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Dexia Credit Local S.A.

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Dexia Credit Local S.A.

Credit Highlights

Issuer Credit Rating
BBB/Watch Neg/A-2

Overview

Key strengths	Key risks
A government-related entity with a high likelihood of receiving extraordinary government support from Belgium and France.	Tail risks resulting from concentration on single entities and countries, like Italy.
State ownership and a funding guarantee for a sizable amount.	Wholesale funding structure influenced by capital markets' appetite for government-guaranteed funding.
Proactive management and strong execution of its wind-down plan, with some successes.	High sensitivity of liquidity needs to interest rates, due to an almost completely swapped balance sheet.
	Loss-making entity in the long term.

Our ratings on Dexia Credit Local (DCL) rely on a consolidated analysis of the Dexia group (Dexia). Our analysis also incorporates our view of DCL's core status within Dexia, for which it is the main bank. DCL accounts for about 99% of Dexia's total assets as of June 30, 2023.

On July 4, 2023, Dexia initiated a request to abandon its banking and investment services licenses and continue its run-off with the support of the French and Belgian governments. In our view, nonbank financial institutions face incremental risk relative to banks because they operate outside a regulated framework. This is why we placed our rating on DCL on CreditWatch with negative implication in July. We aim to resolve the CreditWatch upon agreement by relevant authorities (see "Dexia Group Entities Placed On CreditWatch Negative On Announced De-Banking," published July 7, 2023). We acknowledge that while Dexia would no longer need to meet prudential regulatory requirements or have access to a central bank, it would remain a government-related entity (GRE) during its run-off and still benefit from state-guaranteed funding. Additionally, a new surveillance framework will determine the governance, qualitative, and quantitative requirements that Dexia would be subject to after its de-banking. The creation of a surveillance body in lieu of the previous banking supervisor reflects the governments' willingness to manage the run-off and minimize losses to taxpayers, in our view. After removal of its bank status, Dexia will remain vulnerable to confidence-sensitive market funding and dependent on investors' appetite for government-guaranteed debt, which is its primary funding source. We believe the loss of the emergency liquidity assistance available to banks would weaken the group's stand-alone credit profile. However, maintaining guaranteed debt that qualifies as level-1 high-quality liquid assets supports the stability of funding by its current investors, in particular when compared with entities operating outside a regulated framework.

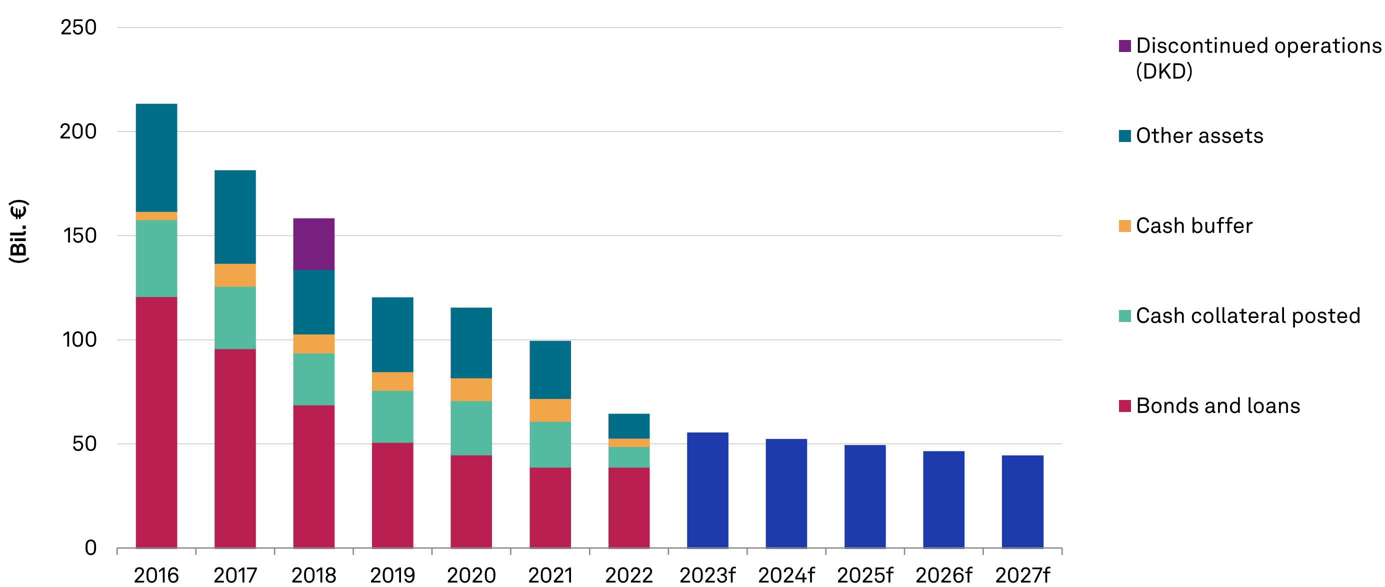
Dexia has shown continuous proactive management of its wind-down process, with further reduction of its balance sheet despite challenging macroeconomics conditions. Dexia reduced its balance sheet by 73% to €64 billion in December 2022 from €230 billion in 2015. It reduced it by a further 6% in the first half of 2023, resulting primarily from the continued rise in interest rates reducing its cash collateral needs, scheduled amortization, and early repayment, as opposed to asset disposals, with its assets totaling €60.6 billion. Over the past five years, total assets fell by €100 billion, mostly resulting from deleveraging actions and the sale of Dexia Kommunalbank Deutchland GmbH (DKD) for €24 billion, as well as from scheduled amortization, albeit to a lesser extent, and cash collateral posted over the past two years.

2022 and the first half of 2023 were marked by major developments. The group further advanced the simplification of the Dexia network in the U.S., as well as Italy, where subsidiary Dexia Crediop was absorbed by DCL on Sept. 30, 2023. What is to remain in Italy is a branch that will carry out exclusively auxiliary and non-regulated activities in support of its head office and facilitate communication with counterparties based in Italy. We don't expect any material impact on Dexia's financials because of the merger. DCL has also undertaken the repatriation of assets and associated derivatives from its Dublin branch to its Paris head office. As of June 30, 2023, a portfolio of €3.8 billion in assets has already been transferred, representing about 40% of the Dublin branch's portfolio in nominal value.

As part of its orderly resolution plan, which the bank could further update once it receives the de-banking agreement, Dexia is aiming to reach total assets of €44 billion by year-end 2027 (see chart 1). We understand the group's deleveraging will take place mainly through scheduled amortization of the portfolio, and asset sales focused on asset-value optimization within an annual budget. Dexia could accelerate the plan when market opportunities arise.

Chart 1

A continued reduction of its balance sheet from proactive management



f--Forecast. Source: S&P Global Ratings.

We believe capitalization will remain sufficient to absorb recurring losses in the medium term. Our view of Dexia's capitalization relies on our projected risk-adjusted capital (RAC) ratio reaching 9.5%-10% by year-end 2025. The group's RAC ratio stood at 11.2% in 2022 and we expect it to gradually weaken to below 10% by year-end 2025 and reach 8% by year-end 2027. This is because we expect Dexia's recurring profitability to remain structurally negative at -€400 million on average over the next three to five years. We don't believe the bank's accumulation of lossses will be entirely offset by reduction of the balance sheet and operating costs in the coming years.

Single–name risk concentration remains high and the risk profile sensitive to any deterioration of the economic situation. We continue to see Dexia risk position as weaker than that of most European banks. This mainly reflects our view that the bank's complex balance sheet and mostly unsecured exposures with very long maturities remain highly sensitive to a deterioration of economic conditions. Our assessment also considers the bank's significant geographic concentration in weaker economies, such as Italy (27%), and single–name risk concentration remains relatively high in light of the bank's loss position and capitalization. Indeed, the 20 largest exposures account for about 50% of its total exposures at default. Increased risk in any of the countries where Dexia is exposed to concentration risk, or any downgrades or defaults, would have a material adverse impact on the group's cost of credit risk and risk-weighted assets.

Dexia's risk profile reflects its position as a former leader in public financing and long-term investor in credit-spread securities portfolios (see chart 2). As of June 30, 2023, credit risk exposure amounted to €48.2 billion, evenly balanced between loans and bonds. Its exposures are predominantly to the public sector and to central governments. According to Dexia's internal system, about 90% of credit risk exposures were investment grade ('AAA', 14%; 'AA', 5%; 'A', 22%; and 'BBB', 50%).

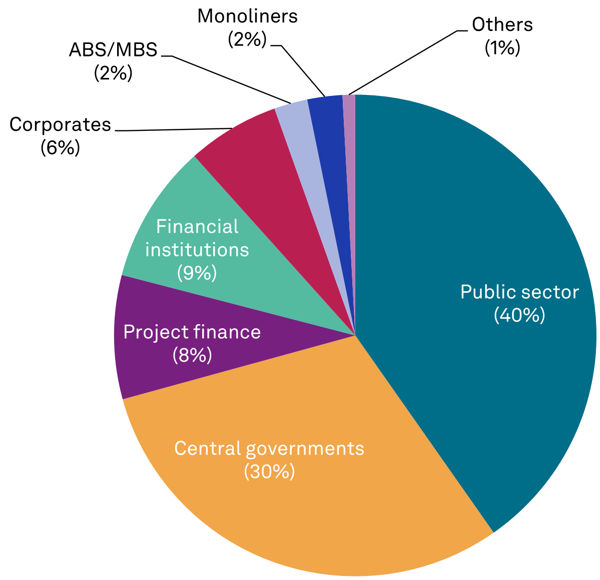
We continue to see some risks areas, mainly exposures to Spanish and U.S. local authorities, corporate finance, and notably to utilities in the U.K. However, we view as positive the bank's substantial efforts over the years to reduce the complexity of its balance sheet, its disposals of risky assets such as loans granted to Puerto Rico and the Chicago Board of Education, and the recent reduction of exposure to the Japanese public sector and Portugal.

New loan loss provisions totaled €33 million as of June 30, 2023. This was mainly due to the increase of provisions on part of the water distribution sector in the U.K. We believe the cost of risk will stay below 50 basis points of customer loans on average in the next three years. As of June 30, 2023, we estimate Dexia's nonperforming loans represented about 1.7% of total customer loans and were adequately covered by reserves. We don't expect a material shift in this ratio over the next two-to-three years.

Chart 2

Breakdown of credit risk exposures

As of June 2023



Source: S&P Global Ratings.

Dexia's funding and liquidity profile remains a weakness, in our view, and relies on investors' appetite for government-guaranteed debt. We consider Dexia's funding and liquidity profile to be weaker than that of many other European banks. This is because the bank has no deposit base and lost access to wholesale-nonguaranteed and unsecured funding markets on which it previously relied. Dexia also remains vulnerable to confidence-sensitive market funding and dependent on investors' appetite for government-guaranteed debt, which is its primary funding source. Yet, Dexia benefits from the prolongation of the funding guarantee for 10 years as of Jan. 1, 2022. The guarantee ceiling is now €75 billion, down from €85 billion previously, reflecting the group's lower funding needs as the balance sheet decreases. The amount outstanding on secured market funding was €3.9 billion and on guaranteed funding, €37.5 billion, in June 2023. We expect state-guaranteed funding to represent around 85% of the total funding mix within our rating horizon.

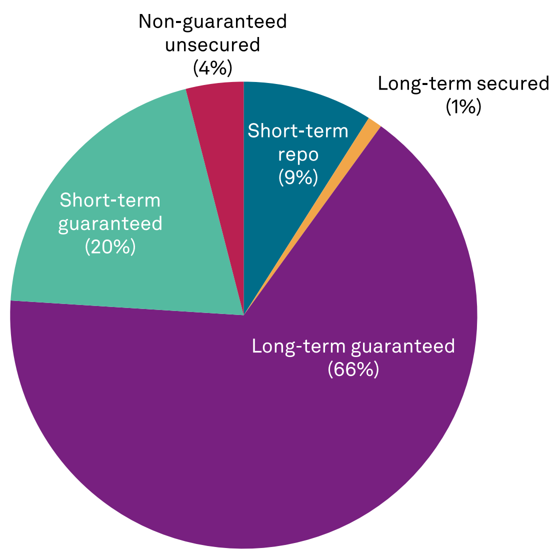
Dexia has discontinued its recourse to funding from the European Central Bank (ECB) since year-end 2017 and, as a wind-down entity, is no longer eligible for ECB funding since Jan. 1, 2022. However, like any bank and until the debanking, Dexia remains eligible to use the ECB's emergency liquidity assistance in case of temporary liquidity issues. We believe that, under Dexia's future framework following the debanking, the French and Belgian governments will have more leeway to support the group in case of financial stress.

Dexia's funding remains concentrated on short-term funding, via various guaranteed programs in euros, pounds sterling, and U.S. dollars. This translates into a low S&P Global Ratings stable funding ratio of 69% and broad liquid assets to short-term wholesale funding of 0.8x at year-end 2022.

We note that Dexia went through the COVID-19 pandemic and recent market turmoil without any liquidity issues, and despite difficult market conditions currently has no funding and liquidity access issues. Therefore as of June 30, 2023, its liquidity coverage ratio stood at 228% and the liquidity buffer at €11.5 billion, of which €2.9 billion was in cash representing more than 18% of the balance sheet.

Chart 3

Funding profile skewed towards stated guaranteed funding
As of March 2023



Source: S&P Global Ratings.

We continue to incorporate the likelihood of extraordinary government support in the event of stress. Our 'BBB' rating is three notches higher than our assessment of the bank's stand-alone credit profile (SACP). This reflects our view that Dexia would be highly likely to receive extraordinary support from the French and Belgian governments in the event of stress.

CreditWatch

The CreditWatch with negative implications reflects Dexia's planned de-banking, which would result in a one-notch downgrade of the rated entity. This is although the debanking would be partly mitigated by the surveillance framework to be established by the two government shareholders and their support. We expect to resolve the CreditWatch within the coming months as we receive additional information regarding approvals from relevant authorities.

Key Metrics

Dexia Credit Local--Key ratios and forecasts					
	--Fiscal year ended Dec. 31 --				
(%)	**2021a**	**2022a**	**2023f**	**2024f**	**2025f**
Growth in customer loans	-11.1	-12.9	(9.0)-(11.0)	(2.7)-(3.3)	(2.7)-(3.3)
Growth in total assets	-13.8	-34.8	(12.0)-(14.7)	(4.6)-(5.6)	(4.5)-(5.5)
Return on average common equity	-5.1	0.1	(5.3)-(5.8)	(7.7)-(8.5)	(5.0)-(5.6)
Return on assets	-0.3	0.0	(0.5)-(0.7)	(0.8)-(1.0)	(0.5)-(0.6)
New loan loss provisions/average customer loans	-0.4	0.0	0.5-0.5	0.6-0.7	0.3-0.4
Gross nonperforming assets/customer loans	1.6	1.6	1.6-1.7	1.6-1.7	1.6-1.7
Risk-adjusted capital ratio	12.4	11.2	11.0-11.6	10.0-10.5	9.5-10.0

All figures are S&P Global Ratings-adjusted. a--Actual. f--Forecast. NIM--Net interest margin.

Key Statistics

Table 1

Dexia S.A.--Key figures					
	--Fiscal year end Dec. 31--				
Mil. €	**2022**	**2021**	**2020**	**2019**	**2018**
Adjusted assets	64,284	98,643	114,406	120,297	158,767
Customer loans (gross)	21,516	24,690	27,763	32,005	35,444
Adjusted common equity	2,594	3,709	3,803	4,477	4,946
Operating revenues	343	(130)	(108)	(413)	(226)
Noninterest expenses	309	298	334	379	365
Core earnings	6	(363)	(612)	(494)	(503)

Source: S&P Global Ratings.

Table 2

Dexia S.A.--Business position					
	--Fiscal year end Dec. 31--				
	2022	**2021**	**2020**	**2019**	**2018**
Total revenues from business line (mil. €)	343	(99)	(7)	N/A	N/A
Other revenues/total revenues from business line	100.00	100.00	100.00	N.M.	N.M.
Return on average common equity	0.08	(5.08)	(8.87)	(12.13)	(7.57)

N/A--Not applicable. N.M.--Not meaningful. Source: S&P Global Ratings.

Table 3

Dexia S.A.--Capital and earnings

	--Fiscal year end Dec. 31--				
(%)	**2022**	**2021**	**2020**	**2019**	**2018**
Tier 1 capital ratio	40.43	31.20	28.16	26.91	26.70
S&P Global Ratings' RAC ratio before diversification	11.24	12.37	11.05	10.96	8.88
S&P Global Ratings' RAC ratio after diversification	8.28	8.95	8.26	8.20	7.76
Adjusted common equity/total adjusted capital	100.00	100.00	100.00	100.00	100.00
Net interest income/operating revenues	13.70	(28.46)	(11.11)	2.91	(21.68)
Fee income/operating revenues	(3.21)	7.69	10.19	1.69	1.77
Market-sensitive income/operating revenues	86.88	102.31	91.67	98.55	110.62
Cost to income ratio	90.09	(229.23)	(309.26)	(91.77)	(161.50)
Preprovision operating income/average assets	0.04	(0.40)	(0.38)	(0.57)	(0.35)
Core earnings/average managed assets	0.01	(0.34)	(0.52)	(0.35)	(0.30)

Source: S&P Global Ratings.

Table 4

Dexia S.A.--Risk-adjusted capital framework data

	Exposure*	**Basel III RWA**	**Average Basel III RW(%)**	**S&P Global Ratings RWA**	**Average S&P Global Ratings RW (%)**
Credit risk					
Government & central banks	35,283,692,139.5	4,411,078,018.3	12.5	6,950,100,940.9	19.7
Of which regional governments and local authorities	19,591,095,467.3	4,314,065,848.2	22.0	3,487,113,609.8	17.8
Institutions and CCPs	3,898,183,911.8	1,095,208,239.1	28.1	907,002,027.6	23.3
Corporate	9,871,908,986.1	5,745,939,725.3	58.2	9,031,629,481.1	91.5
Retail	0.0	0.0	0.0	0.0	0.0
Of which mortgage	0.0	0.0	0.0	0.0	0.0
Securitization§	1,123,943,467.1	752,629,672.5	67.0	1,115,840,570.4	99.3
Other assets†	546,370,547.1	597,596,412.6	109.4	839,599,851.4	153.7
Total credit risk	50,724,099,051.6	12,602,452,067.7	24.8	18,844,172,871.3	37.2
Credit valuation adjustment					
Total credit valuation adjustment	--	704,567,403.2	--	2,192,115,153.3	--
Market Risk					
Equity in the banking book	40,063,833.9	60,385,750.8	150.7	350,697,229.8	875.3
Trading book market risk	--	971,019,175.0	--	1,573,788,300.0	--
Total market risk	--	1,031,404,925.8	--	1,924,485,529.8	--
Operational risk					
Total operational risk	--	52,559,818.8	--	114,923,311.2	--

Table 4

Dexia S.A.--Risk-adjusted capital framework data (cont.)

	Exposure	Basel III RWA	Average Basel II RW (%)	S&P Global Ratings RWA	% of S&P Global Ratings RWA
Diversification adjustments					
RWA before diversification	--	16,338,424,396.6	--	23,075,696,865.6	100.0
Total Diversification/ Concentration Adjustments	--	--	--	8,237,635,690.9	35.7
RWA after diversification	--	16,338,424,396.6	--	31,313,332,556.5	135.7

	Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	S&P Global Ratings RAC ratio (%)
Capital ratio before adjustments	6,605,171,571.9	40.4	2,594,000,000.0	11.2
Capital ratio after adjustments‡	6,605,171,571.9	40.4	2,594,000,000.0	8.3

*Exposure at default. §Securitization Exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and S&P Global Ratings' risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. Sources: Company data as of 'Dec. 31 2022' and S&P Global Ratings.

Table 5

Dexia S.A.--Risk position

	--Fiscal year end Dec. 31--				
	2022	2021	2020	2019	2018
Growth in customer loans	(12.86)	(11.07)	(13.25)	(9.70)	(64.50)
Total diversification adjustment/S&P Global Ratings' RWA before diversification	35.70	38.18	33.74	33.70	14.33
Total managed assets/adjusted common equity (x)	24.78	26.60	30.09	26.88	32.11
New loan loss provisions/average customer loans	0.01	(0.39)	0.53	(0.79)	(0.19)
Net charge-offs/average customer loans	(0.35)	(0.47)	(0.26)	(0.40)	(0.15)
Gross nonperforming assets/customer loans + other real estate owned	1.64	1.64	1.73	1.74	2.29
Loan loss reserves/gross nonperforming assets	41.08	45.07	48.02	39.43	35.22

Table 6

Dexia S.A.--Funding and liquidity

	--Fiscal year end Dec. 31--				
	2022	2021	2020	2019	2018
Core deposits/funding base	1.38	0.85	0.69	0.76	0.58
Customer loans (net)/customer deposits	3,452.50	4,384.08	5,315.25	5,219.21	6,392.36
Long-term funding ratio	59.08	57.60	58.24	61.07	57.34
Stable funding ratio	68.56	65.68	63.96	68.09	51.91
Short-term wholesale funding/funding base	46.93	46.58	45.42	42.47	46.15
Broad liquid assets/short-term wholesale funding (x)	0.80	0.93	0.90	0.92	0.84
Broad liquid assets/total assets	26.17	28.88	26.84	25.84	23.03
Broad liquid assets/customer deposits	2,718.34	5,097.50	5,929.54	5,106.32	6,648.82
Net broad liquid assets/short-term customer deposits	(98.02)	(24.28)	(51.36)	(78.22)	(150.76)
Short-term wholesale funding/total wholesale funding	47.58	46.98	45.73	42.80	46.42

Table 6

Dexia S.A.--Funding and liquidity (cont.)					
	--Fiscal year end Dec. 31--				
	2022	**2021**	**2020**	**2019**	**2018**
Narrow liquid assets/3-month wholesale funding (x)	2.28	2.19	1.92	2.08	1.89

Source: S&P Global Ratings.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Dexia Group Entities Placed On CreditWatch Negative On Announced De-Banking, July 7, 2023

Ratings Detail (As Of October 11, 2023)*		
Dexia Credit Local		
Issuer Credit Rating		BBB/Watch Neg/A-2
Junior Subordinated		D
Senior Unsecured		BBB/Watch Neg
Issuer Credit Ratings History		
07-Jul-2023	*Foreign Currency*	BBB/Watch Neg/A-2
25-Jan-2013		BBB/Stable/A-2
28-Mar-2012		BBB/Watch Neg/A-2
07-Jul-2023	*Local Currency*	BBB/Watch Neg/A-2
25-Jan-2013		BBB/Stable/A-2
28-Mar-2012		BBB/Watch Neg/A-2
Sovereign Rating		
France		AA/Negative/A-1+

Ratings Detail (As Of October 11, 2023)*(cont.)

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.