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Ratings

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# SFIL S.A.

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*This report does not constitute a rating action.*

## Credit Highlights

### Overview

| Key strengths | Key risks |
|---|---|
| Integral link with the French government as a 100% state-owned financial institution. | Concentrated portfolio within the export credit market. |
| Critical role as the first lender to French local and regional governments (LRGs) and public hospitals. | Structurally low profitability from LRG lending and potential downside from the rising cost of funding. |
| Critical mission for the French government's economic policy as the main liquidity provider of refinancing for export credit. | |

**S&P Global Ratings believes the government's commitment to SFIL (Societe de Financement Local) remains intact, despite the reshuffled shareholder structure.** On Sept. 30, 2020, the French government finalized the transfer of a majority stake in SFIL's capital to Caisse des dépôts et consignations (CDC), which became the reference shareholder with about a 99.99% stake; the French government retained one ordinary share. Therefore, SFIL retains its status as a development bank that is 100% government owned. SFIL's integral link with France is strongly underpinned by the government's full involvement in its 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 main strategic decisions.

**We expect SFIL will receive direct extraordinary support from the central government in case of need.** Although the state is not legally and ultimately responsible for SFIL's solvency, as it is for state public agencies (Etablissements Publics d'Etat), it has expressed its very strong commitment to SFIL in a letter of support provided to the French banking regulator. This means the French government, even after the transfer of control of SFIL 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.

## Outlook

The stable outlook on SFIL mirrors our outlook on France. We believe that SFIL will retain its almost certain likelihood of receiving government support in the event of financial distress.

## 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-sector entity status or revised the importance of SFIL's dual mandates.

## 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.

# Rationale

We equalize our ratings on SFIL with those on France (unsolicited: AA/Stable/A-1+). This is because, 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.

Our opinion of an almost certain likelihood of government support hinges on SFIL's:

- Integral link with the French government as a 100% public-sector-owned financial institution benefiting from the state's strong commitment of support and tight state supervision; and
- Critical role for France as the first lender to French LRGs and public hospitals and the main liquidity provider of refinancing for export credit guaranteed by the central government, with about 20% and 40% market shares respectively. In line with the bank's 2022-2026 strategic plan, we expect this role to be further reinforced by France's COVID-19-related recovery plan and the need for green investments over the coming decade. French LRGs have always played a key role in channeling those investments because they account for close to 70% of total civil public investments. In addition, France's €19 billion investment plan for public hospitals will lead to a new investment cycle for which SFIL could play a key role.

SFIL plays a key role in France's economic strategy as the first lender to LRGs and public hospitals. SFIL was created in 2013 to provide the French LRG sector with stable and continued access to long-term funding and remains the first lender to the sector, accounting for about 20% of new loans to French LRGs in 2021. SFIL's first mission, therefore, is to refinance new loan production generated by its partner La Banque Postale (LBP) for French LRGs, and a lower volume for public health institutions. Financial access for LRGs is key, given that they account for close to 70% of total civil public investments in France. These investments are crucial for the maintenance and development of infrastructure in France and the support of the national economy, especially throughout the COVID-19-related slump. In addition, France's €19 billion investment plan for public hospitals will lead to a new investment cycle from which SFIL is well positioned to benefit as the leading lender to French hospitals.

It will also extend the scope of its activities through a new partnership with Banque des Territoires (BDT). Similar to the current partnership with LBP, SFIL will refinance new loans originated by BDT, mainly for social housing financing. The average term of these loans is longer than for what SFIL usually refinances, since BDT's financing includes mainly housing units. SFIL targets €1.6 billion of exposures linked to the BDT partnership by year-end 2026. We believe strong results in 2021 and the new partnership with BDT have strengthen SFIL's position among the various public-sector banks operating within the CDC, highlighting SFIL's relevance for the state.

SFIL supports the government in promoting exports. In 2015, as part of the restructuring of its export promotion policy, SFIL was assigned a second mission of refinancing large export credits guaranteed by the central government. This mission has also been validated by the European Commission, which extended SFIL's mandate validity up to year-end 2027, recognizing that SFIL responds to market failures and confirming that private institutions do not provide these services to a sufficient extent. This export refinancing activity benefits from a full guarantee from the French government through its official export credit agency Bpi Assurance Export. In 2021, SFIL's export refinancing activity recovered strongly with new contracts in five different sectors totaling €2.2 billion, strengthening its leadership in this segment with a market share of about 40% over 2017-2021. We expect export financing activity to remain elevated fueled by a likely increase in energy and defense spending worldwide. In addition, a review will be undertaken to develop SFIL’s approach to export credit in order to strengthen the financing of sustainable projects. That said, we expect this new activity will remain small in volume compared with SFIL's traditional export-credit refinancing.

**SFIL has a sound financial profile.** Its asset quality profile remains strong, and the Russia-Ukraine conflict should not materially affect its credit losses. Typical for banks with a large balance sheet comprising very-low-risk assets, SFIL displays a very high common equity tier 1 ratio (34.6% at year-end 2021) compared with commercial banks. Given its development bank status, SFIL benefits from relaxed leverage requirements under the EU's amended capital requirements regulation. It remains to be seen how Basel III’s output floor implementation will apply to SFIL, since it could lead to a significant reduction in the capital adequacy ratio. That said, SFIL's current capital ratios provide a significant buffer to absorb this impact. Additionally, in our base-case scenario, we anticipate an only moderate capital impact because SFIL could benefit from lower risk weights under the standardized approach, as do some of its European peers.

**The impact of interest rate increases on SFIL's margin is limited.** We recognize that SFIL bases its business model on its continued capacity to access funding at very low cost, given its structurally low asset margins. That said, and although not our base case, a rapid surge in interest rates could affect SFIL's profitability given the inherently longer maturity of the bank’s assets. SFIL is entirely wholesale funded, in line with its public-sector-focused peers, and we view the ongoing support SFIL receives from its public-sector shareholders through LBP and CDC as mitigating funding risks. 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.

## Environmental, Social, And Governance

SFIL's commitment to a green and socially responsible transition of the national economy strengthens our view of the critical role it plays in France, since funding a sustainable future is a key strategic initiative of the central government.

Environmental factors are mainly reflected in our analysis of SFIL's key role in the government's sustainable development initiatives. Since 2019, SFIL has issued several sustainable and green bonds. The second green bond proceeds – issued in October 2020 - are channeled into 137 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.

External social factors are important to SFIL's funding of local projects of public interest, especially regarding local governments and hospitals. We believe SFIL will play a key part in the Segur plan, a large €19 billion investment program for French public hospitals, compared with the hospital sector's current €30 billion of total outstanding debt.

Governance factors are generally neutral to our assessment given SFIL's integral link with the state, which also informs its objectives and mandates as a key public finance institution.

## Related Criteria

- Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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

## Related Research

- Local Government Debt 2022: French LRGs Drive The Investment-Led Recovery While Reducing Debt Intake, March 22, 2022
- France, Feb. 21, 2022
- Groupe Caisse des Depots et Consignations, May 31, 2021

## Ratings Detail (as of May 23, 2022)*

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|---|---|
| **SFIL** | |
| Issuer Credit Rating | AA/Stable/A-1+ |
| Commercial Paper | |
| *Local Currency* | A-1+ |
| Senior Unsecured | AA |
| **Issuer Credit Ratings History** | |
| 25-Oct-2016 | AA/Stable/A-1+ |
| 14-Oct-2014 | AA/Negative/A-1+ |
| 12-Nov-2013 | AA/Stable/A-1+ |

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings credit ratings on the global scale are comparable across countries. S&P Global Ratings credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.