Euro, sovereign debt, liquidity and other issues:
questions and answers from BNP Paribas

After being asked a number of questions about the bank and the Eurozone, we have decided to publish the answers to the most frequently asked questions in three categories below:

- Questions to the bank
- Questions about the Eurozone
- General market questions

Questions to the bank

1) Why does BNP Paribas hold one of the largest sovereign debt portfolios among peers? How does BNP Paribas intend to manage its sovereign debt portfolio in the short and medium term?

Our Eurozone Government bonds banking book portfolio has been brought down to a total of €75bn (1) as at 30 June 2011. Its purpose is essentially two-fold:

a) To provide a liquidity buffer which can be used in situations of liquidity stress, given that government securities are still considered by regulators as one of the most liquid and non-risky assets available for such purpose;

b) As a structural hedge for our deposit base in our four domestic markets, in particular against interest rate risk for non-interest bearing accounts such as current accounts in France.

(1) The figure of €140 billion mentioned in the press was based on an erroneous interpretation of tables published by the EBA and did not reflect Group's risks on sovereign bonds.

2) Why is your exposure to Italy's sovereign bonds so large?

Our banking book sovereign bond exposure to Italy is €21bn, 1.7% of BNP Paribas' total commitments. This amount represents only 1% of the total value of Italian bonds outstanding. The Italian debt market has been liquid and widely used as an interest rate management tool by banks and investors, including BNP Paribas at a time when government bonds were deemed risk free.

3) How likely is it that the current crisis could lead to a freezing up of money markets and overnight interbank lending, similar to what we experienced during the Lehman crisis? Are you well-equipped and sufficiently liquid to deal with such an adverse scenario?

The situation today is very different. Among the large European banks, the fall in activity in the interbank market is not mainly due to counterparty risk issues, but to the banks pre-empting the impact of the future Basel liquidity regulation. The interbank market is therefore likely to focus on instruments of one-month duration or less, which is in line with what BNP Paribas had expected.

Regarding BNP Paribas' funding position:

- BNP Paribas has access to substantial short-term euro funding from a wide spread of sources. Conditions and maturities have not significantly changed in recent weeks. There has been no shortage of funds and no change in counterparties.

- In USD, we have an excess of short-term liquidity which the bank is obliged to deposit at the Fed.

  BNP Paribas has been taking steps since the start of 2011 to secure its funding position by proactively increasing the duration of its short term resources (one month to three months, three months to six months and so on).

  Despite the lower level of funding available to European banks from US money market funds in August, BNP Paribas has been able to tap a wide variety of funding sources. For example, US dollar funds have been sourced from corporates, supras, institutionals, Central Banks, wealth management clients, as well as money market funds across four geographic areas (USA, Asia-Pacific, Gulf countries, Western Europe). The bank has also had recourse to foreign exchange swaps to maintain access to US dollar funds.

The recourse to alternative US dollar funding sources has had cost implications which have impacted pricing.

In addition, BNP Paribas has a sizeable liquidity buffer: BNP Paribas has around €150bn of unencumbered assets eligible as collateral with central banks, of which USD30bn eligible under US Federal Reserve criteria. These eligible assets are made up of Government bonds, loans to United States or Eurozone corporates; self-funded securitizations, and CDs (Certificates of Deposit).

The bank has already secured its long-term position: BNP Paribas 2011 medium and long term funding programme of €35bn was completed in June. As of today a total of €38bn has been raised with an average maturity of 6 years. The USD part represents about 40%.

CDS spreads current levels for European Governments as well as for European Banks do not reflect the bank’s true cost of funding, even senior unsecured funding, which is considerably lower. Furthermore, even in troubled times, BNP Paribas has benefited from “the flight to quality” and has been able to raise funds through covered bonds or private placements at reasonable cost.

4) Is BNP Paribas actively reducing the size of its balance sheet and/or changing its composition?

BNP Paribas is monitoring the size of its balance sheet pro-actively. The size of BNP Paribas' balance sheet (€1.9 trillion as at 30 June 2011) is inflated by International Financial Reporting Standards (IFRS) which do not allow for netting of derivatives and other trading items, which is authorized under US GAAP. The netting according to the US GAAP rules would reduce the balance sheet by ~25%.

5) BNP Paribas is clearly a Global SIFI (Systemically Important Financial Institutions), but its Common Equity Tier One Ratio is below 10%, which regulators are increasingly viewing as a minimum requirement for Global SIFIs. Is your Common Tier One Ratio sufficient in the current uncertain market environment, or will you seek to bolster it?

BNP Paribas already has a Common Equity Tier One ratio of 9.6% as at 30 June 2011. The EBA stress tests showed the resilience of our capital base even in a severe downturn scenario with a 7.9% result. BNP Paribas has constantly been profitable through the 2007-2010 crisis and consistently reinforced its capital base by retaining two-thirds of its profits. We have already doubled our capital base over the past three years. Thanks to our high level of profitability (our H1 2011 annualized 13.8% ROE is the highest in our peer group) we should gradually reach the required level for a Global SIFI without any need of capital injection.

6) How do you explain the discount of your bank share price?

While BNP Paribas’ shares have suffered severe falls along with the sector, it has outperformed its peer group. The share price is down by 35% since the beginning of the year, compared with 36.8% for the Eurozone banks index, 33.7% for the European banks index, and 33.9 % for the main US banks in average (as of 05.09.2011).

We consider this impact of the crisis on the present valuation of BNP Paribas by the market, as discounting unrealistically pessimistic scenarios. If we look at the Net Book Value per Share of € 56.7 as of 30.06.2011, and at the current share price which is around €33 as at 02.09.2011, the total market discount is over €27bn. This seems unjustified by any measurement.

Questions on the Eurozone

1) How do you see the current situation and future perspectives for the Eurozone? How would you be affected by a scenario of default of a major Eurozone country, or by a worst-case scenario of a break-up of the Eurozone?

The Eurozone has a core of wealthy and stable countries, with a low level of private debt, and governments who are taking the necessary measures to restore the soundness of public finance. Those who write about the Euro break-up underestimate both the political and economic reasons why the Euro is there to stay.

A- Proactive Policies show a commitment of the Eurozone governments

Eurozone countries have fixed clear targets in order to first stabilize and then reduce public deficits as share of GDP:

2012: 4.6% in France, 2.8% in Belgium, 1.5% in Germany, 6% in Spain, 3% in Italy
2013: 3% in France, 1.8% in Belgium, 1% in Germany, 3% in Spain, 0.2% in Italy.

More importantly governments have demonstrated their clear political will in Europe to reduce public deficits by taking further supplementary measures to avoid undershooting as a result of deteriorating economic circumstances.

-France (€12 bn deficit reduction plan end-2011 and 2012).
-Italy (balanced budget in 2013, instead of 2014, the Chamber of Deputies passed deficit reduction measures of €48 bn (even if some details are still under discussion)).
-Spain: additional €5bn savings before end-2011 to ensure targets are met.
-Portugal: new measures on 31 August targeting 0% deficit in 5 years: 7% of GDP cut in spending, extension of public sector wage freeze, acceleration in payroll reductions and welfare payments, increase in household and corporate taxes (all tax increases = 3.5% GDP)
- Ireland: growth is reviving faster than expected.

B- European authorities and the ECB have shown their strong will to take the necessary measures to support the governance and cohesion of the Eurozone.

The ECB and the European institutions have committed to support the financial strength of the Eurozone through an increase of resources (European Financial Stability Facility, European Financial Stabilisation Mechanism) and to improve the governance of the Eurozone. These commitments are based on a common interest to protect and uphold growth in Europe.

C- Key economic indicators in the Eurozone are resilient

Growth figures:
H1 2011: 1%. The outlook for 2011 and 2012 is between 1 and 1.5%

Public finance data:
The fiscal deficit in 2010 (including local government) represented 6% of GDP in the Eurozone. In 2011, the outlook is 4.3% in the Eurozone.

Private debt ratio to GDP is at 135% in the Eurozone despite Spain + Ireland's high level of private debt.

Since the private domestic savings pool is large enough in the Eurozone to finance the fiscal deficit, the current account is close to balance (-0.6% of the GDP in 2010.

The figures for the US economy are roughly on par with those in the Eurozone:

Growth H1 2011: +0.35% – Outlook for 2011 and 2012 is between 1 and 1.5%.
The fiscal deficit in 2010 was 10.6% of GDP. The outlook for 2011 is at 9.5%.
The private debt ratio to GDP is at 162% in the US. And the US has a current account deficit around 3% because of its relatively low savings ratio.

3) After the recent downgrade of the United States by S&P, are you worried that France could be next on the list, and how would this affect BNP Paribas?

Standard & Poor's decision to downgrade the US long term debt surprised all market participants, was certainly controversial and triggered the instability we have experienced in the markets since 8 August.

Rating agencies have all reaffirmed the AAA with a stable outlook for France. The government's commitment is clear, there is a well-defined path to be followed, and the policies in place are adjusted to offset the possible negative consequences. There is a strong commitment to reduce the public deficit over time: 5.7% of GDP in 2011, 4.6% in 2012, 3% in 2013. In our opinion, two measures are essential to create an improved base effect for the coming years:
- reforming pensions,

- being at an all-time low, in volume, in terms of increase of expenditure (resulting to some extent to the "one out of two" replacement policy for civil servants and a freeze in their basic wages)

According to our estimates, the effect of these measures will cut expenditure by 0.5% of the GDP each year. An additional element of comfort is that there is a growing consensus among political parties that public deficits should be reduced, despite the divergence on the ways to achieve this.

Finally, France is one of the Eurozone countries which benefits from healthy demographics, with a birth rate of two children per woman. This "demographic dividend" has positive consequences:

- ➔ As estimated by the OECD, the increase in health and pension expenditure as a proportion of the GDP between 2010 and 2015 puts France in a relatively favourable position with a forecasted increase of 1.9% versus 2.1% for the UK and 2.6% for Germany for example.

- ➔ Potential growth is necessary for governments to generate revenues in the future. The OECD estimates put France in a relatively good position thanks to the dynamics of its working age population with OECD potential growth forecasted at 1.5% over the 2010-2015 period and at 1.7% over the 2016-2026 period.

For all these reasons, we do not consider France at specific risk of a sovereign debt downgrade.

General Market Questions

1) Markets are increasingly nervous about the sovereign debt crisis in Europe, and its potential impact on banks' solvency. What is your message to shareholders, clients and employees regarding BNP Paribas' ability to withstand the current crisis?

This is clearly a serious crisis, hence the significant measures that have to be taken across Europe to restore confidence in the sovereign debt market and, more broadly, in the future of developed Western countries. Nevertheless, we feel that market concerns about large European banks in general, and BNP Paribas in particular, are exaggerated.

There are clear differences within the Eurozone countries:

a) Greece: this country is experiencing considerable difficulties in restoring its public finances and restarting economic growth. The EU has offered support to Greece through two plans (May 2010 and July 2011) agreed between Eurozone governments, the ECB and the IMF. These are worth €270 bn, with a contribution from private investors amounting to a discount of 21% on their estimated €135 bn holdings (debt maturing before 2020). The Greek government has also agreed significant measures to reduce its public deficit. It is worth noting that Greece represents only 2.6% of Eurozone's GDP.

➔ BNP Paribas banking book exposure to Greece's sovereign debt is €4bn including a €516mn impairment representing the Group's commitment to the Greek rescue plan. This exposure is only 0.3 % of the Group's total commitments.

b) **Ireland and Portugal**: have also benefited from support plans agreed by the Eurozone governments, the ECB and the IMF respectively in November 2010 and May 2011. These countries have committed to reduction targets for their public deficits and are well on track towards implementing the deficit reduction measures they have voted. Their progress has been recently praised by the European Union, the IMF and the ECB (the so-called "troika").

➔ BNP Paribas' banking book exposure to Ireland's sovereign debt is €400 million while exposure to Portuguese sovereign debt is €1.4bn. These combined exposures represent 0.1 % of the Group's total commitments.

c) **The other Eurozone countries**: these 14 countries have good economic fundamentals and are committed to fiscal deficit reduction targets. BNP Paribas' key retail markets are in 4 high income countries - France, Italy, Belgium and Luxembourg - where the cost of risk is moderate and the rate of household savings is high.

In Italy there were no discretionary measures to support the economy during the 2007-2010 crisis, as a consequence the fiscal deficit remained limited (4.6% in 2010 and 4.2% in 2011). **Italy has a household debt ratio of 61% versus 96% on average in the Eurozone**, 157% in the US, and 149% in the UK. **The average maturity of its debt is 7.2 years** (as in France) against 4.9 years in the US, so its interest payments are less sensitive to a rate increase than it would be in the US. **Finally Italy has a sound banking system** and did not have to suffer the burden of any bailouts during the 2007-2010 crisis.

BNP Paribas has shown consistent profitability over time and proven resilience in the crisis because of its client oriented business model, diversified both in terms of businesses and geographies. Besides our four domestic markets, we also successfully operate a retail business in America and in several emerging countries including Turkey. Our investment solutions franchise spans all European markets and Asia. Our corporate and investment bank, a leading player across all Europe for both capital markets and financing businesses, enjoys strong franchises in Asia and in the Americas. This diversity is reflected in our commitments and is part of the strong foundations of our bank.