FitchRatings

Banks
Other Banks
France

Dexia Credit Local S.A.

Key Rating Drivers

State-Support Driven Ratings: Dexia Credit Local S.A.'s (DCL) ratings reflect Fitch Ratings' view that there is a high probability that additional support would be provided to DCL by Belgium (AA-/Stable) and France (AA/Stable), if required, to complete the orderly wind-down of the company. Both sovereigns are main shareholders of DCL's parent Dexia SA/NV (Dexia). DCL accounts for almost 100% of Dexia's consolidated balance sheet.

Our view is based on the ownership of Dexia, the large funding guarantees provided to DCL by Belgium, France and Luxembourg (AAA/Stable) of up to EUR85 billion as well as the three countries' ability to provide financial support. DCL had EUR63 billion of guaranteed debt outstanding at end-November 2019.

No Retroactive Application of BRRD: Fitch continues to factor in state support for DCL despite the implementation of the EU's Bank Recovery and Resolution Directive (BRRD). This reflects our view that the BRRD will not be applied retroactively to DCL, as long as its orderly wind-down progresses consistently with plans agreed with the European Commission.

Low Risk of Senior Bail-In: Fitch views the risk of senior creditor bail-in as low for DCL. We expect Belgium and France to act pre-emptively, to the extent possible, to maintain DCL's capitalisation above legal minimum requirements.

Deleveraging Progresses Well: DCL's balance sheet was below EUR135billion at end-June 2019 compared with about EUR360 billion at end-2011, when the group was placed in orderly wind-down. DCL also significantly simplified its legal structure.

No Stand-Alone Assessment: Fitch does not assign a Viability Rating to DCL because it cannot be meaningfully analysed as a viable entity in its own right. DCL is in run-off and relies on state guarantees for funding.

Sovereign Guarantee Not Joint: DCL's state-guaranteed debt ratings are aligned with those of Belgium, which is the lowest-rated guarantor. Each of the three states is responsible for a share of the overall guarantee (several but not joint guarantee) and Fitch rates DCL's state-guaranteed debt on a 'first-dollar of loss' basis. The guarantee is unconditional, irrevocable and timely.

Rating Sensitivities

Reduction in State Ownership or Guarantees: DCL's ratings are sensitive to a weakening in Belgium's or France's ability or propensity to provide additional support, which may be reflected in negative rating action on the sovereign. A significant reduction in state ownership or state-guaranteed funding that was not a result of lower funding needs, leading to reduced incentive to provide additional support, would also be rating negative. An upgrade would be contingent on the two states demonstrating even greater support, which is unlikely.

Deviation from Wind-Down Plan: The ratings are also sensitive to DCL progressing with its orderly wind-down consistently with the plan agreed with the European Commission. A material deviation from the plan would likely trigger a fresh state-aid review and heighten the likelihood of the authorities requiring more stringent measures, which could include senior creditors sharing some of the burden. However, this is not Fitch's central scenario.

Rating action on Belgium: DCL's state-guaranteed debt ratings are sensitive to rating action on the lowest-rated guarantor, which is currently Belgium.

Ratings

Foreign Currency	
Long-Term IDR	BBB+
Short-Term IDR	F1
Derivative Counterparty Rating	BBB+(dcr)
Support Rating	2
Support Rating Floor	BBB+
Sovereign Risk	
Long-Term Foreign- and Local-Currency IDRs	AA
Country Ceiling	AAA

Outlooks

Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Foreign- and Local-Currency IDRs	Stable

Applicable Criteria

Bank Rating Criteria (October 2018)
Short-Term Ratings Criteria (May 2019)

Related Research

Belgium (October 2019)
France (June 2019)

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Debt Rating Classes

Rating level	Rating
State-guaranteed	AA-/F1+
Senior preferred	BBB+
Junior subordinated	C

Source: Fitch Ratings

DCL's 'F1' Short-Term IDR is the higher of the two possible Short-Term IDRs that can be assigned for a 'BBB+' Long-Term IDR. This is because we view the sovereign propensity to support as more certain in the short term. We also view the risk of the Belgian or French sovereign paying its direct obligations ahead of providing support to DCL as low and have not identified other potential impediments to the prompt flow of funds to DCL.

The 'AA'/'F1+' ratings of DCL's debt guaranteed by Belgium at 51.4%, France at 45.6% and Luxembourg at 3% are aligned with Belgium's ratings as it is the lowest-rated guarantor. Each of the three states is responsible for a share of the overall guarantee (several but not joint guarantee) and Fitch rates DCL's state-guaranteed debt on a 'first-dollar of loss' basis. The guarantee is unconditional, irrevocable and timely. It covers maturities of up to 10 years and debt issued until end-2021. The guarantee will be extended by 10 years from 2022 but existing instruments will remain covered by the current sovereign guarantee.

DCL's senior preferred debt is rated in line with the Long-Term IDR. No uplift is possible as the IDR is based on sovereign support.

DCL's deeply subordinated Tier 1 notes (FR0010251421) rating of 'C' reflects the continued ban imposed by the European Commission on contractually non-mandatory coupon payment on these notes and the poor recovery prospects. The securities will be subordinated to a deferred additional guarantee fee that will accrue from 2022.

Sovereign Support

Support Factors	Positive	Neutral	Negative
Sovereign ability to support system			
Size of banking system relative to economy			✓
Size of potential problem	✓		
Structure of banking system			✓
Liability structure of banking system		✓	
Sovereign financial flexibility (for rating level)	✓		
Sovereign propensity to support system			
Resolution legislation with senior debt bail-in			✓
Track record of banking sector support		✓	
Government statements of support		✓	
Sovereign propensity to support bank			
Systemic importance		✓	
Liability structure of bank	✓		
Ownership	✓		
Specifics of bank failure		✓	

Chart legend

- Higher influence
- Moderate influence
- Lower influence

High Probability of Support

Fitch considers that there is a high probability that additional support would be provided to DCL by Belgium and France, if required, to complete the orderly wind-down of the company. Both sovereigns are main shareholders of DCL's parent Dexia. DCL is the main operating entity of Dexia accounting for close to 100% of its consolidated balance sheet.

Our view is based on the ownership of Dexia, the sizeable funding guarantees provided to DCL by Belgium, France and Luxembourg as well as the three countries' ability to provide financial support. DCL had EUR63 billion of guaranteed debt outstanding at end-November 2019 and we expect utilisation to remain below the EUR85 billion limit.

At end-2018, Dexia 's assets represented a significant portion of about 35% of Belgium's gross domestic product, where the bank's holding company is incorporated. DCL's balance sheet represented a more limited 7% of France's GDP.

Fitch factors in state support for DCL despite the implementation of the EU's BRRD. This reflects our view that the BRRD will not be applied retroactively to DCL, as long as its orderly wind-down progresses consistently with plans agreed with the European Commission. Fitch views the risk of senior creditor bail-in as low for DCL. We expect Belgium and France to act pre-emptively, to the extent possible, to maintain DCL's capitalisation above legal minimum requirements.

Significant Changes

Extension of State Guarantee

In September 2019, the European Commission approved the extension of the state guarantee beyond end-2021 for 10 years. The terms of the guarantee will be substantially the same except for a lower maximum amount of EUR75 billion instead of EUR85 billion, consistent with the decline in DCL's balance sheet. The new guarantee will be extended by Belgium and France only under a 53%/47% breakdown. The 5bp guarantee fee will be increased by a 135bp deferred fee, which will accrue at a subordinated seniority level.

Large Sale Completed in 2019

DCL finalised the sale of Dexia Kommunalbank Deutschland GmbH (DKD) to Landesbank Hessen-Thueringen Girozentrale (Helaba; A+/Stable) in May 2019, which contributed to a further decline in its balance sheet (of close to EUR25 billion).

Increased Supervisory Requirements

From 2019, the ECB requires Dexia to meet all regulatory requirements applicable to credit institutions it supervises at each group consolidation level. This was driven by improvements in Dexia's and DCL's financial profiles.

Company Summary

Orderly Wind-Down

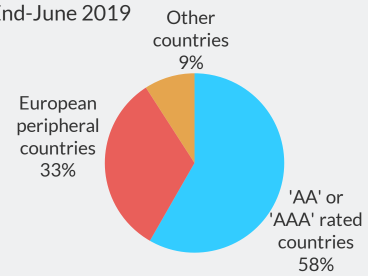
DCL was a specialised public-sector lender operating worldwide. The European Commission approved DCL's parent Dexia's orderly resolution plan in December 2012. It aims to wind down the group in an orderly manner, without threatening financial market stability. The resolution plan included a EUR5.5 billion capital injection by Belgium and France, which results in the two states owning about 53% and 47% of the group's share capital, respectively.

Significant Exposure to European Peripheral Countries

DCL is incorporated in France, which has a large, diversified and wealthy economy. A majority of DCL's credit exposures are to countries rated 'AAA' or in the 'AA' category (about 60% at end-June 2019, including about 20% to France or EUR19 billion). A significant proportion (above 30%) is to higher-risk European peripheral countries.

Credit Risk Exposure by Geography

End-June 2019



Source: Fitch Ratings, DCL

Deep Restructuring

DCL is no longer commercially active. However, its balance sheet will remain large for an extended period. The bank forecasts a balance sheet of less than EUR65 billion at end-2028 (compared with EUR134 billion at end-June 2019). Since entering wind-down, it has sold many operating subsidiaries and completed the mandatory divestment of its commercial franchises agreed with the European Commission.

Following the sale of DKD, DCL's only significant remaining subsidiary is Dexia Crediop S.p.A. in Italy (70% ownership). DCL also has branches in the US and Ireland. The Spanish branch was closed in March 2019 and DCL tranferred all assets of the New York branch to its head office in Paris in 2H19 with the purpose of transforming it into a representative office in 1H20.

Experienced Management Team

Due do the overlap between DCL and Dexia, both entities share the same management team. It is experienced and dedicated to the bank's orderly resolution. The CEO recently resigned and was temporary replaced by a member of the board of directors. Strategic objectives are clear and straightforward. They consist in running down the bank's assets while limiting operational risks and protecting stakeholder interests.

DCL's assets have long residual maturities. We view the recent acceleration in the bank's deleveraging as positive. Targeted asset disposals totalled EUR6.7 billion for the first eight months of 2019 after EUR7.3 billion in 2018.

Low Appetite for Market Risk

DCL has a low appetite for market risk. Its strategy was and remains to hedge almost all interest rate risk, which results in very low sensitivity of the net present value of the banking book to a 1% upward parallel shift of the yield curve (-EUR8 million at end-June 2019).

The bank significantly reduced its sensitivity to spread movements by reclassifying its peripheral European sovereign bonds to amortised costs under IFRS 9, instead of at fair value through equity (previously available-for-sale). The main exposures accounted for at fair value through equity are loans to French and US local authorities, which present a low spread volatility.

Summary Financials and Key Ratios

	30 June 2019	31 December 2018	31 December 2017	31 December 2016
	6 months - interim	Year end	Year end	Year end
	(EURm)	(EURm)	(EURm)	(EURm)
	Reviewed - unqualified	Audited - unqualified	Audited - unqualified	Audited - unqualified
Summary income statement				
Net interest & dividend income	8.0	92.0	239.0	322.0
Net fees and commissions	0.0	-4.0	-4.0	0.0
Other operating income	-211.0	-156.0	-100.0	425.0
Total operating income	-203.0	-68.0	135.0	747.0
Operating costs	196.0	365.0	401.0	410.0
Pre-impairment operating profit	-399.0	-433.0	-266.0	337.0
Loan & other impairment charges	-23.0	-128.0	-33.0	-138.0
Operating profit	-376.0	-305.0	-233.0	475.0
Other non-operating items (net)	-117.0	31.0	2.0	20.0
Tax	5.0	8.0	9.0	54.0
Net income	-498.0	-282.0	-240.0	441.0
Other comprehensive income	222.0	135.0	1,158.0	-447.0
Fitch comprehensive income	-276.0	-147.0	918.0	-6.0
Summary balance sheet				
Gross loans	34,636.0	35,428.0	99,479.0	119,577.0
- Ow impaired	n.a.	742.0	876.0	1,062.0
Loan loss allowances	n.a.	285.0	565.0	695.0
Net loans	34,636.0	35,143.0	98,914.0	118,882.0
Interbank	26,577.0	21,079.0	3,015.0	4,170.0
Derivatives	14,308.0	12,169.0	18,808.0	24,995.0
Other securities & earning assets	50,859.0	55,825.0	16,239.0	22,770.0
Total earning assets	126,380.0	124,216.0	136,976.0	170,817.0
Cash and due from banks	6,752.0	9,269.0	10,721.0	4,222.0
Other assets	515.0	24,871.0	32,737.0	36,987.0
Total assets	133,647.0	158,356.0	180,434.0	212,026.0
Liabilities				
Customer deposits	3,004.0	550.0	2,645.0	8,164.0
Interbank and other ST funding	19,900.0	28,397.0	45,626.0	57,763.0
Other LT funding	67,682.0	66,062.0	81,195.0	87,250.0
Trading liabilities and derivatives	35,602.0	31,971.0	40,681.0	50,774.0
Total funding	126,188.0	126,980.0	170,147.0	203,951.0
Other liabilities	1,011.0	24,708.0	6,071.0	4,763.0
Pref. shares and hybrid capital	56.0	56.0	56.0	56.0
Total equity	6,392.0	6,668.0	4,216.0	3,312.0
Total liabilities and equity	133,647.0	158,356.0	180,434.0	212,026.0

Summary Financials and Key Ratios

	30 June 2019	31 December 2018	31 December 2017	31 December 2016
	6 months - interim	Year end	Year end	Year end
	(EURm)	(EURm)	(EURm)	(EURm)
	Reviewed - unqualified	Audited - unqualified	Audited - unqualified	Audited - unqualified
Ratios (annualised as appropriate)				
Profitability				
Operating profit/RWA	-2.6	-1.0	-0.7	1.1
Net interest income/average earning assets	0.0	0.1	0.2	0.2
Non-interest expense/gross revenues	-96.6	-536.8	297.0	54.9
Net income/average equity	-15.4	-4.8	-6.3	15.5
Asset quality				
Impaired loans ratio	n.a.	2.1	0.9	0.9
Growth in gross loans	-2.2	-64.4	-16.8	-6.8
Loan loss allowances/impaired loans	n.a.	38.4	64.5	65.4
Loan impairment charges/average gross loans	-0.1	0.0	0.0	-0.1
Capitalisation				
Fitch Core Capital (FCC) ratio	20.3	21.0	12.2	7.1
Tangible common equity ratio	4.6	4.0	2.3	1.5
CET 1 ratio	21.5	23.2	16.1	13.1
Basel leverage ratio	n.a.	n.a.	3.8	n.a.
Net impaired loans/FCC	n.a.	7.2	7.7	12.1
Funding & liquidity				
Loans/customer deposits	1,153.0	6,441.5	3,761.0	1,464.7
Liquidity coverage ratio	252.0	200.0	111.0	80.0
Customer deposits/funding	3.3	0.6	2.0	5.3
Net stable funding ratio	n.a.	n.a.	n.a.	n.a.

Source: Fitch Ratings

Key Financial Metrics – Latest Developments

Mainly Exposed to Public-Sector Assets

Above 70% of DCL's credit risk exposure (Exposure at Default) was on low-risk local authorities and sovereigns at end-June 2019 (EUR71 billion out of a total exposure of EUR98 billion). This results in a moderate impaired assets ratio of about 1.3% of credit risk exposure. DCL recorded net releases in loan loss allowances from 2016 to 1H19.

Within the exposure to peripheral European countries, exposure to Italy (EUR21.2 billion at end-June 2019) and Portugal (EUR4.4 billion) are mainly to local authorities and the sovereign (BBB/Negative and BBB/Positive, respectively). The exposure to Spain (EUR6.4 billion) is dominated by local authorities and project finance, with a low exposure to the sovereign (A-/Stable).

At end-June 2019, about 90% of credit risk exposure was rated investment-grade based on DCL's internal ratings. Speculative-grade exposure accounted for about EUR8.6 billion or 135% DCL's equity.

Declining Revenue

DCL is loss-making. The net interest margin declined in line with the balance sheet. The significant collateral posted on swaps (EUR24.5 billion at end-June 2019) needs to be funded and inflates interest costs. DCL's large book of hedging derivatives generates some accounting volatility and has reduced profitability in recent years. Targeted asset sales had a negative impact of more than EUR100 million on pre-tax profit in 1H19. The sale of DKD also weighed on profitability (by EUR115 million). This is despite the low cost of the state guarantee (5bp of outstanding amounts; EUR33 million paid in 2018).

Operating costs are tightly managed. DCL recently outsourced its IT management and its back-office to Cognizant, an IT services and consulting company. Cognizant is also responsible for modernising the bank's IT infrastructure. Outsourcing will allow DCL to switch fixed costs into variable costs as the balance sheet declines further.

Improved Capital Ratios under IFRS 9

DCL's capitalisation is sound in risk-weighted terms, with a common equity Tier 1 (CET1) ratio of 21.5% and total capital ratio of 22% at end-June 2019. After reaching a low point in 2015, capital ratios were supported by the implementation of IFRS 9, which allowed the release of negative available-for-sale reserves. This followed the reclassification of assets at amortised cost, and notably DCL's Italian and Portuguese sovereign bonds.

Capital ratios at end-June 2019 give the bank a buffer over its 13.85% total capital requirement for 2019 and some room to absorb operating losses and losses on sales. Leverage is high due to a low risk-weighted assets density of about 20% as most are public-sector assets, but is improving. Dexia's fully loaded regulatory leverage ratio was 6.4% at end-2018.

High Reliance on State-Guaranteed Funding

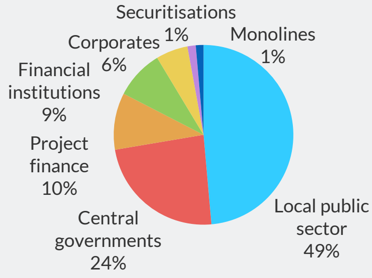
State-guaranteed debt is the main source of DCL's funding. Its contribution to total funding increased significantly to 75% at end-June 2019 from about 60% at end-2018 following the sale of DKD, which was mainly funded through covered bonds. Non-guaranteed unsecured funding was a small proportion of total funding at end-June 2019 (below 5%). The remaining 20% mainly consists of secured repo funding, which is currently more expensive than sovereign guaranteed debt.

DCL will no longer have access to central bank funding from 2022, as decided by the ECB in July 2017. The bank nevertheless benefits from a drawing capacity of EUR5.2 billion until end-2021. We do not expect this to have a significant impact on DCL's orderly resolution as the bank is not reliant on this funding source. It has not used central bank funding since September 2017.

DCL built a liquidity buffer of EUR16 billion at end-June 2019, including EUR7 billion of central bank deposits and EUR5.2 billion of unused central bank funding lines. DCL's liquidity coverage ratio was well above minimum requirements at more than 250% at end-June 2019.

Credit Risk Exposure by Type

End-June 2019



Source: Fitch Ratings, DCL

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