S&P Global Ratings

Research

Research Update:

French Public Bank SFIL 'AA/A-1+' Ratings Affirmed; Outlook Stable

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Overview

- We believe there is an almost certain likelihood that SFIL would receive timely and sufficient extraordinary support from the French government in case of financial distress.
- The transfer of the majority of SFIL's capital to Group Caisse des Dépôts in the coming months does not affect our view of the channel of extraordinary support from the central government to SFIL in case of need, which we assume would remain direct.
- We are consequently affirming our 'AA/A-1+' ratings on SFIL, in line with our sovereign ratings on France.
- The stable outlook reflects that on the sovereign and our view that SFIL will retain its critical role for and integral link with France.

Rating Action

On April 21, 2020, S&P Global Ratings affirmed its 'AA' long-term and 'A-1+' short-term issuer credit ratings on SFIL. The outlook is stable.

Rationale

We equalize our ratings on SFIL with those on France (unsolicited: AA/Stable/A-1+) based on our view of SFIL's critical role and integral link with the French government. We consider that there is an almost certain likelihood that the government would provide timely and sufficient extraordinary support to SFIL in the event of financial distress. We also continue to view SFIL's subsidiary, French covered bond issuer Caisse Française de Financement Local (CAFFIL), as a core entity of the SFIL group.

Moreover, as we consider that SFIL executes strategic government policies, we do not see the likelihood of government support being subject to transition risk. Therefore, we expect that the ratings and outlook on SFIL will move in line with those on France. More generally, we do not consider the French government's general propensity to support its government-related entities to be in doubt.

Following an announcement in late 2018 and an in-principle agreement in late 2019, the French government, Groupe Caisse des Dépôts (CDC) and La Banque Postale (LBP) announced on March 4, 2020, the signing of a binding agreement for the transfer of a majority stake in SFIL's capital to CDC in the coming months. The terms of the agreement are the same as the agreement in principle announced in Oct. 2019. SFIL would remain a development bank that is 100% publicly owned, and CDC would become the reference shareholder. The latter would have a more than 99.99% stake, while the French state would retain one ordinary share. Currently, 75% of SFIL is directly owned by the state, and CDC (20%) and LBP (5%) are the only other shareholders.

As we expected, the channel of extraordinary support from the central government to SFIL in case of need would remain direct. In addition to retaining one ordinary share, the central government would continue to express its commitment to SFIL through a letter of support. Moreover, the state would have the right to appoint a censor to SFIL's board of directors. Given our view of the absence of transition risk under CDC and that SFIL executes strategic government policies, we have decided to stop determining a stand-alone credit profile (SACP).

Our opinion of an almost certain likelihood of government support reflects our view that SFIL:

- Has an integral link with the French government as a 100% public financial institution benefiting from the state's strong commitment of support and tight state supervision.
- Plays a critical role for France as the first lender to French local and regional governments (LRGs) and public hospitals and the main liquidity provider of refinancing of export credit guaranteed by the central government. Moreover, given COVID-19-related economic consequences, local public investment will be key in the near future as French LRGs account for more than 70% of total civil public investments. France's president has also announced a large investment plan for public hospitals and we believe that SFIL could play a key role in it.

Created in 2013, SFIL remains 100% publicly owned after the transfer of control--more than 99.99% by CDC, which is ultimately also fully owned by the central government, and the rest directly by the state. SFIL's integral link with France is strongly underpinned by the government's full involvement in SFIL's supervision, management, and strategic decisions. We understand that the governance mechanism in the shareholders' agreement, which gives the state the right to appoint a censor, results in the French government having de facto veto rights on SFIL's board. Currently, SFIL's CEO is appointed by presidential decree.

Although the state is not legally and ultimately responsible for SFIL's solvency like for state public agencies (Etablissements Publics d'Etat), it has expressed its very strong commitment toward SFIL in a letter of support. That means the French state, even after the transfer of control to CDC, is committed to providing sufficient liquidity and capital support for SFIL to operate on an ongoing basis, comply with regulatory requirements, and meet its financial obligations.

SFIL was created in 2013 to provide the French LRG sector with stable and continued access to long-term funding. SFIL's first mission, therefore, is to refinance new loan production generated by its partner LBP for French LRGs, and for a lower volume for public health institutions. This access is key, given that French LRGs account for more than 70% of total civil public investments (excluding research and development, expenses in databases, and military equipment). These investments are crucial for the maintenance and development of infrastructure in France and the support of the national economy. The European Commission (EC) has recognized SFIL as a development bank, in light of the EC's acknowledgment of a structural market failure in the financing of LRGs in France. SFIL remains the first lender to the sector, accounting for about 30% of new loans to French LRGs in 2019. Under our current assumption of a sudden but temporary

COVID-19-related shock, we estimate that new borrowings by French LRGs will decrease this year before picking up again in 2021. This will likely affect the volume of SFIL's public sector loan refinancing this year, especially compared with the exceptionally high volume registered in 2019 (€5.7 billion), fueled by favorable borrowing conditions, a pre-electoral spending spree, and generally improving budget trends for French LRGs.

In 2015, as part of restructuring its export promotion policy, the French government assigned SFIL a second mission of refinancing large export credits guaranteed by the central government. This mission has also been recognized by the EC as responding to a market failure, confirming that private players did not provide these services to a sufficient extent. We believe this extension of SFIL's activity has reinforced its critical role for the government in resolving failures in the financial market. This export refinancing activity benefits from a full guarantee from the French state through its official export credit agency Bpi Assurance Export. In 2019, SFIL remained one of the main liquidity providers of export credit refinancing in France, with a market share of about 42%. We expect the current COVID-19 pandemic and the ensuing global recession will affect demand, especially in the naval and cruise industry, which made up 67% of SFIL's export credits at year-end 2019. The state funding bill for 2019 and a Dec. 17, 2018, decree have extended the framework of guarantees to all operations that can contribute to the development of France's external trade or have a strategic interest for the French economy abroad. We understand discussions with the EC on this matter are still ongoing, but we believe SFIL's role would be further expanded if it ultimately received the approval from the EC.

SFIL's missions make environmental, social and governance (ESG) factors an integral part of both its internal and external strategy. In Sept. 2019, SFIL published its first environmental and social impact report and strongly committed to reduce its carbon footprint as part of its strategy. Most importantly, in 2019 SFIL issued both its first social emission and its first green bond. The funds raised from the social emission are targeted at public hospitals in France, while the green bond proceeds are channeled into green loans that are distributed to French LRGs through LBP to finance projects in renewable energy, sustainable water management, waste management, urban and local transport, and residential building energy efficiency. We believe that SFIL's commitment to a green and socially responsible transition of the national economy strengthens our view of the critical role it has in France, since funding a sustainable future is a key strategic initiative of the central government.

Typical for banks with a large balance sheet comprising very low-risk assets, SFIL displays a very high Common Equity Tier 1 ratio (24.4% at year-end 2019) compared with typical commercial banks. Given its development bank status, SFIL benefits from relaxed regulatory requirements on leverage under the amended capital requirements regulation at the European level.

Low-risk lending, issued to or guaranteed by public authorities, dominates the current asset base. SFIL expects to reduce the size of the complex loans portfolio significantly to €0.7 billion by year-end 2020 from €4.5 billion in 2015. Underlying legal risk has also been reduced, with only 15 litigation cases as of Dec. 2019 from 132 in Dec. 2015.

We recognize that SFIL bases its business model on its continued capacity to access funding at very low costs, given the structurally low asset margins. SFIL is entirely wholesale funded, in line with other public-sector-focused peers. However, we view the ongoing support SFIL currently receives from its public shareholders through LBP and CDC as mitigating its wholesale funding profile. Our assessment of SFIL's liquidity is supported by its ability to use its portfolio of assets originating from the public sector as collateral for the lending facility from the European Central Bank.

Outlook

The stable outlook on SFIL reflects our stable outlook on France. We believe that SFIL will retain its critical role for and integral link with France. We therefore expect the ratings on SFIL to move in line with those on the sovereign.

Downside scenario

We could lower our ratings on SFIL following a similar rating action on France. We could also lower the rating on SFIL if the central government were to change SFIL's full public status or revised the importance that it gives to SFIL's dual mandates. Following the transfer to CDC, if we considered at one point that the channel of extraordinary government support to SFIL shifted from direct to indirect, we may also consider a negative rating action.

Upside scenario

Conversely, although unlikely, we could raise the rating if France's credit quality were to improve and the likelihood of support for SFIL remained almost certain.

Key Statistics

Table 1

SFIL--Selected Indicators

	--Fiscal year ended Dec. 31--				
(Mil.€)	**2019**	**2018**	**2017**	**2016**	**2015**
Total assets	74.796	72.722	72.432	78.937	83.683
Total equity	1.621	1.563	1.469	1.388	1.385
Net income	50	63	54	18	(59)
Tier 1 capital ratio (%)	24.8	25.3	23.1	23.2	22.3

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed

SFIL	
Issuer Credit Rating	AA/Stable/A-1+
SFIL	
Senior Unsecured	AA
Commercial Paper	A-1+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.