MOODY'S INVESTORS SERVICE

Rating Action: Moody's assigns Aa2/P-1 ratings to Agence France Locale; outlook negative

Global Credit Research - 29 Jan 2015

First-time ratings assignment

London, 29 January 2015 -- Moody's Investors Service has today assigned a first-time long-term issuer rating of Aa2 with a negative outlook to Agence France Locale (AFL). At the same time, Moody's assigned to AFL a standalone bank financial strength rating (BFSR) of C with a stable outlook, equivalent to a baseline credit assessment (BCA) of a3, and a Prime-1 short-term issuer rating.

AFL's BCA of a3 reflects the profile of its business model, as a start-up bank owned by and dedicated to the financing of French local authorities. Its credit profile therefore captures the strong political support and commitment from its owners, and, in turn, their own high creditworthiness. Furthermore, AFL will be subject to banking regulations and supervised by the French supervisory authority (Autorite de Controle Prudentiel et de Resolution -- ACPR).

AFL's long-term issuer rating of Aa2 incorporates four notches of uplift, reflecting both parental support resulting from the explicit joint and several guarantee whereby the members, French regional and local authorities, provide a guarantee up to their respective outstanding loans at AFL, and moderate level of systemic support from the French government (Aa1, negative).

RATINGS RATIONALE

--- DEDICATED BUSINESS MODEL AND LOW ASSET RISK OFFSET RISKS RELATED TO THE START-UP NATURE OF AFL

AFL's BCA of a3 reflects its business model, whereby it extends loans to French local authorities. Moody's considers that exposures to the French public sector represent high quality assets. As a monoline institution, AFL's lending will be strictly limited to the French local governments under the narrowest definition, which further mitigates credit risks. The existence of a strict underwriting policy will also positively contribute to AFL's asset quality and ensure that the bank's asset portfolio will be robust, whilst also ensuring AFL's independence in lending operations.

Furthermore, if the bank strictly observes its own operating policies and internal rules, Moody's believes that AFL will be able to ensure sustainable loan-origination activity, a sound funding structure and adequate solvency. Funding and liquidity management policies are based on very limited maturity gaps and the principle of minimum full coverage by on-balance-sheet liquid assets of the projected net cumulative cash outflows over the following one-year period. Additionally, all loans will be eligible for central bank refinancing.

Solvency and leverage will be adequate. Minimum common equity capital ratio is set at 12.5% and leverage will be at least 3.5%, which is in compliance with Basel III and EU current standards from the outset.

However, there are some risks associated with whether the bank might be able to develop its franchise as expected, which partly offsets AFL's otherwise sound credit profile. Nevertheless, Moody's believes that a scenario of AFL being unable to develop its franchise is unlikely to entail losses that the entity would not be able to absorb with its own resources.

--- STRONG INVOLVEMENT OF FRENCH LOCAL GOVERNMENT FOUNDING MEMBERS

Created at the initiative of the major French local governments (the founding members), AFL benefits from their strong political support and commitment to make the bank work, which Moody's considers is a credible goal given the critical mass of members reached today. The likelihood of more local governments joining AFL is high, provided that AFL is able to tap the capital markets from the start of its activity in early 2015 at affordable costs, translating into competitive lending conditions for the French local authorities, which would greatly foster AFL's status and credibility.

Strict governance and credit policy will ensure AFL's independence from political pressures. The operating entity, i.e. AFL, has been set up as a separate legal entity from Agence France Locale -- Societe Territoriale (FL-ST, unrated), which is the holding company responsible for determining the agency's strategy.

The holding is also entrusted with clearing new members as membership is contingent upon the observance of specific rules aimed at protecting the entity's soundness and at mitigating the risk of political interference. Governance, including the constraints on the composition of AFL's Supervisory Board -- comprising a majority of independent directors -- further ring-fences the banking operations from potential political interference from its members.

--- RISKS ASSOCIATED WITH START-UP NATURE

AFL is confronted with the risks that any start-up faces. The risk of its operations not gaining traction is nevertheless mitigated by the financial commitment and strong political backing from the members. These members currently represent around 13% of the French local public-sector debt and more members are likely to join if its franchise develops according to plan. Moody's also believes that if AFL were to be put in run-off very quickly after its inception (for example if its business model turns out to be non-viable), the company would be able to honour its commitments using its own resources, thereby avoiding the activation of the members' guarantee.

ISSUER RATING INCORPORATES FOUR NOTCHES OF SUPPORT

AFL's long-term issuer rating benefits from four notches of combined support from the parents and the government. Parental support results from the explicit joint and several guarantee from the member local authorities, whereby the members provide a guarantee up to their respective outstanding loans at AFL. Moody's also incorporates a moderate level of systemic support from the French government, reflecting the reputational damage for both the French sovereign and local public sector that would result from a default of AFL. The systemic support remains moderate because of AFL's small market share, and thus its limited systemic importance for the financing of the French local public sector at the outset.

NEGATIVE OULOOK ON LONG-TERM ISSUER RATING

The negative outlook on AFL's long-term issuer rating reflects the negative outlook on the rating of the French government. Furthermore, a downgrade of the French sovereign rating would most likely result in weaker parental support, because of the high correlation between the creditworthiness of the French Government and local authorities. These circumstances would in all likelihood prompt a downgrade of AFL's long-term issuer rating.

WHAT COULD MOVE THE RATINGS UP/DOWN

AFL's standalone credit strength already reflects Moody's views on the likelihood of the viability of its business model. An upgrade could be contemplated when AFL has built up a stable franchise, increased its market shares, generated sustainable profits and accumulated capital to grow its business. An upgrade of AFL's long-term issuer rating could follow (1) an upgrade of its standalone credit strength; or (2) a material improvement in the creditworthiness of the French local government sector; or (3) an increase in our perception of the systemic importance of AFL; and/or (4) an upgrade of France's sovereign rating.

The factors that may exert negative pressure on AFL's standalone credit strength comprise any evidence that AFL's business model is not viable. This includes the institution's inability to (1) build-up a loan portfolio that would enable AFL to break-even in the short run; or (2) raise funding at a cost that allows it to originate competitive loans; or (3) follow the credit and funding policies initially contemplated. Significant deterioration in asset quality or operating deficiency implying increased operational risks could also trigger a downgrade of AFL's standalone credit strength.

AFL's long-term issuer rating could be downgraded if (1) its BFSR is downgraded; or (2) the probability of parental or government support declines; or (3) the French sovereign is downgraded.

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was Global Banks published in July 2014. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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