FitchRatings

RATING ACTION COMMENTARY

Fitch Revises La Banque Postale's Outlook to Negative; Affirms IDR at 'A'

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Fitch Ratings - Paris - 16 Oct 2024: Fitch Ratings has affirmed La Banque Postale S.A.'s (LBP) Long-Term Issuer Default Rating (IDR) at 'A' and the Viability Rating (VR) at 'a'. The Outlook on the Long-Term IDR has been revised to Negative from Stable.

The Negative Outlook on LBP's Long-Term IDR follows Fitch's revision of the Outlook on France's sovereign Long-Term IDR to Negative from Stable on 11 October 2024 (see: Fitch Revises France's Outlook to Negative; Affirms at 'AA-' at www.fitchratings.com), and the subsequent revision to negative of the operating environment (OE) outlook for French banks. The OE is assessed at 'aa-' and capped at the sovereign rating. It will be downgraded should the sovereign be downgraded. Fitch believes the downward pressure on the French sovereign and the OE adds downside risks to LBP's asset quality, capitalisation and funding and liquidity profile.

The Outlook revision also considers the group's much higher exposure to domestic sovereign debt than peers, including through its insurance subsidiary CNP Assurances SA (CNP; A/Stable), and its less diversified business profile.

A full list of rating actions is below.

KEY RATING DRIVERS

Business Profile, Capital Drive Ratings: LBP's ratings primarily reflect its insurance-heavy business mix, as fully-owned CNP represents around 60% of its assets and drives earnings. The group's capitalisation also drives the ratings and is commensurate with risks, although capital is not fully fungible between LBP and CNP. The ratings also consider a market-risk-sensitive risk profile, higher vulnerability to its sovereign exposure than peers in an extreme, but low probability, sovereign stress scenario. Sound asset quality and strong funding and liquidity support the ratings.

Public-Sector-Owned Bancassurer: LBP is a fully-fledged and integrated bancassurance group, and has a significant, but underperforming, franchise in French retail banking, where it has strong deposit market shares in Livret A savings. CNP is the main performance driver, with leading market positions in life and creditor insurance in France. CNP offers strong potential to increase client equipment rates with insurance products in France, and has well-performing operations in Brazil and Italy. Following senior management turnover in 2023, the group has refocused its strategy towards its core businesses and aims at improving its performance.

Market-Sensitive Risk Profile: Credit underwriting standards in the banking business are low-risk. LBP continues to improve its risk governance and control framework. However, LBP's risk controls are slightly weaker than at large French peers, and LBP is more vulnerable to sovereign risk and interest rate and market shocks due to the group's structure and lower diversification. The risk profile also captures CNP's interest and investment risk, which is high relative to European peers but in line with that of French bancassurers.

Sound Asset Quality, Large Sovereign Exposure: LBP's sound impaired loans ratio remains the lowest among large French banks, despite a material increase since end-2021, which was mainly caused by two large corporate exposures that also affected other French banks. We forecast the ratio will stay slightly above 2% up until end-2026, which would still be slightly better than the sector average. The slight deterioration will mainly result from the most vulnerable corporates and unsecured consumer credit to fragile households, while LBP's large home loans portfolio will not markedly weaken.

The group's large exposure to the French sovereign adds downside risks. Sovereign exposure reached a high 120% of common equity Tier 1 (CET1) capital at end-2023 for the banking book, and more than 4x CET1 when also including CNP's insurance portfolios, on which robust policyholder loss absorption features reduce the financial risks to the group.

CNP Drives Adequate Profitability: CNP's performance eroded in 1H24, leading LBP's operating profit/risk-weighted assets (RWAs) ratio to fall to 2.3% in 1H24. The reasonable performance in insurance continues to mostly outweigh the underperformance in French retail banking, which has been structurally loss-making over the past few years. LBP's operating profit/RWAs ratio should remain above 2% over 2024-2026, driven by organic growth in insurance and improved cost control, plus a gradual recovery in French retail, although this could be challenged by the weakening OE. LBP's structurally low return on equity (5% average) constrains the group's profitability.

LBP's profitability has become structurally more volatile because of increased accounting volatility under IFRS17, although CNP is rolling out hedges and adapting its asset allocation. This higher earnings volatility will also be mitigated by increased capital stability.

Danish Compromise Drives Capital: LBP's strong regulatory capital ratios greatly benefit from the favourable treatment of insurance under the Danish Compromise. This overstates loss-absorbing capital available to LBP's creditors. We therefore adjust down our assessment of capitalisation because CNP's capital is not fully fungible with LBP's, despite CNP's dividend record.

LBP's CET1 ratio was 18.3% at end-June 2024, including the distribution of the EUR1 billion exceptional dividend to its parent La Poste. Solid internal capital generation should support a CET1 ratio of around 18%, but we view LBP's high concentration to the French sovereign as a potential constraining factor on our assessment of the group's capitalisation.

Strong Funding and Liquidity: The Negative Outlooks on the French sovereign and OE add downside risks to LBP's very strong funding profile. Our assessment of LBP's funding and liquidity incorporates the bank's substantial excess liquidity. LBP also has one of the lowest loans/deposits ratios of rated large western European banks. Its low reliance on wholesale funding is driven by its very stable and granular retail-deposit base, with a very high share of insured deposits.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

The most likely trigger for a downgrade of LBP's ratings would be a downgrade of the French sovereign or of the OE score, given LBP's limited rating headroom compared to other large French banks, driven by its less diversified business model and more sensitive risk profile and capitalisation.

The ratings could also be downgraded should the group's CET1 ratio drop durably below 14%, or on evidence of material obstacles to capital fungibility within the group, such as regulatory measures preventing regular dividends being routinely upstreamed to LBP. Fitch could also downgrade LBP's ratings if the group's operating profit sustainably declines to below 2% of RWAs and if LBP's impaired loans ratio durably increases to above 3%.

LBP's ratings are also sensitive to severe market shocks if Fitch expects these to result in a durable and significant impact on the group's capitalisation or earnings. We could also downgrade LBP if operating losses in the retail banking operation widen to the extent it would meaningfully impact the group's overall earnings or capital trajectory.

A downgrade of CNP's Insurer Financial Strength Rating to 'A' would likely put pressure on LBP's ratings, due to the size of the insurance activities in its business mix and their key contribution to the group's profitability and internal capital generation.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

An upgrade of LBP's ratings is unlikely in the short term given the Negative Outlook. In the longer term, positive rating action would require a stabilisation of the Outlooks on the French sovereign and OE. Under this scenario, further evidence of improved capital fungibility between CNP and LBP, as well as greater business diversification with a stronger franchise in some key areas, for instance in asset management, private banking or in specialised financial services, could be rating-positive.

To be rating-positive, an increased business diversification would have to result in the group having structurally improved earnings generation, including through a successful turnaround of the retail banking business, and a CET1 ratio remaining well above 16%. This could be manifested by further franchise growth in insurance (particularly non-life), private banking, asset management or lower-risk corporate and investment banking activities, an operating profit/RWAs ratio sustainably at 2.5%-3%, and a return on equity closer to higher-rated peers.

We could affirm LBP's ratings at their current levels and revise the Outlook on the Long-Term IDR back to Stable, even if the French sovereign and OE score were downgraded by one notch, provided that LBP sustainably delivers an operating profit/RWAs ratio of around 3% and materially reduces its sensitivity to a potential stress on its large sovereign holdings.

An upgrade of CNP's Insurer Financial Strength rating would not automatically lead to an upgrade of LBP's ratings, as our assessment of the group's consolidated profile would likely remain constrained by our views on capital fungibility and business diversification relative to higher-rated banking peers.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

LBP's long-term senior preferred debt rating of 'A+' is one notch above the Long-Term IDR, reflecting Fitch's expectation that LBP will continue to maintain large amounts of subordinated and senior non-preferred debt to comfortably meet its total resolution buffer requirement without senior preferred debt. For the same reason, LBP's senior non-preferred debt is rated in line with its Long-Term IDR.

Fitch expects LBP to meet its total minimum requirement for own funds and eligible liabilities (MREL) without using senior preferred debt. LBP has to comply with a total MREL of 26% from 2024, including the 1% countercyclical buffer in force since 2 January, and we project that its subordinated MREL ratio will be slightly below 29% at end-2025 (end-June 2024: 28.7%). To meet this requirement, we expect LBP will continue issuing senior non-preferred debt, and potentially more junior instruments, over the next 12 to 24 months.

Fitch rates LBP's Derivative Counterparty Rating (DCR) and long-term deposits in line with its senior preferred debt because non-guaranteed depositors and derivative counterparties in France benefit from the same level of protection from bank resolution buffers.

The short-term senior preferred debt and deposit ratings are in line with LBP's Short-Term IDR of 'F1+', which is the higher of the two ratings mapping to a long-term debt rating of 'A+'. This reflects Fitch's assessment of LBP's funding and liquidity at 'aa-', with a negative outlook driven by the negative outlook on the French OE.

LBP's subordinated Tier 2 notes are rated 'BBB+', two notches below the bank's VR, to reflect poor recovery prospects in case of a non-viability event. Fitch does not apply further notches for non-performance risk because the terms of the notes do not include contingent conversion triggers.

The bank's additional Tier 1 (AT1) notes are rated 'BBB-', four notches below its VR. This includes two notches for loss severity and two notches for non-performance risk. Our assessment is based on LBP's large consolidated regulatory capital buffers above coupon-omission triggers, estimated at about 850bp of RWAs, and sufficient distributable reserves supported by the dividends received from CNP, which more than offset the loss-making banking operations.

Very High Probability of Government Support

LBP's 'a-' Government Support Rating (GSR) reflects a very high probability of state support, but is currently not a driver in LBP's IDRs. Provision of support would most likely be through LBP's direct parent, La Poste, the French postal service operator, whose public-sector ownership is enshrined in French law.

LBP's GSR is three notches below France's sovereign IDR as support would most likely be provided under the limitations of the EU Bank Recovery and Resolution Directive and state aid considerations. This assessment builds on LBP's indirect public-sector ownership and on the bank's high importance to its parent and to the French state given LBP's public-service mission.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

SENIOR DEBT, DERIVATIVE COUNTERPARTY RATING AND DEPOSITS

LBP's DCR, senior debt, and deposit ratings are primarily sensitive to changes in LBP's IDRs. We would downgrade the DCR, long-term senior preferred and senior non-preferred debt, and deposit ratings by one notch if we expect the bank to no longer meet its total resolution buffer requirement without senior preferred debt, provided the buffer of senior non-preferred and junior debt remains sustainably below 10% of RWAs. LBP's senior debt and deposit ratings are also sensitive to changes to the group's resolution strategy if these affect our expectations around resolution debt buffers available to protect LBP's creditors.

The Short-Term IDR is sensitive to LBP's Long-Term IDR and to LBP's funding and liquidity score (aa-/negative). It would also be sensitive to a downgrade of the French sovereign and the French operating environment score, as they would both constrain our assessment of LBP's funding and liquidity profile in the single 'a' category.

SUBORDINATED DEBT AND AT1

LBP's Tier 2 notes' rating is primarily sensitive to a change in LBP's VR. The notes' rating is also sensitive to a change in notching should Fitch change its assessment of loss severity or relative non-performance risk.

LBP's AT1 notes' rating is primarily sensitive to a change in LBP's VR. The rating of LBP's AT1 notes could also be downgraded if non-performance risk increases relative to the risk captured in LBP's VR, for example, if buffers over mandatory coupon omission triggers fall below 100bp or if distributable reserves become low. Fitch believes the latter could happen if there are interruptions in the regular flow of dividends from CNP to LBP.

GSR

Fitch would likely downgrade LBP's GSR if state control and, ultimately, France's ability or propensity to support LBP diminishes. Given LBP's ownership structure and the important role LBP plays in France as part of La Poste, it is likely that we would only downgrade LBP's GSR if France's Long-Term IDR was downgraded by more than one notch.

An upgrade of the GSR would be contingent on a positive change in the sovereign's propensity to support the bank. In Fitch's view, this is highly unlikely, although not impossible.

VR ADJUSTMENTS

The capitalisation and leverage score of 'a' has been assigned below the 'aa' implied category score for the following adjustment reason: capital flexibility and ordinary support (negative).

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

LBP's ESG Relevance Scores are in line with the standard scoring for western European banks except the Human Rights, Community Relations, Access and Affordability sub factor, which we score at '3' for LBP instead of '2' for most banks. This is to reflect LBP's public-sector mission in supporting financially vulnerable clients, which we believe has some influence on its business generation and earnings profile. This is because LBP has a higher share of financially vulnerable, and so less profitable, customers than French peers.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visithttps://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING		PRIOR
La Banque Postale S.A.	LT IDR Affirmed	A Rating Outlook Negative	A Rating Outlook Stable

	ST IDR	F1+	Affirmed		F1+
	Viability	a	Affirmed		a
	DCR	A+(dcr)	Affirmed		A+(dcr)
	Government Support	a-	Affirmed		a-
subordinated	LT	BBB+	Affirmed		BBB+
long-term deposits	LT	A+	Affirmed		A+
junior subordinated	LT	BBB-	Affirmed		BBB-
Senior preferred	LT	A+	Affirmed		A+
Senior non-preferred	LT	A	Affirmed		A

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Bank Rating Criteria (pub. 15 Mar 2024) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

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