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December 7, 2011

Research Update:

France-Based Credit Mutuel Group's Core Entities 'A+/A-1' Ratings Affirmed On Bank Criteria Change; Outlook Stable

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Overview

- Following a review of France-based Caisse Centrale du Crédit Mutuel (CCCM) under Standard & Poor's revised bank criteria (published on Nov. 9, 2011), we have affirmed our 'A+/A-1' ratings on CCCM and the entities we view as core members of the Credit Mutuel group (GCM).
- At the same time, we affirmed our 'BBB' ratings on the hybrid capital instruments issued by the entities we reviewed and we lowered the ratings on dated subordinated debt to 'A-' from 'A'.
- CCCM's stand-alone credit profile is 'a', reflecting our anchor of 'a-' for GCM and the group's strong business position, adequate capital and earnings, adequate risk position, average funding, and adequate liquidity.
- The long-term rating on CCCM benefits from one notch of uplift for potential extraordinary government support in a crisis, reflecting our view of a "moderately high" likelihood of government support, due GCM's high systemic importance in France and our assessment of the government as "supportive".
- The stable outlook on CCCM and core members of GCM reflects our expectation that the group will improve its capital position, navigate through currently complex market and funding conditions, and show a fairly resilient performance in 2011, despite our view of a less dynamic operating environment in the second half of the year.

Rating Action

As previously announced, on Dec. 7, 2011, Standard & Poor's Ratings Services has affirmed its 'A+/A-1' long-term and short-term counterparty credit ratings on France-based Caisse Centrale du Crédit Mutuel (CCCM) and the entities we view as core members of the Credit Mutuel group (GCM). The outlook on all entities is stable.

At the same time, we affirmed our issue ratings on hybrid capital instruments issued by the group members we reviewed. We lowered our ratings on dated subordinated debt to 'A-' from 'A'.

Rationale

Standard & Poor's bases its ratings on CCCM and the core entities of GCM on its analysis of the group. CCCM's stand-alone credit profile is 'a' and reflects GCM's "strong" business position, "adequate" capital and earnings, "adequate" risk position, "average" funding, and "adequate" liquidity, as our criteria define these terms.

Our bank criteria use our Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. Our anchor for a commercial bank operating only in France is 'a-'. One of the factors we base the BICRA score on is our evaluation of economic risk. We consider that France's economy is highly stable, and enjoy low private-sector credit risk. With regard to industry risk, the French banking industry has a strong regulatory framework, and healthy competition between large players with generally restrained risk appetites. Stable domestic customer deposits stemming from the high French household savings rate underpin systemwide funding. At the same time, most French banks are reliant on wholesale markets to fund their sizable balance sheets.

Our evaluation of GCM's overall economic risk reflects our view of the weighted average economic risk in the countries in which GCM operates. We assess GCM's economic risk as in line with that for the BICRA on France, given the group's predominant presence in France. Our industry risk assessment for GCM is based solely on its home market of France.

GCM comprises 18 regional cooperative bank federations and Credit Industriel et Commercial, which the Crédit Mutuel Centre Est Europe federation acquired in 1998. These two entities and nine other federations make up the banking group Crédit Mutuel Centre Est Europe - Crédit Industriel et Commercial, which was renamed CM10-CIC after five federations of GCM joined former CM5-CIC on Jan. 1, 2011. Given its position as the largest and strongest of the federations, we view CM10-CIC as the driving force of GCM's creditworthiness and we view it as a core member of GCM. Banque Fédérative du Crédit Mutuel (BFCM) is the funding arm of CM10-CIC.

We assess GCM's business position as "strong". This reflects GCM's position at the forefront of the market and its robust domestic franchise, underpinned by its consistently strong historical focus on domestic retail business. On the negative side, GCM's operations show limited geographic diversification. GCM represents the third largest retail-banking network in France. We expect that the group will adapt its strategy and growth to the currently complex environment and funding conditions that have prevailed since midyear 2011 and to more stringent regulations ahead. We also expect lending activity to slow down in France, particularly in the mortgage market. In past years, confronted with modest growth prospects in their core domestic business, some of the Crédit Mutuel federations have expanded into consumer finance in Europe, but we believe medium-term earnings growth in this sector to be uncertain.

Our assessment of GCM's capital and earnings as "adequate" reflects our expectation that the risk-adjusted capital (RAC) ratio for GCM (before diversification benefits) will improve at below 8% in the next 12-18 months. Because of its cooperative structure, GCM also enjoys high internal capital generation, supported by a limited dividend payout ratio. The majority of its revenues consist of interest income and fees, which benefits the recurrence of earnings. Repricing efforts could offset some of the group's higher funding costs. However, we believe that GCM's efforts to preserve liquidity, along with a more difficult economic environment, will reduce consolidated profitability in 2011 and 2012.

GCM's risk position is "adequate", in our view. This assessment reflects the group's expansion in consumer finance and the lower diversity of its loan portfolio than peers', balanced against its strong domestic retail banking and insurance focus and relatively low proportion of capital market activities. Residential mortgages represent more than 50% of GCM's total loan book and, through the cycle, they generated much lower losses than indicated by the risk weight under our RAC framework. At year-end 2010, GCM's nonperforming loans were at a stable 4.2% of gross outstanding loans. The increase from less than 3% in 2007 reflected the integration of the credit consumer portfolios and the deterioration of the credit environment. We believe that GCM has potential capacity to face the credit risks related to its exposure to sovereign debt in southern European countries.

In our opinion, GCM's funding is "average" and its liquidity is "adequate". GCM has been facing risk-averse capital markets and a significant deterioration in funding conditions since August 2011. Affecting the group's position in the market, in our view, is the comparatively high proportion of short-term within its total wholesale funding as of year-end 2010, which we see as a weakness. Nevertheless, we consider that GCM has some time to continue adapting to new conditions, thanks to its liquidity reserves. Although CCCM plays a central role in defining processes and methods for liquidity risk measurement, liquidity risk management remains the responsibility of the regional federations. GCM benefits from a large and stable deposit base, but a portion of regulated deposits has to be held centrally at a state institution (€28.2 billion at year-end 2010), and cannot be used to fund loans. We excluded this amount from our measure of the group's core deposits (€200 billion at year-end 2010). GCM also compares favorably to peers in terms of the ratio of customer loans to total savings (core deposits plus off-balance-sheet savings).

The long-term counterparty credit rating is one notch higher than the SACP on CCCM, reflecting our view of a "moderately high" likelihood of support, due to GCM's high systemic importance in France and our assessment of the French government as "supportive".

The 'BBB' issue ratings on the hybrid junior subordinated debt of all the group's members we reviewed reflects that these instruments stand three notches below the SACP, in accordance with our criteria for instruments containing a nonviability contingency clause leading to a principal write-down.

The 'A-' rating on the dated subordinated debt for the core group members we reviewed is one notch below the SACP in accordance with our criteria for nondeferrable capital instruments in jurisdictions such as France, where we consider that the government is unlikely to support the payment of nondeferrable subordinated debt, even though it may support senior debt.

Outlook

The stable outlook on CCCM reflects our expectation that GCM will improve its capital position, be able to manage the currently complex market and funding conditions, and post a performance that shows some resilience in 2011, despite our view of a less dynamic operating environment in the second half of the year.

We could lower the ratings on CCCM in case of unexpected risks in its consumer finance operations or capital market activities, which would hamper the expected improvement in capitalization. Deterioration of French and European economic conditions beyond what we anticipate in our base case, or market events that trigger significant unexpected impairments, may also contribute to negative pressure on the ratings. Nevertheless, given our view of GCM's high systemic importance, we believe that government support would materialize under such circumstances and limit downside effects.

In line with our methodology, a downward revision of CCCM's SACP by one notch would not automatically affect the long-term counterparty credit rating, assuming everything else remained unchanged. A lowering of the long-term sovereign rating on the Republic of France (unsolicited rating AAA/Watch Neg/A-1+) by more than two notches would trigger a downgrade of CCCM.

We could consider an upgrade if GCM's risk position improved materially, notably through higher diversification, or if its capital strengthens very significantly. We consider such scenarios as remote, however.

Ratings Score Snapshot

Issuer Credit Rating	A+
SACP	a
Anchor	a-
Business Position	Strong (+1)
Capital and Earnings	Adequate (0)
Risk Position	Adequate (0)
Funding and Liquidity	Average and Adequate (0)
Support	1
GRE Support	0
Group Support	0
Sovereign Support	1
Additional Factors	0

Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal, unless otherwise stated.

Related criteria

- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Group Rating Methodology And Assumptions, Nov. 9, 2011
- Bank Hybrid Capital Methodology And Assumptions, Nov. 1, 2011

Related research

- Analytical Linkages Between Sovereign And Bank Ratings, Dec. 6, 2011

Ratings List

Ratings Affirmed

Banque Federative du Credit Mutuel	
Credit Industriel et Commercial	
Caisse Centrale du Credit Mutuel	
Caisse Federale de Credit Mutuel d'Anjou	
Caisse Federale du Credit Mutuel Antilles-Guyane	
Caisse Federale du Credit Mutuel de Maine-Anjou Basse Normandie	
Caisse Federale du Credit Mutuel Nord Europe	
Caisse Federale du Credit Mutuel Ocean	
Credit Mutuel Arkea	
Counterparty Credit Rating	A+/Stable/A-1

Downgraded

	To	From
Banque Federative du Credit Mutuel		
Subordinated	A-	A
Credit Mutuel Arkea		
Subordinated	A-	A

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