

Caisse Francaise de Financement Local Public Sector Covered Bonds Outlook Revised To Stable; 'AA+' Ratings Affirmed

July 11, 2024

Overview

- On May 31, 2024, we lowered to 'AA-' from 'AA' our unsolicited long-term sovereign credit rating on France. The outlook is stable.
- On June 4, following the rating action on France, we lowered to 'AA-' from 'AA' our long-term rating on SFIL. The outlook is stable.
- Following the above rating actions, we revised our outlook on Caisse Francaise de Financement Local Public Sector covered bond program and outstanding issuances to stable from negative and affirmed our 'AA+' ratings.
- Our outlook on the ratings reflects the stable outlook on SFIL.

PARIS (S&P Global Ratings) July 11, 2024--S&P Global Ratings today revised to stable from negative its outlook on Caisse Française de Financement Local (CAFFIL)'s public sector covered bond program and related issuances. We also affirmed our 'AA+' credit ratings on the covered bonds.

This rating action follows the rating action on CAFFIL's parent, SFIL S.A. (see "Seven French Government-Related Entities Downgraded To 'AA-' After Similar Action On France; Outlooks Stable," published on June 4, 2024).

The reference rating level (RRL) on CAFFIL, currently 'aa-', is equal to the issuer credit rating (ICR) on SFIL. SFIL is rated at the same level as France and the rating on the sovereign (France: unsolicited AA-/Stable/A-1+) caps the jurisdictional support uplift. Therefore, the covered bonds do not benefit from any notches of uplift above the RRL, resulting in a jurisdiction-supported rating level (JRL) of 'aa-'.

Our ratings on the covered bonds remain constrained under our counterparty risk criteria (see "Related Criteria"). CAFFIL has entered into a swap agreement with its parent--SFIL, a related entity--the documentation of which is in line with our previous counterparty criteria. We consider counterparty risk in this case to be structurally mitigated and does not constrain the rating on the bonds. However, most of the swap agreements with unrelated entities have no replacement framework. There are currently interest rate and currency swaps in place with more than 20 unrelated counterparties. Because swap termination payments are not subordinated to the

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payment on the covered bonds, and because the notional amount of these swaps is currently above the materiality threshold defined in our counterparty criteria, we have been accounting 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 as described in chart 10 in our counterparty criteria.

However, with the Covered Bond Directive and Regulation (Directive EU 2019/2162; Regulation EU 2019/2160) implementation in July 2022, article 129 of the Capital Requirements Regulation (CRR, Regulation EU 575/2013) was updated stating that exposures in the form of derivatives to credit institutions that qualify for credit quality step 3 (CQS3) can be allowed in the limit of 8% of outstanding covered bonds, only after obtaining permission from local competent authorities, which must first consult the European Banking Authority (EBA) and provided that significant potential concentration problems exist due to the application of credit quality step 1 and 2.

This was also reflected in article R.513-6-1 of the French Monetary and Financial Code (FMFC) and therefore became mandatory for French covered bond issuers. This effectively makes the exposures, in the form of derivatives to credit institutions that do not qualify for CQS3, incompatible with maintaining the European Covered Bond (Premium) label.

We understand that the issuer resolved a situation where a counterparty was no longer eligible under article R.513-6-1 of the FMFC. The issuer's actions in resolving this situation, as recently communicated to us, allows for a different application of our counterparty criteria, as part of the cost of replacing a derivative counterparty of below CQS2 was borne by the issuer. Accordingly, we can view this exposure as comparable to a related derivative counterparty with senior termination payments exposure and therefore subject to the analysis described in chart 11 of our counterparty criteria.

Although there is no contractual obligation to use all commercially reasonable efforts to replace, we believe the issuer will likely replace ineligible counterparties due to the importance of covered bonds as a funding instrument. This view is supported by the fact that the issuer has already replaced an ineligible counterparty and is likely to do so in the future to maintain the European Covered Bond (Premium) label.

Therefore, we apply the higher of the outcomes of charts 10 and 11 of our counterparty criteria, which results in us applying table 12 (related counterparties where swap termination payments rank senior). In our opinion, because the derivative counterparties are highly diversified and most of these that lack contractual replacement commitment are large international banks that typically have S&P Global Ratings' ratings within CQS2, the CQS2 requirement can be interpreted as a 'A-' trigger for the purpose of reading table 12 in this context. Hence, according to table 12, an issuer with an RRL of 'A+' and above and a counterparty replacement at the loss of 'A-', currently results in capping the rating on the covered bonds at 'AA+'.

We also consider that the overcollateralization available to support CAFFIL's public sector covered bond program is commensurate with a 'AA+' rating on the program and related issuances. After we lowered our long-term ICR on SFIL, the covered bond program needs three notches of collateral based uplift (17.30% as of March 31, 2024, data) compared with two notches before (8.45% as of March 31, 2024, data).

There are no rating constraints related to legal, administrative, operational, and sovereign default risks.

We consider that CAFFIL's public sector covered bond program has no unused notches of ratings uplift. This means that any negative rating action on SFIL will result in a similar rating action on the covered bonds, all other things remaining equal.

The stable outlook on our ratings on the covered bonds reflects the stable outlook on the SFIL, of which CAFFIL is considered a core entity.

Related Criteria

- General 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
- Criteria | Structured Finance | Covered Bonds: Covered Bond Ratings Framework: Methodology And Assumptions, June 30, 2015
- Criteria | Structured Finance | Covered Bonds: Covered Bonds Criteria, Dec. 9, 2014
- Criteria | Structured Finance | Covered Bonds: Methodology And Assumptions For Assessing Portfolios Of International Public Sector And Other Debt Obligations Backing Covered Bonds And Structured Finance Securities, Dec. 9, 2014
- Criteria | Structured Finance | General: Global Derivative Agreement Criteria, June 24, 2013
- General Criteria: Global Investment Criteria For Temporary Investments In Transaction Accounts, May 31, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Global Covered Bond Insights Q3 2024: Issuance Still On Solid Footing, June 18, 2024
- Your Three Minutes In Covered Bonds: How The Downgrade Of France Affects French Covered Bonds, June 7, 2024
- Seven French Government-Related Entities Downgraded To 'AA-' After Similar Action On France; Outlooks Stable, June 4, 2024
- France Long-Term Rating Lowered To 'AA-' From 'AA' On Deterioration Of Budgetary Position; Outlook Stable, May 31, 2024
- S&P Global Ratings Definitions, June 9, 2023
- Societe de Financement Local (Sfil), June 5, 2023
- Glossary Of Covered Bond Terms, April 27, 2018

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