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Transaction Update: Caisse Française de Financement Local (Obligations Foncières)

Obligations Foncières Backed By Public Sector Assets

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Ratings Detail

Ratings List		
Description of the covered bonds	**Credit rating***	**Outstanding amount of covered bonds (bil. €; as of Sept. 30, 2012)**
Caisse Francaise de Financement Local	AAA/Negative	61.5

*Standard & Poor's ratings addresses timely payment of interest and ultimate payment of principal on the final maturity date.

Rating And Outlook

On Feb. 1, 2013, Standard & Poor's Ratings Services raised to 'AAA' from 'AA+' and removed from CreditWatch negative its credit ratings on Caisse Française de Financement Local's public-sector covered bond program and related series of covered bonds (obligations foncières) issued under the program (see "Ratings On Caisse Française de Financement Local's Public-Sector Covered Bonds Upgraded To 'AAA' On Completion Of Sale," published on Feb. 1, 2013). Our rating actions followed the sale of Dexia Municipal Agency to the French government-sponsored bank Société de Financement Local, on Jan. 31, 2013. Following the sale, Dexia Municipal Agency has been renamed Caisse Française de Financement Local.

Our rating actions reflected our assessment of the improvement in the issuer's creditworthiness following the sale, which, in our view, more than offsets the effect of counterparty risk that led us to keep the ratings on CreditWatch negative on Jan. 9, 2013 (see "Ratings On Caisse Francaise de Financement Local's Public-Sector Covered Bonds Upgraded To 'AAA' On Completion Of Sale," published on Jan. 9, 2013).

The negative outlook on the ratings on the covered bonds reflects the negative outlooks on the ratings on France (unsolicited; AA+/Negative/A-1+) and on Société de Financement Local (AA+/Negative/A-1+).

Program Update

On Jan. 31, 2013, Société de Financement Local acquired Dexia Municipal Agency, the public-sector covered bond issuer previously owned by Dexia Crédit Local. Dexia Municipal Agency has been renamed Caisse Française de Financement Local. The key points of the sale, which are relevant to our analysis of the covered bonds, are as follows:

- The legal and regulatory framework of the issuer, including its set-up as a "société de credit foncier," are unchanged.
- The current cover pool of assets supporting the covered bonds has not changed as a result of the sale. Over time, the foreign exposures will be wound down as they reach their maturity, and the portion of loans to French local

authorities and hospitals will increase gradually toward 100%, from almost 70% as of Sept. 30, 2012.
- Société de Financement Local will manage the cover pool. A joint venture, co-owned by La Banque Postale and Caisse des Dépots et Consignations, will originate new loans to French local authorities and hospitals. Société de Financement Local will have a core of staff transferred from Dexia Crédit Local, who were previously employed in the management of Dexia Municipal Agency's cover pool.
- Caisse Française de Financement Local will enter into derivative contracts with Société de Financement Local. We understand that these swaps will include a replacement framework consistent with our criteria for assessing counterparty risk (see "Counterparty Risk Framework Methodology And Assumptions," published on Nov. 29, 2012, and "Covered Bonds Counterparty And Supporting Obligations Methodology And Assumptions," published on May 31, 2012). Initially, these swaps will replace those previously signed by Dexia group entities. There will remain swaps with external counterparties, most of which will not contain a replacement framework to mitigate counterparty risk. As swap termination payments are not subordinated, there exists a risk, in our view, that one of these counterparties could default and that the issuer would owe it a (potentially material) termination payment that would rank pari passu with covered bond payments (see "Counterparty Risk Analysis").
- An unlimited credit facility provided by Société de Financement Local will finance the overcollateralization supporting Caisse Française de Financement Local's covered bonds. In our view, Société de Financement Local's obligation to provide sufficient liquidity to Caisse Française de Financement Local to meet its obligations, by funding this facility, creates an effective payment obligation of Société de Financement Local on the covered bonds.

Rationale

The covered bond rating process employed primarily follows the methodology and assumptions outlined in our "Covered Bond Ratings Framework" criteria, published on June 26, 2012.

Legal and regulatory risk analysis

We have assessed legal risk using our "European Legal Criteria For Structured Finance Transactions," published on Aug. 28, 2008. Following the sale of Dexia Municipal Agency to Société de Financement Local, Caisse Française de Financement Local remains incorporated as a "société de crédit foncier" (SCF), and is licensed to issue covered bonds (obligations foncieres) under French law. In our view, the sale has not modified the legal framework of the transaction. We continue to consider that the French covered bond legal framework supports the segregation of collateral assets in favor of covered bondholders. This is supported by the following points in particular:

- Under French covered bond law, all covered bonds benefit from a "privilege," meaning that bondholders have preferred creditor status and the right to be paid prior to other creditors. All covered bonds thus rank pari passu with each other.
- The SCF is committed by law to maintain two per cent of overcollateralization and sufficient liquidity (in the form of repo-eligible assets, for example) to cover liquidity needs for the next 180 days. This mitigates the risk of payment disruptions in the short-term aftermath of a default of the parent bank.
- The SCF is a special-purpose bank and is eligible for repo operations with the French Central Bank (Banque de France). Indeed, Dexia Municipal Agency has used this repo mechanism in the past; therefore the operational set-up is already in place. This supports the SCF's ability to make timely payments on covered bonds after the default of the parent bank.

Operational and administrative risk analysis

We have conducted a review of origination, underwriting, and collection and default management procedures for Caisse Française de Financement Local's cover pool assets. The stock of existing loans owned by Caisse Française de Financement Local will be serviced by Société de Financement Local. Staff and information technology systems will be migrating from the previous servicer, Dexia Crédit Local, to Société de Financement Local. New eligible loans will be originated by a joint venture operated by La Banque Postale and Caisse des Dépots et Consignations. The transfer of such new loans into Caisse Française de Financement Local's cover pool will be subject to the same credit criteria as have been used to select cover pool assets historically. In our view, the operational framework after the sale of Caisse Française de Financement Local to Société de Financement Local is broadly unchanged.

Asset credit quality analysis

We have reviewed the latest available asset information, as of Sept. 30, 2012. We understand that the cover pool composition has remained stable since that date, and that the analysis of this data is therefore representative of the current asset credit risks existing in the cover pool.

Our credit analysis of the cover pool includes an exposure review of the underlying borrowers to estimate the credit risk of each individual exposure. Based on our correlation assumptions between the cover pool assets, we generate a gross default probability for the target rating through a Monte Carlo simulation, using Standard & Poor's CDO Evaluator. We then use the derived default probability as an input for the cash flow analysis. As of Sept. 30, 2012, the resulting scenario default rate (SDR) for Caisse Française de Financement Local's cover pool was 25.13%.

Our approach to recoveries following the default of a public-sector borrower is set out in our criteria article "Surviving Stress Scenarios: Assessing Asset Quality of Public Sector Covered Bond Collateral," published on Sept. 30, 2003. In case of financial difficulties, public-sector issuers can often rely on some support from the sovereign or other level of government. This support is not necessarily timely, or given through an explicit guarantee. For public-sector entities located in European jurisdictions where the sovereign has an investment-grade rating, we assume that ultimate recoveries following a default would be high, but only recovered after a significant delay. Over this period, the cover pool would rely on cash flows received from performing assets to service covered bonds. We assess the effect of delayed recoveries in our cash flow analysis.

The cover pool includes structured loans to French local authorities. As of Sept. 30, 2012, the total outstanding balance of these loans was €16.1 billion. We note that certain French local authorities with financial difficulties have sued Dexia Crédit Local, who originally marketed these loans. We understand however that Société de Financement Local will be managing the risk on these loans, and that to-date unpaid amounts remain minimal--the total balance of loans in arrears in the cover pool as of Sept. 30, 2012 were 0.13% of the total cover pool balance.

The cover pool also includes securitizations, which Dexia Crédit Local has used historically to transfer portfolios of loans to Belgian and Italian local authorities, inter alia. We understand that these exposures will no longer constitute inter-group securitizations, and that they will be wound down as the underlying loans amortize.

Asset-liability maturity mismatch risk analysis

We have reviewed the asset and liability cash flow information provided as of Sept. 30, 2012. We have applied our five-step approach for rating covered bonds, as outlined below (for further details see "Revised Methodology And

Assumptions For Assessing Asset-Liability Mismatch Risk In Covered Bonds," published Dec. 16, 2009).

We uplift the covered bond ratings from the issuer credit rating (ICR) on Société de Financement Local (AA+/Negative/A-1+), for which we consider Caisse Française de Financement Local to be a core subsidiary. According to paragraph 73 of our criteria for assessing asset-liability maturity mismatch (ALMM) in covered bonds, we assign the first notch of uplift if the available credit enhancement covers all credit risks related to the default of the cover pool assets, under a 'AAA' stress scenario. As of Sept. 30, 2012, the available credit enhancement of 14.71% was greater than the credit enhancement of 2.50% which, in our view, would cover all risks other than ALMM risks under a 'AAA' stress scenario. As a result, Caisse Française de Financement Local's covered bonds can achieve at least a one notch uplift above the rating on Société de Financement Local, and can therefore reach a 'AAA' rating. We consider that Société de Financement Local is sufficiently rated at 'AA+' to manage ALMM risk in Caisse Française de Financement Local's covered bonds to a 'AAA' level. Any changes in the ALMM risk classification of Caisse Française de Financement Local's covered bonds would not impact the covered bond rating, all else remaining equal.

We note that the ALMM risk classification under our criteria has increased to "Moderate" from "Low". In our view, this is a result of the interruption of issuance activity over the last two years, which has led to approaching maturities not being refinanced through longer-dated issuance, and therefore to an increasing maturity mismatch between assets and liabilities. In our opinion, this maturity mismatch will gradually reduce when Caisse Française de Financement Local begins to issue again.

We also note that cash received as collateral from derivative counterparties is fungible with the cash used in the operations of Caisse Française de Financement Local, in particular to purchase cover pool assets and finance overcollateralization. In our view, the reimbursement of this collateral constitutes a privileged obligation of Caisse Française de Financement Local. We therefore model the full short-term reimbursement of the collateral alongside covered bond payments in the first quarter of our covered bond cash flow analysis.

Country risk

Under our nonsovereign ratings criteria, we take into account the covered bonds' exposure to country risk through the related sovereign in the eurozone (European Monetary Union; see "Nonsovereign Ratings That Exceed EMU Sovereign Ratings: Methodology And Assumptions," published on June 14, 2011). We consider that the public sector exposures in Caisse Française de Financement Local's portfolio have a high sensitivity to country risk, and that the concentration of nearly 70% of French public sector assets represents a high exposure to French sovereign risk. Our nonsovereign ratings criteria cap our ratings on Caisse Française de Financement Local's covered bonds at one notch above the sovereign rating on France.

Counterparty risk

Under our criteria for assessing counterparty risk in covered bonds, we cap the ratings on Caisse Française de Financement Local's covered bonds at one notch above the rating on Société de Financement Local. We understand that there are derivative agreements in place with unsubordinated termination payments, and no replacement framework exists that is consistent with our current or previous counterparty criteria. The total notional amount of these derivative agreements represents significantly more than the 5% materiality threshold under our criteria. We see a risk that a swap counterparty could default while in-the-money, and be owed a substantial termination payment, which would be due immediately and would rank pari passu with covered bond payments. As of Dec. 31, 2012, this risk existed on derivative agreements with 23 different counterparties, and the largest exposure for a potential termination payment due to a single counterparty was approximately €1.4 billion. We consider however, that Société de Financement Local would cover such a liquidity need. The 'AA+' rating on Société de Financement Local allows Caisse Française de Financement Local's covered bonds to achieve a 'AAA' rating despite this risk. In the event of a downgrade of Société de Financement Local, Caisse Française de Financement Local's covered bonds would continue to be capped at one notch above the rating on Société de Financement Local.

Under our updated counterparty criteria, we regard the account bank risk and commingling risk to be mitigated by a weak link to the French Central Bank (Banque de France). As long as we believe France unlikely to exit the eurozone (European Economic And Monetary Union), we consider the Banque de France's credit standing to be indistinguishable from that of the European Central Bank. As the European Central Bank is currently rated 'AAA', this weak link does not currently limit the ratings on Caisse Française de Financement Local's covered bonds. The weak link does not remove account bank and commingling risk, but creates a link between the ratings on the covered bonds and that on an account bank (see "Assessing Credit Quality By The Weakest Link," published Feb. 13, 2012).

Rating

Our assessment of the risks described above allows Caisse Française de Financement Local's covered bonds to achieve a 'AAA' rating. We have therefore assigned a 'AAA' rating to the covered bonds, and removed the covered bond ratings from CreditWatch negative following the completion of the sale of Caisse Française de Financement Local to Société de Financement Local.

Outlook

The negative outlook on the covered bonds reflects the negative outlook on the ratings on France and on Société de Financement Local due to the country risk and counterparty risk rating caps described above.

If either or both of these entities were downgraded, the ratings on Caisse Française de Financement Local's covered bonds would continue to be capped at one notch above these ratings under our criteria for assessing counterparty risk and country risk, and would be downgraded as a result.

Key Credit Metrics And Cover Pool Information, Dec. 2011 To Sept. 2012

Table 1

Cover Pool Overview		
(€ mil.)	**Dec. 31, 2011**	**Sept. 30, 2012**
Public sector exposures	63,070	59,847
Asset-backed securities	10,328	8,360
Substitute collateral	1,372	517
Cash held at Banque de France	2,198	3,400
Total assets	76,968	72,123
Assets used for repo transactions	3,190	0

Table 2

Breakdown Of Asset-Backed Securities		
(€ mil.)	**Dec. 31, 2011**	**Sept. 30, 2012**
Securitizations guaranteed by originating entities*	6,319	4,678
Standalone securitizations	4,009	3,682
Total asset-backed securities	10,328	8,360

*Italian public-sector securitizations guaranteed by Dexia Crediop per la Cartolarizzazione; Belgian public-sector securitizations guaranteed by Belfius Bank (formerly Dexia Bank Belgium).

Table 3

Breakdown Of Substitute Collateral		
(€ mil.)	**Dec. 31, 2011**	**Sept. 30, 2012**
Covered bonds issued by Dexia LdG	1,350	0
Covered bonds issued by Dexia Sabadell	0	500
Cash on bank accounts	22	17
Total asset-backed securities	1,372	517

Table 4

Cover Pool Distribution By Country		
(% of total assets)	**Dec. 30, 2011**	**Sept. 30, 2012**
France	65	69
Italy	10	10
Belgium	10	7
Switzerland	6	5
UK	3	3
Spain	1	1
Germany	1	1
Other	4	2
Total	100	100

Table 5

Distribution Of Standard & Poor's Rating Assumptions On Cover Pool Assets, By Rating Category		
(%)	**Dec. 31, 2011**	**Sept. 30, 2012**
AAA	1	1
AA	9	8
A	24	22
BBB	49	52
BB	14	10
B	3	8
Total	100	100

Table 6

Cover Pool Credit Metrics		
	Dec. 31, 2011	**Sept. 30, 2012**
Largest individual exposure	5.2	5.2

Table 6

Cover Pool Credit Metrics (cont.)		
Top 5 exposures (%)	17.2	16.6
Top 20 exposures (%)	26.9	27.2
Weighted-average rating	BBB-	BBB-
Weighted-average maturity	9.2	8.8
Scenario default rate (%)	26.3	25.1
Asset default risk (%)	2.5	2.5

Note: Concentration metrics based on aggregation of assets transferred by securitization.

Table 7

Asset-Liability Maturity Mismatch (ALMM) Metrics

	Dec. 31, 2011	Sept. 30, 2012
Asset WAM	9.2	8.8
Liability WAM	5.8	5.4
Maturity gap	3.3	3.4
ALMM (%)	13.8	19.4
ALMM classification	Low	Moderate
Maximum uplift above issuer rating (notches)	7	6
Target credit enhancement for maximum uplift (%)	20.0	25.1
Target credit enhancement for first notch of uplift (%)	2.5	2.5
Available credit enhancement (%)	16.4	14.7

Table 8

Breakdown Of External Derivative Counterparties By Standard & Poor's Rating

(% of total nominal amounts of swaps with external counterparties)	Sept. 30, 2012
AAA	2
AA	17
A	77
Below A and not rated	3

Related Research

- Ratings On Caisse Francaise de Financement Local's Public-Sector Covered Bonds Upgraded To 'AAA' On Completion Of Sale, Feb. 1, 2013
- Ratings On Dexia Municipal Agency's Public-Sector Covered Bonds Kept On CreditWatch Negative Pending Completion Of Sale, Jan. 9, 2013
- Credit FAQ: What's Behind The Updates To The Counterparty Risk Criteria Framework And Related Criteria?, Nov. 29, 2012
- Various Rating Actions Taken On Eight European Covered Bond Programs Following Counterparty Criteria Update, July 12, 2012

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