22 January 2020

Financial Institutions

Crédit Foncier de France Issuer Rating Report

AA- STABLE

Overview

Scope assigns an Issuer Rating of AA- to Crédit Foncier de France ('CFF') with a Stable Outlook, and an identical rating and outlook to its key issuing subsidiary, Compagnie de Financement Foncier ('CoFF').

Highlights

- CFF is a wholly owned subsidiary of BPCE, the central body of the two large French banking groups, the Banque Populaire (BP) – cooperative banks – and Caisses d'Epargne (CdE) – savings banks. CFF's subsidiary CoFF's sole purpose is to act as a covered bond issuer financing the mortgage and public-sector lending of both CFF and the whole BPCE group, with covered bonds (*obligations foncières*).
- In June 2018 it was announced that from early 2019 new lending that now flows through CFF will be conducted by other entities within Groupe BPCE, to create efficiency savings. CFF will continue to manage its existing loans, and CoFF will continue to refinance the Group's public-sector financing activities. From 2019 CFF's balance sheet is expected to shrink gradually as existing loans roll off.
- Crucially, CFF and CoFF still carry the status of affiliates within the Group, and CoFF, the issuer of covered bonds, will remain as a strategic subsidiary. Affiliate legal status implies that both Issuer Ratings are closely linked to the credit quality of BPCE SA[1].
- CFF and CoFF both benefit from an internal guarantee and solidarity within Groupe BPCE. BPCE SA must guarantee the liquidity and solvency of all its affiliates. As a shareholder BPCE is obliged to draw on its own capital resources. Beyond this it would use its own mutual guarantee fund, and subsequently could draw upon the BP and CdE networks' guarantee funds. The three funds had nearly EUR 1.1 bn of cash available for immediate distribution (as of 31 December 2018). If all these sources were to be exhausted, additional sums would be requested from all member banks of the BP and CdE networks. Groupe BPCE's aggregated Tier 1 capital may be used to cover financial failings of any affiliate.

Rating drivers (summary)

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

- CFF and CoFF benefit from the strong internal solidarity system within Groupe BPCE. Any change in the credit quality of BPCE would entail a similar rating impact for CFF and CoFF.
- CFF and CoFF's ongoing weight within Groupe BPCE are likely to reduce over time as assets run off from 2019 onwards. CoFF will remain a strategically important issuer of covered bonds for the whole Group.
- Risk management is strongly aligned to that of Groupe BPCE, and bondholders benefit from the group's strong risk control culture.

[1] Scope Ratings maintains a subscription rating for BPCE SA via its credit intelligence platform ScopeOne. Interested investors can sign up for this service by contacting the ScopeOne Service Centre servicecentre@scopegroup.com.

Ratings & Outlook

Crédit Foncier de France

Issuer Rating	AA-
Outlook	Stable

Compagnie de Financement Foncier (CoFF)

Issuer Rating	AA-
Outlook	Stable

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

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Bloomberg: SCOP

Rating change drivers

Given the close integration of CFF and CoFF within the BPCE group, their ability to improve ratings on a standalone basis is currently limited. However, at Groupe BPCE level, restructuring aimed at reducing excess capacity and lowering costs (as will be the case with respect to both companies' roles from 2019 onwards) eventually could help to drive its credit quality upwards. Groupe BPCE's 2018-2020 strategic plan sets out several objectives including greater efficiency and broad digital transformation.

The rating is based on the positions of CFF and CoFF as affiliates of Groupe BPCE, and thus the benefit of the strong internal guarantee and solidarity system within the Group. Should the Group's commitment to its associates become weaker, the parent's credit quality could have less of an impact on the affiliates' ratings.

Overview

Groupe BPCE, of which **BPCE SA** is the central institution, is France's second largest banking group by assets. BPCE SA was established in 2009 as the central body of the two large French banking groups – the fourteen Banque Populaire banks (BP) and the sixteen Caisses d'Epargne (CdE), each with co-operative shareholders. In addition to CFF and CoFF, the main subsidiaries of the BPCE group consist of Natixis, Banque Palatine and BPCE International.

Crédit Foncier de France is a wholly owned subsidiary of BPCE SA (BPCE). CFF is a bank organised as a société anonyme, subject to French commercial law. However, as a credit institution that is officially approved as a specialist financial institution, CFF is also subject to the provisions of the French Monetary and Financial Code. CFF's roots date back to 1852. It was taken over by CdE in 1999. Within the BPCE Group, CFF has over recent years been operating as a leading specialist in property financing and services, as well as in financing public entities. While CFF's expertise remains highly relevant to the Group, in 2019 its property financing role was taken over by the CdE and BP networks.

Compagnie de Financement Foncier is wholly owned by CFF and licensed as a specialised credit institution and *société de credit foncier*. CoFF was established in 1999, the result of a new legal framework (the French Savings and Financial Security Act) being put in place for covered bond issuance in the wake of CdE's acquisition of CFF. Prior to this, only CFF or Crédit Foncier et Communal d'Alsace et de Lorraine were permitted to issue obligations foncières or covered bonds. The purpose of a *société de crédit foncier* is defined in Article L. 513-2 of the French Monetary and Financial Code: as the granting or acquiring of guaranteed loans i.e. loans backed by first-rank mortgages or real property collateral conferring at least an equivalent guarantee, or exposures to public-sector entities, and financing them by issuing obligations foncières.

CoFF's role is to fund public-sector lending on behalf of Groupe BPCE, and to continue refinancing the mortgage assets already in its cover pool. It is one of the largest covered bond issuers in the world.

Rating drivers (details)

CFF and CoFF both benefit from a strong internal solidarity system within Groupe BPCE, firstly through direct support from the central body BPCE SA (BPCE) using its own capital resources as a shareholder. The entities are further backed by the guarantee funds within the Group and ultimately the ability to tap into the resources of its member banks. Any material change in the credit quality of BPCE would have a direct impact on the ratings for CFF and CoFF.

All credit institutions affiliated with Groupe BPCE, including CFF and CoFF, are covered by its guarantee and solidarity mechanism. This was set up pursuant to Article L. 512-107-6 of the French Monetary and Financial Code (*Code monetaire et financier*). BPCE, as the Group's central institution, is tasked with taking all necessary measures to guarantee the liquidity and capital adequacy of the group and of each network. This includes defining the principles covering intragroup cash flows and investments, as necessary for managing liquidity. It also covers any internal financing mechanisms designed to ensure the solvency of the Group, which includes the establishment and administration of a mutual guarantee fund shared by the BP and CdE networks. BPCE also manages the BP Network Fund and the CdE Network Fund. The amount of deposits made to BPCE for the three funds may not be less than 0.15% nor greater than 0.3% of Group risk-weighted assets.

Although CFF's role has been changing, the operation of the solidarity mechanism will remain unchanged. CFF and CoFF will continue to carry the status of affiliates within the Group. This legal status continues to support the equalisation of their Issuer Ratings with the credit quality of BPCE SA.

If CFF or CoFF were to encounter financial difficulty, BPCE would proceed as follows:

(i) BPCE as the Group's central body would be the first port of call for support, using its own capital (EUR 20.8 bn as at 30 June 2019) in accordance with its duty as a shareholder;

(ii) Should this prove insufficient, it would use the mutual guarantee fund created and controlled by BPCE, which at June 30, 2019 totalled €181 million in assets provided jointly by the BP and CdE networks, and which is increased through an annual contribution (subject to the amounts which would be used in the event of a call for funds);

(iii) If BPCE's capital and this mutual guarantee fund should prove insufficient, BPCE would call on (in equal proportions) both the BP and CdE networks' own guarantee funds of €900 million in total and; finally

(iv) If calls on BPCE's capital and these three guarantee funds should prove insufficient, additional sums would be requested from all member banks of the BP and CdE networks.

It should be noted that the guarantee funds referred to above consist of a Groupe BPCE internal guarantee mechanism activated at the initiative of the BPCE Executive Board or the French banking regulator, which may request that it be used if deemed necessary.

The group's aggregated Tier 1 capital may be used to cover any financial failings of any affiliate. As of 30 June 2019, the Tier 1 capital of the BPCE group (99.6% comprising Common Equity Tier 1 capital) stood at EUR 63.5bn.

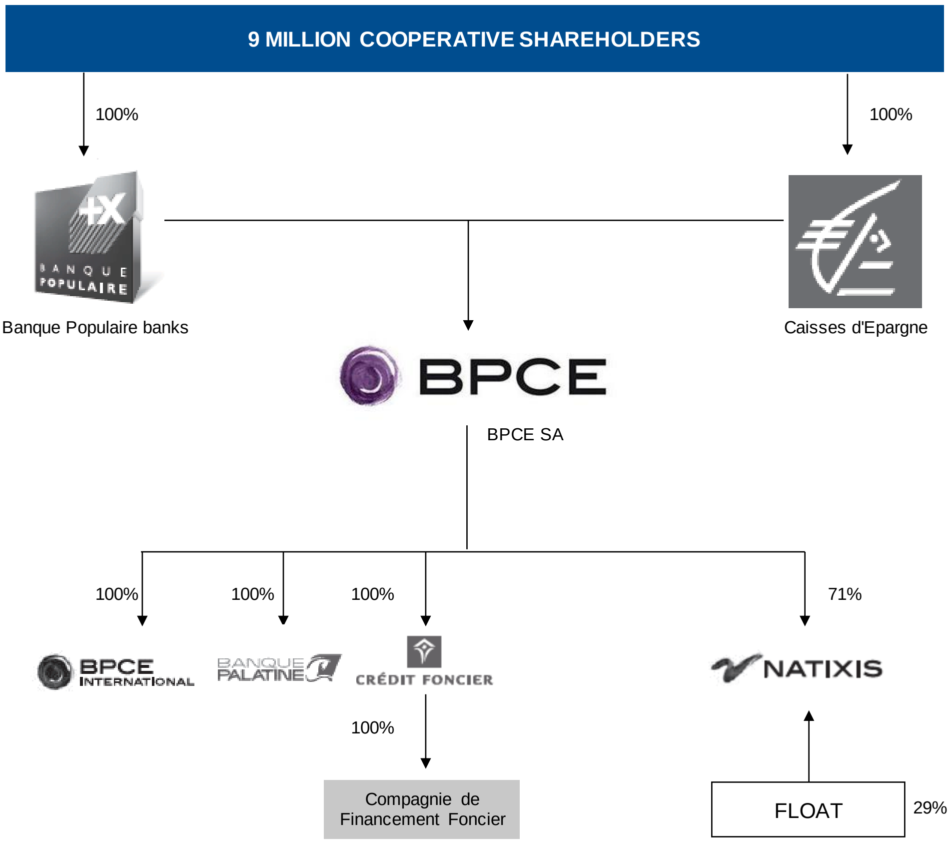
As affiliates, CFF and CoFF do not contribute to the guarantee mechanism of Groupe BPCE and will not be called upon in the event of a BP or a CdE default.

Groupe BPCE has previously shown strong commitment to supporting various entities. For example, it guaranteed a large portion of the net value of a segregated workout credit portfolio for its investment banking arm, Natixis, in 2009. We also note that CFF benefited from a EUR 1.5bn capital increase in late 2011. CFF's securitisation portfolio was transferred to BPCE in September 2014, and BPCE's risk management division conducted 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).

Continuing position within Groupe BPCE, France's second largest banking group by assets, albeit CFF's role will reduce over time as assets run off.

CoFF will continue as a strategically important subsidiary issuing covered bonds for the Group and has achieved deep and diversified market access for its covered bond offerings – which should continue to be the case.



Source: Company data, Scope Ratings

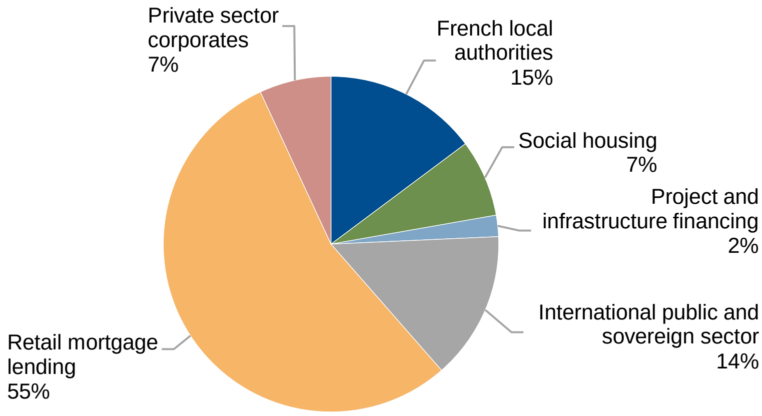
To create greater efficiencies for Groupe BPCE going forward, it was announced in June 2018 that from early 2019, CFF's role would change. Most of the operational aspects of this took effect in 1H19. New loan production ceased during February 2019 and was redeployed within other Groupe BPCE entities. A new real estate partnership management organisation has been set up at Group level. Many of CFF's staff were offered roles elsewhere within the wider Group, moving to their new companies in April 2019, and others accepted voluntary redundancy. Groupe BPCE intends to retain the

CFF brand and legal entity. CFF will continue to service its existing loans, and to manage its largest subsidiary, CoFF. CFF's wholly owned subsidiary Crédit Foncier Immobilier, which provides real estate services such as consultancy, valuation and property management, will eventually be owned directly by BPCE SA, as will Socfim (dedicated to financing developers).

As of 30 June 2019, CFF had a consolidated balance sheet size of EUR 111.7bn (of which CoFF accounted for EUR 74.7bn).

Within CFF's EUR 84.4bn of customer loans, around EUR 45.9bn were home loans to individuals, EUR 5.8bn to investors and real estate professionals, and EUR 32.5bn were public sector loans (which include those supporting infrastructure projects and social housing). Of total exposures 83% were in France. Given the long term of many of its existing loans, it is expected that the size of the balance sheet will reduce gradually now that new loan production has ceased.

Figure 1: CFF Loan Book Split, 1H19

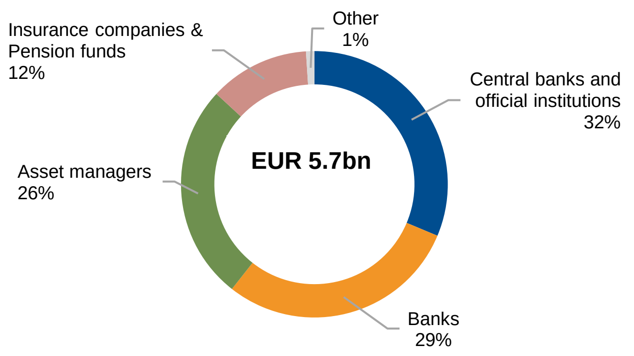


From early 2019 CoFF's role was refocused, mainly to refinance the public sector and similar assets generated by Groupe BPCE as a whole. Previously CoFF was refinancing both residential mortgages and public sector loans granted by CFF and Groupe BPCE's other networks. CoFF's loans selection process is in two stages – the other party (no longer CFF, but other members of Groupe BPCE) originate the loans, and CoFF applies risk filters to screen the loans added to its balance sheet.

CoFF has up until now issued about EUR 6-7bn in covered bonds per year. Total issuance for 2018 was EUR 5.7bn, which included major benchmark issues and private placements. EUR 1.8bn was issued in 1H19. Outstanding obligations foncières stood at €63.5bn at December 31, 2018, (related payables included), and €61.0bn at 1H19. As one of the world's largest covered bond issuers CoFF has developed a deep and diverse international investor base for its covered bond offerings, and Scope expects that this will continue to be the case, as Groupe BPCE intends that the name will continue to be a prominent issuer going forward. The cover pools for its issuance are of mixed collateral types – public sector and mortgages, and these are attractive to many investors. It follows that in future there may be a role for CoFF in refinancing some retail mortgages from other entities in Groupe BPCE, given the depth of its investor base and the margins it is able to achieve. Of CoFF's total assets at 1H19, 54% were mortgage loans or equivalents, and 35% were public sector exposures. Groupe BPCE is a major player in the public sector financing market, with EUR 48.3bn of outstanding loans at the end of 2018.

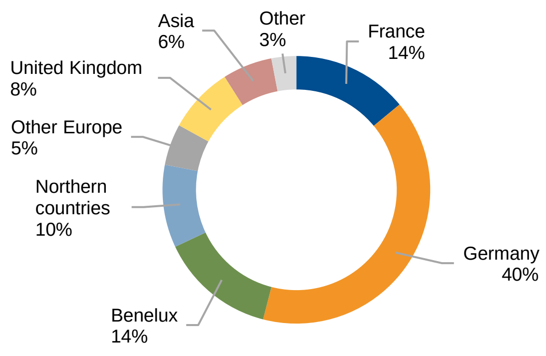
Investors in the EUR 5.7bn raised in 2018 broke down as demonstrated in Figures 2 and 3 below:

Figure 2: 2018 Breakdown of issuances by investor type



Source: Company data, Scope Ratings

Figure 3: 2018 Breakdown of issuances by region



Source: Company data, Scope Ratings

Risk management is strongly aligned to that of Groupe BPCE. Bondholders should continue to benefit from the group's strong risk control culture and oversight as well as the expertise developed by CFF in property financing

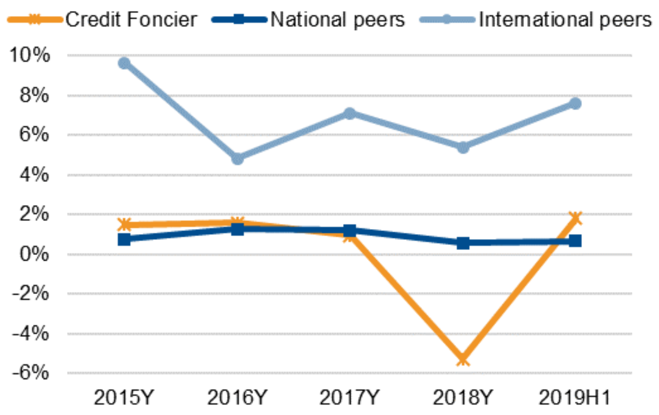
While CFF's executive management is responsible for implementing internal controls – indeed, its risk control systems were originally developed within CFF over a long period – the French Monetary and Financial Code makes BPCE SA ultimately responsible for defining the internal control system of Groupe BPCE and its networks, controlling the financial position of affiliated institutions, and defining Group risk management policies, procedures and limits. Thus, CFF's control systems incorporate the standards set by BPCE, and became more integrated with them from 2012 onwards. Most processes have been digitalised. Periodically internal audits are carried out by members of BPCE's General Inspection department.

From a risk management perspective, CFF has its own risk department comprising between 50 and 60 individuals, and a Board level risk management committee. CFF's Board is chaired by Laurent Mignon, also the Chairman of the Groupe BPCE Management Board and its CEO. CFF's exposures are regularly reviewed in risk management committee meetings at group level.

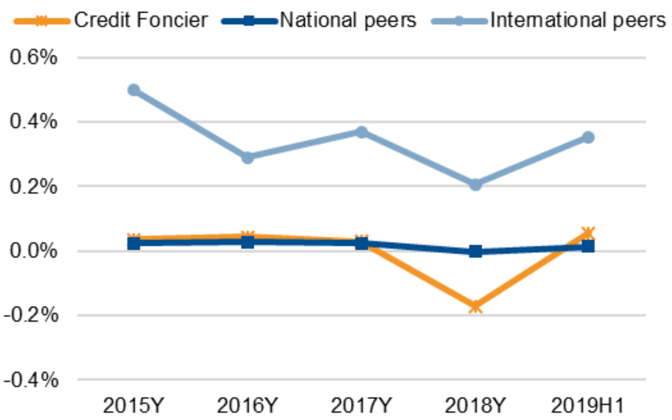
CFF's Risk and Compliance functions are responsible for internal control and compliance for CoFF.

I. Appendix: Peer comparison

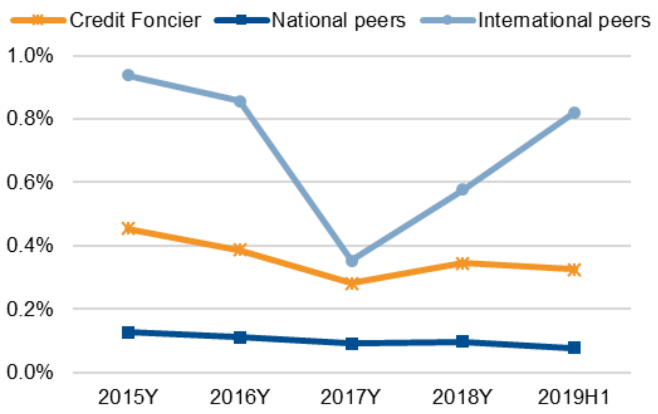
Return on average equity (%)



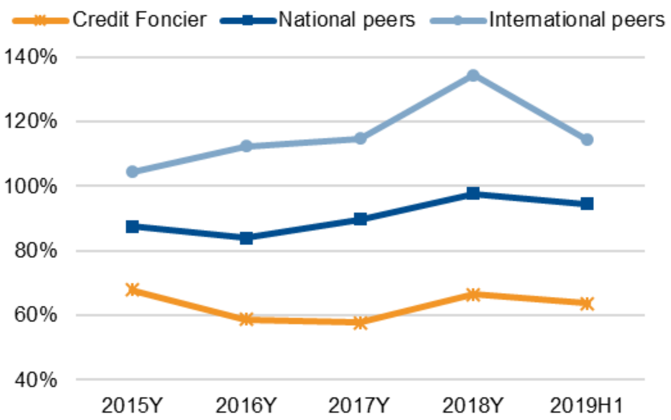
Return on average assets (%)



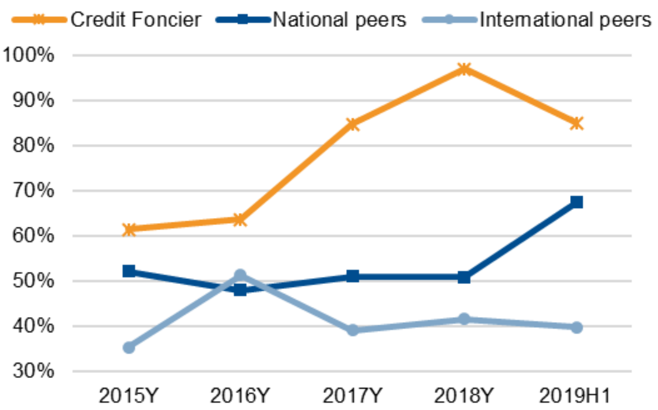
Net interest margin (%)



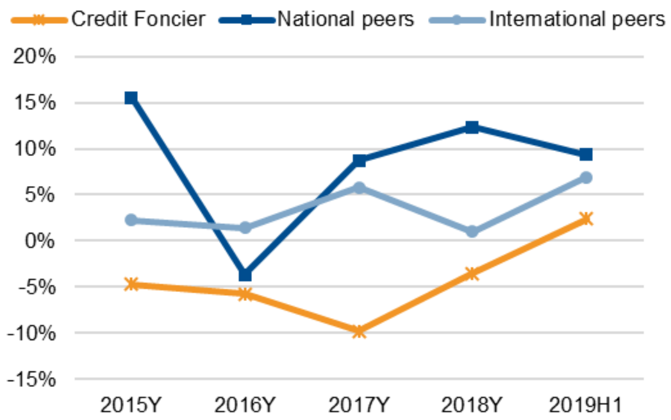
Net interest income/ Operating income (%)



Cost-to-income ratio (%)



Asset growth (%)



Source: SNL, Scope Ratings

*National peers: BNP Paribas Home loan SFH, Societe Generale SFH, Credit Agricole Home Loan SFH, Groupe BPCE, Credit Mutuel Home Loan SFH, La Banque Postale Home Loan SFH, Credit Foncier

International peers: Hypo Burgenland, Hypo Oberoesterreich, Realkredit Danmark, Nordea mortgage bank, Sp mortgage bank, Op mortgage bank, Nordea Hypothek, Swedbank mortgage bank, Stadshypotek, Dusseldorfer Hypotheken, Munchener Hypotheken, DNB Boligkreditt, Coventry Building Society, Yorkshire Building Society, Credit Foncier.

II. Appendix: Selected financial information – Crédit Foncier de France

	2015Y	2016Y	2017Y	2018Y	2019H1
Balance sheet summary (EUR m)					
Assets					
Cash and interbank assets	17,577	14,551	12,106	15,558	15,733
Total securities	17,141	17,043	13,093	19,176	22,095
of which, derivatives	14,454	14,504	10,718	8,888	11,428
Net loans to customers	91,055	86,406	81,157	71,316	69,842
Other assets	8,699	8,731	7,963	4,307	4,005
Total assets	**134,472**	**126,731**	**114,319**	**110,357**	**111,675**
Liabilities					
Interbank liabilities	33,301	30,028	28,002	28,231	28,923
Senior debt	78,199	76,169	69,295	68,002	67,142
Derivatives	10,676	11,421	8,616	8,045	9,584
Deposits from customers	1,365	528	587	320	337
Subordinated debt	427	291	291	10	10
Other liabilities	6,801	4,681	3,772	2,241	2,235
Total liabilities	**130,769**	**123,118**	**110,563**	**106,849**	**108,231**
Ordinary equity	3,056	2,991	3,132	2,916	2,905
Equity hybrids	549	526	527	527	539
Minority interests	98	96	97	65	0
Total liabilities and equity	**134,472**	**126,731**	**114,319**	**110,357**	**111,675**
Core tier 1/common equity tier 1 capital	3,124	2,911	3,181	2,970	2,952
Income statement summary (EUR m)					
Net interest income	584	472	322	374	174
Net fee & commission income	291	232	225	196	93
Net trading income	-96	16	-111	-129	-39
Other income	81	84	122	121	45
Operating income	**860**	**804**	**558**	**562**	**273**
Operating expenses	528	511	473	545	232
Pre-provision income	**332**	**293**	**85**	**17**	**41**
Credit and other financial impairments	237	120	81	60	24
Other impairments	0	0	0	13	0
Non-recurring items	0	0	0	234	-23
Pre-tax profit	**95**	**173**	**-19**	**-292**	**40**
Discontinued operations	0	0	0	0	0
Other after-tax Items	0	0	0	0	0
Income tax expense	45	115	-54	-100	9
Net profit attributable to minority interests	2	1	2	2	0
Net profit attributable to parent	**48**	**57**	**33**	**-194**	**31**

Source: SNL, Scope Ratings

III. Appendix: Ratios – Crédit Foncier de France

	2015Y	2016Y	2017Y	2018Y	2019H1
Funding and liquidity					
Net loans/ deposits (%)	NM	NM	NM	NM	NM
Liquidity coverage ratio (%)	173.0%	110.0%	110.0%	110.0%	110.0%
Net stable funding ratio (%)	NA	NA	NA	NA	NA
Asset mix, quality and growth					
Net loans/ assets (%)	67.7%	68.2%	71.0%	64.6%	62.5%
Problem loans/ gross customer loans (%)	3.7%	4.0%	4.3%	4.6%	4.5%
Loan loss reserves/ problem loans (%)	30.1%	29.6%	31.6%	26.3%	26.0%
Net loan growth (%)	-5.6%	-5.1%	-6.1%	-2.9%	-4.1%
Problem loans/ tangible equity & reserves (%)	70.5%	73.9%	NA	74.5%	73.9%
Asset growth (%)	-4.7%	-5.8%	-9.8%	-3.5%	2.4%
Earnings and profitability					
Net interest margin (%)	0.5%	0.4%	0.3%	0.3%	0.3%
Net interest income/ average RWAs (%)	1.7%	1.5%	1.0%	1.2%	1.2%
Net interest income/ operating income (%)	67.9%	58.7%	57.7%	66.5%	63.7%
Net fees & commissions/ operating income (%)	33.8%	28.9%	40.3%	34.9%	34.1%
Cost/ income ratio (%)	61.4%	63.6%	84.8%	96.9%	85.0%
Operating expenses/ average RWAs (%)	1.6%	1.6%	1.5%	1.8%	1.6%
Pre-impairment operating profit/ average RWAs (%)	1.0%	0.9%	0.3%	0.1%	0.3%
Impairment on financial assets / pre-impairment income (%)	71.4%	41.0%	95.3%	346.8%	58.5%
Loan loss provision/ average gross loans (%)	0.3%	0.1%	0.1%	0.1%	0.1%
Pre-tax profit/ average RWAs (%)	0.3%	0.5%	-0.1%	-1.0%	0.3%
Return on average assets (%)	0.0%	0.0%	0.0%	-0.2%	0.1%
Return on average RWAs (%)	0.1%	0.2%	0.1%	-0.6%	0.2%
Return on average equity (%)	1.5%	1.6%	0.9%	-5.3%	1.8%
Capital and risk protection					
Common equity tier 1 ratio (%, fully loaded)	NA	NA	NA	9.8%	10.0%
Common equity tier 1 ratio (%, transitional)	9.5%	9.2%	10.3%	9.8%	10.0%
Tier 1 capital ratio (%, transitional)	11.8%	11.4%	12.6%	11.7%	11.8%
Total capital ratio (%, transitional)	12.0%	11.4%	12.6%	11.7%	11.9%
Leverage ratio (%)	2.8%	3.4%	3.9%	3.7%	3.6%
Asset risk intensity (RWAs/ total assets, %)	24.4%	25.1%	27.0%	27.4%	26.5%

Source: SNL, Scope Ratings

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