

Global Credit Research - 08 Jul 2015

Noisy-le-Grand, France

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	Baa1/P-2
Baseline Credit Assessment	baa3
Adjusted Baseline Credit Assessment	baa3
Senior Unsecured	Baa1
Subordinate MTN -Dom Curr	(P)Ba1
Commercial Paper	P-2
Other Short Term -Dom Curr	(P)P-2
Parent: Renault S.A.	
Outlook	Positive
Corporate Family Rating	Ba1
Senior Unsecured	Ba1
Commercial Paper -Dom Curr	NP
Other Short Term -Dom Curr	(P)NP
Companhia de Cr., Financ. e Invest. RCI BR	
Outlook	Stable
Corporate Family Rating -Dom Curr	Ba1
Issuer Rating -Dom Curr	Ba1
NSR Issuer Rating	Aa1.br
RCI Banque Sucursal Argentina	
Outlook	Stable
Issuer Rating -Dom Curr	B1

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Key Indicators

RCI Banque (Consolidated Financials)[1]

	[2]12-14	[3]12-13	[3]12-12	[3]12-11	[3]12-10	Avg.
Total Assets (EUR million)	32,019.0	29,505.0	28,767.0	27,105.0	24,110.0	[4]7.4
Total Assets (USD million)	38,744.7	40,656.2	37,926.2	35,186.2	32,344.6	[4]4.6
Tangible Common Equity (EUR million)	3,058.0	2,815.0	2,609.0	2,485.0	2,380.0	[4]6.5
Tangible Common Equity (USD million)	3,700.3	3,878.9	3,439.7	3,225.9	3,192.9	[4]3.8
Problem Loans / Gross Loans (%)	3.0	3.5	3.5	3.5	4.8	[5]3.6
Tangible Common Equity / Risk Weighted Assets (%)	12.3	12.9	12.1	11.8	12.5	[6]12.3
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	23.2	26.7	27.6	27.1	32.9	[5]27.5
Net Interest Margin (%)	3.1	3.2	3.5	3.8	3.9	[5]3.5
PPI / Average RWA (%)	3.2	3.9	4.0	4.1	4.3	[6]3.2

Net Income / Tangible Assets (%)	1.4	1.7	1.8	1.9	2.0	[5]1.8
Cost / Income Ratio (%)	34.9	31.4	30.9	30.0	30.6	[5]31.6
Market Funds / Tangible Banking Assets (%)	60.9	66.6	78.9	81.7	80.7	[5]73.8
Liquid Banking Assets / Tangible Banking Assets (%)	6.2	6.2	5.0	4.5	5.8	[5]5.5
Gross Loans / Total Deposits (%)	299.2	331.9	499.3	543.5	411.2	[5]417.0

Source: Moody's

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or transitional phase-in; IFRS [3] Basel II; IFRS [4] Compound Annual Growth Rate based on IFRS reporting periods [5] IFRS reporting periods have been used for average calculation [6] Basel III - fully-loaded or transitional phase-in & IFRS reporting periods have been used for average calculation

Opinion

SUMMARY RATING RATIONALE

RCI Banque's (RCI) credit assessment of baa3 is supported by (1) the bank's franchise which reflects its role as a strategic captive for Renault S.A. (Renault; Ba1, positive), and (2) its sound risk management and financial fundamentals, including high and stable earning streams as well as limited credit losses on both its retail and dealer exposures. The baa3 BCA therefore reflects the strengths of the subsidiary and a credit profile healthier than that of its parent.

At the same time, the BCA is constrained by the bank's lack of business diversification, large exposures to car dealers as well as the reliance on confidence-sensitive wholesale-funding, albeit progressively being reduced. These are characteristics more commonly associated with non-investment-grade ratings, as shown by the rating levels of other non-bank auto finance companies with similar business models.

RCI's strategic role within the Renault / Nissan alliance closely ties its standalone creditworthiness to the strength of its parent, Renault. So far, Renault and Nissan Motor Co., Ltd. (A3, stable) have demonstrated a high degree of resilience to macroeconomic pressures despite the cyclical nature of the car market, which in turn affords a degree of protection to RCI.

The Baa1 long-term deposit and senior unsecured debt ratings reflect (1) the bank's baa3 BCA and adjusted BCA; and (2) the two-notch uplift under the Advanced LGF analysis, stemming from the large volume of senior long-term debt. The advanced LGF analysis applies to RCI given that it is subject to an operational resolution regime under the Bank Recovery and Resolution Directive (BRRD). The outlooks on the long-term deposit and senior unsecured debt ratings are stable.

We assigned a Counterparty Risk Assessment (CR Assessment) of A3(cr)/Prime-2(cr) to RCI.

RCI'S BCA IS SUPPORTED BY ITS STRONG + MACRO PROFILE

RCI's operating environment is heavily influenced by European countries and its Macro Profile is in line with the EU average Macro Profile at Strong +.

In general, French banks benefit from operating in a nation with a large and broadly diversified economy, a robust institutional framework and a very low susceptibility to event risk. Nevertheless, France's long-term economic performance will continue to be constrained by subdued growth prospects, a loss in competitiveness relative to its trading partners, a gradual erosion of its export-oriented industrial base and rigidities in labour, goods and service markets. French banks' high reliance on wholesale funding is and will remain a source of vulnerability: this reliance arises both from the large stock of loans and financial assets to finance and from the intense competition on deposits, stemming from regulated savings accounts and insurance products. The French banking sector is relatively concentrated, with several banks benefiting from high retail market share in their core regions.

RATING DRIVERS

- RCI is a key vehicle of the strategy of its industrial parent
- RCI's risk profile remains high because of some structural features
- RCI exhibited strong resilience to the current operating environment despite cyclical nature of the car market

- RCI is reliant on wholesale funding, a credit weakness ; partly mitigated by limited refinancing risk, an increasing deposit base and an adequate liquidity buffer
- Adequate capitalisation supports the bank's risk profile
- RCI exhibited limited deterioration to date in the bank's retail, corporate and dealer loan books
- Large volume of senior unsecured long-term debt resulting in debt and deposit ratings benefiting from a very low given-failure rate and two-notch uplift from the BCA
- Low probability of government support resulting in no uplift from BCA for debt and deposits

RATING OUTLOOK

RCI's deposit and senior unsecured debt ratings carry a stable outlook.

WHAT COULD CHANGE THE RATING - UP

The bank's monoline business model and its captive status inherently limit any upwards movement on the BCA that could develop following (1) a material reduction in the reliance on wholesale funding; or (2) any other material improvement in the bank's credit fundamentals.

Under our advanced LGF analysis, the long-term and short-term deposit and senior unsecured debt ratings could be positively affected by significant issuance of subordinated instruments.

WHAT COULD CHANGE THE RATING - DOWN

A downgrade of RCI's ratings could materialise if (1) the parent's credit profile weakens; or (2) the bank's credit fundamentals deteriorate.

DETAILED RATING CONSIDERATIONS

Our detailed considerations for RCI's current BCA of baa3 are based on the bank's 2014 financial report. Our scorecard uses RCI's financial ratios for the period 2012-2014. Unless noted otherwise, data in this report is sourced from company reports and Moody's Banking Financial Metrics.

RCI IS A KEY VEHICLE OF THE STRATEGY OF ITS INDUSTRIAL PARENT

RCI is a wholly-owned captive finance company that supports the sales of the Renault/Nissan alliance by offering auto loans to customers (both individual and corporates) and loans to dealers to help them finance their inventories. RCI also offers related services such as maintenance, insurance and roadside assistance, and has started offering savings accounts through the Internet in February 2012. In 2013, RCI started collecting deposits in Germany (current and term savings accounts) and launched a term deposit offer in France. RCI also started collecting deposits in Austria in May 2014. At year-end 2014, total savings accounts exceeded EUR6.5 billion, which represented 26% of average performing loans outstanding. The bank also started collecting online retail deposits in the United Kingdom in June 2015. As a result of its mandate as a captive finance company, the bank's franchise is reliant on the performance of the brands of the Renault/Nissan group alliance. Moreover, the wholesale funded nature of the bank means that its franchise may quickly suffer in the event of market turmoil.

RCI is one of the largest automotive captive banks in Europe, in terms of total assets and loans, reflecting the market shares of the Renault/Nissan alliance brands. The bank operates in 37 countries across the globe. Its main markets are those where its parent is most active in Europe: France, Germany, the UK and Italy and, to a lesser extent, Spain. The bank has also been increasingly active in new markets such as South America (Brazil and Argentina), "Asia-Pacific" (South Korea), Eurasia (Russia, Turkey and Romania) and the "Africa-Middle East-India" region (Morocco, India).

Loans to retail customers and to corporate clients (excluding dealers) can take the form of long-term leases, which are almost exclusively finance leases (EUR6.1 billion, as at year-end 2014) and to a much lesser extent operating leases (EUR309 million, as at year-end 2014). The residual value risk was EUR912 million at year-end 2014 and is therefore limited.

Although ancillary products and services, such as insurances, warrantee extensions and maintenance contracts, have been developed in recent years to improve customer loyalty, we believe they do not materially enhance the

bank's diversification, which remains mainly focused on existing customers of the Renault/Nissan alliance car brands.

RCI'S RISK PROFILE REMAINS HIGH BECAUSE OF SOME STRUCTURAL FEATURES

As is the case with other captive companies, RCI's creditworthiness is constrained by corporate management issues, while we view its credit risk management as sound. Unlike many other finance companies, RCI has a full banking license, and for this reason it is subject to similar regulatory prudential standards (capital, liquidity, etc.) as other credit institutions and to ongoing supervision. This oversight, together with access to central bank refinancing facilities, provides a certain level of protection to creditors.

One of RCI's main risks is the lack of business diversification, as it is a captive specialised institution. As such, a downturn in sales volumes of Renault/Nissan alliance brands could result in lower origination volumes and therefore lower revenues. It also results in relatively high credit risk concentration towards car dealers, which represented 28% of the bank's loan book of EUR28 billion, as at year-end 2014. Although we recognise that this portfolio is granular, as it comprises a large number of borrowers, the high degree of correlation among car dealers leads us to consider these exposures cumulatively from a credit risk concentration viewpoint.

Despite a certain degree of independence, RCI is closely linked with its parent Renault, as it is an important vehicle of the group strategy and therefore highly influenced by the group commercial policy and sales volumes. We consider this as an overriding issue for the risk positioning factor.

We note that no members of RCI's supervisory board is truly independent insofar as that they have ties to either RCI or the Renault/Nissan alliance. We believe that this could potentially give rise to conflicts of interest between RCI and its parent. We nonetheless take comfort from the presence of independent board members at the level of its parent Renault, which we believe should provide for an independent perspective on RCI's strategy and risk management. In addition, RCI split the functions of chairman and chief executive officer in order to comply with European banking directives in October 2014.

RCI EXHIBITED STRONG RESILIENCE TO THE CURRENT OPERATING ENVIRONMENT DESPITE CYCLICAL NATURE OF THE CAR MARKET

RCI's net profit margins are high, owing to the profitable car-financing activities (including packaged products, which are less price-sensitive than plain-vanilla loans) and contained funding costs. On customer financing transactions, RCI seeks to pass any increases in funding costs onto customers. In addition, it benefits indirectly from marketing initiatives undertaken by its parent, which are therefore cost-neutral for the bank. RCI has maintained stable profit margins over recent years and we do not expect margins to decline significantly because of its predominately variable cost base.

Given its status as a captive specialised institution, RCI lacks income stream diversification. In common with its peers, RCI's profitability is also characterised by its reliance on net interest income, which represented 79% of its net banking income in 2014.

Given its cost structure, RCI has the ability to sustain a significant fall in volume without jeopardising its profitability. The bank's business model is such that the cost structure includes only a low proportion of fixed costs, allowing RCI to adjust to lower volumes and thereby maintain its level of returns. At year-end 2014, the cost-to-income ratio stood at 35%, modestly higher than those reported for full years 2013, 2012 and 2011. This high cost efficiency reflects the fact that the RCI benefits from various services provided by the group (e.g.; distribution channels).

RCI IS RELIANT ON WHOLESAL FUNDING, A CREDIT WEAKNESS ; PARTLY MITIGATED BY LIMITED REFINANCING RISK, AN INCREASING DEPOSIT BASE AND AN ADEQUATE LIQUIDITY BUFFER

RCI is mainly wholesale-funded, making it vulnerable to sudden changes in investors' confidence. Restricted market access could lead to a shortening of the bank's maturity profile and higher funding costs, which would constrain loan origination. This would in turn affect the strength of RCI's franchise and ultimately reduce its earnings generation, particularly if any funding constraints coincided with higher loan impairments. Our assigned Combined Liquidity score of b1 reflects the relative weakness of funding and liquidity for the rating of the bank.

However, we recognize that RCI (1) strives to match its assets and liabilities thereby limiting maturity transformation and refinancing risk; and (2) that it has access to considerable liquidity, principally in the form of committed bank credit lines to bridge any mismatches or temporary market access restrictions.

We note positively that the bank (1) receives very limited funding from the Renault group, and (2) has started collecting internet deposits from retail customers in 2012, which accounted for approximately 26% of outstanding loans as at year-end 2014 (average performing loans in 2014). In February 2014, RCI announced that it now targeted a deposit base representing 30% of its outstanding loans by 2016. The funds collected in 2014 - a total of EUR2.2 billion - represent a significant 33% of RCI's funding plan for the year.

RCI claims to have a funding surplus because it finances its loan book with longer term liabilities, resulting in little refinancing risk. Funds outstanding through Euro CD/CP programmes (domestic and international) totalled EUR952 million, or 4% of funding, as at year-end 2014. Funds drawn under these programmes are fully covered, in accordance with RCI's policy, by confirmed bilateral back-up lines with banks of high credit standing. The bank has been able to issue debt of various maturities on the markets on a number of occasions in the past couple of years and in different currencies. We also take comfort from the geographic spread of the resources and investors.

Securitisation is used both for funding purposes and to increase asset liquidity. Its use has increased over the years and has stabilised between 2006 and 2012. At year-end 2014, securitisation represented 14% of the bank's funding. We note that RCI still has a sizeable pool of securitizable assets available. In a stress scenario, RCI should therefore be able to increase its recourse to securitization to make its balance sheet more liquid and create ECB-eligible assets.

In its 2014 financial report, RCI stated that it could carry out its commercial business activity for more than eleven months without having recourse to unsecured public funding markets, due to its EUR6.9 billion available liquidity. In this market shutdown scenario, it would use its EUR4 billion available confirmed lines of credit, which we believe could be subject to changes in availability and pricing.

ADEQUATE CAPITALISATION SUPPORTS THE BANK'S RISK PROFILE

RCI Banque had a common equity tier 1 ratio of 11.4% (including transitional floors on risk-weighted assets) as at year-end 2014, broadly stable from year-end 2013. Excluding transitional floors, the core Tier 1 ratio would be 14.8%. We believe that RCI Banque's economic solvency is adequate given its risk profile. Securitisation transactions remain on the balance sheet and do not generate any capital relief.

As part of our analysis on European auto banks, we consider the extent to which the aggregate exposures to car dealers are posing risks to RCI. This is because although this portfolio is well diversified in terms of borrowers and geographies, we consider that these exposures represent substantial aggregate risks due to their correlation. We concluded that based on the current risk profile of Renault and related consequences for its network of dealers, RCI's capital is sufficiently strong to absorb losses resulting from these exposures in a highly adverse scenario of widespread dealer defaults and significant increase in retail loan losses.

RCI EXHIBITED LIMITED DETERIORATION TO DATE IN THE BANK'S RETAIL, CORPORATE AND DEALER LOAN BOOKS

At year-end 2014, RCI's problem loans represented 2.96% of total loans (2013: 3.48%). The portfolio remained well-provisioned with loan loss reserves accounting for 80% of problem loans, as at year-end 2014. We see RCI's customer base as relatively risky and note that high provisions have been sustained over time, and that RCI experienced a sharp deterioration in asset quality in the recession, notably in Spain and Romania, before continuously improving since 2010.

Overall, our assigned BCA is baa3, one notch below the unadjusted Financial Profile of baa2. This is due to our adjustment of -1 for business diversification as for other similar monoline issuers.

NOTCHING CONSIDERATIONS

LOSS GIVEN FAILURE AND ADDITIONAL NOTCHING

RCI is subject to the EU Bank Resolution and Recovery Directive (BRRD), which we consider to be an Operational Resolution Regime. We assume residual tangible common equity of 3% and losses post-failure of 8% of tangible banking assets, a 25% run-off in "junior" wholesale deposits, a 5% run-off in preferred deposits, and assign a 25% probability to deposits being preferred to senior unsecured debt. These are in line with our standard assumptions.

We believe that RCI's deposits are likely to benefit from a very low loss-given-failure, due to the loss absorption provided by (i) the large amount of senior unsecured debt should deposits be treated preferentially in a resolution;

and (ii) the small volume of deposits. We factor in the modest deposit volume (we estimate junior deposits to make up less than 2% of the bank's tangible banking assets in failure) and the subordination of 3% of tangible banking assets (and about 38% in the event of deposits being preferred to senior debt). This results in a Preliminary Rating Assessment (PRA) two notches above the BCA.

We believe that RCI's senior unsecured debt is also likely to benefit from a very low loss-given-failure. This is supported by the senior debt's own volume (about 35% of the group's tangible banking assets in failure, or 37% including junior deposits), and the amount of subordination including residual equity (3%). This results in a Preliminary Rating Assessment (PRA) two notches above the BCA.

GOVERNMENT SUPPORT

The implementation of the BRRD has led us to reconsider the potential for government support to the bank's creditors. We expect a low probability of government support for debt and deposits, resulting in no uplift to the baa1 PRAs on both the long-term deposits and senior unsecured debt issued by the bank.

COUNTERPARTY RISK ASSESSMENT

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities.

The CR Assessment is positioned at A3(cr)/Prime-2(cr).

The CR Assessment, prior to government support, is positioned three notches above the Adjusted BCA of baa3, based on the cushion against default provided to the senior obligations represented by the CR Assessment by subordinated instruments amounting to 40% of Tangible Banking Assets. The main difference with our Advanced LGF approach used to determine instrument ratings is that the CR Assessment captures the probability of default on certain senior obligations, rather than expected loss, therefore we focus purely on subordination and take no account of the volume of the instrument class.

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Our Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating Factors

RCI Banque

Macro Factors	
Weighted Macro Profile	Strong +

Financial Profile						
Factor	Historic Ratio	Macro Adjusted Score	Credit Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
<i>Problem Loans / Gross Loans</i>	3.3%	a3	← →	a3	Sector concentration	Long-run loss performance
Capital						

TCE / RWA	12.3%	a3	← →	a3	Risk-weighted capitalisation	
Profitability <i>Net Income / Tangible Assets</i>	1.4%	a2	← →	a2	Earnings quality	Return on assets
Combined Solvency Score		a3		a3		
Liquidity Funding Structure <i>Market Funds / Tangible Banking Assets</i>	60.9%	caa1	← →	b3	Extent of market funding reliance	Term structure
Liquid Resources <i>Liquid Banking Assets / Tangible Banking Assets</i>	6.2%	b1	← →	ba2	Access to committed facilities	
Combined Liquidity Score		b3		b1		

Financial Profile

baa2

Qualitative Adjustments

Business Diversification
Opacity and Complexity
Corporate Behavior

Adjustment

-1
0
0

Total Qualitative Adjustments

-1

Sovereign or Affiliate constraint

Aa1

Scorecard Calculated BCA range

baa2 - ba1

Assigned BCA

baa3

Affiliate Support notching

0

Adjusted BCA

baa3

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency rating	Foreign Currency rating
Deposits	2	0	baa1	0	Baa1	Baa1
Senior unsecured bank debt	2	0	baa1	0	Baa1	Baa1
Dated subordinated bank debt	-1	0	ba1	0	(P)Ba1	

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