Crédit Foncier de France
Issuer Rating Report

Scope Ratings has assigned an Issuer Credit-Strength Rating (ICSR) of AA- to Crédit Foncier de France (CFF) with a Stable Outlook. Both the rating and outlook mirror the ICSR of AA- with Stable Outlook assigned to BPCE SA – CFF's parent company.

The AA- ICSR with Stable Outlook also applies to Compagnie de Financement Foncier (CoFF), the wholly owned subsidiary of CFF. CoFF's sole purpose is to finance the mortgage and public-sector lending of both its parent company and the BPCE group as a whole, through the issuance of covered bonds (obligations foncières).

On 21 December 2016 Scope Ratings upgraded by one notch the ICSR of BPCE SA, and the ratings of senior unsecured debt not eligible for TLAC and/or MREL, in line with other French banks. The rating actions have followed the passage of the Sapin II law, which, to address the bail-in provisions of BRRD in France, introduces the possibility for French banks to issue a new class of non-preferred senior unsecured debt. This new class of senior unsecured liabilities is eligible for TLAC and/or MREL. In liquidation or resolution, the new securities would rank below the banks' senior unsecured liabilities – deposits, derivative and other financial contracts, and outstanding senior unsecured debt – but above subordinated debt and/or capital securities.

This report refers to the entire CFF group, including Compagnie de Financement Foncier.

For the full list of ratings see the 'Ratings' section at the end of this report.

Highlights

CFF is a fully owned subsidiary of BPCE, which was established in 2009 as the central body of the two large French banking groups, Banque Populaire (BP) – cooperative banks – and Caisses d'Epargne (CE) – savings banks. CFF has been a part of the BPCE group since 1999. All affiliated French regulated credit institutions (FRCI) within the BPCE group, including CFF, benefit from an internal guarantee and solidarity system that is defined by law. BPCE is legally obliged to guarantee the liquidity and solvency of affiliated FRCIs. BPCE has established a joint solidarity fund under the French Monetary and Financial Code, which has around EUR 1.3bn of funds available for immediate distribution (as of 30 September 2016). In addition, BPCE states that the group's aggregated Tier 1 capital may be used to cover any financial failings of any affiliated FRCI. As of 30 June 2016, the consolidated Tier 1 capital of the BPCE group stood at around EUR 40.1bn.

In previous years, BPCE already demonstrated support within the group to safeguard liquidity and solvency of its affiliates; along with the establishment of a guarantee mechanism on a Natixis credit portfolio, CFF benefited from a EUR 1.5bn capital increase in late 2011.

Lead Analyst

Michaela Seimen Howat
m.seimenhowat@scoperatings.com

Team Leader

Sam Theodore
s.theodore@scoperatings.com

Scope Ratings AG

Suite 407
2 Angel Square
London EC1V 1NY

Phone +44 20 3457 0444

Headquarters

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100
Service +49 30 27891 300

info@scoperatings.com
www.scoperatings.com

Bloomberg: SCOP

Rating drivers (summary)

The rating drivers, in decreasing order of importance in the rating assignment, are:

1. CFF benefits from a strong internal guarantee and solidarity system within the BPCE group, further enhanced by the consent that, in the case of a major credit event, there should be no obstacles to free capital circulation within the group. It should be noted in this respect that a rating or outlook change for BPCE would entail a similar action for CFF.
2. CFF's business and funding profile has been aligned in the context of the gradually restructured and simplified BPCE group set-up. While this results in CFF's increased dependence on the group, bondholders should benefit from the group's strong risk-control measures and funding alignments. The more integrated structure helps to avoid an adverse and costly funding environment for BPCE group members by eliminating inter-group competition as well as supporting improved efficiency and, ultimately, profitability.
3. A scaled-down business of CFF and the currently low-for-longer interest rates put pressure on the bank's profitability; furthermore, the bank faces restrictions on reducing capacity and, hence, costs. However, CFF has been able to carve out expertise in some niche and specialised mortgage-lending areas, enabling the bank to employ to some extent, and with cost efficiencies, current excess capacity and to create a unique selling point not only across the group, but also in the market.
4. CFF's strong focus on the real estate market generates some concentration risk and could make it more vulnerable in a general economic downturn. In this respect, its public-sector lending portfolio also displays some risks.

Rating-change drivers

Given CFF's close integration in the BPCE group and the direct link of its ratings to BPCE's, its ability to improve its rating on a standalone basis is currently limited. However, at BPCE group level, a material restructuring aimed at reducing excess capacity and significantly lowering costs could help to drive ratings upwards.

The low interest rate environment combined with strong competitive pressures should lead to a more integral approach within the BPCE group to increase cross-selling opportunities. Strong developments in this respect, underlined by the strong profitability of group members, could help to boost Groupe BPCE's ratings and, thereby, also CFF's ratings.

Any signs of weakened commitments within Groupe BPCE and/or competitive business set-ups among group members could prompt a review of the aligned rating, which is currently based on the strong internal guarantee and solidarity system.

Weakened credit quality of Groupe BPCE will have a direct impact on CFF's rating.

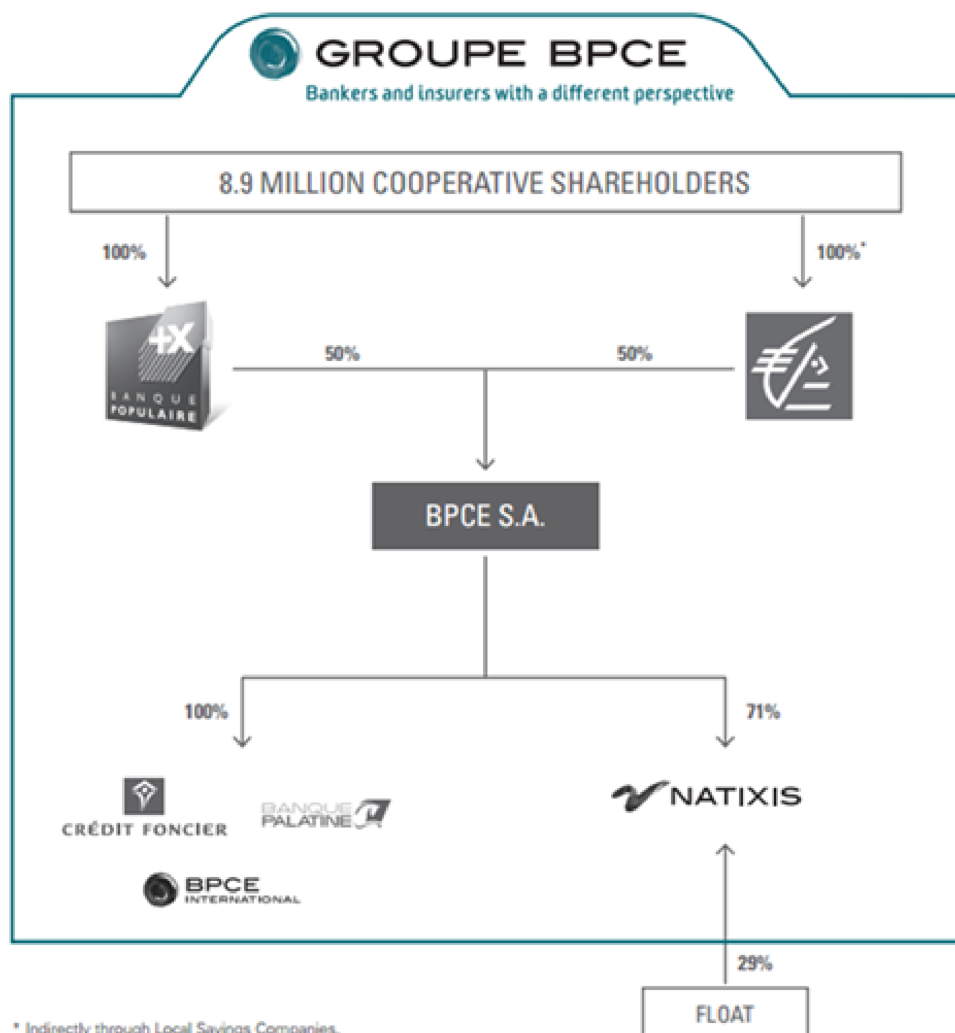
Should CFF's profitability show atypical and counter-cyclical negative results compared to competitors, credit ratings could be reviewed.

Background

History and business set-up

CFF is a bank organised as a société anonyme (corporation), which is subject to French commercial law. However, as a credit institution that is also officially approved as a specialist financial institution, CFF is additionally subject to the provisions of the French Monetary and Financial Code applicable to credit institutions. CFF was initially established in 1852 and was integrated into Groupe BPCE in 1999. Our issuer rating report on Groupe BPCE contains more details (updated in September 2016).

Figure 1: Group BPCE's simplified structure



Within the BPCE Group, CFF has been established as a leading specialist in property financing and services, as well as in financing public entities. The bank's clients comprise individuals, professionals, investors and local authorities.

CFF’s businesses can be broken down into five different segments:

- **Property finance for individuals**, where mortgage products for new and existing homes are promoted. CFF is also active in the buy-to-let sector and can offer specialised financing for first-time buyers, lower-income groups or older customers through specific products and services such as reverse mortgages. We understand that this area provides a particular competitive advantage for the bank. These products are distributed via a multi-channel network of 228 branches in France, around 7,000 business partners in the real estate sector, and an internet platform. As of year-end 2015, around EUR 48.5bn of loans were outstanding in this segment.
- **Financing for investors and real estate professionals:** In this segment CFF focuses on property investors and professionals like real estate management companies, builders, and investment funds, and provides credit arranging and syndication for financing their businesses. Outstanding loans in this segment amount to around EUR 7.7bn.
- **Public-entity services** includes financing for local authorities and entities in charge of social housing. However, CFF may also fund major infrastructure projects through public-private partnerships. Loans in this segment amounted to around EUR 44.1bn as of year-end 2015.
- CFF may also provide **real estate services** via its wholly owned subsidiary Crédit Foncier Immobilier. Real estate services include consultancy, research and valuation, as well as brokerage and property management. These services target institutional investors, residential and commercial property groups as well as major landlords.
- **Financial transactions** of CFF are outsourced to its wholly owned subsidiary Compagnie de Financement Foncier. This entity refinances residential mortgages and loans to the public sector through either the issuances of obligations foncières or securitisations. Compagnie de Financement Foncier issues between EUR 6bn and EUR 7bn in covered bonds per year.

CFF is becoming fully integrated in the group’s IT system. A project is under way to align the various IT systems in the group within the next two years. Also, asset-liability management will be captured through a standardised IT system at group level.

However, from a risk management perspective, CFF exposures are already regularly reviewed in risk committee meetings at group level.

Recent events

2015 year-end and interim 2016 results

As at year-end 2015, CFF had a balance sheet size of around EUR 134bn. Going forward, this will be capped at around EUR 100bn, which will be partly achieved via securitisations and the sale of real estate.

CFF employs around 2,680 staff and plans to reduce headcount by around 450 in the short term, which will benefit the bank’s cost-reduction aims. Although risks and general costs are reducing, CFF’s results are strongly impacted by the low interest rate environment and early repayments. In 2015, CFF was affected by around EUR 145m of write-downs on its exposure to Austrian Heta Asset Resolution AG; however, this was resolved via the sale of the entire exposure. Increased intra-group synergies will gradually contribute to better profitability thanks to a lower cost structure; albeit we note that the bank has already improved substantially in this respect and realised an acceptable cost-income ratio of around 61.2% as of year-end.

In the first nine months of 2016, CFF had an aggregated new loan production of EUR 6.5bn, with new loan production of EUR 2.1bn in Q3 2016. This was particularly driven by home loans granted to individual customers, totalling around EUR 1.7bn.

CFF’s net banking income for the first nine months of 2016 was 8.4% lower compared to the same period in 2015 (restated to account for exceptional items, including the CVA/DVA impact). The lower result was due to a decline in net interest income and lower commissions from fewer requests for early redemption, which had previously provided some fee-income boost in 2015.

The bank’s total capital ratio stands at around 11.7% and its CET1 ratio at around 9.4% as of H1 2016, slightly lower compared to previous year-end results.

Rating drivers (details)

1. **CFF benefits from a strong internal guarantee and solidarity system within Groupe BPCE, further enhanced by the consent that, in the case of a major credit event, there should be no obstacles to free capital circulation within the group. It should be noted in this respect that a rating or outlook change for BPCE would entail a similar action for CFF.**

Groupe BPCE's guarantee and solidarity mechanism was set up pursuant to Article L. 512-107-6 of the French Monetary and Financial Code. The mechanism aims to ensure the liquidity and capital adequacy of the group and its associates, and to organise financial support within Banque Populaire and Caisse d'Epargne networks. According to information in BPCE's annual report for 2015, BPCE is tasked with taking all necessary measures to guarantee the capital adequacy of the group and of each network, including implementing the appropriate internal financing mechanisms within the group.

Over the past years, the group has already shown some strong commitment with regard to the various entities. For example, CFF's securitisation portfolio was transferred to BPCE in September 2014, and BPCE's risk management division conducts the monitoring of this. In addition, a disposal plan was established and coordinated by the group finance division.

Groupe BPCE also implemented action plans in 2015, specifically to ensure the capital adequacy of its networks and subsidiaries. For example, BPCE may grant redeemable subordinated loans, or subscribe for perpetual, deeply subordinated notes as in the case of Crédit Foncier (EUR 550m).

2. **CFF's business and funding profile has been aligned in the context of the gradually restructured and simplified Groupe BPCE set-up. While this results in CFF's increased dependence on the group, bondholders should benefit from the group's strong risk control measures and funding alignments. The more integrated structure helps to avoid an adverse and costly funding environment for BPCE group members by eliminating inter-group competition, as well as supporting improved efficiency and, ultimately, profitability.**

To simplify and centralise the BPCE group, not only were risk management functions lifted to group level, but also funding management were centralised. In this context, CFF has been set up, next to BPCE, as a specialised covered bond issuer within the group. To do this, CFF's subsidiary, Compagnie de Financement Foncier (CoFF), issues French covered bonds, known as obligations foncières, to finance CFF's loan business. While CFF has established an EMTN debt issuance programme, we understand that, according to internal rules of funding management within Groupe BPCE, the bank is currently not entitled to issue senior unsecured debt for funding purposes.

Furthermore, all group assets and liabilities are subject to internal liquidity pricing; guidelines are decided by Groupe BPCE's asset and liability management committee, which assesses changes in market liquidity costs and asset-liability matching.

In addition to these more administrative measures, the business model of CFF has also been adjusted so that the bank is better recognised within the group as a specific service provider.

3. **A scaled-down business of CFF and currently low-for-longer interest rates put pressure on the bank's profitability. Furthermore, the bank faces restrictions on reducing capacity and, hence, costs. However, CFF has been able to carve out expertise in some niche and specialised mortgage-lending areas, enabling the bank to employ to some extent, and with cost efficiencies, current excess capacity and to create a unique selling point not only across the group, but also in the market.**

To contain risks and the potential for inter-group competition from overlapping business segments, CFF's structure has been adjusted over the past years. However, a scaled-down balance sheet, combined with a highly competitive market and low interest rates, puts strong pressure on the bank's profitability. Furthermore the costs and restrictions of redundancies in France might burden the bank with overcapacities for some time.

Nevertheless, ongoing restructuring and efficiency measures at group level should increase economies of scale over time.

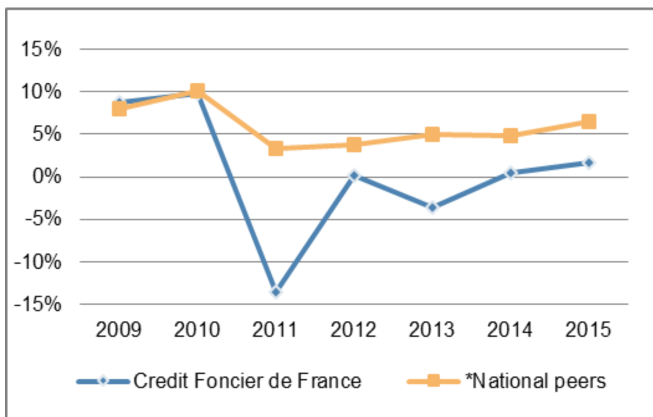
4. **CFF's strong focus on the real estate market generates some concentration risk and could make it more vulnerable in a general economic downturn. In this respect, its public-sector lending portfolio also displays some risks.**

Although we note that the bank has developed a competitive advantage with mortgages to lower-income clients in France, we believe this loan segment might prove less resilient during an economic downturn.

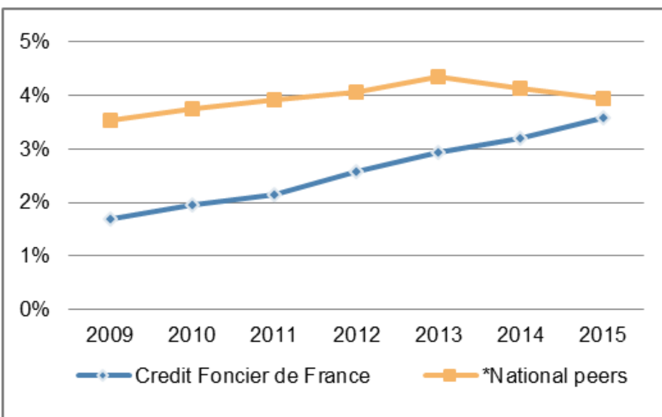
Also, CFF has a large exposure to the public sector with more complex loan structures and larger sizes; hence, risks in this respect could put disproportional pressure on its profitability. A recent example was the bank's exposure to Austrian Heta Asset Resolution AG, which strongly impacted 2015 results due to the larger provisions.

Appendix A: Peer comparison

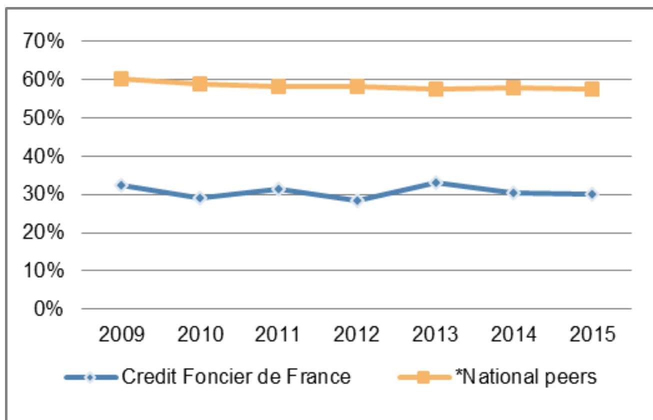
Return on average equity (%)



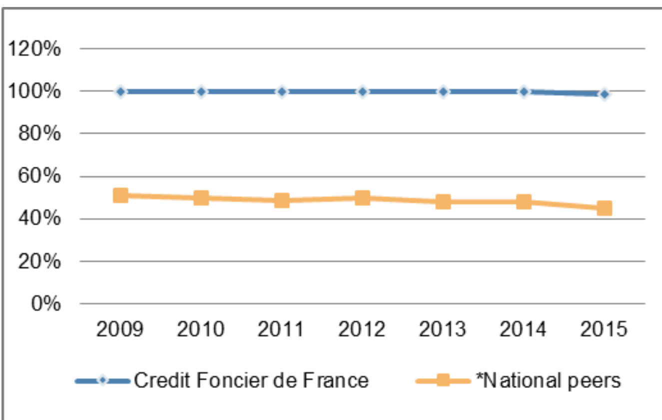
Impaired loans % total gross loans



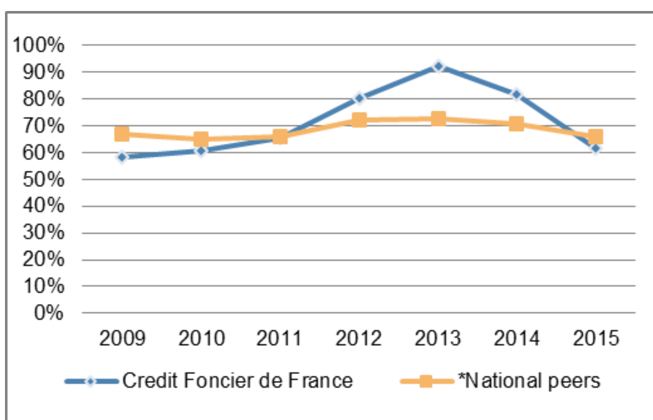
Loan-loss reserves % impaired loans**



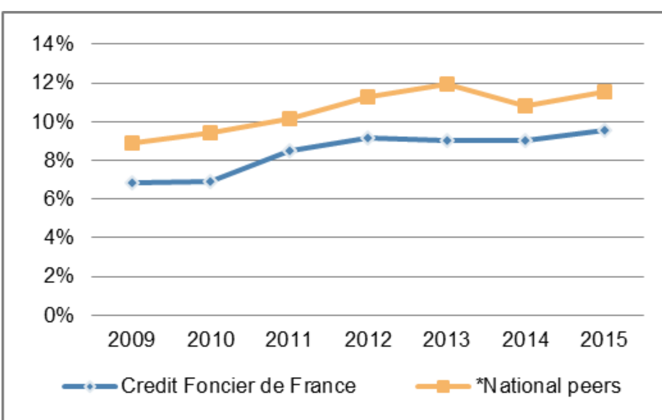
Wholesale funds % total funds



Cost-income ratio (%)



Common equity tier 1 – transitional (CET1) ratio (as a % of RWAs)**



Source: SNL, Scope Ratings

*Peers: BNP Paribas, Societe Generale, Credit Agricole Group, Groupe BPCE, Credit Mutuel Group, La Banque Postale, CFF

**Note: From 2014 CET1 ratios represent 'fully loaded' ratios

Appendix B: Selected financial information – Crédit Foncier de France

	2010	2011	2012	2013	2014	2015
Balance sheet summary (EUR bn)						
Assets						
Cash and interbank assets	7.8	7.3	22.3	22.6	14.5	17.6
Total securities	4.2	3.0	3.8	3.3	3.6	2.7
Derivatives	10.5	15.2	17.3	11.0	16.8	14.5
Net loans to customers	114.6	115.2	111.5	104.5	96.4	91.1
Other assets	5.5	7.6	8.4	6.5	9.7	8.7
Total assets	**142.6**	**148.3**	**163.3**	**148.0**	**141.1**	**134.5**
Liabilities						
Interbank liabilities	16.0	16.3	36.7	44.1	34.6	33.3
Senior debt	109.0	108.9	102.2	86.0	83.9	78.2
Derivatives	8.2	12.0	12.1	7.0	12.2	10.7
Deposits from customers	0.3	0.4	0.3	0.3	0.3	1.4
Subordinated debt + non-equity hybrids	0.8	0.8	0.8	0.8	0.6	0.4
Other liabilities	5.6	6.4	7.6	6.1	6.5	6.8
Total liabilities	**139.9**	**144.8**	**159.6**	**144.3**	**138.1**	**130.8**
Ordinary equity	2.6	3.4	3.6	3.6	2.9	3.1
Equity hybrids	0.0	0.0	0.0	0.0	0.0	0.5
Minority interests	0.1	0.1	0.1	0.1	0.1	0.1
Total liabilities and equity	**142.6**	**148.3**	**163.3**	**148.0**	**141.1**	**134.5**
Core tier 1 / common equity tier 1 capital	3.1	4.2	3.9	3.7	3.1	3.1

	2010	2011	2012	2013	2014	2015
Income statement summary (EUR m)						
Net interest income	0.7	0.8	707.0	482.0	526.0	584.0
Net fee & commission income	0.2	0.2	162.0	207.0	208.0	291.0
Net trading income	0.0	-0.1	-218.0	-191.0	-775.0	-96.0
Other income	0.1	0.1	72.0	96.0	710.0	81.0
Operating income	**1.0**	**0.9**	**723.0**	**594.0**	**669.0**	**860.0**
Operating expense	0.6	0.6	580.0	549.0	547.0	528.0
Pre-provision income	**0.4**	**0.3**	**143.0**	**45.0**	**122.0**	**332.0**
Loan-loss provision charges	0.1	0.2	128.0	253.0	111.0	237.0
Other impairments	0.0	0.0	0.0	0.0	0.0	0.0
Non-recurring items	0.1	-0.8	-1.0	0.0	0.0	0.0
Pre-tax profit	**0.3**	**-0.6**	**14.0**	**-208.0**	**11.0**	**95.0**
Discontinued operations	0.0	0.0	0.0	0.0	0.0	0.0
Income tax expense	0.1	-0.2	5.0	-80.0	-7.0	45.0
Net profit attributable to minority interests	0.0	0.0	2.0	2.0	3.0	2.0
Net profit attributable to parent	**0.3**	**-0.4**	**7.0**	**-130.0**	**15.0**	**48.0**

Source: SNL, Scope Ratings

Appendix C: Ratios – Crédit Foncier de France

	2010	2011	2012	2013	2014	2015
Funding/Liquidity						
Total deposits % total funds	0.3%	0.3%	0.2%	0.2%	0.3%	1.2%
Wholesale funds % total funds	99.7%	99.7%	99.8%	99.8%	99.7%	98.8%
Liquidity coverage ratio (%)			n.a.	n.a.	n.a.	173.0%
Net stable funding ratio (%)			n.a.	n.a.	n.a.	n.a.
Asset mix, quality and growth						
Gross loans % funded assets	85.7%	85.1%	74.3%	74.9%	75.6%	74.4%
Impaired loans % gross loans	2.0%	2.2%	2.6%	2.9%	3.2%	3.6%
Loan-loss reserves % impaired loans	29.2%	31.5%	28.6%	33.1%	30.4%	30.1%
Gross loan growth (%)	1.4%	0.7%	-3.2%	-6.0%	-7.7%	-5.5%
Impaired loan growth (%)	18.5%	10.3%	16.3%	6.6%	0.4%	6.1%
Funded assets growth (%)	2.7%	1.5%	10.9%	-6.8%	-8.6%	-3.9%
Earnings						
Net interest income % revenues	70.0%	83.0%	97.8%	81.1%	78.6%	67.9%
Fees & commissions % revenues	20.7%	23.5%	22.4%	34.8%	31.1%	33.8%
Trading income % revenues	2.3%	-13.7%	-30.2%	-32.2%	-115.8%	-11.2%
Other income % revenues	7.0%	7.1%	10.0%	16.2%	106.1%	9.4%
Net interest margin (%)	0.6%	0.6%	0.5%	0.4%	0.4%	0.5%
Pre-provision income % risk-weighted assets (RWAs)	1.0%	0.7%	0.3%	0.1%	0.3%	1.0%
Loan-loss provision charges % pre-provision income	24.6%	46.9%	89.5%	562.2%	91.0%	71.4%
Loan-loss provision charges % gross loans (cost of risk)	0.1%	0.1%	0.1%	0.2%	0.1%	0.3%
Cost income ratio (%)	60.5%	65.6%	80.2%	92.4%	81.8%	61.4%
Net interest income / loan-loss charges (x)	7.2	5.1	5.5	1.9	4.7	2.5
Return on average equity (ROAE) (%)	9.8%	-13.6%	0.2%	-3.6%	0.5%	1.6%
Return on average funded assets (%)	0.2%	-0.3%	0.0%	-0.1%	0.0%	0.0%
Retained earnings % prior year's book equity	9.8%	-15.7%	0.2%	-3.6%	0.4%	1.7%
Pre-tax return on common equity tier 1 capital	12.6%	-18.7%	0.4%	-5.4%	n.a.	n.a.
Capital and risk protection						
Common equity tier 1 ratio (%, fully loaded)	n.a.	n.a.	n.a.	n.a.	9.0%	9.6%
Common equity tier 1 ratio (%, transitional)	6.9%	8.5%	9.2%	9.0%	n.a.	n.a.
Tier 1 capital ratio (%, transitional)	7.6%	9.1%	9.8%	9.7%	n.a.	n.a.
Total capital ratio (%, transitional)	8.7%	9.9%	10.4%	9.9%	n.a.	n.a.
Tier 1 leverage ratio (%)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Total loss coverage (CET1 + loan-loss provisions) % RWAs	8.6%	10.2%	11.1%	11.5%	n.a.	n.a.
Non-senior MREL estimate (%)	2.6%	3.2%	3.0%	3.2%	2.8%	3.3%
Asset risk intensity (RWAs % total assets)	28.1%	31.0%	26.4%	28.1%	24.7%	24.3%

Source: SNL, Scope Ratings

Ratings – Crédit Foncier de France*		Ratings – Compagnie de Financement Foncier (CoFF)	
Issuer Credit-Strength Rating	**AA-**	**Issuer Credit-Strength Rating**	**AA-**
Outlook	Stable	Outlook	Stable
Senior unsecured debt	N/A	Senior unsecured debt	N/A
Short term debt rating	N/A	Short term debt rating	N/A
Short term debt rating outlook	N/A	Short term debt rating outlook	N/A

* The ratings are not applicable to debt issued by unguaranteed subsidiaries of the rated parent.

Regulatory Disclosures

Information pursuant to Regulation (EC) No 1060/2009 on credit rating agencies, as amended by Regulations (EU) No. 513/2011 and (EU) No. 462/2013

Responsibility

The party responsible for the dissemination of the financial analysis is Scope Ratings AG, Berlin, District Court for Berlin (Charlottenburg) HRB 161306 B, Executive Board: Torsten Hinrichs (CEO), Dr. Stefan Bund and Dr. Sven Janssen.

The rating analysis has been prepared by Michaela Seimen Howat, Executive Director

Responsible for approving the rating: Sam Theodore, Group Managing Director

The rating concerns an issuer, which was evaluated for the first time by Scope Ratings AG.

The rating outlook indicates the most likely direction of the rating if the rating were to change within the next 12 to 18 months. A rating change is, however, not automatically ensured.

Information on interests and conflicts of interest

The rating was prepared independently by Scope Ratings, but for a fee based on a mandate of the issuer and with participation of the issuer (solicited).

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Key sources of Information for the rating

Website of the rated entities, Annual reports/ quarterly reports of the rated entities, public covered bond specific reports, Programme documentation and terms and conditions of the covered bonds issued, confidential information on the cover pool composition and related cash flow structures Current performance record, Detailed information provided on request, Data provided by external data providers, Interview with the rated entity, External market reports, Press reports, data series and research by central banks from reputable market participants.

Scope Ratings considers the quality of the available information on the evaluated company to be satisfactory. Scope ensured as far as possible that the sources are reliable before drawing upon them, but did not verify each item of information specified in the sources independently.

Examination of the rating by the rated entity prior to publication

Prior to publication, the rated entity was given the opportunity to examine the rating and the rating drivers, including the principal grounds on which the credit rating or rating outlook is based. The rated entity was subsequently provided with at least one full working day, to point out any factual errors, or to appeal the rating decision and deliver additional material information. Following that examination, the rating was not modified.

Methodology

The methodology applicable for this rating "Bank Rating Methodology" (May 2016) is available on www.scoperatings.com. The historical default rates of Scope Ratings can be viewed on the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope's credit rating, definitions of rating symbols and further information on the analysis components of a rating can be found in the documents on methodologies on the rating agency's website.

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