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BNP, SocGen Accelerate Trading-Book Cuts

By Fabio Benedetti-Valentini - Oct 27, 2011

BNP Paribas SA and Societe Generale SA, France's largest banks, are accelerating cuts in their 1.1 trillion-euro ($1.5 trillion) trading books to avoid going to shareholders or the government for capital.

The banks, which last month began a program to trim about 300 billion euros in assets by 2013, have focused on cutting dollar-funded businesses such as aircraft lending after Europe's sovereign debt woes squeezed funding. The lenders' statements show that their trading operations have not gone unscathed.

Reluctant to lose their top spots in the risky yet lucrative trading and derivatives business, Societe Generale and BNP Paribas hadn't shrunk the operations as much as rivals such as Deutsche Bank AG and UBS AG. The French banks may have little choice after European Union leaders pushed lenders to boost capital. BNP Paribas and Societe Generale need 5.4 billion euros in new capital, the region's banking regulator said today.

"It's a striking sin of pride," said Francois Chaulet, who helps manage 250 million euros at Montsegur Finance in Paris. "They all want to keep their rankings, but French banks risk not having the necessary capitalization."

The two banks have already made some cuts. In the first half, BNP Paribas statements show its trading book, with bonds, equities, repurchase agreements and derivatives, shrank about 8 percent to 717 billion euros, after holding steady in 2010.

Societe Generale's trading book slipped 4 percent in the first six months to 219 billion euros, after rising 35 billion euros last year. Its derivatives trading fell 8 percent to 176 billion euros after rising by a similar percentage last year.

Shares Jump

French banks need about 8.8 billion euros in fresh capital, according to the European Banking Authority, with 2.1 billion euros for BNP Paribas and 3.3 billion euros for Societe Generale.

BNP Paribas and Societe Generale said they'll meet the new capital requirements through their own means. BNP Paribas rose as much as 16 percent in Paris, the biggest intraday jump in a

month. It traded 8.3 percent higher at 32.53 euros as of 9:28 a.m. Societe Generale gained as much as 15 percent, also the steepest gain since Sept. 27. It rose 7.7 percent to 20.20 euros.

The two banks have said they are shrinking corporate- and investment-banking, without commenting on specific cuts. Societe Generale's corporate- and investment-banking unit, home to its trading business, accounted for 30 percent of sales and 44 percent of net income in 2010. At BNP, it was 27 percent of revenue and 41 percent of pretax profit.

'Almost Intact'

Between 2007 and 2010, BNP Paribas cut its post-Fortis- purchase capital-markets assets including trading and derivatives by about 10 percent and Societe Generale by about 6 percent, estimates Christophe Nijdam, an analyst at AlphaValue in Paris. For Frankfurt-based Deutsche Bank the figure was 25 percent, Credit Suisse Group AG 55 percent and UBS 47 percent.

"For French banks, it was unthinkable before this summer, but the trading book is no longer immune from cuts," he said. "They're naturally more inclined to cut other businesses before the trading book. Some of the trading book is more profitable but also riskier. They prefer to cut the lending book."

Societe Generale is the world's largest equity derivatives house by sales, according to a June report by JPMorgan Cazenove. BNP Paribas is No. 3, behind Goldman Sachs Group Inc.

"To avoid weakening its results, Societe Generale has kept its corporate and investment bank almost intact," said Pierre Flabbee, an analyst at Kepler Capital Markets in Paris. "If you want to cut the balance sheet's size, capital-market commitments can fall at very high speeds, but results too."

Worsening Context

Shrinking operations may result in an acceleration of job cuts at the banks. BNP Paribas Chief Executive Officer Baudouin Prot said Sept. 22 that the bank plans "significant" staff reductions at its corporate and investment-banking unit. Societe Generale said Sept. 14 that it's seeking a 5 percent cost reduction at its unit with possible job cuts.

BNP Paribas and Societe Generale, both based in Paris, are racing to shrink balance sheets after their stocks plunged during the summer and U.S. money-market funds became reluctant to lend them dollars, making it difficult to refinance their international operations.

Before today, BNP Paribas, France's largest bank, had tumbled 44 percent, while Societe Generale slid 54 percent since early July, more than the 26 percent drop in the 46-member Bloomberg Europe Banks and Financial Services Index.

"In many respects, the French banks have been holding on to the hope that things would be better," said Julian Chillingworth, who helps manage 16 billion pounds ($25.5 billion) at Rathbone Brothers Plc in London.

Selling Frenzy

Markets have taken a turn for the worse. The biggest Wall Street firms are posting their worst quarter in trading and investment banking since the depths of the credit crunch. Deutsche Bank, Europe's biggest investment bank, on Oct. 25 posted a decline in trading revenue for the third quarter.

Selling operations in the current financial context would be difficult, Chillingworth said.

"It's all very well that you're announcing sales of assets but you need to find a buyer," he said.

BNP Paribas said last month it'll cut risk-weighted assets by about 70 billion euros by the end of next year. It plans to slash total assets by 10 percent, or about 200 billion euros.

Societe Generale, France's second-largest lender by market value, said this month it will shrink its risk-weighted assets by as much as 80 billion euros by 2013, decreasing funding needs by as much as 95 billion euros.

Tougher Rules

Their asset-cutting efforts mirror those of European rivals. UBS, Deutsche Bank, Barclays Plc and Credit Suisse have disclosed plans to shrink their combined risk-weighted assets by as much as $415 billion to prepare for stricter capital requirements under Basel III rules.

"Everybody is trying to reduce risk-weighted assets as soon as possible," said Kian Abouhossein, a JPMorgan analyst in London. "They've already all started, but they'll probably find it harder than expected because the environment is clearly getting tougher."

Starting Dec. 31, European investment banks face higher risk-weighted assets as part of an upgrade of Basel II rules. The value-at-risk will be "stressed" for longer and capital charges on products such as credit-default swaps will increase.

Societe Generale said last year the upgraded Basel II rules will boost risk-weighted assets by 40 billion euros. BNP Paribas, which had capital markets risk-weighted assets of 71 billion euros at the end of 2010, said in March that upgraded Basel II and III will add about 60 billion euros more.

Capital Needed

The higher the risk-weighted assets, the more capital the banks need against them. Europe's banks will need to raise 106 billion euros in fresh capital under tougher rules being introduced, the regulator said. The extra reserves aimed at meeting a temporary requirement for banks to hold 9 percent in core reserves, after sovereign debt writedowns, the EBA said.

EU leaders met yesterday to hammer out a package to bolster the region's rescue fund, recapitalize banks and convince investors to cut Greece's debt load to prevent contagion effects in Italy and Spain. Policy makers and bankers converged on a 50 percent writedown for Greece's lenders.

At the end of June, French financial firms had $681 billion in public and private debt in Greece, Portugal, Ireland, Italy and Spain, according to Basel, Switzerland-based Bank for International Settlements. That's the biggest exposure to those countries and almost a third more than German lenders.

'Lesser Evil'

Both BNP Paribas and Societe Generale say they can meet new Basel capital requirements without capital injections. Avoiding capital increases may mean scaling back some risky trading businesses, and thus their capital needs.

"They will definitely have to reduce their trading activities," said Valerie Cazaban, who helps manage 100 million euros at Stratege Finance in Paris. "It's the lesser of the evils. It would shrink their balance sheets, it can be done in stages, and it is better than reaching out to shareholders."

BNP, which reports third-quarter earnings Nov. 3, is cutting $82 billion in corporate- and investment-banking assets. In the first half, it cut liquidity needs by $22 billion, "mainly in capital markets activities," the bank said.

Societe Generale, which is set to report results on Nov. 8, said Oct. 4 its "capital markets' liquidity needs have already been significantly reduced during the summer."

Deeper reductions in some of its trading operations may be in the offing.

"It'll becoming very difficult to keep the trading and derivatives books intact," said Montsegur's Chaulet. "The banks must reduce risky assets, and raising capital in current conditions is impossible."

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