Compagnie de Financement Foncier

French Covered Bonds – Performance Update

Covered bond rating
AAA

Outlook
Stable

Last rating action
23 Oct 2023

Issuer rating
A+

Outlook
Stable

Last rating action
27 Jun 2023

Rating rationale (summary)

The AAA ratings with a Stable Outlook on the French covered bonds (*obligations foncières*) issued by Compagnie de Financement Foncier S.A. (CoFF) are based on the bank's issuer rating of A+, enhanced by four notches due to governance support.

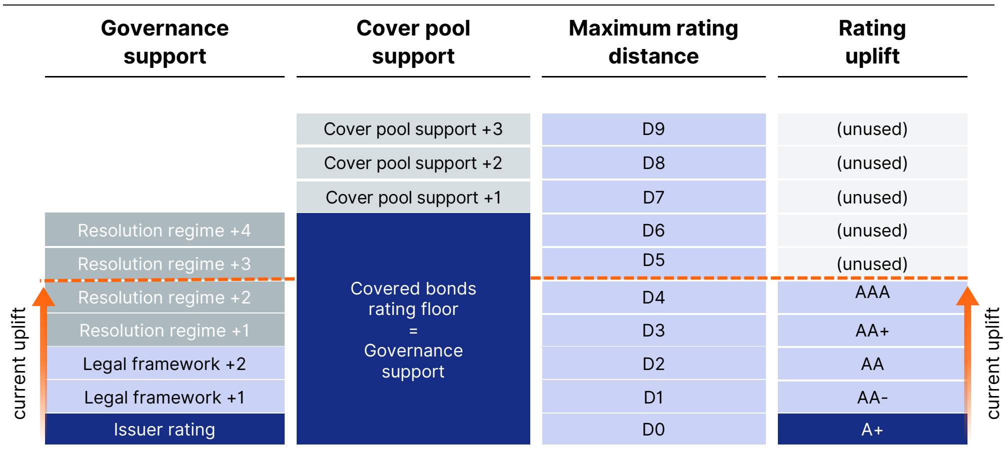
Cut-off date	Cover pool	Cover asset type	Covered bonds	Rating/Outlook
30 September 2023	EUR 58,392m	Mixed	EUR 50,605m	AAA/Stable

CoFF, wholly owned by Crédit Foncier de France (CFF), is an integral member of Groupe BPCE, a leading banking group in France. Both CoFF and CFF are rated A+/Stable by Scope. CoFF is the largest covered bond issuer of Groupe BPCE and provides secured funding for the group's financing activities. Our issuer rating on CoFF reflects its role as a strategic subsidiary within the group and its inclusion in the group's internal guarantee and solidarity system.

Governance support from the French legal and resolution framework is the primary rating driver. It provides the covered bonds with six notches of uplift above the issuer rating. Only four notches are needed to raise the covered bond rating to the highest achievable level.

Our cover pool analysis provides additional rating stability. We have assigned the interplay between complexity and transparency a cover pool complexity (CPC) category of 'low', allowing for a maximum additional uplift of up to three notches on top of the governance support uplift. The programme benefits from a five-notch buffer against an issuer downgrade as the maximum theoretical uplift is of nine notches, as opposed to the four notches used to achieve the highest rating for these covered bonds.

Figure 1: Covered bond rating building blocks



Related Research

[Scope affirms Compagnie de Financement Foncier's French covered bonds at AAA/Stable, October 2023]

[Scope affirms A+/Stable issuer ratings on Crédit Foncier and Compagnie de Financement Foncier, June 2023]

Changes since the last performance update

In line with strategic changes within Groupe BPCE, CoFF's mixed cover pool has a strong focus on granular, domestic sub-sovereign and lower-tier public sector exposures. As a consequence, the mortgage pool is de-risking, reflecting the progression in loan amortisation and seasoning.

The cover pool's size and the covered bonds' outstanding amount are expected to further decrease without materially changing the programme's risk profile, thanks to the issuer's strategy to mitigate market risk.

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The issuer

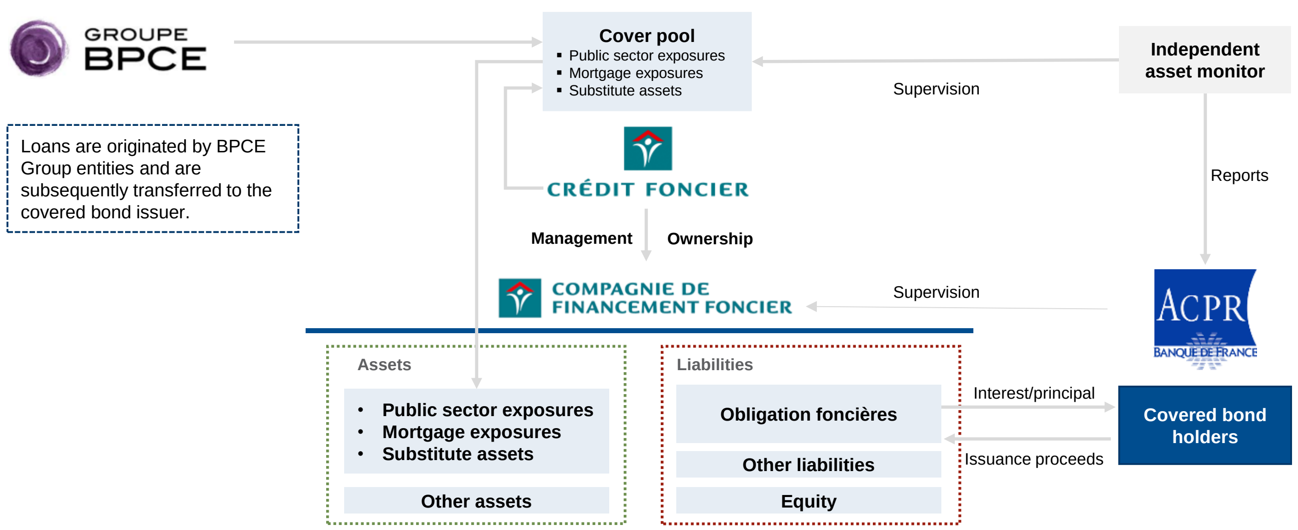
CoFF and CFF benefit from the strong internal solidarity system within Groupe BPCE. The strength of intragroup support is ultimately sensitive to the group's ability to improve its structural efficiency. Any change in the credit quality of BPCE SA, the central body of Groupe BPCE, will entail a similar rating impact for CFF and CoFF.

Our credit view reflects the stable and generally predictable financial fundamentals of Groupe BPCE, as well as its low-risk business model, anchored in domestic retail banking and financial services. Groupe BPCE holds a leading position in the French banking and financial services market. Further details on our credit assessment of CoFF, CFF and Groupe BPCE are available at www.scoperatings.com.

Programme structure

CoFF issues obligations foncières as a *société de crédit foncier* (SCF). The French covered bond framework permits issuers to operate as specialist banks. Most of CoFF's operations are provided by its parent, CFF, and these activities are governed by service-level agreements. The issuer needs to maintain compliance with regulatory requirements and is independently supervised.

Figure 2: Issuance structure



Source: Scope Ratings

Governance support analysis

The strength of the French legal and resolution framework raises the uplift by up to six notches

Governance support factors enhance the covered bond rating by six notches above CoFF's issuer rating. Only four of these notches are needed to maintain the AAA rating. This is based on: i) France's strong legal covered bond framework; and ii) its resolution regime and the systemic importance of CoFF's covered bonds.

Legal framework analysis

Two notches from the strong covered bond framework

The current French covered bond framework meets all the relevant criteria in our rating Covered Bond Rating Methodology, allowing up to two notches of rating differentiation.

The cover pool is fully segregated upon insolvency of the issuer. The bonds have a preferential claim on the respective assets (including overcollateralisation). The issuer is a specialist financial institution supervised by the French regulator (Autorité de Contrôle Prudentiel et de Résolution). Investors have no direct recourse to the parent of the issuer, only to the specialist issuer.

The respective covered bond act does not foresee the issuer's insolvency impacting its ability to make timely payments on its covered bonds. The act stipulates a maximum 18 month mismatch between the weighted average cover assets and covered bonds. Further liquidity provisions such as the mandatory liquidity buffer that covers shortfalls within the next 180 days are available. Additional mechanisms can be contracted by the issuer (such as prematurity tests and/or soft bullets). Repo financing can also be used to cover temporary liquidity shortfalls.

Programme enhancements remain available as all other creditors of the SCF rank junior to covered bonds, available overcollateralisation (OC) on the balance sheet remains fully available for covered bond holders upon the issuer's insolvency (or the parent's) and must be at least 5% above the level of outstanding covered bonds. Derivative counterparties rank pari passu with covered bonds and will not accelerate upon the issuer's insolvency. The framework benefits from explicit liquidity risk guidelines. As regulated entities, issuers must maintain an active market risk management to comply with regulatory requirements.

In addition to general banking supervision by the French banking regulator, several additional external monitoring requirements are in place. An independent trustee (*contrôleur spécifique*) supervises statutory or contractual maintenance requirements. Failure to comply must be flagged to the regulator. Trustees are liable for any misconduct and are independent from both the issuer and the sponsor bank.

Resolution regime analysis

Four additional notches from the supportive resolution environment

Four additional notches of uplift for the covered bonds reflect the benefits of the resolution regime and the bonds' systemic importance in France.

Resolution is monitored at group level and CoFF is via CFF included into the BPCE support system. The BPCE group is resolvable and will comply with all regulatory requirement that also benefit CFF.

The market has a strong footprint with both international as well as domestic investors. The French covered bond market is in the top five globally with EUR 367bn of outstanding bonds at end-2022. In 2022, almost EUR 60bn were issued, making France rank in the top five in respect to new issuances. As of mid-2023, CoFF's covered bonds accounted for 16% of all French issuances.

The systemic importance of covered bond funding in France is high. Stakeholders are highly incentivised to support French covered bonds. This high systemic importance is likewise expected to incentivise regulators to use the resolution framework without impairing the functioning of covered bonds.

Cover pool analysis

The programme's governance credit support of up to six notches already corresponds to the highest possible rating. It is the key rating driver and, as such, cover pool support is not needed. We determine whether cover pool support could further stabilise the ratings in part by examining the interplay between complexity and transparency. This analysis translates into a CPC category of 'low', which allows for a maximum three-notch cover-pool-related uplift on top of the governance uplift.

Our cover pool analysis stabilises the rating at AAA. This would stand even if the bank were downgraded to BBB-, assuming that maintained OC did not constrain the cover pool uplift.

Cover pool characteristics

Reporting date	Q3 2023	Q3 2022
Balance (EUR m)	58.392	59.079
Residential	44.0%	46.0%
Commercial	0.8%	1.0%
Public Sector	46.1%	43.3%
Substitute	8.1%	8.7%
Other	1.0%	1.0%

Cover pool composition

CoFF's covered bond programme is secured by a mixed cover pool comprising public-sector loans (43.1%), mortgage exposures (44.8%; of which 44.0 pp are residential and 0.8 pp commercial) and substitute assets (8.1%). This composition is broadly stable within the respective sub-pools.

Mortgage pool: cover pool analysis

The mortgage pool is highly granular with around 339,000 loans, which are well diversified across France. Most of the mortgage loans are owner-occupied fixed-for-live loans benefiting from a public guarantee. Since our last review in September 2022 the pool's balance decreased by 3%, reflecting the strategic shift to fund most of Group BPCE's mortgage loans outside CoFF. This is also reflected in a decreasing remaining life and drop in loan-to-value (LTV).

General information (mortgage)

Reporting date	Q3 2023	Q3 2022
No. of loans	339,705	351,627
Avg. size (EUR)	77,027	79,089
Top 10 (%)	0.5%	0.6%
Remaining life (y)	9.2	9.6
Weighted average initial LTV	71.6%	74.0%
Weighted average indexed LTV	61.9%	65.9%

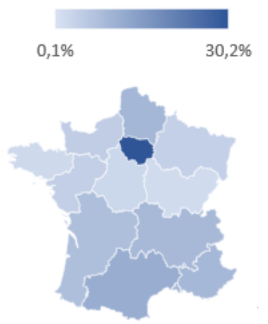
Repayment type (%)

Reporting date	Q3 2023	Q3 2022
Annuity	97.7%	97.8%
Interest-only	2.3%	2.2%

Interest rate type (%)

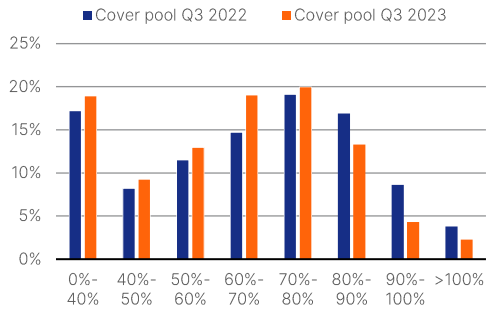
Reporting date	Q3 2023	Q3 2022
Fixed	94.9%	93.5%
Floating	5.1%	6.5%

Figure 3: Regional distribution



Source: Scope Ratings, CoFF

Figure 4: LTV distribution (whole loan)



Source: Scope Ratings, CoFF

Indexed LTV ratios have decreased by around 4 pp (versus a drop of 7 pp in September 2022). We expect this trend to continue in the coming years.

The credit quality of the cover pool remains strong. Our mortgage credit risk analysis takes into account default and recovery vintage data provided by the issuer. The analysed data includes the credit performance of annual origination vintages during 2000-2020, a timeframe which contains several periods of economic stress.

We assumed an annual average default probability of 15 bp, unchanged since our last review. This reflects the pool's high seasoning and its limited inflow of newly (riskier) underwritten mortgages. We further assume a weighted average recovery rate of 70.0% (up from 67.0%) under the most stressful scenario, reflecting decreasing LTV.

Public sector pool: cover pool analysis

The public sector pool mainly comprises self-originated, domestic sub-sovereign and lower-tier public sector exposures. Following strategic changes at group level, the relative share of the public sector sub-pool and the domestic focus of the pool continue to increase. International exposures, currently about a quarter of the sub-pool, will amortise but will not be replenished upon maturity. The weighted average credit quality remained stable, at an equivalent rating of a-.

General information (public sector)

Reporting date	Q3 2023	Q3 2022
No. of loans	8,710	7,351
No. of exposures	3,908	3,188
Avg. size (EUR m)	6.9	8.0
Top 10 (%)	10.5%	12.0%
Remaining life (years)	8.1	8.1

Debtor breakdown (%)

Reporting date	Q3 2023	Q3 2022
Sovereigns	15.1%	19.5%
Regional/federal	32.5%	32.4%
Local/municipal	30.3%	28.0%
Others	22.1%	20.2%

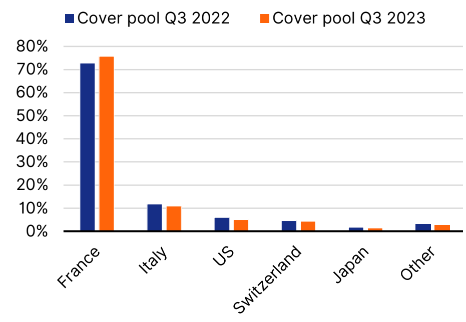
Repayment type (%)

Reporting date	Q3 2023	Q3 2022
Annuity	79.4%	77.5%
Interest-only	20.6%	22.5%

Interest rate type (%)

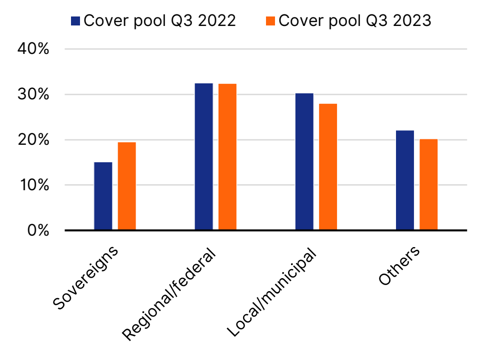
Reporting date	Q3 2023	Q3 2022
Fixed	75.3%	74.4%
Floating	22.2%	22.8%
Other	2.5%	2.8%

Figure 5: Country distribution



Source: Scope Ratings, CoFF

Figure 6: Debtor type distribution



Source: Scope Ratings, CoFF

For the public sector pool, we derived a default distribution by using name-by-name credit assessments and consolidating the exposures into risk-representing entities, reflecting the obligor's final guarantor. We also used a correlation framework to incorporate the impact of geographical and debtor concentrations. The annual average default probability further decreased to 12 bp from 14 bp in our previous analysis, reflecting a lower share of risky international exposures. At the same time, the coefficient of variation increased to 121% from 117%.

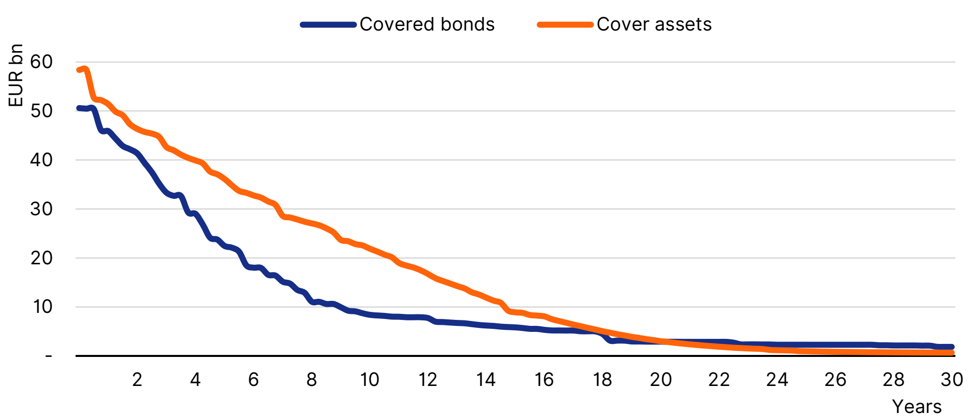
For each exposure, we applied stressed recovery rate assumptions of between 40% and 75% based on obligor type. This resulted into a weighted average recovery rate of 65.0% under the most stressful scenario.

Cash flow risk analysis

The OC supporting the AAA rating is floored at the legal minimum of 5%. The rating is based on governance support. Cover pool support is not a rating driver.

The cover pool support can maintain the current AAA rating up to a five-notch issuer downgrade

Figure 7: Amortisation profile



Source: Scope Ratings, CoFF

To test rating stability in case of a hypothetical issuer downgrade, we determined the OC needed to support the current rating uplift if the programme had to rely on cover pool support. We performed a full analysis supported by detailed data provided by CFF. We found that based on current OC, cover pool support can maintain the current AAA rating up to a five-notch issuer downgrade.

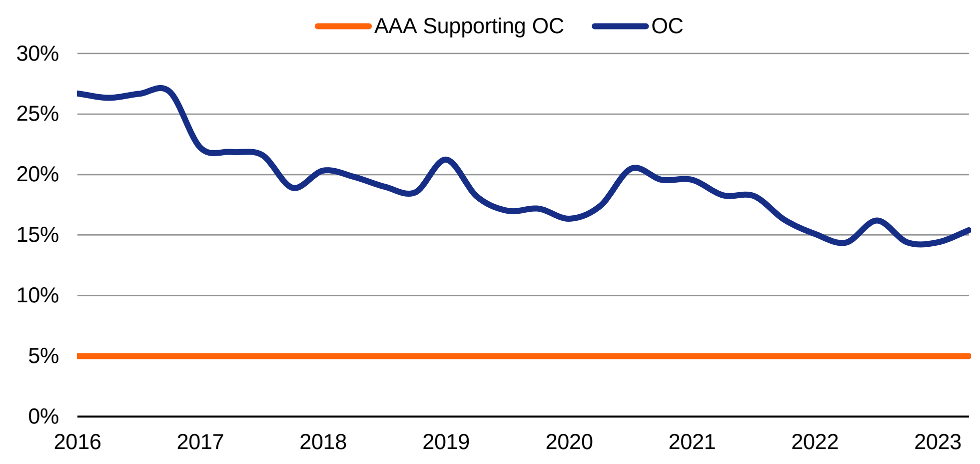
The issuer has a prudent strategy to mitigate market risk (i.e. interest and foreign exchange risks). Residual interest rate risk is low. Maturity mismatch is also limited, reflecting the issuer's focus on matching cash flows, particularly in the short term, and its provision of immediate liquidity for the first 180 days via highly liquid collateral registered in the cover pool.

The rating-supporting OC mainly reflects the programme's sensitivity to low prepayments in combination with increasing and non-reverting interest rates. In a scenario in which asset sales are needed to repay interest or principal, we calculated the net present value of remaining cash flow using a discount curve, adding asset-specific liquidity premiums that reflect the composition of the sub-pools. We used liquidity premiums of 300 bp for mortgage assets and 283 bp for public-sector assets.

Availability of OC

Due to the high issuer rating, we account for the maintained OC, which as of Sept 2023 stands at 15.4%. CoFF typically provides much higher OC than the French legal minimum, currently at 5%. This demonstrates the issuer's willingness and ability to support the covered bond programme's strong credit quality. We also view positively the fact that the internal OC guidance is not static but a function of the portfolio's composition and risk profile. We are not aware of plans that would significantly change the risk profile or reduce available OC.

Figure 8: OC development



Source: Scope Ratings, CoFF

Other risk considerations

Main counterparty exposure relates to CoFF

The rated bonds are exposed to CoFF and CFF's roles as originator, servicer, account provider and paying agent. No documented replacement mechanisms would automatically shield the covered bonds from a credit deterioration of, for instance, the counterparties providing bank accounts. However, in such a scenario, the strong alignment of interests between the bank and the covered bondholders would prevent negative impacts before a regulator intervenes. As part of its risk management process, the bank regularly monitors its accounts to ensure that any required remedial action is taken at an early stage.

We expect any regulatory intervention in CoFF to involve the use of available resolution tools with the aim of maintaining the issuer. We do not expect the active management and servicing of the cover pool to be severely impacted in such a scenario.

Market risks hedged with derivatives that mostly feature counterparty risk mitigations

CoFF actively uses derivatives to limit or eliminate market risk. We take comfort from the fact that the derivative counterparties generally have high credit quality, benefit from the Bank Recovery and Resolution Directive and are resolvable. Further, most of the derivatives entered into by CoFF have mechanisms to mitigate counterparty risk, i.e. collateralisation upon a counterparty's negative credit migration, including the ability to replace it with counterparties of stronger credit quality. Most derivatives are market-standard micro and macro hedges, and the diversity of counterparties should also facilitate their replacement.

Country risk does not affect the ratings

Sovereign risk does not limit the ratings of CFF's mixed covered bonds. We believe the risks of an institutional framework meltdown, legal insecurity and currency-convertibility problems are remote.

Governance remains key ESG factor

Governance considerations such as the strength of supervision and prudent management play a major role in our covered bond analysis, reflected in both our governance analysis and our cover pool support analysis. In addition, our CPC category measures the issuer's management of the interplay between complexity and the level of transparency provided to investors.

The information provided by the issuer did not enable us to incorporate potential credit benefits from ESG-compliant cover assets in our analysis (e.g. better recovery prospects for more energy-efficient collateral or a lower liquidity premium).

We acknowledge, that CoFF has issued its first inaugural Social (Social Housing & Healthcare) covered bond in October 2023 over EUR 500m. Its social covered bond is issued out of Groupe BPCE Sustainable Development Bond Programme. The bond's proceeds finance or refinance eligible loans for social housing and healthcare assets. According to CoFF, the eligible loan portfolio as of October 2023 is EUR 819m split 59% on social housing and 41% on public hospitals. While we do not expect to see a relevant spread improvement, this initiative widens the issuer's funding outreach and attracts investors focused on ESG.

Sensitivity analysis

The issuer rating of A+ in combination with the governance support uplift of up to six notches allows the AAA rating to be maintained without the need for credit support from the cover pool, even upon an issuer downgrade of up to two notches.

Five-notch buffer against potential change in issuer rating

The covered bond rating can withstand an issuer downgrade of five notches, considering the possible three notches of potential uplift provided by the cover pool. However, such an issuer rating downgrade would require a major adverse shock to the French economic and banking environment. Such a shock would also likely result in changes in the cover pool's asset quality and risk structure and would thus require the constant monitoring of the programme's credit quality.

Appendix: Summary of covered bond characteristics

Reporting date	30 September 2023	30 September 2022
Issuer name	Compagnie de Financement Foncier S.A.	
Country	France	
Covered bond name	Obligations foncières (French covered bonds)	
Covered bond legal framework	French legal covered bond framework	
Cover pool type	Mixed assets	
Composition	Residential = 44.0%	Residential = 46.1%
	Commercial = 0.8%	Commercial = 1.0%
	Public sector = 46.1%	Public sector = 43.2%
	Substitute/other assets = 9.1%	Substitute/other assets = 9.7%
Issuer rating	A+/Stable	A+/Stable
Current covered bond rating	AAA/Stable	AAA/Stable
Covered bond maturity type	Hard bullet	Hard bullet
Cover pool currencies	EUR (100% hedged)	EUR (100% hedged)
Covered bond currencies	EUR (100% hedged)	EUR (100% hedged)
Governance support (notches)	6	6
Maximum additional uplift from CPC category (notches)	3	3
Maximum achievable covered bond uplift (notches)	9	9
Covered bond rating buffer (notches)	5	5
Cover pool (EUR m)	58.4	59.1
of which substitute assets and deposits (EUR bn)	4.8	5.7
Covered bonds (EUR m)	50.6	51.7
Overcollateralisation: current/legal minimum	15.4%/5.0%	14.4%/5.0%
Overcollateralisation to support current rating	5.0% (legal minimum)	5.0% (legal minimum)
Overcollateralisation upon a one-notch issuer downgrade	5.0% (legal minimum)	5.0% (legal minimum)
Weighted average life of assets	8.0 years	8.2 years
Weighted average life of liabilities	6.9 years	7.1 years
Number of loans (public sector/mortgages)	8,710/339,705	7,351/351,780
Average loan size (tsd EUR) (public sector/mortgages)	3,091/77.0	3,475/79.1
Top 10 exposures (public sector/mortgages)	10.5%/0.5%	12.0%/0.6%
Interest rate type – assets (public sector and mortgages)	Fixed: 84.9%	Fixed 84.1%
	Floating: 15.1%	Floating 15.9%
Interest rate type – liabilities (after hedging)	Fixed: 66.0%	Fixed 63.6%
	Floating: 34.0%	Floating 36.4%
Weighted average eligible-loan LTV ratio (mortgage)	71.6%	74.0%
Geographic split (top three) (public sector/mortgages)	France: 75.7%/98.0%	France: 72.7%/97.9%
	Italy 10.9%/0.0%	Italy 11.8%/0.0%
	US 5.0%/0.0%	US 5.9%/0.0%
Default measure (public sector/mortgages)	Non-parametric/Inv Gaussian	Non-parametric/Inv Gaussian
Mean default rate (public sector/mortgages)	2.3% / 2.2%	2.0% / 2.2%
Coefficient of variation (public sector/mortgages)	117.3% / 150.0%	121.2% / 150.0%
Base – recovery assumption (public sector/mortgages)	100% / 95.0	100% / 95.0%
Stressed – recovery assumption (public sector/mortgages)	65.0% / 67.0%	65.5% / 70.0%
Max. liquidity premium (public sector/mortgages)	289 bp / 300 bp	283 bp / 300 bp
Servicing fee (public sector/mortgages)	10 bp / 25 bp	10 bp / 25 bp

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