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# Transaction Update: Compagnie de Financement Foncier

## Obligations Foncieres

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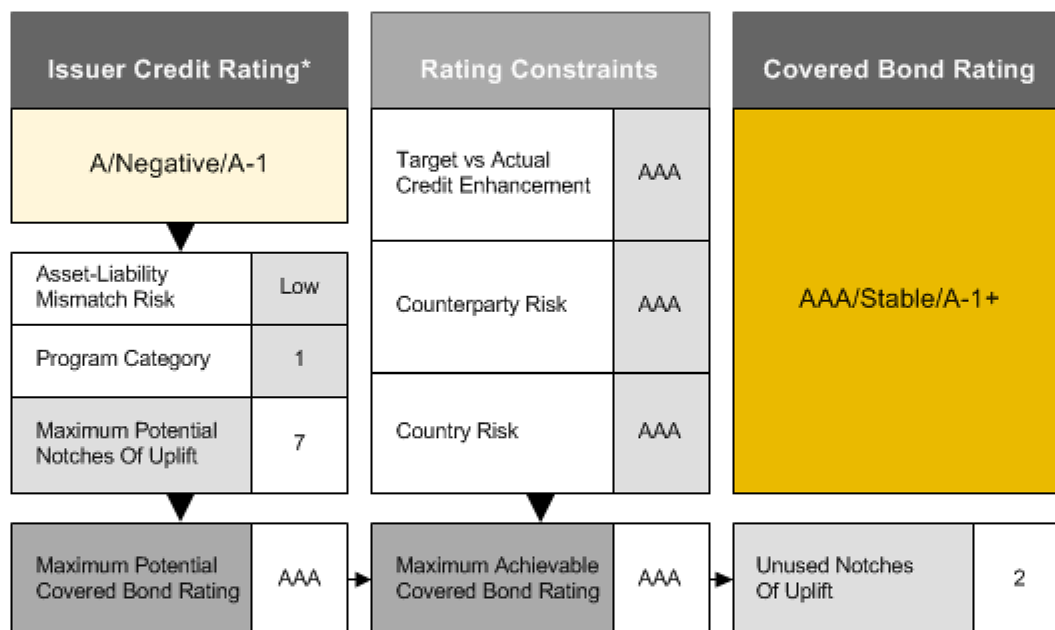
# Transaction Update: Compagnie de Financement Foncier

## Obligations Foncieres

## Ratings Detail




## Program Overview

**Table 1**

| Compagnie de Financement Foncier's Covered Bond Program* | |
|---|---|
| Jurisdiction | France |
| Type of covered bonds | Legislation-enabled |
| Underlying assets | Residential mortgages, public sector assets, and substitute assets |
| Outstanding covered bonds (bil. €) | 73.3 |
| Year of first issuance | 1999 |
| Rating at closing/year | AAA/1999 |
| Extendible maturities | No |
| Target credit enhancement (%) | 11.8 |
| Available credit enhancement (%) | 15.8 |

*Based on data as of Dec. 31, 2013.

## Major Factors

### Strengths

- Good and stable asset quality, comprising seasoned French mortgages, public sector assets which are mainly French, and substitute assets.
- Overcollateralization, which is consistent with the 'AAA' rating; the issuer having traditionally maintained a level of assets commensurate with the maximum rating.
- The issuer's status as a "société de crédit foncier" (SCF) a special-purpose financial institution regulated by French law (including a minimum of 5% overcollateralization).
- Active management of cash flows, resulting in "low" asset-liability mismatch (ALMM) risk, which leads to two unused notches of ratings uplift.
- A large number of assets that are repoable with the European Central Bank, which enchances the liquidity in the transaction.

### Weaknesses

- A significant (though decreasing) exposure to its parent group BPCE through eligible investments, bank accounts, and swaps.
- The portfolio's growing exposure to French public assets which could change our assessment of the transaction's "low" country risk.

## Outlook: Stable

The stable outlook on the covered bonds ("obligations foncières" or OFs) issued by France-based Compagnie de Financement Foncier (CFiF) reflects our view that adverse developments relating to the issuer, cover pool, or other factors would not automatically lead to a rating action on the covered bonds.

The main reason for this is the two unused notches of uplift for the ratings, which provide a buffer if we were to lower our long-term issuer credit rating (ICR) on BPCE (A/Negative/A-1) or if ALMM risk increased. Similarly, a one-notch downgrade of France (AA/Stable/A-1+) would not automatically affect our ratings on the covered bonds. In addition, we understand that CFiF intends to keep decreasing the covered bonds' counterparty risk exposure on BPCE, the rating on which is currently a trigger for a number of structural mechanisms in the transaction.

## Rationale

From our analysis of the legal and regulatory framework for covered bonds in France, we have concluded that the assets in the cover pool are isolated from the risk of a bankruptcy or insolvency of Crédit Foncier de France or BPCE. This asset isolation allows us to assign higher ratings to the covered bonds than the ratings on BPCE. We determine the maximum achievable covered bond rating by analyzing the cover pool's asset credit quality, payment structure, and cash flow mechanics.

We observe active management of the cover assets, whose quality has in our view stayed relatively stable. CFiF's cover pool contains a mixture of asset types, and we analyze the mortgage loans separately from the other assets.

According to our ALMM criteria, ALMM risk as of Dec. 31, 2013, is "low," and the program is in Category 1 (see "Revised Methodology And Assumptions For Assessing Asset-Liability Mismatch Risk In Covered Bonds," published on Dec. 16, 2009). This combination allows for a covered bond rating that is seven notches higher than the long-term ICR. Since we regard CFiF as a core entity of BPCE, we apply the ratings uplift to the 'A' long-term ICR on BPCE to derive our long-term rating on the covered bond program and related issuances.

In addition, as of Dec. 31, 2013, the available credit enhancement is 15.8%. This exceeds our target of 11.8% for the 'AAA' ratings.

There are currently no legal, operational, counterparty, or country risks that constrain the 'AAA' covered bond ratings. Our ratings on covered bonds whose terms only allow us to address principal repayment are 'AAAp'; these represent less than 1% of the bonds by outstanding balance.

Our criteria for rating covered bonds are outlined in "Covered Bond Ratings Framework: Methodology And Assumptions," published on June 26, 2012.

## Program Description

CFiF was set up as a specialized financial institution (or SCF) in 1999 and is one of the world's largest covered bond issuers. The pool of assets securing the OFs are mainly originated or bought by Crédit Foncier de France and transferred to CFiF. In future, other entities in the group will originate more of the assets. This will reflect CFiF's growing strategic role as a refinancing tool for the whole group.

OFs are French legislation-enabled covered bonds monitored by an independent trustee. To attract a diverse investor base, CFiF issues them under various programs:

- €125 billion medium-term notes;
- US$10 billion medium-term securities;
- €10 billion "Certificats de dépôt" (certificates of deposit);
- €10 billion "Bons à Moyen Terme Négociables" (medium-term notes); and
- A$5 billion medium-term notes.

The different programs issue different types of bonds. All rank pari passu and have recourse under French law to the same cover pool, which comprises residential mortgage loans, global public-sector assets, and substitute assets. A significant portion of the substitute assets comprises short-term exposures to BPCE, guaranteed by longer-term assets.

In a guideline published Nov. 26, 2012, the European Central Bank (ECB) stated that covered bonds issued after March 13, 2013, are no longer eligible for ECB repo operations if the cover pool contains external structured finance assets. Following this, CFiF sold its structured finance assets from the cover pool and had none remaining by the end of 2013.

The pool's exposure to France is increasing steadily, and we understand that it will continue to do so. This is because the structured finance assets that CFiF sold were internationally diverse, and because Crédit Foncier de France is now concentrating on its traditional domestic business (comprising mortgage loans and public sector assets).

**Table 2**

**Compagnie de Financement Foncier Covered Bond Program Participants**

| Role | Name | Rating | Rating dependency |
|---|---|---|---|
| Originator | Crédit Foncier de France | A- | No |
| Sponsor | BPCE (CFiF rating equalized with the ICR of BPCE, see 5 step table) | A | Yes |
| Contingent commitment on swaps (rating trigger on sponsor for swap not in line with our criteria, see 'counterparty risk' section) | BPCE | A | Yes |
| Credit Line provider | BPCE | A | Yes |
| Caution to some mortgage assets | Crédit Logement | A+ | No |
| Bank account provider | BPCE | A | Yes |
| Servicer | Crédit Foncier de France | A- | Yes |
| Swap provider | Australia and New Zealand Banking Group Ltd. | AA- | No |
| Swap provider | Barclays Bank PLC | A | Yes |
| Swap provider | BNP Paribas | A+ | No |
| Swap provider | Crédit Agricole Corporate and Investment Bank | A | Yes |
| Swap provider | Citibank N.A. | A | Yes |
| Swap provider | Commerzbank AG | A- | Yes |
| Swap provider | Crédit Foncier de France | A- | Yes |
| Swap provider | Credit Suisse International | A | Yes |
| Swap provider | Deutsche Bank AG | A | Yes |
| Swap provider | Dexia Credit Local | BBB | No |
| Swap provider | DZ BANK AG Deutsche Zentral-Genossenschaftsbank | AA- | Yes |
| Swap provider | The Goldman Sachs Group Inc. | A- | No |
| Swap provider | HSBC France | AA- | Yes |
| Swap provider | JPMorgan Chase Bank N.A. | A+ | Yes |
| Swap provider | Merrill Lynch International Bank Ltd. | A | No |
| Swap provider | Morgan Stanley | A- | No |
| Swap provider | Natixis S.A. | A | Yes |
| Swap provider | Natixis S.A. (guaranteed by Caisse des Dépôts et Consignations) | AA | Yes |
| Swap provider | Nomura Derivatives Products Inc. | AA- | No |
| Swap provider | Royal Bank of Canada | AA- | No |
| Swap provider | Société Générale | A | Yes |
| Swap provider | The Royal Bank of Scotland PLC | A- | Yes |
| Swap provider | UBS SA | A | Yes |
| Swap provider | UniCredit Bank AG | A- | No |
| Swap provider | Zuercher Kantonalbank | AAA | Yes |

## Issuer-Specific Factors

## Legal and regulatory risks

In our view, France's legal framework for covered bonds sufficiently addresses the legal aspects in our covered bond criteria, enabling us to rate the covered bonds higher than the issuer.

France's legal framework for covered bonds comprises article L513-2 and related articles of the "Code Monétaire et Financier". It has recently been updated (decree 2014-526 dated 23 May 2014). Only an SCF can issue OFs under the framework. OF-holders have recourse first to the issuer and, second, to the assets in the cover pool.

Under French law, holders of privileged liabilities, such as covered bonds, have a preferential claim to the SCF's assets ahead of all other creditors. The SCF must maintain overcollateralization of at least 5% for the privileged liabilities, weighted in accordance with the legal framework, and ensure 180 days of liquidity needs at all times. The difference between the weighted-average life (WAL) of the assets ensuring regulatory OC and that of the privileged liability cannot exceed 18 months. Only assets meeting the legal eligibility criteria can form part of the regulatory minimum collateralization. Eligible assets are:

- First-ranking mortgage loans with a maximum loan-to-value ratio of 60%, or 80% for residential property;
- Guaranteed mortgage loans, to a maximum of 35% of the cover pool;
- State-guaranteed real estate loans with a maximum loan-to-value ratio of 100%;
- Public-sector loans to states or local authorities; and
- Highly rated asset-backed securities, if at least 90% of those assets are eligible assets as described above.

Substitute assets meeting the legal eligibility criteria can also be in the cover pool, but they must not exceed 15% of the liability to privileged creditors.

An SCF can make a repurchase agreement, including after the sponsor's bankruptcy.

We base our analysis of legal risk on the guidelines in "Europe Isolation And Special-Purpose Entity Criteria--Structured Finance," published on Sept. 13, 2013, and other criteria articles listed in our covered bond rating framework.

## Operational and administrative risks

Crédit Foncier de France services the cover pool assets, which are recorded to ensure segregation from its own assets. Use of the cover pool assets for other purposes is restricted. The Contrôleur Spécifique audits CFiF's compliance with French law.

In addition to adhering to regulatory requirements, CFiF has committed to a minimum overcollateralization of 5%, according to its investor report, as well as enough liquidity to pay privileged creditors for one year in a run-off scenario. It also commits to a maximum spread of two years between the duration of all its assets and that of its liabilities. As of Dec. 31, 2013, CFiF had more than €39 billion of assets (before discounting) eligible for repos with the ECB.

Our analysis of operational and administrative risks follows the principles laid out in our "Covered Bond Rating Framework: Methodology And Assumptions," published on June 26, 2012.

## Cover-Pool Specific Factors

### Asset credit quality

The main change in the cover pool is CFiF's removal of its remaining structured finance assets. This has resulted in a significant amount of cash temporarily invested with the French central bank, with a very short maturity. We have not received confirmation from the issuer about the future of these assets, but we will continue to monitor the situation. The cover pool's credit quality is relatively stable and compares favorably with peers'. We base our analysis on loan-by-loan data on the mortgage, public finance, and substitute assets in the pool as of Dec. 31, 2013 (see table 3).

**Table 3**

**Compagnie de Financement Foncier Covered Bond Program Pool Composition**

| | As of Dec. 31, 2013 | | As of March 31, 2013 | |
|---|---|---|---|---|
| **Asset type** | **Value (mil. €)** | **Percentage of cover pool (%)** | **Value (mil. €)** | **Percentage of cover pool (%)** |
| Mortgage assets | 38,800 | 45.5 | 38,153 | 41.8 |
| Public sector | 39,398 | 46.2 | 30,052 | 32.9 |
| Securitization | 0.0 | 0.0 | 11,113 | 12.2 |
| Substitute assets | 7,009 | 8.3 | 11,976 | 13.1 |
| Total cover pool assets | 85,208 | 100.0 | 91,294 | 100.0 |

Most of the residential mortgage loans (99%) are in France, and the other assets diversified internationally but with a large proportion of French assets. The pool also includes "billets hypothecaires," promissory notes issued by Crédit Foncier de France and secured by—mostly French—mortgage loans. We believe the covered bonds would have access to the underlying mortgages should Crédit Foncier de France default, so we include the promissory notes, on a look-through basis, as residential mortgage assets.

Our relatively low asset default risk measure of 7.2% as of Dec. 31, 2013 reflects the pool's overall credit quality (see table 4). We analyze credit quality using our criteria for rating French RMBS and the article "Surviving Stress Scenarios: Assessing Asset Quality Of Public Sector Covered Bond Collateral," published on Sept. 30, 2003.

**Table 4**

**Compagnie de Financement Foncier Covered Bond Program Key Credit Metrics**

| | **Dec. 31, 2013** | **March 31, 2013** |
|---|---|---|
| | **Mortgage loan assets** | |
| Weighted-average LTV (%)* | 72.7 | 71.5 |
| Weighted-average loan seasoning (months)§ | 59.5 | 58.1 |
| Balance of loans in arrears (%)† | 4.1 | 3.9 |
| Buy-to-let loans (%) | 23.6 | 24.2 |
| Subsidized loans | 44.5 | 41.2 |
| **Credit analysis results:** | | |
| Weighted-average foreclosure frequency (WAFF; %) | 16.1 | 17.6 |
| Weighted-average loss severity (WALS; %) | 29.1 | 28.2 |
| Asset default risk (%) | 7.2 | 2.6 |



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**Table 4**

| Compagnie de Financement Foncier Covered Bond Program Key Credit Metrics (cont.) | | |
|---|---|---|
| **Country medians:** | | |
| WAFF (%) | 16.3 | 19.9 |
| WALS (%) | 29.1 | 28.9 |
| Asset default risk (%) | 7.8 | 9.2 |
| | **Public sector assets and substitute assets** | |
| Weighted-average rating of public, structured finance, and substitute assets | BBB | BBB+ |
| Weighted-average loan asset maturity (months) | 109.1 | 122.0 |
| Largest obligor (% of the public sector and substitute assets) | 24.6 | 22.0 |
| Five largest obligors (% of the public sector and substitute assets) | 33.0 | 31.6 |
| 20 largest obligors (% of the public sector and substitute assets) | 44.5 | 46.9 |
| | **Credit analysis results** | |
| Scenario default rate (SDR) (%) | 15.4 | 13.5 |
| Asset default risk (%) | 7.2 | 2.6 |
| **Country medians**:** | | |
| Weighted-average asset rating | BBB | BBB |
| SDR (%) | 25.3 | 24.0 |
| Asset default risk (%) | 4.9 | 2.6 |

*Nonindexed. §Seasoning refers to the elapsed loan term; the figure excludes loans in arrears and defaulted loans. †More than 30 days. **Unless specified otherwise, country median refers to the median level of that field as derived from comparable transactions that we rate in France. LTV--Loan-to-value.

***Residential mortgages:*** The residential mortgage loans have weighted-average foreclosure frequency (WAFF) and weighted-average loss severity (WALS) assumptions that are very close to the median of the French mortgage pools that we rate. The pool's seasoning or weighted-average loan-to-value ratio (which drive our WAFF and WALS assumptions) are also comparable to the median pool and have been stable (see tables 5 and 6).

**Table 5**

| Compagnie de Financement Foncier Covered Bond Program Mortgage Loans Assets Distribution By Seasoning | | |
|---|---|---|
| | **Dec. 31, 2013** | **March 31, 2013** |
| **Elapsed term (months)** | **--Percentage of mortgage loan assets (%)*--** | |
| Less than 18 months | 15.5 | 14.7 |
| 18-24 | 4.7 | 5.6 |
| 24-36 | 11.4 | 15.3 |
| 36-48 | 13.8 | 10.8 |
| 48-60 | 8.7 | 7.6 |
| More than 60 | 41.4 | 41.7 |
| Weighted-average loan seasoning (months) | 59.5 | 58.1 |

*Does not add up to 100 due to rounding and because we exclude loans in arrears and defaulted loans.

**Table 6**

**Compagnie de Financement Foncier Covered Bond Program Mortgage Loans Assets Distribution By Loan-to-Value Ratios***

| | Dec. 31, 2013 | March 31, 2013 |
|---|---|---|
| (%) | Percentage of mortgage loan assets (%) | |
| 0-60 | 20.1 | 20.7 |
| 60-70 | 11.0 | 11.9 |
| 70-80 | 28.2 | 32.5 |
| 80-90 | 24.7 | 22.4 |
| 90-100 | 15.4 | 11.9 |
| Above 100 | 0.7 | 0.6 |
| | Weighted-average LTV | |
| | 72.7 | 71.5 |

*Nonindexed. LTV--Loan to value.

Given Crédit Foncier de France's historical focus on residential mortgages to low-income borrowers and buy-to-let mortgages, nearly 45% of the loans are subsidized/regulated. We have increased our base WAFF assumptions by 20% for these loans in accordance with our criteria. Nearly one-quarter of the loans are for buy-to-let purposes and we have stressed this by increasing our base WAFF assumptions by 30% (see tables 7 and 8).

Some loans have state guarantees from FGAS ("Fonds de Guarantie de l'Accession Sociale"), but we exclude the FGAS guarantees in our analysis and do not regard the related loans as direct exposures to France when considering country risk.

A guarantee from external guarantor Crédit Logement, instead of property, secures about 5% of the mortgage loans. To reflect the incremental risk from not having direct recourse to the underlying property, we have increased our base WALS assumptions by 40% for these loans.

**Table 7**

**Compagnie de Financement Foncier Covered Bond Program Mortgage Loans Assets Distribution By Loan Type**

| | 31-Dec-13 | 31-Mar-13 |
|---|---|---|
| | --Percentage of mortgage loan assets--(%) | |
| Subsidized/regulated loans | 44.5 | 41.2 |

**Table 8**

**Compagnie de Financement Foncier Covered Bond Program Mortgage Loans Assets Distribution By Property Occupation**

| | Dec. 31, 2013 | March 31, 2013 |
|---|---|---|
| | Percentage of mortgage loan assets (%) | |
| Owner-occupied | 76.4 | 75.8 |
| Buy-to-let | 23.6 | 24.2 |
| Total | 100.0 | 100.0 |



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***Public-sector and substitute assets:*** The public sector assets mostly comprise very-short term exposure to the French central bank and loans to French local and regional governments. Most of the public-sector assets are of investment-grade credit quality (rated 'BBB' or higher; see table 9). Despite the sale of the international structured finance assets, the cover pool remains diversified internationally (see table 10).

Loans to BPCE, with terms of less than 60 days, represented 7.7% of the cover pool as of Dec. 31, 2013, and comprise most of the pool's substitute assets. As they meet our criteria for eligible investments, we treat them as cash available within the first quarter. We do not take into account the longer-term assets which back them.

**Table 9**

**Compagnie de Financement Foncier Covered Bond Program Public Sector And Substitute Assets Distribution By Credit Assumptions***

| | Dec. 31, 2013 | March 31, 2013 |
|---|---|---|
| | Percentage of cover pool excluding mortgage assets (%) | |
| AAA§ | 25.9 | 2.2 |
| AA | 13.1 | 28.3 |
| A | 17.3 | 22.2 |
| BBB | 19.5 | 17.3 |
| BB | 5.9 | 5.2 |
| B or lower | 3.2 | 2.4 |
| Non-defaulting assets** | 15.1 | 22.4 |
| Total | 100 | 100 |

*Aggregated by rating category. §Includes very short-term assets with the French central bank. **Loans to BPCE.

**Table 10**

**Compagnie de Financement Foncier Covered Bond Program Public Sector And Substitute Assets Distribution By Country**

| | Dec. 31, 2013 | March 31, 2013 |
|---|---|---|
| Top five concentrations | --Percentage of cover pool excluding mortgage assets (%)-- | |
| France | 35.8 | 31.0 |
| Italy | 6.2 | 10.2 |
| U.S. | 5.1 | 12.7 |
| Japan | 2.8 | 2.3 |
| Switzerland | 2.6 | 3.0 |
| Other* | 47.5 | 40.8 |
| Total | 100.0 | 100.0 |

*Includes loans to BPCE and the French central bank.

## Payment structure and cash flow mechanics

From our calculations, cash flows from the cover pool would be sufficient, at the given rating, to make timely payment of interest and payment of principal on the final legal maturity date to the covered bond holders.

Under our ALMM criteria, a program's ALMM exposure and ability to cover the mismatch translate into the potential notches of uplift we use to derive the covered bond rating. CFiF can raise funds through borrowing and asset sales in a country where covered bonds are well established and have systemic importance. The program is therefore in

Category 1. To assess ALMM risk, we calculate the percentage of the cover pool showing a mismatch between the maturity of the assets and maturity of liabilities. As of Dec. 31, 2013, the ALMM percentage was 0%, which we classify as "low" (see table 11). In our view, CFiF effectively manages ALMM by maintaining a large amount of short-term exposure to its ultimate parent BPCE, even if this amount has been steadily decreasing since late 2012. As of the Dec. 31, 2013 pool cut-off date, the ALMM exposure was further lowered by the proceeds from the sale of the structured finance assets, invested in very short-term maturities.

**Table 11**

**Compagnie de Financement Foncier Covered Bond Program ALMM Metrics**

| | Dec. 31, 2013 | March 31, 2013 |
|---|---|---|
| Asset WAM (years) | 9.1 | 9.9 |
| Liability WAM (years) | 7.7 | 7.6 |
| Maturity gap (years) | 1.4 | 2.3 |
| ALMM (%) | 0.0 | 2.3 |
| ALMM classification | Low | Low |
| Maximum uplift above issuer rating (notches) | 7 | 7 |
| Target credit enhancement for maximum uplift (%) | 11.8 | 13.6 |
| Target credit enhancement for first notch of uplift (%) | 7.2 | 2.6 |
| Available credit enhancement (%) | 15.8 | 14.3 |
| **Country medians:** | | |
| Weighted-average ALMM (%) | 0.0 | 9.0 |
| Target credit enhancement (%) | 12.3 | 20.7 |
| Available credit enhancement (%) | 25.0 | 23.4 |

ALMM--Asset-liability maturity mismatch. WAM--Weighted-average maturity.

The combination of covered bonds in Category 1 and "low" ALMM risk allows a maximum of seven notches of ratings uplift above our long-term ICR on BPCE to rate the covered bonds. This means we can rate CFiF's covered bonds 'AAA' if the available credit enhancement is at least equal to our target credit enhancement, and counterparty and country risk do not constrain the rating.

We have determined a target credit enhancement of 11.8% as of Dec. 31, 2013, for the program, which is lower than our median of 12.3% for French public-sector covered bond programs, owing to a lower scenario default rate and ALMM risk.

As of Dec. 31, 2013, the program's credit enhancement of 15.8% exceeded the 11.8% target. This allows us to apply the full seven notches of ratings uplift to rate the program, absent constraints from counterparty or country risk.

***Cash flow stresses and considerations.*** For our cash flow analysis, we applied credit stresses that are commensurate with a 'AAA' ratings scenario, as well as liquidity, interest rate, and currency stresses. We also modeled cash flows using various default timing and prepayment patterns. We stressed cash flows hedged with swaps that do not meet our criteria without the benefit of those swaps.

The model simulates the sale of some assets to meet any liquidity shortfalls, after applying stressed discounting to the scheduled proceeds. The share of buy-to-let loans (more than 23% of the pool's residential mortgages) increases the

refinancing rate of the mortgage assets. The refinancing rate has decreased, however, for public assets, compared with our Aug. 23, 2013 review. This is due to the removal of the structured finance assets (see "Transaction Update: Compagnie de Financement Foncier Covered Bonds"). The refinancing rate we used to model the mortgage cash flows is 5.13% over the stressed index, and 3.70% for the non-mortgage cash flows.

There are no structural mechanisms to allocate assets proportionately to each bond or to check for amortization. The bonds are never accelerated. There is therefore a risk of time subordination for bonds with later maturity dates if there is a cash shortfall. Our target credit enhancement figure indicates the amount of overcollateralization that would cover timely payment on all the covered bonds in a 'AAA' stress scenario.

We analyzed the cash flows according to our criteria in "Revised Methodology And Assumptions For Assessing Asset-Liability Mismatch Risk In Covered Bonds," published on Dec. 16, 2009, "Assessing Asset-Liability Mismatch Risk In Covered Bonds: Revised Methodology And Assumptions For Target Asset Spreads", published on April 24, 2012, our cash flow criteria for European RMBS, and our criteria for rating French RMBS (see Related Criteria And Research).

## Additional Factors

### Counterparty risk

We have identified several counterparty risks, which do not currently constrain the 'AAA' ratings, however, since they have been addressed:

- Collection bank accounts. The bank account agreement with BPCE is in line with our current counterparty criteria and stipulates replacement of the account bank if our long-term ICR on BPCE falls below 'A'.
- Commingling risk. To mitigate this risk for collections in bank accounts in Crédit Foncier de France's name if it defaults, Crédit Foncier de France will fund a commingling reserve if it is downgraded below 'BBB'. The reserve, to be held in a separate bank account, will represent one month of collections, flowing through the Crédier Foncier de France account, including prepayments. This amount should cover payments to covered bond holders while borrowers redirect their payments to the new collection account.
- Credit line provider. CFiF has a credit line from BPCE of up to €3 billion to cover its liability for collateral deposits received from swap counterparties. The line would be drawn if the short-term rating on BPCE fell below 'A-1'; it is therefore in line with our criteria for limited direct support. The credit line provider is not a privileged creditor under the law, so it would rank behind covered bond holders in insolvency. This means that in our cash flow analysis we do not add a liability mirroring the amount of collateral deposited, as long as the latter is less than €3 billion.
- Swaps: CFiF benefits from having diverse swap counterparties and does not leave unhedged positions. We give benefit to the internal swaps in our cash flow analysis as they reflect our current counterparty criteria (see "Counterparty Risk Framework Methodology And Assumptions," published on June 25, 2013). There are 22 unrelated swap counterparties; "external swaps". We include in our cash flow analysis external swaps that are in line with current or previous counterparty criteria in accordance with "Covered Bonds Counterparty And Supporting Obligations Methodology And Assumptions," published on May 31, 2012, and do not give credit to the hedges of those which are not. Because of the ratings on those swap counterparties, and the level of diversification, we did not deduct any notches from the maximum potential ratings uplift. Internal swaps meet our current counterparty criteria, and are incorporated in our cash flow analysis.
- Swap termination payments. The notional value of swaps not meeting our criteria represents more than 5% of

CFiF's outstanding covered bonds. Because swap termination payments are not subordinated to the covered bonds, they could constrain our ratings on the covered bonds according to our covered bonds counterparty criteria (see "Covered Bonds Counterparty And Supporting Obligations Methodology And Assumptions," published on May 31, 2012). To mitigate this risk, CFiF has introduced a link to BPCE and has committed to replacing or amending these swaps should our short-term ICR on BPCE fall below 'A-1'.

CFiF has been continually decreasing its swap notional amount. We understand that it intends to keep doing so whilst maintaining counterparty diversification (see table 2 for the list of counterparties).

### Country risk

CFiF's removal of the structured finance assets—which were predominantly in the U.S., the Netherlands, and Italy—and its investment of the proceeds of these assets with the French central bank have reduced the pool's international exposure. Furthermore, we understand that Crédit Foncier de France's origination of public-sector assets will focus exclusively on France in the future, and public sector assets received from other BPCE entities for refinancing will also be French. However, as of Dec. 31, 2013, we consider that although the public-sector assets are increasingly France-based, the cover pool still offers international diversification and is considered multijurisdictional with a low country risk under our nonsovereign ratings criteria (see "Nonsovereign Ratings That Exceed EMU Sovereign Ratings: Methodology And Assumptions," published on June 14, 2011). According to our criteria, covered bonds in an investment-grade country (sovereign rating is 'BBB-' or higher) with a low country risk can be rated at most six notches higher than the sovereign. Because the underlying mortgage loans in CFiF's cover pool were originated in France and our long-term rating on France is 'AA-', the sovereign rating does not cap our ratings on CFiF's covered bonds.

We consider country risk according to our nonsovereign ratings criteria.

## Potential Effects Of Proposed Criteria Changes

Our ratings are based on our applicable criteria, including those set out in the criteria articles "Nonsovereign Ratings That Exceed EMU Sovereign Ratings: Methodology And Assumptions," published on June 14, 2011, "Revised Methodology And Assumptions For Assessing Asset-Liability Mismatch Risk In Covered Bonds," published on Dec. 16, 2009, and "Surviving Stress Scenarios: Assessing Asset Quality of Public Sector Covered Bond Collateral," published on Sept. 30, 2003. However, please note that these criteria are under review (see "Advance Notice Of Proposed Criteria Change For Covered Bonds, " published on April 29, 2014, Advance Notice of Proposed Criteria Change: Ratings Above The Sovereign--Structured Finance, published on April 12, 2013, and "Advance Notice Of Proposed Criteria Change: Methodologies And Assumptions For Rating Certain Covered Bonds And CDOs," published on Aug. 5, 2010).

As a result of this review, our future criteria applicable to rating covered bonds may differ from our current criteria. These criteria changes may affect the ratings on the outstanding covered bonds issued by Compagnie de Financement Foncier. Until such time that we adopt new criteria, we will continue to rate and surveil these covered bonds using our existing criteria (see the list of related criteria below).

## Glossary

### Asset-liability mismatch (ALMM)

The risk of a timing mismatch between the cash flows of a program's assets and liabilities, as described in paragraphs 23 to 32 of the ALMM criteria, published Dec. 16, 2009.

### Asset default risk (ADR)

Asset-default risk equals all credit risks related to the default of the cover pool assets, including interest rate risks and foreign exchange rate risks. In other words, the asset default risk reflects all credit and cash flow risk except the market-value risk arising from ongoing ALMMs. We assign the first notch of uplift above the ICR on the issuer if the available credit enhancement covers asset-default risk (see Step 5 ofour rating approach in the 2009 ALMM criteria).

### Scenario default rate (SDR)

The SDR is the modeled gross level of asset defaults of public-sector and other assets (except mortgage loans) that our CDO Evaluator estimates and that covered bonds are expected to be able to withstand at the 'AAA' rating level. This figure is comparable with the WAFF for mortgage loans.

### Target asset spread

The methodologies and assumptions to calculate the target asset spread is described in paragraph 59 of the ALMM criteria, published Dec. 16, 2009, and in "Assessing Asset-Liability Mismatch Risk In Covered Bonds: Revised Methodology And Assumptions For Target Asset Spreads," published April 24, 2012.

### Target credit enhancement and actual credit enhancement

The methodologies and assumptions to calculate the target credit enhancement and actual credit enhancement are described in paragraphs 69–72 of the ALMM criteria, published Dec. 16, 2009.

### Time to recovery

This represents the weighted-average time needed to recover or restructure the cover pool assets following a default.

### Unused uplift (notches)

In general, the term "unused uplift (notches)" refers to the difference between the maximum potential uplift (in notches) resulting from Step 3 of our 2009 ALMM criteria, and the number of notches between the ICR on the issuer and the rating on the covered bond program. However, the unused notches of uplift can only be greater than zero if: (1) the available credit enhancement is commensurate with the target credit enhancement level and (2) the maximum potential rating on the covered bonds is 'AAA', or the maximum potential rating on the covered bonds is limited to below 'AAA' by the results of our assessment of country and/or counterparty risk according to the criteria in "Nonsovereign Ratings That Exceed EMU

Sovereign Ratings: Methodology And Assumptions" published June 14, 2011, "Covered Bonds Counterparty And Supporting Obligations Methodology And Assumptions" published May 31, 2012, and "Counterparty Risk Framework Methodology And Assumptions," published Nov. 29, 2012.

For example, three notches of unused uplift may result if:

- The ICR on the covered bond issuer is 'A+', the covered bond program qualifies for the maximum seven potential notches of uplift due to sufficient overcollateralization, and the covered bond rating is not subject to constraints under our assessment of country and counterparty risk, i.e. the covered bond rating is 'AAA'.
- The ICR on the covered bond issuer is 'BBB+', the covered bond program qualifies for the maximum seven potential notches of uplift due to sufficient overcollateralization, but the covered bond program rating is limited to 'AA-' by the results of our assessment of country and/or counterparty risk.
- The values under column headed by "Unused uplift (notches)" in table 1 refer to the number of notches the ICR can be lowered by, without resulting in an automatic downgrade of the respective covered bond program.

### WAFF

WAFF is the weighted-average foreclosure frequency of the mortgage loans in the cover pool. The foreclosure frequency reflects the probability that a default on a mortgage loan would lead to foreclosure. The estimated foreclosure frequency is a function of borrower and loan characteristics, as well as the economic stress scenario commensurate with a certain rating level. This figure is comparable to the SDR for public-sector and other assets.

### WALS

WALS is the weighted-average loss severity. The loss severity quantifies the loss realized as a result of foreclosure. The expected loss is predicated on assumptions about the potential decline in the market value of collateral that may secure the asset, as well as the expenses incurred in foreclosing on and reselling the property, considering an economic stress scenario, commensurate typically with a certain rating level.

### WAFF and WALS

The potential loss associated with an entire pool can be calculated by multiplying the weighted-average foreclosure frequency (WAFF) with the weighted-average loss severity (WALS) at the 'AAA' rating level (see paragraph 70 of the ALMM criteria). Note that the product of WAFF and WALS does not equal the asset default risk referred to in paragraph 73 of the ALMM criteria.

### WA rating

The purpose of displaying the weighted-average (WA) obligor rating is mainly to show a relative ranking of the public-sector cover pools with respect to their credit quality. The weighted-average rating is a modeled output of the CDO Evaluator, the credit rating model that we use for the credit analysis of public-sector assets. It does not reflect the weighted-average product of the rating on the individual obligors and the respective exposures to them. The weighted-average rating is computed rather as the credit rating that would have a probability of default and maturity that best approximates the portfolio's weighted-average maturity and expected portfolio default rate. The latter is the weighted-average default rate of the portfolio, based on the asset default rates specified in Standard & Poor's default table, which, in turn, are based on historical default rates we have compiled. The weighted-average rating reflects the actual remaining life of the assets, rather than some fixed hypothetical remaining life. The use of the latter would increasingly distort the default probabilities of the portfolio as the actual average remaining life shortens over time. Note that in our credit analysis, we separate borrowers into rated and unrated borrowers. We will stress nonrated assets more severely because we do not regularly monitor their credit quality. For further information on the credit analysis please refer to "Rating Pfandbriefe--The Analytical Perspective," published Jan. 27, 2003.

## Related Criteria And Research

### Related criteria

- Principles for Rating Debt Issues Based on Imputed Promises, Oct. 24, 2013
- Europe Asset Isolation And Special-Purpose Entity Criteria--Structured Finance, Sept. 13, 2013
- Counterparty Risk Framework Methodology And Assumptions, June 25, 2013
- Global Derivative Agreement Criteria, June 24, 2013
- Covered Bond Ratings Framework: Methodology And Assumptions, June 26, 2012
- Covered Bonds Counterparty And Supporting Obligations Methodology And Assumptions, May 31, 2012
- Global Investment Criteria For Temporary Investments In Transaction Accounts, May 31, 2012
- Assessing Asset-Liability Mismatch Risk In Covered Bonds: Revised Methodology And Assumptions For Target Asset Spreads, April 24, 2012
- Nonsovereign Ratings That Exceed EMU Sovereign Ratings: Methodology And Assumptions, June 14, 2011
- Methodology: Credit Stability Criteria, May 3, 2010
- Revised Methodology And Assumptions For Assessing Asset-Liability Mismatch Risk In Covered Bonds, Dec. 16, 2009
- Methodology And Assumptions: Update To The Criteria For Rating French Residential Mortgage-Backed Securities, Jan. 6, 2009
- Methodology And Assumptions: Update To The Cash Flow Criteria For European RMBS Transactions, Jan. 6, 2009
- Cash Flow Criteria for European RMBS Transactions, Nov. 20, 2003
- Surviving Stress Scenarios: Assessing Asset Quality of Public Sector Covered Bond Collateral, Sept. 30, 2003
- Criteria for Rating French Residential Mortgage-Backed Securities, July 16, 2003

### Related research

- Ratings On Compagnie de Financement Foncier's French Covered Bond Program Affirmed At 'AAA/A-1+'; Outlook Stable, June 24, 2014
- Europe's Housing Market Recovery Is Not Yet On Solid Ground, April 30, 2014
- Advance Notice Of Proposed Criteria Change for Covered Bonds, April 29, 2014
- France 'AA/A-1+' Ratings Affirmed On Gradual Economic And Fiscal Adjustments; Outlook Stable, April 25, 2014
- Institutional Framework Assessments For International Local And Regional Governments, Jan. 13, 2014
- France Long-Term Ratings Lowered To 'AA' On Weak Economic Growth Prospects And Fiscal Policy Constraints; Outlook Stable, Nov. 8, 2013
- Transaction Update: Compagnie de Financement Foncier Covered Bonds, Aug. 23, 2013
- French-Based Compagnie de Financement Foncier Covered Bonds Program Affirmed At 'AAA/A-1+'; Outlook Stable, Aug. 7, 2013
- Advance Notice of Proposed Criteria Change: Ratings Above The Sovereign--Structured Finance, April 12, 2013
- Advance Notice Of Proposed Criteria Change: Methodologies And Assumptions For Rating Certain Covered Bonds And CDOs, Aug. 5, 2010

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