and risk weighted assets are consolidated 50% each – however, in effect, each of Natixis's strategic shareholders is potentially liable for 100% of the bank through a joint and several affiliation (similar to a guarantee).

Groupe Banque Populaire (GBP)

GBP was hit to the same extent as GCE by the troubles at Natixis and CIBG in 2007 and posted a EUR1bn net income excluding minorities in 2007, against EUR1.1bn in H107 and EUR1.7bn in 2006. GBP has not yet disclosed the detailed impact of Natixis and CIBG on its 2007 financials, but these should in theory mirror those published by GCE given that the two groups have equivalent stakes in Natixis, they consolidate it proportionally, and each acquired 50% of CIBG in December 2007. At the same time, the group's retail banking activities performed relatively well, with operating income and operating profit up 5% and 1.5% respectively, and a cost to income ratio improving to 62.7%. However, the second half of the year was more difficult than the first half for the group's regional banks, which posted a 4% drop in revenue. The group's cost to income ratio was very poor, at 101% in H207 and 79.3% for full year 2007. On the positive side, GBP's Tier 1 ratio was robust at 9.1% at end-2007, although the comments regarding the affiliation of Natixis also apply here.

Credit Agricole (CA)

CA's net income fell by 13% to EUR6.5bn in 2007 as its CIB subsidiary, Calyon, was the hardest hit French bank by the financial crisis in absolute terms (EUR4.1bn negative impact on operating profit, or EUR2.7bn negative impact on net income). On the positive side, CA went through significant changes during the year. The group's presence in Italian retail banking through a 16.8% stake in Banca Intesa has been replaced by full control of two retail banks (FriulAdria and Cariparma), Greece's Emporiki Bank has been restructured and returned to profit, and CA's newly created consumer finance joint venture with Fiat, FGAFS, performed particularly well. Furthermore, AM activities continued to grow, despite the dismantling of its Italian subsidiary, jointly owned with Intesa Sanpaolo.

These changes generated a total of EUR1.4bn capital gains in CA's 2007 results. At the same time, activity remained robust in domestic retail banking, including at Credit Lyonnais (one of CA's two domestic retail networks). On the negative side, Calyon's operating income and impairment charges were impacted by EUR3.2bn and EUR0.9bn provisions/write-downs respectively due to the crisis, and CA's CIB division posted a EUR812m loss for the year. These figures included EUR2.2bn write-downs on ABS and CDOs, a EUR807m provision against the monoline insurer ACA, and a EUR1.2bn provision against other monoline insurers. As a whole, while CA's organic and external growth in 2007 was reflected in the 14% rise in operating expenses, operating income grew by just 1.6%, the cost to income ratio deteriorated to 68% from 61% in 2006, and impairment charges were up 95% due to the financial crisis. CA's Tier 1 ratio fell slightly from 7.7% at end-2006 to 7.4% at end-2007.

Credit Mutuel Centre Est Europe (CMCEE)

CMCEE focused on growth in 2007, with 94 branch openings and 263,000 new clients. As a result, savings and loans were up 13% and 23% respectively. However, this growth was offset by the group's increasing reliance on wholesale funding (whose cost kept rising during the year) and by EUR180m write-downs on the group's ABS/residential mortgage-backed securities (RMBS) portfolio. As whole, CMCEE's operating income was virtually flat in 2007, with an increasing contribution from bancassurance activities. At 58%, CMCEE's cost to income ratio deteriorated by only

1.6% in 2007 and remained the best among large French banks. Unlike its peers (with the exception of LBP), CMCEE's P&L account has been very little affected by the financial crisis and the group is now benefiting from its decision to exit the CIB business in recent years, when its peers (and notably its cooperative peers) were investing heavily in this business. The 7% fall in net income is mostly attributable to lower capital gains realised on private equity compared with 2006.

La Banque Postale (LBP)

LBP, fully-owned by France's La Poste (rated 'AAA' Negative Outlook), controls around 12% of retail deposits in France but, within loan markets, its only sizeable franchise lies in retail mortgages, where its share falls short of 4%. Over EUR6.7bn of new mortgages were written in 2007 and these loans were up 33% during the year, well above the sector average. The bank's results show some progress, with operating income up 2% to EUR4.7bn, operating profit up 16% to EUR497m and net income up 9% to EUR540m, producing an operating ROE of around 13%. Fitch views these achievements positively given fierce competition in the domestic mortgage sector and high costs associated with rejuvenating the bank's brand and image. LBP's subsidiaries, which operate mainly in life assurance and asset management, are performing well and brought in roughly one third of pre-tax profits for the year.

LBP has been authorised by the government to provide consumer finance loans and during 2008 it will actively be seeking a partner with whom to develop this business. The extension of micro loans for social purposes, also authorised in Q207, will be further developed. Another target for the year will be to extend its internet banking facilities which should help to reduce the high cost/income ratio. Despite much debate (see below), the 'Livret A' savings deposit currently distributed only by LBP and two further French banks, should soon be available for distributions through all French banks. This represents a significant blow to LBP since commissions earned from this service are an important source of revenue for the bank and many customers are attracted to LBP solely because of this facility.

On the positive side, the bulk of LBP's assets are very low risk and the bank commands high capital ratios (the Tier 1 ratio at end-2007 has not yet been published by the bank, but it stood at a very high 11.10% at end-2006).

Outlook for 2008

Official estimates are that GDP for 2008 should fall just short of 2%. With the exception of LBP and CMCEE (where Fitch expects to see regular growth in bancassurance revenue, strict cost control and minimal subprime fallout on its EUR142m subprime ABS/RMBS portfolios), the outlook for or all other leading French banks, given the current volatile market conditions, is quite unclear.

On the negative side:

- the recent failure of large financial players has shown that the financial crisis is not over and French banks remain highly exposed to a worsening of the crisis, be it via the US subprime market, their LBO activity and their exposure to monolines or other financial players. Additional write-downs/provisions are expected in 2008. On the CDO side, the loss rates used by French banks to value the financial instruments and make the necessary write-downs are currently (and are likely to move) in line with the ones used by their European peers, but below US banks. Problems could expand from the subprime segment to the Alt-A segment, and to consumer finance and this could impact results significantly at SG (remaining net exposure to super senior tranches of CDOs at end-2007: EUR3.6bn) and Calyon (EUR2.7bn) and, to a lesser extent, Natixis (EUR0.6bn); BNPP's exposure is virtually nil. While these banks have published their exposure (net of hedges) to the monoline insurers and their provisions against these exposures, the hedges may turn out to be ineffective. This, in turn, could result in higher losses for banks with significant exposure to monoline insurers.

While Calyon's net exposure to monolines remained significant at end-2007 (EUR2.1bn), it did not exceed EUR1bn at other banks (Natixis: EUR0.95bn; BNPP: EUR0.7bn; SG: EUR0.4bn). Regarding LBOs, the most exposed is again Calyon (EUR6.1bn), followed by Natixis (EUR5.5bn), SG (EUR3bn) and BNPP (EUR2.5bn);

- the loss of revenue in CIB divisions due to the distressed activity in structured finance is expected to pose a problem for certain banks. CIB accounted for 32% of SG's operating income in H107 (ie, before the crisis), against 30% for BNPP, 19% for CA (Calyon: over 90%), 12% for GCE and 15% for GBP (Natixis: 43%). As a whole, Fitch is expecting a difficult year for CIB in 2008, especially in fixed income activities, and ROE at CIB divisions is likely to fall back significantly. Equity business is also very important at SG and BNPP. While this should help boost revenues at the CIB unit, SG must work hard to restore its reputation in the wake of its fraud-related proprietary trading loss and it has announced a reduction in limits and risk appetite for the near future, thus reducing profitability at CIB. BNPP has already warned the market that it will be difficult for the group's CIB division to generate as much revenue in 2008 as in 2007, although this remains its target;
- only CA, SG, CMCEE and LBP managed to either increase or stabilise operating income in domestic retail banking between H107 and H207 (by no more than 1%-2%). For other banks, the fall varied between 3% for BNPP and 14% for GCE. Continued strength in employment and tax cuts should provide some support for consumer spending this year. However, pressure on real wages from higher headline inflation, a cooling housing market, declining household credit growth and the slump in confidence will see consumer spending growth fall below 2% this year. Investment growth should remain stronger and with corporate borrowing accelerating through the course of 2007 there seems little direct impact from the credit crunch. Nevertheless with the exports likely to slow further overall, GDP growth is forecast to decline to 1.6% in 2008 – its lowest rate since 2003. As a result, operating income in domestic retail banking is likely to be under pressure during the year;
- in addition, AM and private banking activities have been indirectly affected by the financial crisis since mid-2007 due to withdrawals and compensations paid out to certain investors, particularly those invested in enhanced funds. In fact, revenue from this business line decreased for all large French banks except BNPP between H107 and H207. The drop reached 16% at SG, 8% at Natixis, and 5% at CA, and the outlook for 2008 is negative given the continuity of the crisis.

On the positive side:

- non-structured activities in CIB have not been affected by the financial crisis and are expected to repeat their 2007 all-time record profits in 2008. This is particularly true for equity derivative and project finance activities, in which SG, BNPP and CA are very strong;
- defaults (corporate and retail) show no signs of spiralling, there is no subprime market in France, and there is no sign of a potential house crisis in 2008;
- international retail banking and specialised financial services showed regular and strong growth at BNPP, SG and CA in 2007 (+4% at BNPP between H107 and H207, +13% at SG and CA) and remain key growth drivers for 2008. The growth will be focused on Italy and Greece for CA, on Italy for BNPP and in eastern Europe for SG (notably due to the acquisition of Russia's Rosbank). However, the fortunes of BNPP's retail banking activities in the US via Bancwest are unclear. GCE, GBP, Natixis, CMCEE and LBP are much less involved in these alternatives sources of revenue and will not benefit to the same extent from their upside potential in 2008.

There also exist some specific issues that could impact French banks' performance in 2008. The first issue is the distribution of the Livret A regulated savings deposit. Currently, only three banks are allowed to distribute this product: LBP, GCE and CM. The European Commission has heard the complaints from the other banks and has ruled that all French banks should be allowed to distribute this saving deposit. While this is expected for the coming months, the French government has not yet pronounced on the future of how this regulated savings product should be distributed. As a whole, the loss of exclusivity for Livret A distribution is very negative for LBP and GCE as these two groups are likely to lose part of their commission income and part of their client base. LBP is likely to benefit from special state subsidies since its dependence on Livret A distribution commissions is high. GCE is still contesting the proposed changes, stating that they are detrimental to the social housing sector, which is financed by this special deposit. The group has already announced that it would be closing branches and firing some staff to offset any loss of revenue resulting from these changes. These changes will undoubtedly be beneficial to other banks as they will gain customers and can offer them other (ie, more remunerative) saving products.

Identifying how SG will manage in its "post-fraud" life remains to be seen. So far, SG's activities have not been affected by the fraud perpetrated by Mr Kerviel, and the only negative issue is the reduced appetite for market risks, which will result in lower revenue. However, the investigation on the fraud is not over, and any new conclusion will have to be followed as it could jeopardise the bank's reputation.

CIFG is a problem specific to GCE and GBP for 2008. The two groups have already fully written down their investment in the company, CIFG's capital has proved insufficient to maintain the 'AAA' rating and CIFG operates in a distressed market. While GCE and GBP have already said publicly that any new capital support will not be automatic, this cannot be ruled out. In addition, were GCE and GBP to sell their stake in the company, this would probably be at a loss. While the two groups have sufficient equity to weather such additional losses/write-downs, these could hamper their performance significantly again in 2008.

In addition, cost reduction will be necessary at most banks in 2008. Natixis has announced a large redundancy plan for 2008. This is expected to lift not only its own profitability, but also that of its two large institutional shareholders, GCE and GBP. So far no other French bank has announced redundancy plans due to the financial crisis, but cost cutting programmes and redundancy plans at other banks cannot be ruled out as the financial crisis becomes more severe. The target for such banks would certainly be to maintain cost to income ratios below 70%. This could prove difficult at Natixis. While it is about to lose part of the commission for distributing Livret A, LBP has received the approval to distribute consumer credits and would like to select a financial partner with whom to develop this activity before end-2008. It is also hoping to receive approval to distribute non-life insurance products. This should help the bank lower its high cost to income ratio. GCE is working on the merger of its various IT systems to increase cost efficiency.

Finally, M&A activity could be an important issue in 2008. Most large French banks are dealing with the financial crisis and ruling out significant external growth in foreign markets in the near future. Nevertheless, CA is looking in Spain at Bankinter, and in Italy at Banca delle Marche and Ducato (a specialist in consumer finance, currently owned by Banco Popolare), and GBP has engaged in exclusive negotiations with HSBC in order to acquire seven of its French regional retail banks. These acquisitions would benefit CA's and GBP's performance. The possibility of large French banks merging cannot be ruled out, though BNPP has affirmed that it is not interested in making a bid for SG. CIB had pushed both profitability and share prices to high levels in the last few years, but the strong turnaround since Q307 and the recent fall in their market capitalisation makes French banks more vulnerable to takeover bids than in the recent past. Obviously, SG is subject to much speculation following the recent fraud, and bids from domestic or foreign banks are possible for

2008. If SG were acquired by a French bank, it could be dismantled to avoid business duplication for the buyer(s). The market capitalisation of Natixis has shrunk (its share price has fallen from EUR23 in January 2007 to EUR10 at end-March 2008). Given that GCE and GBP each own 34.7% of Natixis's capital, a takeover bid for Natixis by another banking group cannot be envisaged. However, Natixis's two institutional shareholders could be either increasing their stake in the bank further or look to open Natixis's capital to other institutional shareholders looking for production platforms at a low cost. Cooperative groups are protected from hostile takeover bids but can agree on M&A. Although subject to regular rumours, a merger between GCE and GBP is not expected for a few years.

As a whole, assuming that there will be between a 2% and 15% fall in revenue in domestic retail banking and AM, a 5% increase in revenue in international retail banking and specialised financial services, and that the crisis will have a similar impact in full year 2008 as it did in H207 (which is a conservative assumption unless the financial conditions of the monoline insurers deteriorates very significantly), combined operating income and operating profit for the eight banks covered in this report could fall by about 2% and 10% respectively in 2008. In terms of growth, and not taking into account the fraud at SG, the strongest performer in 2008 is likely, again, to be BNPP. In absolute terms, BNPP and CA could well be neck and neck with each other (although CA's revenue mix is much more conservative). This also means that Fitch is not concerned about these banks' capitalisation.

The Outlook From a Ratings Point of View

The Outlooks for the Long-term IDRs of four out of France's leading eight banks is Negative, the rest being Stable. The Negative Outlook on LBP's Long-term IDR reflects the Negative Outlook on its parent's IDR. Under pressure from the EC, La Poste could lose its implicit State guarantee. In Fitch's opinion, these pressures show no signs of easing. Should this occur, LBP's Long-term IDR, which is linked to that of La Poste, will be affected. On the other hand, the Negative Outlooks on Natixis's, GCE's and GBP's Long-term IDRs are the direct consequences of the difficult and uncertain operating environment on these banks' performance. The trend in these last three ratings is likely to be determined by the fortunes of Natixis and CFIG in 2008. It could be accompanied by negative rating actions on these banks' Individual Ratings and, for GCE and Natixis, on the Short-Term IDRs. However, Natixis's Long-Term IDR is aligned with GCE's, and any negative action on Natixis's IDR will only be justified if the burden of its stakes in Natixis and in CFIG becomes too heavy for GCE. This is not the case so far, given GCE's solid capital base. A change of the Outlook on BNPP's, SG's or CA's Long-Term IDR from Stable to Negative cannot be ruled out if a worsening of the crisis impacts their performance significantly later on during the year. However, among French banks with CIB activities, BNPP has emerged as the most risk-averse in terms of avoidance of structured business. Another driver for SG's Outlook would be an increased reputational risk as the investigation into its fraud evolves. At this stage, the agency cannot see any reason that could justify a negative rating action on CMCEE. While French banks enjoy strong and stable customer deposit bases and are not dependent on securitisation for funding, they are regular issuers of short- and long-term debt in the market. Fitch will be following closely any trouble these banks might encounter in securing long-term funding at good rates as well as their recourse to ECB funding, which has increased (albeit not worryingly) in the last six months.

Appendix

Table 1: Comparative Performance Ratios - Major French Banks

(%)	Operating ROAA - 2007	Operating ROAA - 2006	Operating ROAE - 2007	Operating ROAE - 2006	Cost/Income - 2007	Cost/income - 2006
BNP Paribas	0.61	0.73	19.20	22.55	62.50	61.70
Credit Agricole	n.a.	0.77	n.a.	17.53	68.46*	61.10
Societe Generale	0.57	0.84	20.62	27.29	68.14	62.51
Credit Mutuel	0.75	0.88	16.32	19.39	58.17	56.58
Centre Est						
Europe						
Groupe Caisse d'Epargne	0.22 ^a	0.59	5.59 ^a	16.51	84.43 ^a	74.89 ^a
Natixis	0.27	0.65	7.44	16.71	85.33	69.01
Groupe Banque Populaire	n.a.	0.90	n.a.	15.24	79.34 ^a	65.99 ^a
La Banque Postale	0.42 ^a	0.38 ^a	12.99 ^a	11.51 ^a	89.17 ^a	90.59 ^a

^a Computed from the bank's results presentation
Source: Fitch's database

Table 2: Ranking by Assets and Equity - Major French Banks

(EURm)	Assets Dec 2007	Assets Jun 2007	Equity Dec 2007	Equity Jun 2007	Tier 1 ratio Dec 2007
BNP Paribas	1,694.5	1,663.6	51.8	50.0	7.30
Credit Agricole	n.a.	1,516.1	n.a.	64.9	7.40
Societe Generale	1,071.8	1,124.6	25.6	32.4	6.62
Credit Mutuel Centre Est	413.1	n.a.	18.7	n.a.	8.52
Europe					
Groupe Caisse d'Epargne	601.5 ^a	584.8	22.4 ^a	22.2	8.70
Natixis	520.0	538.5	17.6	18.7	8.30
Groupe Banque Populaire	n.a.	342.0	n.a.	21.1	9.10
La Banque Postale	122.0 ^a	n.a.	3.9 ^a	n.a.	n.a.

^a Computed from the bank's results presentation
Source: Fitch's database

Table 3: Ratings Assigned by Fitch to Major French Banks

	LT IDR/outlook	ST IDR	Individual rating	Support rating	Support rating floor
BNP Paribas	AA/stable	F1+	A/B	1	A-
Credit Agricole	AA/stable	F1+	B	1	A-
Societe Generale	AA-/stable	F1+	B	1	A-
Banque Federative du Credit Mutuel*	AA-/stable	F1+	n.a.	2	BBB+
Groupe Caisse d'Epargne	AA-/negative	F1+	B	1	A-
Natixis	AA-/negative	F1+	C	1	n.a.
Groupe Banque Populaire	A+/negative	F1	B	2	BBB+
La Banque Postale	AA+/negative	F1+	C/D	1	n.a.

^a Credit Mutuel Centre Est Europe's issuing vehicle
Source: Fitch

Table 4: Comparative Asset Quality Ratios - Major French Banks

(%)	Impair. charges/av. loans - 2007	Impair. charges/av. loans - 2006	Impair. loans/av. loans - 2007	Impair. loans/av. loans - 2006
BNP Paribas	0.34	0.23	n.a.	n.a.
Credit Agricole	n.a.	0.29	n.a.	2.86
Societe Generale	0.30	0.26	3.48	3.72
Credit Mutuel Centre Est Europe	0.07	0.10	2.35	2.96
Groupe Caisse d'Epargne	0.10 ^a	0.01	n.a.	2.04
Natixis	0.00	0.06	1.01	1.27
Groupe Banque Populaire	n.a.	0.25	n.a.	3.49
La Banque Postale	0.08 ^a	0.04 ^a	n.a.	0.48

^a Computed from the bank's results presentation
Source: Fitch's database

Table 5: Profit and Loss Account per Bank (EURm)

	BNPP						SG					
	2006	2007	07/06 (%)	H107	H207	H207/ H107 (%)	2006	2007	07/06 (%)	H107	H207	H207/ H107 (%)
Operating income	27,656	30,020	9	16,427	13,593	-17	21,922	20,994	-4	12,688	8,306	-35
Non-interest expenses	17,065	18,764	10	9,434	9,330	-1	13,703	14,305	4	7,515	6,790	-10
Pre-provision operating profit	10,591	11,256	6	6,993	4,263	-39	8,219	6,689	-19	5,173	1,516	-71
Loan loss provisions	783	1,725	120	518	1,207	133	679	905	33	378	527	39
Operating profit	9,808	9,531	-3	6,475	3,056	-53	7,540	5,784	-23	4,795	989	-79
Other	762	1,527	100	277	1,250	351	538	-3,898	n.a.	30	-3,928	n.a.
Taxes	2,762	2,747	-1	1,728	1,019	-41	2,293	282	-88	1,332	-1,050	-179
Net income	7,808	8,311	6	5,024	3,287	-35	5,785	1,604	-72	3,493	-1,889	-154
Cost to income (%)	61.70	62.50	0.80	57.43	68.64	11.21	62.51	68.14	5.63	59.23	81.75	22.52

	CA						CMCEE					
	2006	2007	07/06 (%)	H107	H207	H207/ H107 (%)	2006	2007	07/06 (%)	H107	H207	H207/ H107 (%)
Operating income	29,156	29,610	2	16,650	12,960	-22	7,183	7,210	0	n.a.	n.a.	n.a.
Non-interest expenses	17,814	20,272	14	10,292	9,980	-3	4,064	4,194	3	n.a.	n.a.	n.a.
Pre-provision operating profit	11,342	9,338	-18	6,358	2,980	-53	3,119	3,016	-3	n.a.	n.a.	n.a.
Loan loss provisions	1,481	2,888	95	972	1,916	97	143	124	-13	n.a.	n.a.	n.a.
Operating profit	9,861	6,450	-35	5,386	1,064	-80	2,976	2,892	-3	n.a.	n.a.	n.a.
Other	764	1,772	132	1,222	550	-55	286	45	-84	n.a.	n.a.	n.a.
Taxes	3,156	1,735	-45	1,622	113	-93	934	776	-17	n.a.	n.a.	n.a.
Net income	7,469	6,487	-13	4,986	1,501	-70	2,328	2,161	-7	n.a.	n.a.	n.a.
Cost to income (%)	61.10	68.46	7.36	61.81	77.01	15.19	56.58	58.17	1.59	n.a.	n.a.	n.a.

	GCE						GBP					
	2006	2007	07/06 (%)	H107	H207	H207/ H107 (%)	2006	2007	07/06 (%)	H107	H207	H207/ H107 (%)
Operating income	11,320	9,768	-14	5,758	4,010	-30	8,083	7,445	-8	4,464	2,981	-33
Non-interest expenses	8,478	8,247	-3	3,937	4,310	9	5,334	5,907	11	2,894	3,013	4
Pre-provision operating profit	2,842	1,521	-46	1,821	-300	-116	2,750	1,538	-44	1,571	-33	-102
Loan loss provisions	23	259	1,026	30	229	663	308	485	57	191	294	54
Operating profit	2,819	1,262	-55	1,791	-529	-130	2,442	1,053	-57	1,380	-327	-124
Other	2,294	395	-83	184	211	15	99	339	242	178	161	-10
Taxes	1,281	290	-77	526	-236	-145	841	337	-60	465	-128	-128
Net income	3,832	1,367	-64	1,449	-82	-106	1,700	1,055	-38	1,093	-38	-103
Cost to income (%)	74.89	84.43	9.53	68.37	107.48	39.11	65.99	79.34	13.35	64.83	101.07	36.24

	Natixis						LBP					
	2006	2007	07/06 (%)	H107	H207	H207/ H107 (%)	2006	2007	07/06 (%)	H107	H207	H207/ H107 (%)
Operating income	8,001	6,899	-14	4,611	2,288	-50	4,644	4,745	2	n.a.	n.a.	n.a.
Non-interest expenses	5,053	5,321	5	2,737	2,584	-6	4,207	4,231	1	n.a.	n.a.	n.a.
Pre-provision operating profit	2,948	1,578	-46	1,874	-296	-116	437	514	18	n.a.	n.a.	n.a.
Loan loss provisions	50	244	388	11	233	2,018	8	18	125	n.a.	n.a.	n.a.
Operating profit	2,898	1,334	-54	1,863	-529	-128	429	497	16	n.a.	n.a.	n.a.
Other	11	-16	-245	187	-203	-209	219	223	2	n.a.	n.a.	n.a.
Taxes	705	97	-86	414	-317	-177	151	180	19	n.a.	n.a.	n.a.
Net income	2,204	1,221	-45	1,636	-415	-125	497	540	9	n.a.	n.a.	n.a.
Cost to income (%)	69.01	85.33	16.32	65.03	127.48	62.45	90.59	89.17	-1.42	n.a.	n.a.	n.a.

GCE and GBP: Net income excluding minorities

Natixis: Profits from retail banking are included in operating income but excluded when computing the cost to income ratio

Source: For BNPP, SG, CMCEE and Natixis, figures come from Fitch's database. For CA, GCE, GBP and LBP, figures are extracted or computed from the bank's results presentations

Table 6: Divisional Breakdown of Operating Income and Operating Income Growth per Bank

	BNPP						SG					
	Operating Income Growth		Operating income				Operating Income Growth		Operating income			
	H207/ H107	07/06	2006	H107	H207	2007	H207/ H107	07/06	2006	H107	H207	2007
(%)												
Domestic retail banking	-3	2	20	18	19	19	0	3	30	28	38	32
Internat. retail bkg and fin. services	4	14	33	32	37	34	13	21	23	23	36	29
CIB	-30	3	29	30	23	27	-88	-35	31	32	5	21
Asset manag/Ins/private bkg	2	21	16	16	18	17	-16	17	14	16	18	17
Other	-65	92	2	5	2	4	50	59	1	1	2	1
Total operating income	-11	11	100	100	100	100	n.a.	-2	100	100	100	100
	CA						CMCEE					
	Operating Income Growth		Operating Income				Operating Income Growth		Operating income			
	H207/ H107	07/06	2006	H107	H207	2007	H207/ H107	07/06	2006	H107	H207	2007
(%)												
Domestic retail banking	1	-1	57	49	64	56	n.a.	1	62	n.a.	n.a.	65
Internat. retail bkg and fin. services	13	63	12	16	23	19	n.a.	n.a.	0	n.a.	n.a.	0
CIB	-113	-49	19	19	-3	9	n.a.	-31	12	n.a.	n.a.	8
Asset manag/Ins/private bkg	-5	11	13	13	16	15	n.a.	12	23	n.a.	n.a.	27
Other	-105	-253	-1	2	0	1	n.a.	-93	3	n.a.	n.a.	0
Total operating income	-22	2	100	100	100	100	n.a.	-3	100	n.a.	n.a.	100
	GCE						GBP					
	Operating Income Growth		Operating income				Operating Income Growth		Operating income			
	H207/ H107	07/06	2006	H107	H207	2007	H207/ H107	07/06	2006	H107	H207	2007
(%)												
Domestic retail banking	-14	-5	69	69	86	76	-4	5	69	67	96	78
Internat. retail bkg and fin. services	-13	11	6	6	8	8	-13	11	9	8	11	10
CIB	-105	-48	11	12	-1	7	-105	-48	15	15	-1	9
Asset manag/Ins/private bkg	-8	14	6	7	9	8	-8	14	8	9	12	10
Other	-121	-80	9	6	-2	2	-1,561	677	-1	1	-18	-8
Total operating income	-30	-14	100	100	100	100	-33	-8	100	100	100	100
	Natixis											
	Operating Income Growth		Operating income									
	H207/ H107	07/06	2006	H107	H207	2007						
(%)												
Domestic retail banking	-33	-1	9	9	13	10						
Internat. retail bkg and fin. services	-13	11	25	23	43	33						
CIB	-106	-48	44	43	-5	27						
Asset manag/Ins/private bkg	-8	14	25	25	49	33						
Other	n.a.	18	-2	0	0	-3						
Total operating income	-53	-15	100	100	100	100						

Natixis: Profits from retail banking are included in operating income
 Source: Banks' publications

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