S&P Global Ratings

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Research Update:

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

April 25, 2019

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.
- We are consequently affirming our 'AA/A-1+' ratings on SFIL, in line with our long-term sovereign rating 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 25, 2019, 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 for 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, 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. On Nov. 15, 2018, the Ministry of Economy and Finance announced the central government was in talks with Group Caisse des Dépôts (CDC) to transfer the control of SFIL to CDC. The ministry also stated that SFIL would remain 100% publicly owned and all of its shareholders, including the government, would ensure that its financial strength was preserved, its economic base was protected, and any necessary support was provided. At this stage, the potential transfer to CDC does not affect our view of the channel of extraordinary support from the central government to

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SFIL in case of need, which we assume would remain direct.

Furthermore, we consider the French government's contingent liabilities as limited and unlikely to constrain its capacity and willingness to support SFIL in a timely manner in case of financial distress. More generally, we do not consider the French government's general propensity to support its government-related entities to be in doubt.

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 the main liquidity provider of the refinancing of export credit guaranteed by the central government.

Created in 2013, SFIL is 100% publicly owned: currently 75% directly by the state, and the rest indirectly through CDC (20%) and La Banque Postale (LBP; 5%), both of which are ultimately fully owned by the central government. 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 results in the French government having de facto veto rights on SFIL's board. Moreover, a presidential decree appoints SFIL's CEO.

Although the state is not legally ultimately responsible for SFIL's solvency as it is for state public agencies (Etablissements publics d'Etat), it has expressed its very strong commitment toward SFIL as its shareholder of reference in a letter of support. That means the French state is committed to providing sufficient liquidity and capital support for SFIL to operate on an ongoing basis, to comply with regulatory requirements, and to meet its financial obligations. In our view, the credit facilities from CDC and LBP (ceilings of, respectively, €10 billion and €1.5 billion), as well as past legislative resolutions aimed at solving an issue related to complex loans, are strong signs of the state's ongoing support.

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 to a lesser extent finance loans 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 an estimated 23% of new loans to French LRGs in 2018.

In addition, SFIL has been assigned the corollary mission of derisking the stock of sensitive complex loans contracted by French LRGs. In our view, SFIL has now almost fully resolved this issue, thanks also to the support from the central government, which funded exit fees for some LRGs through a special support fund. There are very few outstanding cases of litigation and the corresponding financial risks are very limited.

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. This second mission is expanding, and in 2017 SFIL became the main liquidity provider of export credit refinancing, with a market share above 50%, and remained the leader in 2018. 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, which in turn also expands SFIL's refinancing mission.

SFIL's missions make environmental, social, and governance (ESG) factors an integral part of both its internal and external strategy. On its asset side, LRG and public hospital investment projects generally have a social or environmental goal, and refinancing of credit export is limited to loans compliant with the Organisation for Economic Co-operation and Development's environmental and social guidelines. On the liability side, SFIL and CAFFIL have put a social bond framework in place that resulted in CAFFIL's first €1 billion issuance, in February 2019, which was to fund public hospital investments. We also understand that SFIL is willing to introduce a green bond framework later in 2019, which would refinance green loans contracted by LRGs.

We have maintained our assessment of SFIL's stand-alone credit profile (SACP) at 'bbb+'. Our assessment of SFIL's SACP incorporates our view of the entity's bank-like business focus on funding LRGs. We consider SFIL's business position to be constrained by its high business and geographic concentration on refinancing French local authorities and public health institutions, and by its dependence on the financial conditions under which it raises funding in the covered bond market through CAFFIL.

We consider SFIL's capital and earnings to be very strong, reflecting our expectation that the group's risk-adjusted capital (RAC) ratio before diversification and concentration adjustments will be above 15% for the next two years, as well as its improving but still modest earning capacity, and no dividend pay-out. Our new projection is still heavily influenced by the sovereign rating on Italy, due to SFIL's material exposure to Italian regions. We also consider it is important to emphasize that the bank is still subject to potential tail losses that relate to the ongoing derisking of complex loans with LRGs, although this risk has reduced in recent years. We will keep monitoring the trajectory of the RAC ratio in case of an unexpected event. Additionally, SFIL's leverage ratio stood at 1.9% as of end-2018. Given its development bank status, SFIL will benefit from relaxed or waived regulatory requirements under the amended capital requirements regulation at the European level.

SFIL expects to reduce the size of the complex loans portfolio significantly to €0.9 billion by end-2019 from €4.5 billion in 2015, and it has reduced risk in the complex loans that are potentially the most at risk. Underlying legal risk has also been reduced, with only 18 litigation cases as of December2018 from 132 in December 2015. We assess SFIL's risk position as moderate, reflecting the bank's focus on funding low-risk LRGs in France and its reduction of pockets of risk. A change in SFIL's risk policy, more aggressive origination, or deterioration of credit metrics could lead us to reconsider our assessment of the combined capital, earnings, and risk position.

SFIL is entirely wholesale funded, in line with other public sector-focused peers, and remains vulnerable to changes in its funding costs. However, we view the ongoing support SFIL 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. We will also closely follow the talks between the central government and CDC to transfer control of SFIL to CDC. If this potential transfer shifted the channel of extraordinary government support to SFIL from direct to indirect, in our view, we may consider that SFIL's ratings are subject to a transition risk. This would result in a negative rating action.

Upside scenario

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

Ratings Score Snapshot

	To	From
Issuer Credit Rating	AA/Stable/A-1+	AA/Stable/A-1+
SACP	bbb+	bbb+
Anchor	bbb+	bbb+
Business Position	Moderate (-1)	Moderate (-1)
Capital and Earnings	Very Strong (+2)	Very Strong (+2)
Risk Position	Moderate (-1)	Moderate (-1)
Funding and Liquidity	Average and Adequate (0)	Average and Adequate (0)
Support	+5	+5
ALAC Support	0	0
GRE Support	+5	+5
Group Support	0	0
Sovereign Support	0	0
Additional Factors	0	0

Related Criteria

- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017

- 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: Group Rating Methodology, Nov. 19, 2013
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Summary: France, April 5, 2019
- Local Government Debt 2019: French LRG Borrowings Will Stay Low Despite Higher Investments, Feb. 25, 2019

Ratings List

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