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Weekly Credit Brief

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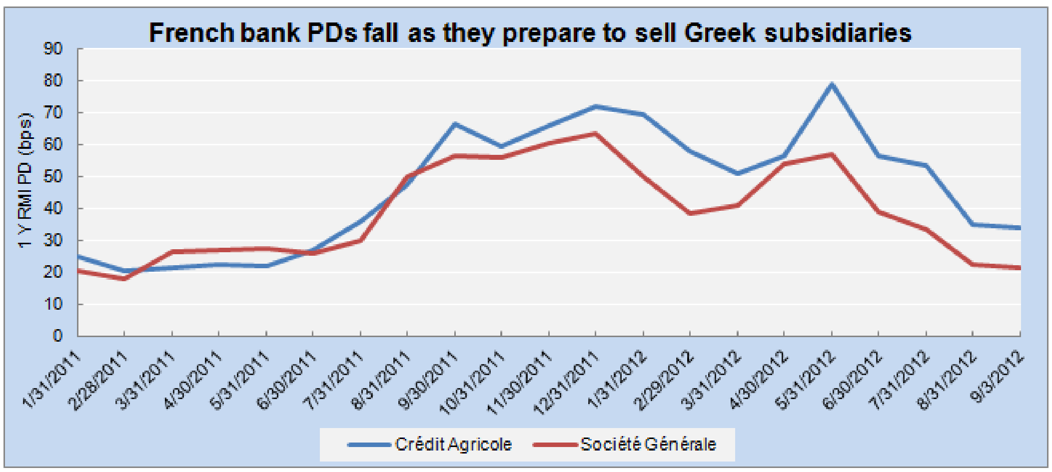
Story of the Week

Planned sale of Greek subsidiaries is a credit positive for Crédit Agricole, and Société Générale

By James Weston

The 1-year RMI probability of default (RMI PD) for Crédit Agricole* and Société Générale, respectively the second and third largest French banks by total assets, fell last week after each lender announced continuing progress in their efforts to sell off their troubled Greek subsidiaries, part of wider deleveraging efforts to improve capital positions and reduce financing needs. The announcements are a credit positive for each bank, as each lender's profitability has been significantly affected by ongoing portfolio write-downs and the need for capital injections at their respective Greek subsidiaries.

In addition, the potential sales of these Greek subsidiaries highlight the benefit of leaner balance sheets for French banks. Asset sales combined with a focus on decreasing funding gaps at southern European subsidiaries are expected to improve the overall liquidity and funding profiles of French banks. However, market participants expect continued deleveraging and restructuring at French banks to weigh on earnings in the short term, while problems at Greek subsidiaries illustrate the risks that businesses in peripheral Europe pose to French banks. Moreover, continuing risks in the Greek banking sector and a rapidly contracting Greek economy highlight the need for both Crédit Agricole and Société Générale to dispose of their Greek subsidiaries quickly.



Earnings and deleveraging: Crédit Agricole's earnings fell 55% QoQ to EUR 111mn in Q2, with the bank recording a EUR 370mn loss at Emporiki and EUR 527mn of impairments on its legacy Intesa Sanpaolo shareholdings. Earnings at Société Générale fell 42% QoQ during Q2 to EUR 433mn, as the bank recorded EUR 436mn of goodwill writedowns on past acquisitions. However, provisions for loan losses at Société Générale fell by almost 50% to EUR 497mn in Q2. In addition to the pending sales of their respective Greek subsidiaries, both lenders are selling stakes in other non-core businesses. Crédit Agricole is in advanced stages in negotiations to sell its Cheuvreux and CLSA brokerage units. Société Générale is set to sell its stake in investment management firm TCW to the Carlyle Group and TCW management.

Crédit Agricole and Emporiki Bank: On August 28, Crédit Agricole said that it had received several binding offers for its troubled Greek subsidiary Emporiki Bank from Greek lenders, and may complete a sale of Emporiki in a matter of weeks. Emporiki bank has cost Crédit Agricole EUR 6bn since a EUR 4.3bn takeover in 2006, with losses increasing in the last year as asset quality declined. Crédit Agricole injected EUR 2.3bn of capital into Emporiki in July, converting a portion of funding provided to Emporiki into equity. Eurobank Ergasias and National Bank of Greece have confirmed their interest but are yet to submit offers. Alpha Bank has offered to buy all of Emporiki.

Société Générale and Geniki Bank: On August 29, Société Générale said that it is at an advanced stage in discussions to sell Greek subsidiary Geniki Bank to Athens-based Piraeus Bank. Losses at Geniki reached EUR 796mn in 2011, as the bank increased provisions for bad loans and impairments on holdings of Greek government bonds. Losses likely continued through the first half of 2012, as the Greek economy collapsed. Société Générale has pushed through a reduction in total loans at Geniki while deposits have remained resilient, decreasing the funding gap at Geniki and making it a more palatable target for Greek lenders shut out of funding markets.

Government conditions: Both Crédit Agricole and Société Générale will likely complete subsidiary sales at below market prices, especially with the Greek government looking to impose strict conditions on any potential deals. The Hellenic Financial Stability Fund (HFSF), Greece's bank-bailout fund, is a major shareholder in the four Greek lenders eyeing French-owned Greek banks, and has said it will only approve a sale of Emporiki if the bank is fully funded with adequate liquidity. Crédit Agricole may have to make a further equity injection to ensure a sale, with market participants estimating at least EUR 200mn of additional capital is needed to protect the lender from future loan losses. The Greek government may require Société Générale to take a small stake in Piraeus if the sale of Geniki is approved, in order to reduce the amount of recapitalization funds the government has to provide to Piraeus. These conditions are designed to avoid the Greek government having to pump taxpayers' money into ailing lenders.

Hellenic Postbank: Highlighting the continuing risk of failure in the Greek banking system, and the need for French banks to dispose of their Greek subsidiaries, the Greek Finance Ministry said on August 30 that the majority state-controlled lender was no longer viable. The bank is believed to have lost around EUR 1bn over 2011, almost two times the EUR 514mn equity position the bank last reported in Q3 2011. Moreover, analysts anticipate even higher losses in 2012, given large increases in non-performing loans at other Greek lenders, and the Greek debt restructuring in March. Postbank last reported holdings of EUR 5.7bn of Greek sovereign bonds in Q3 2011, with market participants expecting a EUR 3bn write-down on these holdings following the sovereign restructuring.

The HFSF will likely take control of the lender, and begin winding down the bank's operations and selling healthy assets. The potential sales of both Emporiki and Geniki, and the closure of Postbank are part of a larger sweeping consolidation of the Greek banking sector. The government injected EUR 18bn of temporary recapitalization funds into the four largest privately-owned Greek banks in May. A formal recapitalization, expected before the end of the year, will likely lead to a nationalization of a majority of the Greek banking system, which would lead to even higher linkages between Greek lenders and the sovereign.

*Readers should note Crédit Agricole's RMI PD is for Crédit Agricole SA, and may not necessarily represent the combined strength of the Crédit Agricole Group, which includes Crédit Agricole SA and 39 French cooperative retail banks. The RMI PDs for these banking cooperatives are available to RMI users with global access at rmicri.org

Sources:
Emporiki hits Crédit Agricole net (WSJ)
Crédit Agricole sees Greek unit sale within weeks (Reuters)
Société Générale in talks to sell Greek unit to Piraeus (WSJ)
Hellenic Postbank shares suspended (FT)

In the News

Fed says credit quality of large loans improves for 2012
Aug 27. The Federal Reserve reported the quality of large loans at federally supervised banks improved for the third successive year, with problem credits falling 8.1% to USD 295bn.However, the Fed and other regulatory agencies reported that poorly underwritten loans originated in 2006 and 2007 continue to adversely affect bank portfolios. Ongoing debt restructuring, bankruptcy resolutions and corporate access to capital markets have enabled banks to increase the credit quality of large loans in their books. Provisions for loans and losses have declined, leading to a 21% increase in overall bank earnings for the quarter ending June 2012. The KBW Banking Index, which includes 24 large banks, has risen 20% this year, outperforming the S&P 500 by 7.5 percentage points. (Bloomberg)

Raiffeisen warns of rising bad loans in Eastern Europe
Aug 29. Austrian-based Raiffeisen Bank International (RBI), one of the largest lenders in emerging European markets, said it expects bad loans to increase in East European markets due to difficult economic conditions. Though the bank maintains its forecast for stable business volumes in 2012, a decline in net interest income, coupled with increasing nonperforming loans (NPL), drove its earnings down by almost 70% over the last quarter. RBI expects a further increase in NPL on account of higher defaults in Hungary and other southeastern European economies. Other Austrian banks, including Erste Group and UniCredit's

Austrian subsidiary, have also cut their earnings forecasts for their Eastern European operations as economies across Europe weaken. (Reuters)

Crisil ups Indian corporate debt restructuring estimates by 63%

Aug 31. Indian-based credit rating agency Crisil raised its estimate for new corporate debt restructuring (CDR) cases by 63% to INR 3.25tn, from a previous estimate of INR 2tn. Slowing domestic growth and high interest rates aimed at taming stubborn inflation have increased corporate distress. Banks have curtailed the supply of unsecured credit, exacerbating refinancing and liquidity pressures that Indian companies face. Lenders will likely be heavily affected by the potential CDR at state-owned electricity distribution networks. Around INR 1.5tn of loans at such companies may be restructured, since a majority continue to sell electricity at throwaway rates in line with populist government policy. The Reserve Bank of India is wary of increasing use of CDR mechanisms, as it believes banks are making use of such mechanisms to avoid classifying assets as non-performing. (The Economic Times)

JPMorgan seeks to reduce clearing and settlement risks

Aug 30. JPMorgan Chase (JPM), the largest US bank by assets and a major provider of clearing and settlement services to other financial firms, is reviewing its dealings with a large number of brokerages that use JPM to settle their trades. The review, which WSJ reports started over six months ago, involves an assessment of the profits such clients generate versus the risks they pose. JPMorgan is believed to be planning to reduce services offered to some clients, and has reportedly already stopped serving others. (WSJ)

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