

Dexia Credit Local S.A.

Key Rating Drivers

State-Support Driven Ratings: Dexia Credit Local S.A.'s (DCL) ratings reflect Fitch Ratings' view of a high probability that additional support would be provided to DCL by Belgium (AA-/Negative) and France (AA/Negative), if required, to complete an 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) as well as the three countries' ability to provide financial support. DCL currently has about EUR55 billion of guaranteed debt outstanding and we expect utilisation to remain below the EUR85 billion limit.

Stable Outlook: The Stable Outlook reflects our view that France's and Belgium's Negative Outlooks do not materially reduce the two countries' ability to support DCL. This is because DCL's Long-Term Issuer Default Rating (IDR) is mainly driven by the sovereigns' propensity to support.

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 continues in line 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 about EUR120 billion at end-June 2020, compared with about EUR360 billion at end-2011, when the group was placed in orderly wind-down. Since then, 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: 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 (a 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

Sovereign Rating Action: DCL's ratings are sensitive to a weakening in Belgium's or France's ability or propensity to provide additional support. We would likely downgrade DCL's Long-Term IDR if the two sovereigns' ratings are downgraded to the 'A' category. 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.

Deviation from Wind-Down Plan: The ratings are also sensitive to DCL progressing with its orderly wind-down in line 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.

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	Negative

Applicable Criteria

[Bank Rating Criteria \(February 2020\)](#)

Related Research

[Fitch Affirms Belgium at 'AA-'; Outlook Negative \(October 2020\)](#)

[Fitch Affirms France at 'AA'; Outlook Negative \(November 2020\)](#)

[Belgium \(October 2020\)](#)

[France \(November 2020\)](#)

[Economics Dashboard: Global GDP Forecast Update \(November 2020\)](#)

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Debt Rating Classes

Rating Level	Rating
State-guaranteed debt	AA-/F1+
Senior preferred debt	BBB+
Junior subordinated debt	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 the French sovereign paying its direct obligations ahead of providing support to DCL as low. We 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 (51.4%), France (45.6%) and Luxembourg (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 (a 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 before end-2021.

In September 2019, the European Commission approved the extension of the state guarantee beyond end-2021 for an additional 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 under a 53%/47% breakdown and the 5bp guarantee fee will be gradually increased by a conditional deferred fee up to 135bp, which will accrue at a subordinated seniority level. This deferred fee is payable on the group's liquidation provided DCL no longer holds a banking licence.

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 the 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		✓	

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 currently has about EUR55 billion of guaranteed debt outstanding.

At end-June 2020, DCL's assets represented a significant portion (about 30%) of 2019 gross domestic product (GDP) in Belgium, where the bank's holding company is incorporated. DCL's balance sheet represented a more limited 5% of France's GDP.

Fitch continues to factor 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

Change in Supervisor

Since July 2020, Dexia SA/NV has been supervised as a "less significant institution" by both the French and Belgian bank regulators, the Autorite de Controle Prudentiel et de Resolution (ACPR), which acts as the consolidating supervisor, and the Belgian National Bank, instead of being directly supervised by the ECB. Dexia remains nonetheless supervised under the Single Supervisory Mechanism.

Dexia Crediop S.p.A's New Shareholder Structure

On 8 September 2020, Dexia finalised the acquisition of the minority 30% shareholding of Banco BPM SpA and BPER Banca SpA in Dexia Crediop S.p.A, bringing DCL's ownership in the Italian subsidiary to 100%. We view this as a significant step towards the finalisation of the simplification of DCL's organisational structure. It will enable the group to examine various strategic options concerning the future of the subsidiary.

Company Summary

Orderly Wind-Down

DCL was a specialised public sector lender operating worldwide. The European Commission approved 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 (nearly 60% of total exposure at end-June 2020, including about 20% to France or EUR19 billion). A significant proportion (above 30%) is to higher-risk European peripheral countries.

Deep Restructuring

DCL is no longer commercially active. However, its balance sheet will remain large for an extended period. 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 Dexia Kommunalbank Deutschland GmbH (DKD), in May 2019, DCL's only significant remaining subsidiary is Dexia Crediop S.p.A.

Experienced Management Team

Due to the overlap between DCL and Dexia, both entities share the same management team. It is experienced and dedicated to the bank's orderly resolution. Pierre Crevits, former executive director of the National Bank of Belgium, replaced the departing CEO in May 2020. The strategic objectives are clear and straightforward. They consist of running down the bank's assets while limiting operational risks and protecting stakeholder interests.

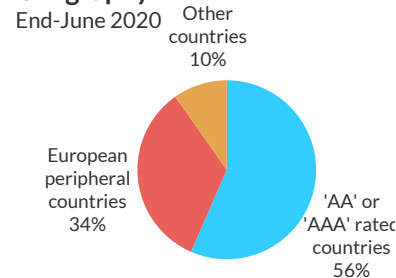
DCL's assets have long residual maturities. We view the recent acceleration in the bank's deleveraging as positive. The bank targets EUR13 billion of sales to be achieved between July 2019 and end-2022, despite difficult market and economic conditions.

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. This results in a very low sensitivity of the net present value of the banking book to a 1% upward parallel shift of the yield curve (about minus EUR25 million at end-June 2020).

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.

Credit Risk Exposure by Geography



Source: Fitch Ratings, DCL

Summary Financials and Key Ratios

	30 Jun 20		31 Dec 19	31 Dec 18	31 Dec 17
	6 months - interim	6 months - interim	Year end	Year end	Year end
	(USDm)	(EURm)	(EURm)	(EURm)	(EURm)
	Reviewed - unqualified	Reviewed - unqualified	Audited - unqualified	Audited - unqualified	Audited - unqualified
Summary income statement					
Net interest and dividend income	-84	-75.0	27.0	92.0	239.0
Net fees and commissions	-6	-5.0	-7.0	-4.0	-4.0
Other operating income	-518	-463.0	-650.0	-156.0	-100.0
Total operating income	-608	-543.0	-630.0	-68.0	135.0
Operating costs	231	206.0	359.0	365.0	401.0
Pre-impairment operating profit	-839	-749.0	-989.0	-433.0	-266.0
Loan and other impairment charges	106	95.0	-265.0	-128.0	-33.0
Operating profit	-945	-844.0	-724.0	-305.0	-233.0
Other non-operating items (net)	116	104.0	-117.0	31.0	2.0
Tax	2	2.0	-17.0	8.0	9.0
Net income	-831	-742.0	-824.0	-282.0	-240.0
Other comprehensive income	-284	-254.0	415.0	135.0	1,158.0
Fitch comprehensive income	-1,115	-996.0	-409.0	-147.0	918.0
Summary balance sheet					
Assets					
Gross loans	31,861	28,452.0	31,990.0	35,428.0	99,479.0
- Of which impaired	n.a.	n.a.	476.0	742.0	876.0
Loan loss allowances	0	0.0	219.0	285.0	565.0
Net loans	31,861	28,452.0	31,771.0	35,143.0	98,914.0
Interbank	25,765	23,009.0	21,564.0	21,079.0	3,015.0
Derivatives	16,252	14,513.0	13,135.0	12,169.0	18,808.0
Other securities and earning assets	54,132	48,341.0	43,417.0	55,825.0	16,239.0
Total earning assets	128,010	114,315.0	109,887.0	124,216.0	136,976.0
Cash and due from banks	6,425	5,738.0	9,211.0	9,269.0	10,721.0
Other assets	223	199.0	266.0	24,871.0	32,737.0
Total assets	134,658	120,252.0	119,364.0	158,356.0	180,434.0
Liabilities					
Customer deposits	3,012	2,690.0	609.0	550.0	2,645.0
Interbank and other short-term funding	14,017	12,517.0	15,596.0	28,397.0	45,626.0
Other long-term funding	69,770	62,306.0	63,542.0	66,006.0	81,139.0
Trading liabilities and derivatives	41,287	36,870.0	32,826.0	31,971.0	40,681.0
Total funding	128,086	114,383.0	112,573.0	126,924.0	170,091.0
Other liabilities	609	544.0	476.0	24,708.0	6,071.0
Preference shares and hybrid capital	63	56.0	56.0	56.0	56.0
Total equity	5,900	5,269.0	6,259.0	6,668.0	4,216.0
Total liabilities and equity	134,658	120,252.0	119,364.0	158,356.0	180,434.0
Exchange rate		USD1 = EURO.893017	USD1 = EURO.89015	USD1 = EURO.873057	USD1 = EURO.83382

Source: Fitch Ratings, Fitch Solutions, Dexia Credit Local

Summary Financials and Key Ratios

	30 Jun 20	31 Dec 19	31 Dec 18	31 Dec 17
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	-6.4	-2.7	-1.0	-0.7
Net interest income/average earning assets	-0.1	0.0	0.1	0.2
Non-interest expense/gross revenue	-37.9	-57.0	-536.8	297.0
Net income/average equity	-25.9	-12.8	-4.8	-6.3
Asset quality				
Impaired loans ratio	n.a.	1.5	2.1	0.9
Growth in gross loans	-11.1	-9.7	-64.4	-16.8
Loan loss allowances/impaired loans	n.a.	46.0	38.4	64.5
Loan impairment charges/average gross loans	0.6	0.0	0.0	0.0
Capitalisation				
Common equity Tier 1 ratio	20.0	23.5	23.2	16.1
Fully loaded common equity Tier 1 ratio	n.a.	n.a.	n.a.	n.a.
Tangible common equity/tangible assets	4.4	5.2	4.0	2.3
Basel leverage ratio	n.a.	n.a.	n.a.	3.8
Net impaired loans/common equity Tier 1	n.a.	4.1	6.5	5.8
Funding and liquidity				
Loans/customer deposits	1,057.7	5,252.9	6,441.5	3,761.0
Liquidity coverage ratio	211.0	236.0	200.0	111.0
Customer deposits/funding	3.5	0.8	0.6	2.0

Source: Fitch Ratings, Fitch Solutions, Dexia Credit Local

Key Financial Metrics – Latest Developments

Mainly Exposed to Public Sector Assets

We do not expect a material deterioration in DCL’s asset quality due to current economic conditions. Above 70% of DCL’s credit risk exposure (Exposure at Default) was on low-risk local authorities and sovereigns at end-June 2020 (EUR60 billion out of a total exposure of EUR84 billion). Within the exposure to peripheral European countries, exposure to Italy (EUR19.5 billion at end-June 2020) and Portugal (EUR3.8 billion) are mainly to local authorities and the sovereigns (rated BBB-/Stable and BBB/Stable, respectively). The exposure to Spain (about EUR5 billion) is dominated by local authorities and project finance, with a low exposure to the sovereign (A-/Stable).

At end-June 2020, slightly more than 90% of credit risk exposure was rated investment-grade based on DCL’s internal ratings. Speculative grade exposure accounted for about EUR6.3 billion or 120% of DCL’s equity.

Declining Revenue

DCL is loss-making as the net interest margin declines in line with the balance sheet. The significant collateral posted on swaps (EUR24.6 billion at end-June 2020) needs to be funded and inflates interest costs. This is despite the low cost of the state guarantee (5bp of outstanding amounts: EUR33 million was paid in 2019). Taxes and regulatory contributions amounted to EUR61 million in 1H20.

DCL’s large book of hedging derivatives generates some accounting volatility and has reduced profitability in recent years. In contrast, the reversal of loan impairment charges have supported profitability. DCL booked EUR95 million of loan impairment charges in 1H20 corresponding mostly to forward-looking provisioning on Stage 1 and Stage 2 loans.

Active deleveraging is also driving down profitability as it generated EUR62 million of losses in 1H20.

Satisfactory Capitalisation

DCL’s capitalisation is sound in risk-weighted terms, with a common equity Tier 1 ratio of 20% and total capital ratio of 20.2% at end-June 2020. 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, notably DCL’s Italian sovereign bonds.

Capital ratios at end-June 2020 give the bank a buffer over its 13.75% total capital requirement for 2020 (including a capital conservation buffer of 2.5%) and some room to absorb operating losses and losses on sales. Dexia’s fully-loaded regulatory leverage ratio was a relatively high 8.2% at end-2019, despite a low risk-weighted assets density of about 20% as most exposures are public sector assets or sovereign bonds.

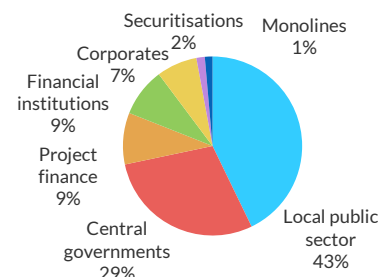
High Reliance on State-Guaranteed Funding

State-guaranteed debt is the main source of DCL’s funding. Its contribution to total funding increased significantly to 85% at end-June 2020 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 2020 (below 5%). The remaining funding mainly consists of short-term and long-term repo funding.

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.

DCL built a liquidity buffer of EUR18 billion at end-June 2020, including EUR7 billion of central bank deposits and EUR5.2 billion of unused central bank funding lines.

Credit Risk Exposure by Type End-June 2020



Source: Fitch Ratings, DCL

Environmental, Social and Governance Considerations

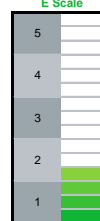
FitchRatings Dexia Credit Local S.A.

Credit-Relevant ESG Derivation

Dexia Credit Local S.A. has 5 ESG potential rating drivers			Overall ESG Scale	
<ul style="list-style-type: none"> Dexia Credit Local S.A. has exposure to compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security) but this has very low impact on the rating. Governance is minimally relevant to the rating and is not currently a driver. 	key driver	0	issues	5
	driver	0	issues	4
	potential driver	5	issues	3
		4	issues	2
	not a rating driver	5	issues	1

Environmental (E)

General Issues	E Score	Sector-Specific Issues	Reference
GHG Emissions & Air Quality	1	n.a.	n.a.
Energy Management	1	n.a.	n.a.
Water & Wastewater Management	1	n.a.	n.a.
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.
Exposure to Environmental Impacts	2	Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Company Profile; Management & Strategy; Risk Appetite; Asset Quality



How to Read This Page

ESG scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the individual components of the scale. The right-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned to each sector-specific issue. These scores signify the credit-relevance of the sector-specific issues to the issuing entity's overall credit rating. The Reference box highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis.

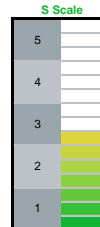
The Credit-Relevant ESG Derivation table shows the overall ESG score. This score signifies the credit relevance of combined E, S and G issues to the entity's credit rating. The three columns to the left of the overall ESG score summarize the issuing entity's sub-component ESG scores. The box on the far left identifies some of the main ESG issues that are drivers or potential drivers of the issuing entity's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the score.

Classification of ESG issues has been developed from Fitch's sector ratings criteria. The General Issues and Sector-Specific Issues draw on the classification standards published by the United Nations Principles for Responsible Investing (PRI) and the Sustainability Accounting Standards Board (SASB).

Sector references in the scale definitions below refer to Sector as displayed in the Sector Details box on page 1 of the navigator.

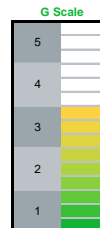
Social (S)

General Issues	S Score	Sector-Specific Issues	Reference
Human Rights, Community Relations, Access & Affordability	2	Services for underbanked and underserved communities; SME and community development programs; financial literacy programs	Company Profile; Management & Strategy; Risk Appetite
Customer Welfare - Fair Messaging, Privacy & Data Security	3	Compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security)	Operating Environment; Company Profile; Management & Strategy; Risk Appetite
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Company Profile; Management & Strategy
Employee Wellbeing	1	n.a.	n.a.
Exposure to Social Impacts	2	Shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices	Company Profile; Financial Profile



Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference
Management Strategy	3	Operational implementation of strategy	Management & Strategy
Governance Structure	3	Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal /compliance risks; business continuity; key person risk; related party transactions	Management & Strategy; Earnings & Profitability; Capitalisation & Leverage
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Company Profile
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Management & Strategy



CREDIT-RELEVANT ESG SCALE	
How relevant are E, S and G issues to the overall credit rating?	
5	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
4	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
3	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
2	Irrelevant to the entity rating but relevant to the sector.
1	Irrelevant to the entity rating and irrelevant to the sector.

DCL's highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

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