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Dexia Credit Local S.A.

Key Rating Drivers

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-/Stable) and France (AA/Negative), if required, to complete the orderly wind-down of the bank. DCL is the main operating entity of Dexia SA/NV (Dexia), which is about 53% owned by Belgium and 47% by France.

Strong Evidence of Support: Our view is based on the ownership of Dexia, the sizeable funding guarantees provided to DCL by Belgium, France and Luxembourg (AAA/Stable) and France and Belgium's ability to provide financial support. DCL had about EUR48 billion of guaranteed debt outstanding at end-November 2021 and we expect utilisation to remain below the EUR85 billion limit applicable until end-2021.

Stable Outlook: The Stable Outlook differs from the Negative Outlook on France's rating and reflects our view that a one-notch downgrade of France's rating would not result in a downgrade of DCL's rating. 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 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 regulatory requirements.

Deleveraging Progressing Well: DCL's balance sheet was about EUR102 billion at end-June 2021, compared with EUR362 billion at end-2011, when Dexia was placed in orderly wind-down. DCL has also significantly simplified its legal structure since then.

Extension of State-Guaranteed Debt: The European Commission approved the extension of the state guarantee beyond end-2021 for 10 years. The new guarantee will be extended by Belgium and France only under a 53%/47% breakdown and the terms will be substantially the same except for a lower maximum amount. This does not change our view on support.

No Viability Rating Assigned: 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 orderly wind-down and relies on state guarantees for funding.

Rating Sensitivities

Sovereign Support Assessment: DCL's ratings are sensitive to a weakening in Belgium or France's ability or propensity to provide support. We would be likely to downgrade DCL's Long-Term IDR if the two sovereign's ratings are both downgraded to the 'A' category. A significant reduction in state ownership or state-guaranteed funding that is not a result of lower funding needs would also be rating negative. Conversely, we could upgrade DCL's Long-Term IDR if France's sovereign's rating were upgraded, while Belgium remains in the 'AA' category.

Deviation from Wind-Down Plan: A material deviation from DCL's wind-down plan agreed with the European Commission would lead to a negative rating action. It would be likely to 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 our 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 (November 2021)

Related Research

Fitch Affirms Dexia Credit Local at 'BBB+'; Outlook Stable (November 2021)

Fitch Affirms France at 'AA'; Outlook Negative (November 2021)

Fitch Revises Belgium's Outlook to Stable; Affirms at 'AA-' (September 2021)

France (November 2021)

Belgium (November 2021)

Analysts

Julien Grandjean
+33 1 44 29 91 41
julien.grandjean@fitchratings.com

Romain Levasseur
+33 1 44 29 91 76
romain.levasseur@fitchratings.com

Debt Rating Classes

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

Source: Fitch Ratings

DCL's Short-Term IDR of 'F1' is the higher of the two possible Short-Term IDRs mapping to a Long-Term IDR of 'BBB+'. This is because we view the sovereign's propensity to support as more certain in the near term. We also view the risk of the Belgian or French sovereign paying their 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 sovereigns 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 before end-2021.

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 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 and the 5bp guarantee fee may be increased by a conditional deferred fee that will progressively reach 135bp by 2027, which will accrue at a subordinated seniority level. Debt instruments issued before end-2021 will remain covered by the state 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 the deferred conditional 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.

Our view on support is based on the ownership of Dexia, the sizeable funding guarantees provided to DCL by Belgium, France and Luxembourg (AAA/Stable) of up to EUR85 billion as well as France and Belgium's ability to provide financial support. The extension of a new guarantee by only Belgium and France from 2022 for a reduced maximum amount of EUR75 billion does not change our view on support.

At end-June 2021, DCL 's assets represented a significant portion (about 27%) of 2020 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.

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.

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 (DKD), DCL's only significant remaining subsidiary is Dexia Crediop S.p.A. in Italy, which is now 100% owned after DCL bought back the 30% of minority interests in 2020. DCL is looking at different strategic options for its Italian subsidiary, to further simplify its organizational structure.

Experienced Management Team

The overlap between DCL and Dexia means both entities share the same management team which Fitch views as experienced and dedicated to the bank's orderly resolution. The CEO resigned in 2020 and was replaced by Pierre Crevits, former executive director of the National Bank of Belgium.

Strategic objectives are clear and straightforward. They consist in running down the bank's long-residual-maturity assets while limiting operational risks and protecting stakeholder interests.

Significant Exposure to Peripheral European Countries

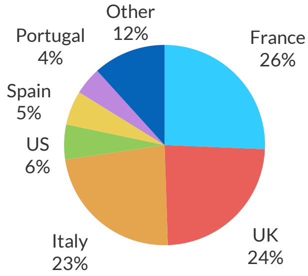
DCL is incorporated in France, which has a large, diversified and wealthy economy. Seventy-three percent of the bank's portfolio was exposed to the public sector or to central governments at end-June 2021. The bank has some exposure to higher-risk European peripheral countries, which represented about 35% at end-June 2021.

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 (about -EUR48 million at end-June 2021).

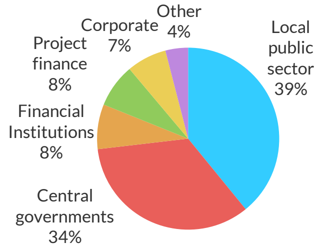
The bank significantly reduced its sensitivity to spread movements by reclassifying its peripheral European sovereign bonds to amortised costs under IFRS 9, instead of at fair value through equity (previously available for sale). The main exposures accounted for at fair value through equity are loans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

Credit Exposure by Geography
EUR77bn at end-June 2021



Source: Fitch Ratings, DCL

Credit Exposure by Counterparty
EUR77bn at end-June 2021



Source: Fitch Ratings, DCL

Summary Financials and Key Ratios

	30 Jun 21		31 Dec 20	31 Dec 19	31 Dec 18
	6 months - interim (USDm)	6 months - interim (EURm)	year end (EURm)	Year end (EURm)	Year end (EURm)
	Reviewed - unqualified	Reviewed - unqualified	Audited - unqualified	Audited - unqualified	Audited - unqualified
Summary income statement					
Net interest and dividend income	26	22.0	40.0	70.0	92.0
Net fees and commissions	-6	-5.0	-10.0	-7.0	-4.0
Other operating income	-65	-55.0	-204.0	-694.0	-156.0
Total operating income	-45	-38.0	-174.0	-631.0	-68.0
Operating costs	191	161.0	318.0	358.0	365.0
Pre-impairment operating profit	-236	-199.0	-492.0	-989.0	-433.0
Loan and other impairment charges	-56	-47.0	170.0	-265.0	-128.0
Operating profit	-181	-152.0	-662.0	-724.0	-305.0
Other non-operating items (net)	n.a.	n.a.	104.0	-117.0	31.0
Tax	62	52.0	n.a.	-17.0	8.0
Net income	-242	-204.0	-558.0	-824.0	-282.0
Other comprehensive income	172	145.0	-70.0	415.0	135.0
Fitch comprehensive income	-70	-59.0	-628.0	-409.0	-147.0
Summary balance sheet					
Assets					
Gross loans	29,117	24,501.0	27,126.0	31,990.0	35,428.0
- Of which impaired	n.a.	n.a.	462.0	476.0	742.0
Loan loss allowances	0	0.0	231.0	219.0	285.0
Net loans	29,117	24,501.0	26,895.0	31,771.0	35,143.0
Interbank	21,498	18,090.0	20,776.0	21,564.0	21,079.0
Derivatives	10,665	8,974.0	11,100.0	13,135.0	12,169.0
Other securities and earning assets	48,451	40,770.0	44,705.0	43,417.0	55,825.0
Total earning assets	109,731	92,335.0	103,476.0	109,887.0	124,216.0
Cash and due from banks	10,734	9,032.0	9,866.0	9,211.0	9,269.0
Other assets	323	272.0	181.0	266.0	24,871.0
Total assets	120,788	101,639.0	113,523.0	119,364.0	158,356.0
Liabilities					
Customer deposits	9,285	7,813.0	518.0	609.0	550.0
Interbank and other short-term funding	9,681	8,146.0	18,717.0	15,596.0	28,397.0
Other long-term funding	62,441	52,542.0	55,897.0	63,542.0	66,006.0
Trading liabilities and derivatives	32,169	27,069.0	32,201.0	32,826.0	31,971.0
Total funding	113,575	95,570.0	107,333.0	112,573.0	126,924.0
Other liabilities	517	435.0	498.0	476.0	24,708.0
Preference shares and hybrid capital	n.a.	n.a.	56.0	56.0	56.0
Total equity	6,695	5,634.0	5,636.0	6,259.0	6,668.0
Total liabilities and equity	120,788	101,639.0	113,523.0	119,364.0	158,356.0
Exchange rate		USD1 = EUR0.841468	USD1 = EUR0.821963	USD1 = EUR0.89015	USD1 = EUR0.873057

Source: Fitch Ratings, Fitch Solutions, DCL

Summary Financials and Key Ratios

	30 Jun 21	31 Dec 20	31 Dec 19	31 Dec 18
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	-1.4	-2.8	-2.7	-1.0
Net interest income/average earning assets	0.0	0.0	0.1	0.1
Non-interest expense/gross revenue	-423.7	-182.8	-56.7	-536.8
Net income/average equity	-7.3	-9.8	-12.8	-4.8
Asset quality				
Impaired loans ratio	n.a.	1.5	1.5	2.1
Growth in gross loans	-9.0	-15.9	-9.7	-64.4
Loan loss allowances/impaired loans	n.a.	57.0	46.0	38.4
Loan impairment charges/average gross loans	-0.4	0.4	0.0	0.0
Capitalisation				
Common equity Tier 1 ratio	24.8	24.5	23.5	23.2
Tangible common equity/tangible assets	5.5	5.0	5.2	4.0
Net impaired loans/common equity Tier 1	n.a.	4.0	4.1	6.5
Funding and liquidity				
Loans/customer deposits	313.6	5,195.6	5,252.9	6,441.5
Customer deposits/funding	11.4	0.7	0.8	0.6

Source: Fitch Ratings, Fitch Solutions, DCL

Key Financial Metrics – Latest Developments

Mainly Exposed to Public Sector Assets

We do not expect a material deterioration in DCL's asset quality owing to the strong recovery in Europe and the overall sound quality of DCL's loan book (Stage 3 loans ratio of 1.5% at end-2020). At end-June 2021, slightly more than 90% of credit risk exposure was rated investment grade based on DCL's internal ratings. Speculative-grade exposure accounted for about EUR6.2 billion or 110% of DCL's common equity Tier 1 capital.

The bank's exposures to Italy (EUR17.8 billion at end-June 2021) and Portugal (EUR3.4 billion) are mainly to local authorities and the sovereign (BBB-/Stable and BBB/Stable, respectively). The exposure to Spain (EUR4.2 billion) is dominated by local authorities and project finance, with a low exposure to the sovereign (A-/Stable).

Declining Revenue

DCL is loss-making. The net interest margin declines in line with the shrinking balance sheet. The significant collateral posted on swaps (EUR22.5 billion at end-June 2021) needs to be funded and inflates interest costs. This is despite the low cost of the state guarantee (5bp of outstanding amounts; EUR29 million paid in 2020). DCL's large book of hedging derivatives generates some accounting volatility and has reduced profitability in recent years, as has active deleveraging. In contrast, reversal of loan impairment charges has supported profitability in recent years (except in 2020) and even in 1H21 (EUR47 million), mainly linked to a change in macro-economic assumptions in IFRS 9 scenarios.

Operating costs are tightly managed, as the bank tries to adapt its costs to the decreasing loan book. In 2019, DCL outsourced its IT management and its back office to Cognizant, an IT services and consulting company. Cognizant is also responsible for modernizing the bank's IT infrastructure.

Satisfactory Capitalisation

DCL's capitalisation is sound in risk-weighted terms, with a common equity Tier 1 ratio of 24.8% and total capital ratio of 25% at end-June 2021. After reaching a low point in 2015, the 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.

The capital ratios at end-June 2021 give the bank a buffer over its 11.25% total capital requirement for 2021 (including current temporary easing measures) and some room to absorb operating losses and losses on sales.

High Reliance on State-Guaranteed Funding

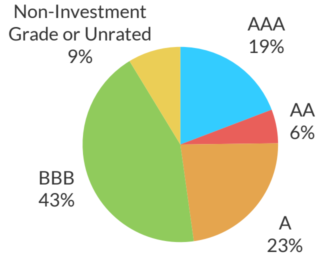
State-guaranteed debt is the main source of DCL's funding. Its contribution to total funding increased significantly to 78% at end-June 2021 from about 60% at end-2018 following the sale of DKD, which was mainly funded through covered bonds. Non-guaranteed unsecured funding only represented 3% of total funding at end-June 2021. The rest mainly consists of short- 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. It has not used central bank funding since September 2017.

DCL built a liquidity buffer of EUR16.6 billion at end-June 2021, including EUR9 billion of cash and central banks deposits. Dexia's liquidity coverage ratio was well above minimum requirements at more than 245% at end-June 2021.

Credit Exposure by Internal Rating

EUR77bn at end-June 2021



Source: Fitch Ratings, DCL

Environmental, Social and Governance Considerations

FitchRatings **Dexia Credit Local S.A.**

Banks
Ratings Navigator

Credit-Relevant ESG Derivation

				Overall ESG Scale
Dexia Credit Local S.A. has 5 ESG potential rating drivers 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
	not a rating driver	4	issues	2
		5	issues	1

Environmental (E)

General Issues	E Score	Sector-Specific Issues	Reference	E Scale
GHG Emissions & Air Quality	1	n.a.	n.a.	5
Energy Management	1	n.a.	n.a.	4
Water & Wastewater Management	1	n.a.	n.a.	3
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.	2
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	1

Social (S)

General Issues	S Score	Sector-Specific Issues	Reference	S Scale
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	5
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	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Company Profile; Management & Strategy	3
Employee Wellbeing	1	n.a.	n.a.	2
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	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Management & Strategy	5
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	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Company Profile	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Management & Strategy	2
				1

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.

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.