Caisse Française de Financement Local (Caffil)

Public Sector Obligations Foncières

Full Rating Report

Ratings

Obligations foncières	AA+/Stable

Key Data

	Nov 13
Asset type	Public sector
Reference IDR	AA
D-Cap	Moderate high
'AA+' breakeven over-collateralisation (OC) (%)	7.5
Cover assets (EURbn)	63.8
Covered bonds (EURbn)	55.7

Source: Fitch/Caffil

Figure 1

D-Cap Assessment

D-Cap	3
Asset segregation	Very Low
Liquidity gap and systemic risk	Moderate
Systemic alternative management	Low
Cover pool-specific alternative management	Moderate
Privileged derivatives	Moderate high

Source: Fitch

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Key Rating Drivers

Link to Sovereign Rating: The 'AA+' rating on Caisse Française de Financement Local's (Caffil) public sector obligations foncières (OF) is influenced by France's 'AA+' Long-Term Issuer Default Rating (IDR), as loans granted to French local authorities represent 70% of the cover pool. In rating scenarios above the sovereign, Fitch Ratings assumes high default and low recoveries given default on local authority debt. This would not be compensated by the overcollateralisation (OC) available to OF holders.

Time Subordination: The OF are rated one notch above the reference IDR of Caffil's parent, Société de Financement Local (Sfil; AA/Stable), based on good (above 51%) recoveries from the cover pool in the event of an OF default. The 7.5% break-even OC for the 'AA+' rating mainly arises from the allocation of recoveries on OF deemed to be in default, which Fitch models to occur in chronological order of maturity rather than pro-rata.

Increased Credit Loss: Fitch's credit loss assumption for the cover pool is 11.2% in a 'AA+' scenario. This level reflects its international exposure (30%) with Italian local authorities (10.4%) comprising the largest exposure. Italian securitisation notes formerly part of the cover pool and guaranteed by Dexia Crediop S.p.A. (BBB/Negative/F3) were unwound and the underlying assets transferred to Caffil in December 2013. Fitch modelled the increased direct exposure to Italian local authorities, compared to the previous reliance on the guarantee.

Programme Highlights

New Originator: Caffil has recently started to refinance loans originated by La Banque Postale (LBP, A+/Stable/F1+) to French local and regional governments; a first transfer of these loans to the cover pool was completed in September 2013 for an amount of EUR516m.

Risky Loans: Over a fifth of the loans in Caffil's total cover pool are loans with a complex interest rate structure, with 55% of these loans considered to be more risky, for an overall amount of EUR8.0bn as of September 2013.

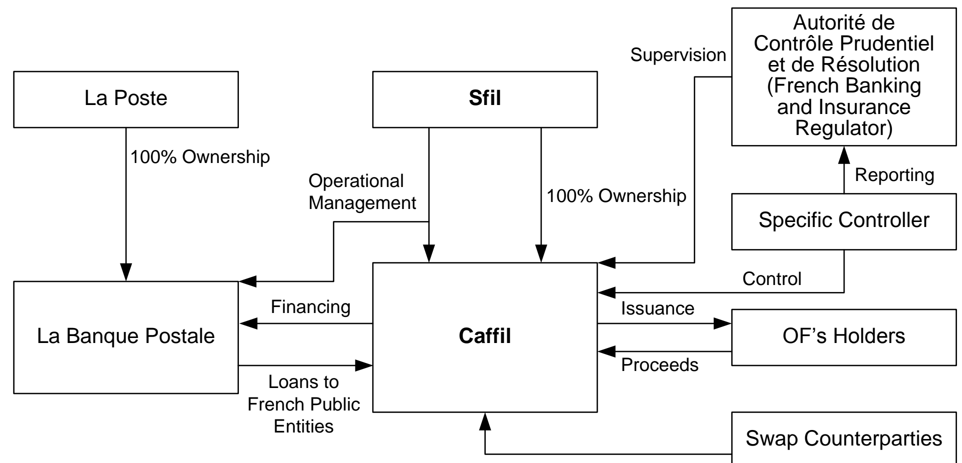
In its analysis, Fitch does not size for the potential risk of significant termination payments being borne by the cover pool, in the event of a simultaneous restructuring of a large part of the sensitive loans. Fitch however takes comfort from the current initiatives undertaken by the French government and the issuer to address this matter and does not expect a disorderly default of these loans in a stress scenario commensurate with the rating of the French sovereign.

Complex Hedging Structures: Fitch has assessed the privileged derivative component of Caffil discontinuity cap (D-Cap) as moderate high, due to the materiality of the exposure, the complexity of hedging, and only partial compliance with Fitch's covered bonds counterparty criteria, notably regarding replacement language. In total, Caffil has 28 counterparties in relation to interest rate and currency swaps.

Programme not Dormant: No OF were issued ahead of the sale of Dexia Municipal Agency, Caffil's predecessor entity, to Sfil, but issuance resumed in 2013. Fitch no longer treats the programme as being in wind-down and therefore gives credit in its analysis to the lowest OC of the last 12 months (14.4% from November 2012).

Figure 2

Structure Diagram



Source: Fitch

Figure 3

Key Participants

Issuer	Caisse Française de Financement Local
Parent	Sfil
Originator	La Banque Postale (A+/Stable/F1+)
Servicer	Sfil

Source: Caffil

Background

Caisse Française de Financement Local (Caffil) is a credit institution accredited as a Société de Crédit Foncier (SCF), wholly owned by Sfil.

Sfil is a financial institution owned by the French state (AA+/Stable/F1+), Caisse des dépôts et Consignations (CDC, AA+/Stable/F1+) and LBP, with respectively 75%, 20% and 5% of capital. In January 2013, Sfil acquired Dexia Municipal Agency (DMA), following the completion of Dexia's restructuring process, and rebranded it Caffil.

The sole purpose of Caffil is to act as a refinancing vehicle for the new public sector lending business of LBP. Caffil is constituted as a société anonyme (limited company) and is managed by a directoire (executive board) and a conseil de surveillance (supervisory board). The SCF has no employees and subcontracts all operational tasks to Sfil.

The Originator

LBP is the fourth-largest French bank by deposits amount, with a market share of 10%, and is the largest bank in France by number of retail customers and network size. La Poste (LP) is the sole owner of LBP. Since 3Q12, LBP has been originating loans to public local authorities, with the first pool of loans being refinanced via Caffil in September 2013. LBP is planning to lend annually up to EUR4bn and to reach up to a quarter of the market share in this segment by 2015. Sfil offers services not only to Caffil, but also LBP by providing commercial and risk management support and back-office operations.

Programme Overview

Caffil is licensed to issue OF, a form of French legislative covered bonds. Although the cover pool securing OF can include both mortgages and public sector loans, Caffil assets are only exposed to public sector assets. Issuance of OF is governed by articles L515 - 13 to 515 - 33 of the Code Monétaire et Financier (the French Monetary Code), implemented on 25 June 1999 (and subsequently amended) and by the regulations of the Autorité de contrôle prudentiel et de résolution (ACPR). The covered bonds rank pari passu among themselves and represent direct, unconditional and unsubordinated obligations of the issuer. SCF law prohibits a parent company's bankruptcy from being extended to the SCF and all OF holders and swap counterparties benefit from a privilege.

Related Criteria

Covered Bonds Rating Criteria (September 2013)

Asset Analysis Criteria for Covered Bonds of European Public Entities (January 2013)

Covered Bonds Rating Criteria – Public Sector Liquidity and Spread Assumption Addendum (February 2013)

Counterparty Criteria for Structured Finance and Covered Bonds (May 2013)

Continuity Analysis

Fitch has assessed the discontinuity risk components for Caffil's OF, as summarised in Figure 5. Overall, the programme has been assigned a D-Cap of 3 (Moderate high). The D-Cap is driven by the highest risk from the five components listed in Figure 4 (ie the weakest link). For further information on how the agency assesses each of the components in the D-Cap, please see the criteria report *Covered Bonds Rating Criteria.*

Figure 4

Summary of Fitch's Assessment of D-Cap Components

Asset segregation	Very low
Liquidity gap and systemic risk	Moderate
Systemic alternative management	Low
Cover pool-specific alterative management	Moderate
Privileged derivatives	Moderate high

Source: Fitch

Asset Segregation

Fitch assessed the risk for asset segregation for SCF programmes as 'Very low'. This assessment is mainly driven by the strong French OF framework. Under the legal framework, the cover assets are segregated in a separate single-purpose legal entity − the SCF − rather than being ring-fenced within the balance sheet of an institution with wider business objectives. OF holders and other privileged parties have a priority claim over all the assets of the SCF. In the event of an SCF's bankruptcy, principal and interest payments to the non-privileged creditors will be stopped until the privileged resources (primarily OF) are fully redeemed; these will not be accelerated but will remain payable when due. In addition, the law prohibits a parent company's bankruptcy from being extended to the SCF.

Validity of the Transfer

Loans originated by LBP are transferred to the cover pool by means of a bordereau, a true sale agreement. Caffil also has an indirect exposure to UK municipal loans via a collateralised loan to Dexia Credit Local (DCL, A/Stable/F1). These loans are segregated within DCL's balance sheet and would be validly transferred to Caffil upon a default of DCL. The existing loans in the cover pool were to a large extent originated directly in the name of the issuer (DMA) or transferred via bordereau. All borrowers have been notified of the transfer to Caffil. Bonds held by Caffil were purchased from DCL or on the market. All such assets are purchased at fair market value, subject to control by the auditors and the specific controller. These transfers are in line with Code Monétaire et Financier and should not be challenged under the SCF law.

Commingling Risk

French debtors, including new borrowers of loans originated by LBP, pay directly to Caffil via an account at the French Treasury. The balance on this account is swept daily to a unique bank account opened in the name of Caffil, held with an external counterparty, currently rated 'A'/Stable/'F1'. Foreign borrowers pay to specified accounts (held at banks rated at least 'A'/Stable/F1) in their local currency, where proceeds are swapped into euros. Italian bonds pay directly to Caffil's external account via Monte Titoli, an Italian Clearing House.

As the majority of the collections are redirected to an account held by eligible external counterparties, the commingling risk is deemed to be remote. In addition, under Caffil management rule, should the rating of an external account bank be downgraded below 'A'/'F1' or such rating be placed on RWN, Caffil will endeavour to find another account bank.

Potential commingling risk exists with DCL, stemming from the portion of loans granted to UK municipalities. The payments from the underlying assets securing a loan to DCL are received directly by DCL. Although this risk has not been addressed by the loan structure and there is no commingling reserve in place, due to the minimal size of this loan in the total cover pool (3%) and the short residual maturity of the loan, the commingling risk is deemed not to be material.

Set-Off Risk

Under French law, legal set-off cannot be invoked following the notification to the borrower that the loan has been transferred to the issuer. However, prior to such notification, a borrower could potentially set-off amounts due and payable under their loan. The set-off risk with LBP is mitigated by the notification, following the change of the domiciliary bank, for the payments to the French Treasury to be sent to the debtors immediately upon the sale of the asset and their inclusion in the cover pool. Since Caffil does not take deposits from public sector entities, the risk of borrowers initiating potential set-off procedures is also not deemed to be applicable to Caffil.

Claw-Back Risk

According to French law, any contract entered into by an SCF or for its benefit is not subject to claw back. The provisions allowing an administration to render certain transactions entered into during the hardening period (période suspecte) null and void are not applicable for transactions entered into by an SCF, provided that such transactions are made in accordance with their exclusive legal purpose and without fraud. The assignment of the assets to the cover pool was performed either via the direct origination of loans in the name of the issuer or by means of a bordereau, and the transfer (including any security relating to the loans) takes effect and becomes enforceable against third parties at the signing date of the bordereau. Consequently, Fitch considers claw-back risk to be remote under the SCF Law.

Availability of OC

According to the OF law, the ratio of assets (subject to certain weighting) to liabilities must be at least 102% at all times. Caffil commits itself to a minimum regulatory coverage ratio of 105%. The credit enhancement for the OF is made up of a non-privileged loan of EUR6.8bn provided by Sfil as of September 2013.

Liquidity Gaps and Systemic Risk

Fitch has assessed the liquidity gaps and systemic risk as ‘Moderate’, driven by the legislative protection for OF, which stipulates that the cover pool must contain sufficient liquid assets to cover net negative cash flows over a rolling six-month period, but has a wide definition of liquid assets, including assets eligible to repo operations with the Eurosystem.

As with most covered bond programmes, the incoming cash flows from cover assets do not exactly match, at all times, the cash outflows on the liabilities. Liquidity shortages may therefore arise, especially just before the maturity of an OF.

The agency assumes the time needed to liquidate the cover assets to be a function of the debtor/guarantor type, instrument type and asset location (please see the criteria report *Covered Bonds Rating Criteria – Public Sector Liquidity and Spread Assumption Addendum*, dated 1 February 2013).

Caffil’s potential liquidity needs over the 12-month period starting from November 2013, calculated on a quarterly basis, cannot be fully covered by the cover assets classified as the most liquid class two. The liquid class two assets are assumed to be liquidated within one month in a stressed environment following an issuer default. This class of assets mainly consists of bonds that benefit from a state guarantee. In its analysis, Fitch relies on Caffil’s ability to obtain temporary financing from repoing cover assets directly with the Eurosystem, via an account in its own name at the Banque de France. As of November 2013, around 65% of Caffil’s assets were eligible for such repo transaction. The agency gives additional credit to the ability of Caffil to repo its own covered bonds (up to 10%) within the Eurosystem. Consequently, short-term liquidity gaps are mitigated by the issuer’s rapid access to additional liquidity.

Systemic Risk

France has a sovereign rating of 'AA+'/Stable/'F1+'. According to Fitch's covered bond rating criteria, the D-Cap is therefore not constrained by systemic risk considerations.

Systemic Alternative Management

Fitch has assessed the level of risk under systemic alternative management as 'Low'. An SCF subcontracts all its operational tasks to a third-party credit institution, and it is the responsibility of the SCF's board to renew or replace the management contract, though the French law on OF does not explicitly provide for the replacement of the original manager. It only specifies that, in case of the insolvency of the institution managing the SCF, the management contract can be revoked immediately (unlike the general French bankruptcy law, whereby the insolvency administrator of the managing institution could insist on the management contract staying in place). Nevertheless, the fact that the assets securing the covered bonds are already segregated in a separate legal entity — rather than being part of the balance sheet of a larger institution — should facilitate the task of the alternative manager.

Cover Pool-Specific Alternative Management

Fitch has assessed the level of risk under cover pool alternative management as 'Moderate', reflecting the quality of Caffil's systems and processes and the specificities of managing the underlying assets.

To manage its covered bonds business, Caffil uses an IT system which is highly developed for internal use, although the underlying system is standard in the market. The system has been inherited from DCL and is currently undergoing a separation process between DCL and Caffil, which is due to be completed in 2Q14. Once the IT system has been separated it will be further adjusted in accordance with specific internal needs. LBP uses the same IT system as Caffil, thus facilitating the process of asset transfer between the entities. Cash flows, future payments from the cover assets, as well as those due on the privileged debt can easily be extracted from the IT systems.

In Fitch's opinion, the nature of Caffil's assets would make it more difficult for a third-party administrator to take over than in the case of other, more standard public sector cover pools. The cover pool includes risky loans, for an amount of EUR8.0bn as of September 2013. These loans are structured products originated before the 2008 financial crisis, linked to foreign interest rates or currencies and, to large extent, have an esoteric hedging structure. Following a number of legal cases raised by French municipalities against the issuer to reduce the interest burden associated with these loans, Caffil is actively restructuring these sensitive loans into plain vanilla ones. The restructuring process involves a significant level of cooperation between the issuer, the borrower and the respective swap counterparties.

This complexity of managing Caffil assets and liabilities is compounded by the very large number of assets (in total 55,722 assets) spread across multiple jurisdictions and the need to keep track of several hundred individual publicly and privately placed OF, as well as numerous swap contracts.

Following the completion of Dexia's restructuring process, Fitch no longer treats Caffil's programme as being in wind-down, as new OF have been issued in the market since 2Q13.

Privileged Derivatives

Fitch has assessed the privileged derivatives component as 'Moderate high', driven by the materiality of the exposure, the complexity of the hedging, and partial compliance with Fitch's covered bonds counterparty criteria.

Caffil enters into different swap agreements to hedge against interest rate and currency risks. All the assets and liabilities are swapped into a three-month Euribor euro-denominated rate and are then swapped into EONIA to eliminate basis risks.

Caffil has entered into swap agreements with 27 external counterparties. Upon completion of Dexia's restructuring, Sfil replaced DCL in all derivative transactions entered between DCL and Caffil (ex-DMA) and remains the sole internal swap counterparty. While replacement language is in place in six external agreements, it is not fully compliant with Fitch's counterparty criteria. The swap agreement with Sfil has, however, been updated and the replacement language has been brought in line with Fitch's applicable criteria.

Should a counterparty be downgraded below 'F1+', the swap documentation provides that such counterparty will post collateral on a weekly basis if rated at least 'A-', and on a daily basis if rated below 'A-'. Collateralisation takes place on a unilateral basis, if the market value of the swap is in favour of Caffil. As only the mark-to-market of the swap is posted, without a volatility cushion, the breakeven OC for the assigned rating may increase. Termination costs due to a defaulting swap counterparty rank pari passu with the covered bonds under the SCF legislation, and are deemed to be material. Currently, Caffil owns sufficient liquid assets to mitigate such potential termination payments to privileged derivative counterparties; however, there is no dynamically adjusted protection against this risk.

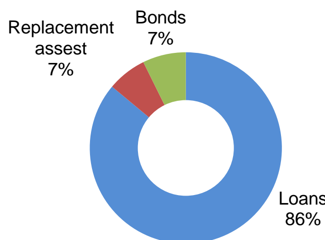
Cover Pool

As of November 2013, the cover pool consisted of over 55,722 assets for a total outstanding balance of EUR63.8bn. These assets are debt securities or loans advanced to public bodies or fully guaranteed by public entities (92.7%) and replacement assets (7.3%), as shown in Figure 6.

Over 2Q13, Caffil had modified the profile of its cover pool by divesting its securitisation notes. As a part of this decision, Caffil sold its ABS exposures on Italian and Belgian local governments to its parent company. As of December 2013, Italian securitisation notes formerly part of the cover pool and guaranteed by Dexia Crediop S.p.A. were unwound and the underlying assets transferred to Caffil. In its analysis, Fitch modelled the increased direct exposure to Italian local authorities, compared to its previous reliance on the guarantor's creditworthiness.

Figure 5

CAFFIL's Pool Breakdown by Asset Type, Sep 2013



Source: Caffil

Caffil has started to refinance loans to French local and regional governments originated by LBP and a first transfer of these loans, totalling EUR516.2m, to the cover pool was completed in September 2013.

In line with new eligibility criteria for assets transferred to Caffil's cover pool, the concentration of loans granted to French public sector entities will continue to increase, while international exposures will be reduced via the natural amortisation of these assets and strategic divestment decisions.

Over a fifth of the loans in Caffil's total cover pool has a complex interest rate structure, with 55% of these considered to be more risky ones, for an overall amount of EUR8.0bn as of September 2013. Prior to the financial crisis of 2008, the structured loans were widely offered to French local authorities and were popular products featuring an interest rate linked to foreign currencies, commodities indices, or levels of leverage. With the financial crisis and the consequent volatility in the markets, the servicing of these loans became very expensive and uneconomical for public entities.

Currently, the French government is taking active measures to find a lasting solution to this problem. It is in the process of creating a multi-year national support fund to allow local governments to finance the unwinding of sensitive loans — the details of which are yet to be decided — as well as making amendments to the law to prevent the absence of an effective interest rate being invoked as grounds for litigation cases. As part of its own initiative, Caffil is targeting the most risky loans by providing additional funding to the borrowers to refinance the transformation costs of turning structured loans into plain vanilla loans.

In its analysis, Fitch does not size for the potential risk of significant termination payments being borne by the SCF in the event of a simultaneous restructuring of a large part of the sensitive loans. Fitch however takes comfort from the current initiatives undertaken by the French government and the issuer to address this matter and the agency does not expect a disorderly default of these loans in a stress scenario, as reflected in the rating of the French sovereign.

Figure 6

Fitch Default Model Output (%)

Rating level	RDR	RRR	RLR
AA+	21.1	46.9	11.2
AA	19.2	47.9	10.0

RDR – Rating default rate
RRR – Rating recovery rate
RLR – Rating loss rate
Source: Fitch

Collateral Credit Analysis

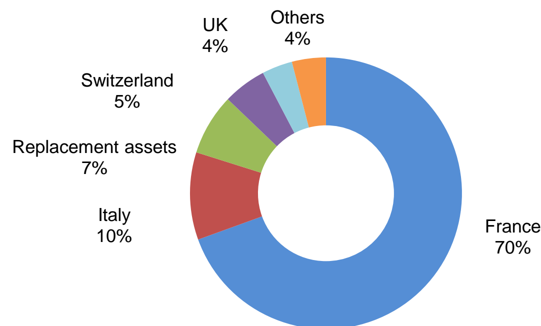
Fitch's credit analysis is based on line-by-line data provided by the issuer as of 30 September 2013 and was conducted in line with Fitch's asset analysis criteria, published on 30 January 2013 (please see *Asset Analysis Criteria for Covered Bonds of European Public Entities*). The agency derived a stressed cumulative default rate and recovery rate for the cover pool. Figure 7 summarises the findings of Fitch's credit analysis in different rating scenarios.

The credit analysis is based on Fitch's Portfolio Credit Model (PCM), which is used to derive a distribution of portfolio default and loss rates. The inputs for PCM consist primarily of the creditworthiness of the obligors, as indicated by their individual ratings, their assumed recovery rates and the asset amortisation profiles. Fitch assesses the individual credit quality of each obligor or guarantor included in the pool. The agency first takes into account Fitch's public ratings of the obligors/guarantors if available, or if not available, the lowest of the other publicly available ratings. Lastly, in the absence of any rating, the agency will apply internal credit opinions from Fitch's International Public Finance (IPF) team.

Caffil's portfolio is internationally diversified, with a total exposure to 13 countries located across Europe, America and far-East Asia. Over two thirds of the portfolio is concentrated in France, with Italy and Switzerland being the next largest exposures, as outlined in Figure 8.

Figure 7

Caffil's Pool Geographical Breakdown, Sep 2013



Source: Fitch

As the French exposure dominates the cover pool, with 70% of the total, the OF rating on a probability of default (PD) basis is credit-linked to the French sovereign rating. Although the OF rating could exceed the French sovereign, based on recovery given default, this would coincide with high defaults (80%) and low (15%) recoveries on French local authority debt, which would not be compensated for by the level of OC given credit to by Fitch. Under a 'AA+' scenario in its PCM analysis, Fitch does not assume a default of the French sovereign, but rather assesses the individual probability of default of sub-national obligors under the assumption that the sovereign is still solvent.

Given that Caffil's multi-jurisdiction portfolio is concentrated within the eurozone, Fitch assumes there to be a high contagion risk between sovereign entities should one of them default. In line with its applicable criteria, the agency groups eurozone countries together and assumes that if one eurozone country defaults, then all other eurozone countries with a lower rating than the defaulting country will also default. Hence, the probability of default of Caffil's portfolio in a 'AA+' scenario is largely driven by the heightened probability of default of lower-rated sovereigns, such as Italy (BBB+/Negative) and respective sub-sovereign debtors.

Consequently, the overall credit quality of the cover pool has worsened, due to the increased direct exposure to the Italian local and regional governments and the revision of Fitch's assumptions on the default probability of French and UK municipalities following the downgrade of both sovereigns to 'AA+' from 'AAA' in 2013. The WA rating of the cover pool is now equivalent to 'BBB-'.

Cash Flow Analysis

According to French law, OF remain payable at their scheduled maturity upon an issuer's insolvency. This leads to a sequential distribution of recoveries from the cover pool in the event of a covered bond default. In such case, Fitch assumes an ongoing allocation of funds from the cover pool towards the full payment of the covered bonds in their chronological order of maturity. For other programmes where a covered bond default causes the cross default of all outstanding covered bonds, Fitch models a pro-rata allocation of recoveries in the event of a default.

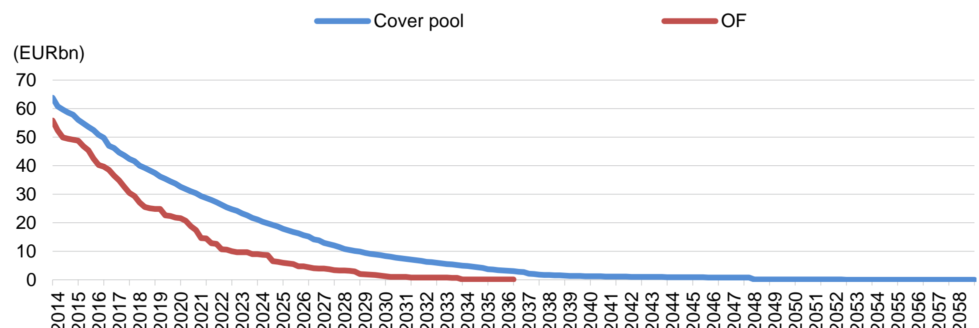
To model recoveries given default on Caffil's OF, the agency compared: (i) the present value of the remaining cover assets' cash flows, discounted at a current interest rate curve plus one-half of the refinancing spread in the targeted rating scenario; to (ii) the present value of the remaining OF, discounted as per the same interest rate curve. Comparisons were made starting from the time the OF had amortised to 10% of total current outstanding amount.

The expected cash flows from the assets were modified to reflect Fitch's prepayment, servicing and management costs, delinquencies, defaults and recovery assumptions in stressed scenarios and to simulate different issuer default timings. Fitch does not apply additional stresses on interest rates as the reference IDR is sufficiently high (ie at least 'AA'/'F1+', as per agency's *Covered Bonds Rating Criteria*).

Based on the cover pool composition, Fitch assumed the refinancing spread in a 'AA+' scenario is about 360bp (for more information, please see the criteria report entitled *Covered Bonds Rating Criteria – Public Sector Liquidity and Spread Assumption Addendum*).

Fitch checked that the level of OC given credit to under the programme would provide more than 51% recoveries on defaulted covered bonds in a 'AA+' scenario under its applicable methodology. This is commensurate with covered bonds being rated one notch above the reference IDR under Fitch criteria.

Figure 8
Amortisation Profile



Source : Caffil

Figure 9
Maturity Mismatches

Weighted average asset remaining life (years)	8.3
Weighted average liability remaining life (years, called at the earliest call date)	5.4

Source: Caffil

Maturity Mismatches

The redemption profile of the OF does not match the amortisation of the cover pool. The cover pool comprises predominately amortising loans as well as bullet bonds, with a WA remaining life (WAL) of around 8.3 years, while the outstanding OF have a WAL of around 5.4 years. As a result, temporary surpluses or shortfalls in funds could arise in an amortisation scenario.

Fitch assumes that any cash not needed to repay liabilities is reinvested within a deposit account, at an assumed rate of 50bp below three-month Euribor. In case of a liquidity shortfall, Caffil is assumed to follow the above mentioned time subordinated allocation of funds from the cover pool.

Interest Rate and Currency Mismatches

Caffil enters into different swap agreements to hedge against interest rate and currency risks. Fitch gives full credit to the existing hedging structure and models post-swap cash flows in its analysis.

The improvement in the reported post-swap margin on the liability side has a positive impact on the break-even OC level for the rating. Fitch also expects an increase of the WA margin on the asset side, as new loans that are transferred to the cover pool are priced in accordance with the then current market conditions.

Cash Flow Model Output

Fitch has calculated a break-even OC of 7.5% for the ‘AA+’ rating, compared to 9.8% at ‘AAA’, previously. As of November 2013, Caffil's EUR55.7bn outstanding public sector OF were secured by a cover pool of EUR63.8bn, resulting in nominal OC of 14.4%. In its analysis, Fitch relies upon the lowest nominal OC in the past 12 months from November 2012 (14.4%). The break-even OC for the rating will be affected, among others factors, by the profile of the cover assets relative to outstanding covered bonds, which can change over time, even in the absence of new issuances. Therefore, it cannot be assumed that a given level of OC supporting the assigned rating will remain stable.

Rating Outlook

Fitch has assigned a Stable Outlook to the covered bond rating, reflecting both the Stable Outlook on the French Sovereign and on the reference IDR.

Rating Sensitivity

The ‘AA+’ rating would be vulnerable to a downgrade if either of the following occurs: (i) the French sovereign’s IDR is downgraded by one notch to ‘AA’; or (ii) the OC level decreases below 7.5%, which is the minimum OC for a 'AA+’ rating on the covered bonds. A drop in OC to the 5% commitment by Caffil would lead to a downgrade of the OF by one notch to ‘AA’, in line with the reference IDR.

Ongoing Programme Review

The agency will periodically review the credit quality of the cover pool and perform a cash flow analysis to assess whether the current OC provides protection against identified risks commensurate with the rating of the OF issued by Caffil under this programme. Cover pool and OF information will be displayed on Fitch’s covered bond surveillance tool (available at www.fitchratings.com) and updated regularly.

Appendix 1: Cover Pool Statistics and Liabilities

Figure 10

Cover Pool and OF as of 30 September 2013

	Assets	Liabilities
Outstanding balance (EURbn)	64.4	55.8
Bonds (% by loan amount)	9.6	95.5
Loans (% by loan amount)	90.4	4.5
Pre-swap positions (%)		
Floating rate	29.4	7.7
Fixed rate	45.1	78.0
Convertible rate	25.5	14.3
EUR denomination	92.4	85.9

Source: Fitch/Caffil

Appendix 2: Legal Framework

Figure 11

Main Characteristics of French Obligations Foncières

Code Monétaire et Financier (January 2011)

Issuers	The issuer can only be a Société de Crédit Foncier (SCF). This is a credit institution with the status of a finance company, ie it is not allowed to take deposits like a fully-fledged bank. The exclusive purpose of an SCF is to grant or acquire real estate loans, loans to public entities and securities, and to finance these assets either with privileged bonds known as Obligations Foncières (or other resources, the contracts of which mention the privilege), or non- privileged resources. SCFs are forbidden to hold equity interests in other companies.
Supervision	SCFs are under the supervision and control of the French Banking Authority, the Autorité de Contrôle Prudential (ACP). The SCF must send to the ACP an annual report relating the performance of its assets and its interest rate exposure. This must be published in the Bulletins des Annonces Légales Obligatoires (BALO) within 45 days after the SCF's accounts have been approved by the relevant body. The ACP also sets criteria for the calculation of the coverage ratio and checks its value twice a year. It gives its agreement for the appointment of a specific controller and can dismiss them.
Public sector assets	Public sector collateral can be: • exposures to states, regional and local authorities, or public entities within the EEA, the EU or countries benefiting from the highest rating grade by an agency approved by the ACP; • exposures to development banks or international organisations benefiting from the highest rating grade; and • exposures to regional and local authorities or public entities benefiting from the second highest rating grade by an agency approved by the ACP. These assets cannot exceed 20% of the total OFs outstanding. Debt deriving from leasing contracts, which a French public entity has entered into as a lessee, is also eligible.
Substitute assets	They can consist of deposits or loans to, or debt issued by, credit institutions rated at least 'AA-', or 'A-' if the exposure does not exceed 100 days. Replacement assets cannot exceed 15% of the total OF outstanding
Minimum OC	The NPV of the cover assets must be a minimum 2% higher than that of the outstanding OF, including interest and principal obligations, at all times.
Specific controller	A specific controller must be appointed by the SCF's management, with agreement of the ACP. The controller is responsible for the SCF's compliance with legal requirements. She/he will verify that the coverage ratio is compliant with the law. In that respect, the controller checks the quarterly issuance programme of the SCF and approves any new issuance of more than EUR500m. The controller must also comment on the appraisal method used by the SCF. This is done annually. The appraisal and the comments are published. The controller will also check that the duration mismatches are not excessive and the eligibility of the assets in the pool. The specific controller must send an annual report to the ACP and to the board of directors of the SCF. The controller is liable for any mistakes made in the performance of her/his duties.
Assignment of loans	The assignment of loans to an SCF takes place by means of a bordereau signed by the parties; the transfer (including any security relating to the loans) takes effect and becomes enforceable against third parties at the signing date of the bordereau.
ALM and servicing	Loan servicing and ALM must be contracted out to a credit institution acting on behalf of, and for the account of, the SCF, which will also represent it in legal proceedings. Debtors must be informed of a change of servicer by post.
Privilege	The OF enjoy a preferential claim over all the assets of the SCF, including any hedging instruments. In addition, any expenses due on the operations will rank pari passu with the OF. In the event of the insolvency of an SCF (règlement amiable, redressement judiciaire or liquidation judiciaire): • the OF (interest and principal) are redeemed at their due date (no acceleration of payments). No other creditors can claim nor will they receive payments (including interest payments) until debt owed to the holders of Obligations Foncières has been fully paid.
Swaps	SCFs can enter into hedging contracts that also benefit from the privilege if the hedge covers either the assets or the Obligations Foncières. If they hedge non- privileged resources, they do not have the benefit of the statutory privilege.
Liquidity	Requirement to cover principal and interest payments on the OF and sums due to swap counterparties for a period of 180 days, taking into account all cash flows expected on the cover assets and other eligible assets to be granted as collateral with the Banque de France, or by entering into refinancing agreements with credit institutions benefiting from the highest level of short-term credit quality, established by an external rating agency recognised by the ACP.

Source: Fitch

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