

Transaction Update: Caisse Francaise de Financement Local (Public Sector Covered Bonds)

Obligations Foncières Backed By Public Sector Assets

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Ratings Detail

Reference Rating Level	aa	+	Jurisdiction-Supported Rating Level	aa	+	Maximum Achievable Covered Bond Rating	aa+	=	Covered Bond Rating	
Resolution Regime Uplift	0		Assigned Jurisdictional Support Uplift	0		Collateral Support Uplift	+1		AA+/Stable	
Systemic Importance	Very Strong		Jurisdictional Support Assessment	Very Strong		Overcollateralization Adjustment	-1		Rating Constraints	aa+
Resolution Counterparty Rating	N/A		Legal Framework	Very Strong		Liquidity Adjustment	0		Counterparty Risk	aa+
Issuer Credit Rating	AA		Systemic Importance	Very Strong		Potential Collateral Based Uplift	+2		Country Risk	aaa
			Sovereign Credit Capacity	Very Strong						

N/A--Not applicable.

*We apply the notches of uplift to the long-term rating on SFIL, to which we consider CaFFiL to be a core entity, to derive the ratings on the covered bonds.

Major Rating Factors

Strength	Weaknesses
<ul style="list-style-type: none"> Very high issuer credit rating (ICR) as a starting point for our notching up analysis. 	<ul style="list-style-type: none"> Counterparty risks constrain the covered bond ratings to one notch above the long-term ICR on Caisse Francaise de Financement Local SCF's (CaFFiL) parent bank, SFIL. Available credit enhancement is sufficient to support only a one-notch uplift above the long-term ICR on SFIL.

Outlook: Stable

The stable outlook on our covered bond ratings reflects the stable outlook on CaFFiL's parent bank, SFIL (AA/Stable/A-1+). We would automatically lower our ratings on the covered bonds should we lower our ICR on SFIL, or if the available credit enhancement were to drop below the level that is commensurate with 'AA+' ratings. We would raise our ratings on the covered bonds if we raised our long-term rating on SFIL and if the derivatives in the program were compliant with our counterparty criteria, and in both cases if the available credit enhancement led to the number of notches required for the rating uplift.

Rationale

We are publishing this transaction update following our annual review of CaFFiL's legislation-enabled public sector covered bond program.

In our analysis, we assume that the issuer's parent has defaulted and look to the resolution regime, the jurisdictional support, and the cover pool to repay the covered bonds. The ratings reflect the likelihood of the covered bonds being repaid in a timely manner on their legal final maturity.

From our analysis of the legal and regulatory framework for covered bonds in France, we have concluded that the assets in the cover pool are isolated from the risk of the bankruptcy or insolvency of SFIL. This asset isolation allows us to assign a higher rating to the covered bonds than our long-term ICR on SFIL.

SFIL is domiciled in France, which applies the EU's Bank Recovery and Resolution Directive (BRRD). We assess the systemic importance of covered bonds in France as very strong, under our "Assessments For Jurisdictional Support According To Our Covered Bonds Criteria," published on Nov. 27, 2020. A successful resolution of the issuer's parent increases the likelihood that the issuer would continue servicing its covered bonds without accessing the cover pool or receiving jurisdictional support, even following a bail-in of SFIL's senior unsecured obligations.

Our assessment of the expected jurisdictional support for CaFFiL SCF's covered bond program--which is primarily backed by French public sector loans--is very strong. This could result in a potential uplift from the reference rating level (RRL) of up to three notches (see "Covered Bonds Criteria," published on Dec. 9, 2014). However, the number of notches of uplift is constrained at the rating on the sovereign.

Based on the credit and cashflow information as of June 30, 2021, our analysis shows that the available credit enhancement—13.28%—is in line with one notch of collateral uplift, at 6.43% (6.46% in our previous review), but below the 18.70% target credit enhancement for the maximum potential collateral uplift. The covered bonds can therefore achieve a 'AA+' rating from a cash flow perspective.

Furthermore, counterparty risk caps our ratings on the covered bonds at 'AA+', one notch above the RRL.

There are currently no rating constraints to the rating relating to legal, operational and administrative, or country risks.

We have based our analysis on criteria articles referenced in the "Related Criteria" section

Program Description

Under the program term, CaFFiL issues covered bonds (obligations foncières), which are backed by a pool of exposures to public sector assets. As a société de crédit foncier (SCF), CaFFiL is licensed and regulated by the French banking regulator, Autorité de Contrôle Prudentiel et de Résolution.

The program was first established in 1999 as Dexia Municipal Agency, an entity of Dexia Credit Local. In 2013, Dexia Municipal Agency was sold to the new SFIL and the covered bond program, which from then on was entirely independent from Dexia Credit Local, was renamed CaFFiL. This change in name and ownership did not affect its status as an SCF. CaFFiL is therefore the refinancing arm of SFIL and as such fulfills a public role of providing affordable financing to French local authorities and, more recently, and still to a lesser extent, to support large French export contracts.

CDC, SFIL's new reference shareholder, confirmed its commitment in a letter of support, completed by a letter of support from the State, in the context of SFIL's continuing status as a state-owned development bank.

Table 1

Program Overview*	
Jurisdiction	France
Year of first issuance	1999
Covered bond type	Legislation-enabled
Outstanding covered bonds (bil. €)	51.24
Redemption profile	Hard bullet
Underlying assets	Public sector loans
Jurisdictional support uplift	0
Unused notches for jurisdictional support	0
Target credit enhancement (%)	18.70
Credit enhancement commensurate with 'AA+' rating (%)	6.43
Available credit enhancement (%)	13.28
Collateral support uplift	1
Unused notches for collateral support	0
Total unused notches	0

*As of Sept. 30, 2021.

Table 2

Program Participants			
Role	Name	Rating	Rating dependency
Originator	SFIL	AA	N
Originator	La Banque Postale	A+	N
Issuer	CaFFiL	AA	Y
Bank account provider	Banque de France	NR	Y
Bank account provider	Trésor Public (French sovereign)	AA	N
Bank account provider	Natixis S.A.	A	N
Bank account provider	La Banque Postale	A+	N

Table 2

Program Participants (cont.)			
Role	Name	Rating	Rating dependency
Bank account provider	Skandinaviska Enskilda Banken AB (publ)	A+	N
Bank account provider	Belfius Bank SA/NV	A	N
Bank account provider	Citibank N.A.	A+	N
Custodian	Société Générale Securities Services Luxembourg	NR	N
Swap counterparty	SFIL	AA	Y
Swap counterparty	ING Bank NV	A+	Y
Swap counterparty	Royal Bank of Canada	AA-	Y
Swap counterparty	Société Générale	A	N
Swap counterparty	Natixis S.A.	A	N
Swap counterparty	Natwest Markets PLC	A-	Y
Swap counterparty	BNP Paribas SA	A+	Y
Swap counterparty	JP Morgan Dublin PLC	NR	Y
Swap counterparty	JP Morgan Chase Bank NA	A+	Y
Swap counterparty	JP Morgan AG	A+	Y
Swap counterparty	Crédit Agricole Corporate and Investment Bank	A+	Y
Swap counterparty	Belfius Bank SA/NV	A	Y
Swap counterparty	Credit Suisse International	A+	Y
Swap counterparty	Deutsche Bank AG	BBB+	Y
Swap counterparty	Barclays Bank PLC	A	Y
Swap counterparty	HSBC Continental Europe	A+	Y
Swap counterparty	Morgan Stanley Capital Services LLC	A+	Y
Swap counterparty	Unicredit Bank AG	BBB+	Y
Swap counterparty	Goldman Sachs Mitsui Marine Derivative Products LP	AA-	Y
Swap counterparty	Bank of America NA	A+	Y
Swap counterparty	Bank of America Europe DAC	A+	Y
Swap counterparty	DZ BANK AG Deutsche Zentral-Genossenschaftsbank, Frankfurt am Main	A+	Y
Swap counterparty	Citibank Europe PLC	A+	Y
Swap counterparty	Barclays Bank Ireland PLC	A	Y
Swap counterparty	Banco Bilbao Vizcaya Argentaria S.A.	A	Y
Swap counterparty	Credit Agricole Corporate and Investment Bank	A+	Y

NR--Not rated. Y--Yes. N--No. Information as of September 2021.

Rating Analysis

Legal and regulatory risks

Under an SCF program, the issuer, a special-purpose entity licensed as a credit institution, issues "obligations foncières" (OFs), which are unsubordinated senior secured obligations and rank pari passu among themselves. OF-holders have recourse first to the issuer and, second, to the SCF's assets--the cover pool--over which they have a senior claim.

In our view, France's legal framework for OFs, defined in article L513-2 and related articles of the "Code Monétaire et Financier," sufficiently addresses the legal risk considerations highlighted in our covered bonds criteria such as asset isolation and the absence of bond acceleration, enabling us to rate the covered bonds higher than the issuer.

If the issuer becomes insolvent, OFs and other privileged debts, such as swaps, pay in accordance with their payment schedule, ahead of the SCF's other debts or nonprivileged creditors in relation to the SCF's assets.

Our legal analysis is based on our criteria "Asset Isolation And Special-Purpose Entity Methodology," published on March 29, 2017, and our covered bond rating framework criteria.

Operational and administrative risks

SFIL services the cover pool assets, which are recorded separately to ensure segregation from its own assets. Use of the cover pool assets for other purposes is restricted.

We have not identified any operational or administrative risks that would affect our assessment of the program. We consider the servicing and origination procedures to be in line with CaFFiL's peers. In addition, we believe that the bank's management is committed to maintaining an adequate level of overcollateralization (OC) for the covered bonds.

As a regulated entity, CaFFiL is subject to ongoing monitoring of its compliance with legal covenants from the contrôleur spécifique.

Our analysis of operational and administrative risks follows the principles laid out in our covered bonds rating framework criteria.

Resolution regime analysis

SFIL is headquartered in France, a jurisdiction that applies the EU BRRD resolution framework. We assess the systemic importance for French public sector covered bonds as very strong. This assessment means that the RRL can be two notches above the long-term ICR. As we consider the issuer to be a core entity of SFIL, we therefore uplift the rating on the bonds from SFIL's long-term ICR (AA/Stable/A-1+). The RRL is equal to the ICR, that is, 'aa'. This is because according to our covered bond criteria, if an issuer is a government-related entity, the RRL is typically equal to the ICR.

Jurisdictional support analysis

In our jurisdictional support analysis, we assess the likelihood that a covered bond program facing stress would receive support from a government-sponsored initiative instead of from the liquidation of collateral assets in the open market. We have assessed jurisdictional support for French public-sector covered bonds as very strong, reflecting that the program can receive up to three notches of jurisdictional uplift above the RRL.

However, as the rating on the sovereign (France: unsolicited AA/Stable/A-1+) caps the jurisdictional support uplift, and SFIL is rated at the same level as France, the covered bonds do not benefit from any notches of uplift, resulting in a jurisdiction-supported rating level (JRL) of 'aa'. Moreover, because SFIL is directly or indirectly 100% owned by the French state and benefits from an almost certain likelihood of extraordinary support from the government in the event of financial distress, we consider it extremely unlikely that these unused notches could ever be realized and conclude that there are no unused notches of jurisdictional support for ratings uplift.

Collateral support analysis

We analyzed loan level data as of June 30, 2021, and assessed the portfolio's credit quality by applying our criteria for rating covered bonds backed by public sector assets (see "Methodology And Assumptions For Assessing Portfolios Of International Public Sector And Other Debt Obligations Backing Covered Bonds And Structured Finance Securities," published on Dec. 9, 2014).

The pool comprises loans to public sector entities, the majority of which (over 87%) are French (see table 6). The pool also comprises substitute assets: bank bonds, loans to SFIL, and cash (see table 3). Cash is a non-defaulting asset that is not part of our credit analysis but is considered in our cash flow analysis.

Table 3

Cover Pool Composition				
	--As of June 30, 2021--		--As of June 30, 2020--	
Asset type	Value (mil. €)	Percentage of cover pool	Value (mil. €)	Percentage of cover pool
Public sector	56,760.22	97.73	55,035.86	95.01
Substitute assets	913.81	1.57	1,693.98	2.92
Cash	403.55	0.69	1,197.46	2.07
Total value	58,077.58	100	57,927.29	100

We assess asset credit quality using our 'AAA' stressed measure of the level of defaults--the scenario default rate (SDR)--and our measure of recoveries given default. We view French public-sector hospitals as central government-related entities, ruled and supervised by the central government and not by local and regional governments (LRGs). However, if a French hospital were to default on a loan, we expect that the defaulted debt would be restructured in a similar manner to that of an LRG, and would not be as marketable as defaulted sovereign debt. We also consider that French public-sector hospitals are very dependent on central government decisions, due to their limited revenue flexibility and rigid cost structures. These features similarly characterize French departments, which we assess as category B under our aforementioned criteria. We have therefore assessed our recovery assumptions for French public-sector hospitals as category B.

The SDR has slightly increased due mainly to the application of our methodology for granular pools defined for the analysis of the export refinancing loans. These are now 21 loans, with spread-out maturities to effectively 13 underlying borrowers which now represent 6.96% of the pool, growing from 1% three years ago. In the granular methodology we consider the credit rating of the underlying asset instead of that of the ultimate guarantor (France in this case). This results in a lower share for France, which has reduced from 5.87% to 0.54%. In last year's analysis, given that the pool was not sufficiently diversified (nine borrowers only) we used the non-granular methodology and therefore the credit substitution between the borrower and the French State, which resulted in a higher exposure to France. Using the granular methodology we consider the recovery coming from the guarantor on top of that of the underlying obligor, that is after the recovery of the corporate. Additionally, the assets' weighted-average life has increased and the top-20 concentration of obligors has decreased slightly, these factors being negative and positive, respectively. The assets' credit quality and the recovery rate have remained fairly stable (see tables 4, 5, and 7), although the recovery rate has increased marginally as a result of the application of the methodology for granular pools, explained above.

Table 4

Key Credit Metrics		
Public sector loans	As of June 30, 2021	As of June 30, 2020
Weighted-average loan asset maturity (years)*	7.57	7.19
20 largest obligors (% of cover pool)	19.38	20.01
Credit analysis results:		
Scenario default rate (%)	35.45	33.27
Weighted-average recovery rate (%)	77.47	77.25
Weighted-average time to recovery (years)	3.3	3.51
Largest obligor test result (% of covered bonds)	4.06	5.81
Largest industry test result (% of covered bonds)	2.58	2.41
Largest sovereign test result (% of covered bonds)	3.79	5.0
Largest T&C test result (% of covered bonds)	0	0

*According to the loan-by-loan collateral data maturity dates. N/A--Not applicable. T&C--Transfer and convertibility.

Table 5

Public Sector And Substitute Assets Distribution By Credit Assumptions		
	Percentage of cover pool excluding cash (%)	
Rating category (aggregate)	As of June 30, 2021	As of June 30, 2020
AAA	0.60	1.03
AA	5.93	10.58
A	21.39	20.67
BBB	56.93	57.10
BB	0.25	0.00
B or lower	14.90	10.62
Total	100.00	100.00

Table 6

Geographical Distribution		
	Percentage of cover pool (excluding cash)	
	As of June 30, 2021	As of June 30, 2020
France	84.54	87.67
Italy	7.36	7.71
Switzerland	2.21	1.24
Germany	0.81	0.65
Canada	0.66	0.61
Others	4.42	2.12
Total	100	100

Table 7

	As of June 30, 2021			As of June 30, 2020		
	'AAA' recovery rate (%)	Time to recovery (years)	Share of pool (%)	'AAA' recovery rate (%)	Time to recovery (years)	Share of pool (%)
Cat. A LRGs	90	4	50.68	90	4	50.61
French municipalities, communes urbaines, commune de communes, commune d'agglomeration			42.84			42.16
French regions			4.6			3.68
French social housing			1.55			1.78
Swiss assets			0.01			0.03
Other French LRGs			0.23			2.26
Other non-French LRGs			1.45			2.70
Cat. B LRGs	75	4	31.58	75	4	36.86
French department			13			12.11
French public hospitals			10.46			10.60
Italian assets (municipalities, region, province)			5.12			5.68
Other French LRGs			1.9			6.76
Other non-French LRGs			1.1			1.71
Sovereigns	37	0	5.65	37	0	8.26
France			0.54			6.13
Italy			1.99			2.03
U.K.			0			0.04
Portugal			0.01			0.02
Others			3.1			0.04
Non-LRGs			12.09			4.27
French non-LRGs secured	50	0	0.34	50	0	1.01
French non-LRGs unsecured	18	0	6.24	18	0	1.76
Other non-LRGs	18	0	5.51	18	0	1.50
Total/weighted-average	77.47	3.3	100	77.25	3.51	100

LRGs--Local and regional governments.

Our analysis of the covered bonds' payment structure shows that the cover pool assets' cash flows would be sufficient to make timely payments of interest and principal to the covered bondholders at a 'AA+' rating level.

We analyze the cash flows under our credit stresses, as well as under liquidity and interest rate stresses. We also run different default timing and prepayment patterns. We assume a servicing fee of 10 basis points.

The program is exposed to structural asset-liability mismatch risk as the covered bonds have bullet maturities. Our model simulates a stressed sale of assets whenever a liquidity gap occurs in our analysis. The discount applied for the assets in the program is 436 basis points, on top of the stressed interest rate at the time of the shortfall. This discount is a function of the nature of the assets and is outlined in our "Assessments For Target Asset Spreads According To Our

Covered Bonds Criteria" article, published Nov. 27, 2020.

Interest and currency mismatches are covered by swaps, which we took into account regardless of whether the swap contracts reflect our current counterparty criteria or not (see our "Counterparty risk" section).

The issuer uses the swap collateral received from counterparties to invest in the cover pool. As such, it is part of our asset cash flows. The issuer would need to return this collateral should rates move in the counterparty's favor or if the counterparty were to be upgraded such that no posting would be required under the documentation. This would result in a liability ranking pari passu with the covered bonds. We do not model this return of collateral in our calculation for the first notch of uplift, however, as we consider that it is captured by the one-notch cap above the RRL (see "Counterparty risk"). We include this return of swap collateral in our 'AAA' target credit enhancement calculation.

There are no structural mechanisms to allocate assets proportionately to each bond or to check for amortization. The bonds are never accelerated. There is therefore a risk of time subordination for bonds with later maturity dates if there is a cash shortfall. Our rating addresses the timely repayment of all bonds. All of the outstanding covered bonds are hard bullet.

Because there is an active secondary market for the assets in the cover pool, the program can potentially benefit from up to four notches of collateral-based uplift above the JRL, although the available credit enhancement currently limits such uplift.

Liquidity risk. We do not apply any adjustment for liquidity risk because the program covers 180 days of liquidity in application of the SCF regulation. The vast majority of assets in the cover pool are repoable with the Banque de France (BdF) with which the program is already registered, so that liquidity can be realized immediately from the cover pool.

Overcollateralization commitment. The program complies with the 5% regulatory minimum OC but this is not a dynamic figure and is below the OC commensurate with the current rating. We therefore deduct a notch for uncommitted OC from the maximum number of potential notches of uplift. This means that in order to benefit from one notch of collateral uplift, the program will need to cover 'AAA' credit risk, and to benefit from two notches of collateral uplift, it would need to cover 'AAA' credit risk and 75% of the refinancing costs.

Based on information provided as of June 30, 2021, our analysis shows that the available credit enhancement of 13.28% covers the credit risk at a 'AAA' level, allowing the program to achieve one notch of uplift above the RRL. The 'AAA' credit risk level is 6.43% (6.46% in our last review).

The target credit enhancement of 18.70% (20.64% in our previous analysis) has decreased due mainly to the lower probability of default and marginally higher excess spread.

We analyze cash flow risk according to our criteria for rating covered bonds backed by public-sector assets and our covered bonds criteria.

Table 8

Collateral Uplift Metrics		
	As of June 30, 2021	As of June 30, 2020
Asset WAM (years)*	7.86	7.94
Liability WAM (years)	7.13	6.66

Table 8

Collateral Uplift Metrics (cont.)		
	As of June 30, 2021	As of June 30, 2020
Available credit enhancement	13.28	12.77
Required credit enhancement for coverage of 'AAA' credit risk (%)§	6.43	6.46
Required credit enhancement for current rating ('AAA' credit risk (%))	6.43	6.46
Coverage of 'AAA' credit risk and 75% of refinancing costs (%)	15.63	17.10
Target credit enhancement for maximum uplift (%)	18.70	20.64
Potential collateral-based uplift (notches)	2	2
Adjustment for liquidity (Y/N)	N	N
Adjustment for committed overcollateralization (Y/N)	Y	Y
Collateral support uplift (notches)	1	1

*Based on the assets' consolidated amortizing profile. WAM--Weighted-average maturity.

Additional Rating Factors

Counterparty risk

We have identified several counterparty risks to which the covered bonds could be exposed. Some are structurally addressed, while others are not and therefore constrain the ratings on the bonds to 'AA+'.

Bank accounts. CaFFiL has several bank accounts. Typically these are swept daily, such that CaFFiL does not have an overnight credit exposure to the counterparty. CaFFiL is exposed to the credit risk of the BdF, as it holds cash there in an account that does not have any downgrade language. The ratings on the covered bonds are therefore weak-linked to the creditworthiness of BdF.

Commingling risk. The covered bonds are exposed to commingling risk stemming from the borrowers' payments to CaFFiL's accounts at commercial banks (which represent about 10% of the borrowers), as they would continue to do so even after the bank's default until instructed to redirect payments. We have therefore sized one month's worth of payment losses for these payments in our cash flow analysis.

Asset and liability swaps. From a counterparty risk perspective, there are two types of swaps in this transaction:

- Swaps with a related entity, SFIL, the documentation of which reflects our previous counterparty criteria (replacement option three). We consider that these swaps' counterparty risk is structurally mitigated and does not constrain the rating on the bonds. We take the hedges into account in our cash flow analysis.
- Swaps with unrelated entities that have no replacement framework or replacement frameworks from older criteria. Because swap termination payments are not subordinated to the payment on the covered bonds, and because the notional amount of these swaps is currently above the threshold defined in our covered bonds counterparty criteria, we account for the liquidity risk of these potential payments by limiting the ratings on the covered bonds to the higher of one notch above our RRL, and the outcome from the relevant table in our counterparty criteria. This results in a 'AA+' rating. As these swaps already introduce a cap to the ratings, we take the benefit of their hedges into account in our cash flow simulations.

Sovereign risk. We analyze sovereign risk under our structured finance sovereign risk criteria (see "Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions," published on Jan. 30, 2019).

This is a multi-jurisdictional pool of public sector assets. The issuer is located in France, which is part of a monetary union, and liquidity risk is covered for six months. The multi-jurisdictional treatment for covered bonds under the applicable criteria, including the supplemental tests—largest sovereign test and largest transfer and convertibility test, results in the rating on the program not being constrained by sovereign default risk.

Environmental, social, and governance factors We have not observed material changes in the exposure to ESG credit factors in the covered bond program since we published "ESG Industry Report Card: Covered Bonds," on Nov. 9, 2020.

Related Criteria

- Environmental, Social, And Governance Principles In Credit Ratings, Oct 10, 2021
- Criteria | Structured Finance | General: Counterparty Risk Framework: Methodology And Assumptions, March 8, 2019
- Criteria | Structured Finance | General: Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions, Jan. 30, 2019
- Legal Criteria: Structured Finance: Asset Isolation And Special-Purpose Entity Methodology, March 29, 2017
- Global Investment Criteria For Temporary Investments In Transaction Accounts, May 31, 2012
- Global Derivative Agreement Criteria, June 24, 2013
- Methodology And Assumptions For Assessing Portfolios Of International Public Sector And Other Debt Obligations Backing Covered Bonds And Structured Finance Securities, Dec. 9, 2014
- Covered Bond Ratings Framework: Methodology And Assumptions, June 30, 2015
- Covered Bonds Criteria, Dec. 9, 2014
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Global Covered Bond Insights Q4 2021, Dec. 13, 2021
- Covered Bonds Outlook 2022, Dec. 9, 2021
- S&P Global Ratings Definitions, Nov. 10, 2021
- French Covered Bond Market Insights 2021, June 16, 2021
- Societe de Financement Local (SFIL), April 30, 2021
- ESG Industry Report Card: Covered Bonds, Nov. 9, 2020
- Assessments For Jurisdictional Support According To Our Covered Bonds Criteria, Nov. 27, 2020
- Assessments For Target Asset Spreads According To Our Covered Bonds Criteria, Nov. 27, 2020

- Covered Bond Monitor: Technical Note, Sept. 6, 2019

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