FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Dexia Credit Local at 'BBB+'; Outlook Stable

Thu 27 Oct, 2022 - 12:25 PM ET

Fitch Ratings - Paris - 27 Oct 2022: Fitch Ratings has affirmed Dexia Credit Local S.A.'s (DCL) Long-Term Issuer Default Rating (IDR) at 'BBB+' with a Stable Outlook. A full list of rating actions is below.

Fitch has withdrawn DCL's Support Rating of '2' and Support Rating Floor of 'BBB+' as they are no longer relevant to the agency's coverage following the publication of its updated Bank Rating Criteria. In line with the updated criteria, we have assigned DCL a Government Support Rating (GSR) of 'bbb+'.

KEY RATING DRIVERS

Support-driven Ratings: DCL's ratings reflect Fitch's 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, which is around 53% owned by Belgium and 47% by France.

Strong Evidence of Support: Our view is based on Dexia's ownership, the sizeable funding guarantees provided to DCL by Belgium and France as well as both sovereigns' ability to provide financial support. DCL had about EUR40 billion of guaranteed debt outstanding at the end of October 2022 and we expect utilisation to remain below the EUR75 billion limit applicable since January 2022.

Stable Outlook: The Outlook is Stable despite 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 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 EUR77 billion at end-June 2022, compared with about EUR360 billion at end-2011, when Dexia was placed in orderly wind-down. Since then, DCL has significantly simplified its legal structure.

Extension of State-Guaranteed Debt: The European Commission approved the extension of the state guarantee beyond end-2021 for 10 years. The extended guarantee is granted by Belgium and France under a 53%/47% split and the terms are 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

Factors that could, individually or collectively, lead to negative rating action/downgrade:

DCL's ratings are sensitive to a weakening in Belgium or France's ability or propensity to provide additional support. We would likely downgrade DCL's Long-Term IDR if the two sovereigns' ratings were both 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.

A material deviation from DCL's wind-down plan agreed with the European Commission would lead to negative rating action. It 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.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

An upgrade would be contingent on the two states demonstrating even greater support, which we view as unlikely. We could upgrade DCL's Long-Term IDR if France's sovereign's rating was upgraded, while Belgium remains in the 'AA' category. However, this is unlikely given the Negative Outlook on France's Long-Term IDR.

We could also upgrade DCL's Long-Term IDR if it sustainably reduces the size of its balance sheet well below the state guarantee size, while the need for additional capital injection becomes clearly remote.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

SHORT-TERM IDR

DCL's Short-Term IDR of 'F1' is the higher of the two possible Short-Term IDRs mapping to a 'BBB+' Long-Term IDR. This is because we view the sovereigns' 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.

STATE-GUARANTEED DEBT

The 'AA-'/'F1+' ratings of DCL's debt guaranteed by Belgium at 53% and France at 47% are aligned with Belgium's ratings as it is the lowest-rated guarantor. Both sovereigns are 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 at first demand. It covers maturities of up to 10 years and debt issued before end-2032.

Since 1 January 2022, DCL has been operating under the extended guarantee, which has been granted for another 10 years. The terms of the extended funding guarantee are substantially the same except for a lower maximum of EUR75 billion instead of EUR85 billion, including EUR72 billion for debt issues and EUR3 billion for intraday interbank overdraft. The decrease of the size of the funding guarantee is consistent with the decline in DCL's balance sheet. The 5bp guarantee fee is increased by a conditional deferred commission that will progressively rise up to 135bp in 2027, payable at the time of the liquidation of the group and insofar as DCL no longer has a banking licence.

SENIOR PREFERRED DEBT

DCL's senior preferred debt is rated in line with the Long-Term IDR.

DERIVATIVE COUNTERPARTY RATING (DCR)

The 'BBB+(dcr)' DCR is at the same level as DCL's Long-Term IDR as the IDR is based on sovereign support and because derivative counterparties in France have no preferential status over other preferred senior obligations in a resolution scenario.

JUNIOR SUBORDINATED DEBT

DCL's deeply subordinated Tier 1 notes' (FR0010251421) 'C' rating 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 conditional deferred fee that will accrue from 2022.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

SHORT-TERM IDR

DCL's Short-Term IDR could be downgraded if the Long-Term IDR was downgraded.

STATE-GUARANTEED DEBT

The 'AA-' long-term rating on DCL's state-guaranteed debt is sensitive to rating action on the lowest-rated guarantor, which is currently Belgium. The 'F1+' short-term rating on DCL's state-guaranteed debt would be downgraded if the Short-Term IDR of either of the two guarantors was downgraded.

SENIOR PREFERRED DEBT

DCL's senior preferred debt ratings are primarily sensitive to changes in its IDRs.

DERIVATIVE COUNTERPARTY RATING

DCL's DCR is primarily sensitive to changes in its Long-Term IDR.

JUNIOR SUBORDINATED DEBT

Fitch does not expect coupon payment to resume on DCL's deeply subordinated Tier 1 notes and therefore sees no upside for the instrument's rating.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

DCL's ratings are sensitive to rating action on Belgium or France. DCL's sovereign-guaranteed debt is sensitive to rating action on the lowest-rated guarantor, which is currently Belgium.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the 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. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY / DEBT	RATING		PRIOR
Dexia Credit Local S.A.	LT IDR Affirmed	BBB+ Rating Outlook Stable	BBB+ Rating Outlook Stable

	ST IDR	F1	Affirmed	F1
	Support	WD	Withdrawn	2
	Support Floor	WD	Withdrawn	BBB+
	DCR	BBB+(dcr)	Affirmed	BBB+(dcr)
	Government Support	bbb+	New Rating	
guaranteed	LT	AA-	Affirmed	AA-
Senior preferred	LT	BBB+	Affirmed	BBB+
junior subordinated	LT	C	Affirmed	C
guaranteed	ST	F1+	Affirmed	F1+

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Bank Rating Criteria (pub. 07 Sep 2022) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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Dexia Credit Local S.A.	EU Issued, UK Endorsed

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