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Research Update:

French Development Bank Agence Francaise de Developpement Affirmed At 'AA/A-1+'; Outlook Remains Negative

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Overview

- We think Agence Française de Développement (AFD) will continue to play a critical role in providing official aid to developing countries and France's overseas territories, backed by an expected increase in lending capacity.
- In our view, plans for AFD to work more closely with the main government financing arm CDC won't weaken AFD's integral link with the sovereign, and we believe AFD will remain under the supervision of the Ministry for Foreign Affairs and the treasury.
- We continue to see an almost certain likelihood that the French government would provide timely and sufficient extraordinary support to AFD in the event of financial distress.
- We are affirming our 'AA/A-1+' ratings on AFD and our 'A+' rating on AFD's subordinated debt.
- The negative outlook on AFD reflects that on France.

Rating Action

On Feb. 23, 2016, Standard & Poor's Ratings Services affirmed its 'AA/A-1+' long- and short-term issuer credit ratings on French state-owned development bank Agence Francaise de Développement (AFD). The outlook is negative.

At the same time, we affirmed our 'A+' rating on AFD's €500 million undated deferrable subordinated debt.

Rationale

We equalize our ratings on AFD with those on the Republic of France (AA/Negative/A-1+; unsolicited ratings), reflecting our opinion that there is an almost certain likelihood that the French government would provide timely and sufficient extraordinary support to AFD in the event of financial distress.

We consider AFD to be a government-related entity (GRE). Under our criteria for rating GREs, our view of an almost certain likelihood of support reflects our view of AFD's:

- Critical role as the legally mandated agency for the French government's bilateral aid and concessionary lending to developing countries and French overseas territories; and
- Integral link with the state, as a fully owned, directly controlled public financial institution.

With the aim of further centralizing the government's financing arms within “Team France” and boosting France's development policy, in August 2015 President Hollande announced the tightening of ties between AFD and the main government financing arm CDC. We anticipate a law on the integration of AFD into the CDC group--without affecting AFD's capital--to be submitted to the parliament in the first quarter of 2016, with full implementation likely by the end of the year. In our view, this reform will have no impact on the link between AFD and the French government, and we believe it reaffirms AFD's role as being pivotal to France's development policy.

In assessing AFD's link with the government as integral, we factor in our expectation that the reform will maintain AFD as an Etablissement Public à Caractère Industriel et Commercial (EPIC). This status prevents AFD from being subject to bankruptcy proceedings, since the French government has ultimate legal responsibility for all of AFD's financial obligations, and gives AFD access to cheap wholesale funding. More importantly, this status alone supports AFD’s business model, based on leveraging state budgetary resources, which limits the impact of development policy on AFD's budget. Moreover, the EPIC status enables AFD to have prompt access to emergency funding from the French treasury through the state's public debt fund, Caisse de la Dette Publique, which can implement in a timely manner any financial operation to defend France's credit standing.

We also consider that the French government's direct monitoring of AFD, and its financial and operational involvement with AFD, will remain strong. AFD's public-service-focused activities cannot be carried out on a commercial basis, in our view. According to the reform plan, the two line ministries will continue to define AFD's medium-term objectives through the committee for inter-ministerial cooperation (CICID); we understand the 2017-2019 contract of objectives will be signed by the end of this year.

The French government has provided extraordinary support to AFD in the past through its direct takeover of debt cancellations of African countries under the International Monetary Fund and World Bank's Heavily Indebted Poor Countries initiatives. AFD benefits from a reserve account provided by the French government. Since June 2015, a legal contract clarifies that this account automatically and immediately covers sovereign defaults. On the other hand, ongoing support for AFD has been demonstrated by a change in the dividend policy, resulting in greater retained earnings in 2015 that increased the agency's capital. Further capital increases are expected from 2016, thanks to the transformation of current loans from French treasury (Ressources à conditions spéciales), amounting to €2.4 billion, into equity.

In the context of rising budgetary constraints, AFD's role has become even more important to the French government in meeting international official development assistance (ODA) obligations, at limited cost to the budget, leveraging state ressources. In contrast, government transfers to multilateral development entities, which still channel 70% of France's ODA, weigh directly on the government's budget. The reform plan reaffirms AFD's crucial role in meeting France's long-term international commitment to development and, since the COP21 Conference, to climate change.

AFD delivers aid, provides concessional loans and technical assistance, and helps define the French approach to ODA. Along with the fight against extreme poverty, which is the primary goal of ODA, we expect AFD's objectives under the 2017-2019 framework to continue to embody a wider notion of development. This should include economically sustainable development, environmental protection, climate change, and education, as well as political freedom, stability, and governance. More generally, AFD has increasingly become a soft tool for French economic diplomacy, with indirect support for exports and investment abroad. The reform plan envisages reinforcing this aspect of AFD's activities, thanks to increased synergies with CDC on decentralized cooperation. All in all, AFD plans to double its assets to €60 billion by 2020, and annual commitments are expected to approach €12.5 billion by 2020 from an estimated €8.5 billion in 2016. Of the additional €4 billion in annual commitments, about €2 billion will be dedicated to climate change.

On a stand-alone basis, AFD's loan exposures are risky, in our view, reflecting concentration in speculative-grade countries (rated 'BB+' and lower). Non-government-guaranteed loans increased to 95% of the total portfolio at year-end 2014, compared with 70% five years earlier. Nonetheless, we believe AFD's banking regulatory framework underpins sound governance and risk management practices. Counterparty risk exposure is managed within global limits and AFD's exposure to currency and interest rate risks remains limited. Furthermore, this risky exposure translates into relatively low nonperforming loans, given that the French government covers sovereign risk and AFD can resort to diplomatic pressure to have loans repaid. Despite a sharp increase in loans outstanding, AFD's loan provisioning has remained conservative, as shown by the European Central Bank's most recent asset quality review. We regard risk monitoring as adequate, although concentration risk remains high: The 10 largest country exposures accounted for 49% of AFD's loan portfolio as of year-end 2014.

At 17.4% on Dec. 31, 2014, AFD's regulatory capital ratio was well above the minimum requirement of 8%. We expect AFD to strengthen its capital base in 2016 through conversion of €2.4 billion of special state resources into additional Tier 1 capital. This would more than double AFD's solvency ratio in 2016. Although such a solvency ratio looks high compared with that of commercial banks, in our view it adequately captures AFD's inherently higher credit and concentration risks. In addition, the French government would provide supplementary funding to AFD in the form of special state resources. Overall, the strengthening of AFD's capital ratio is likely to anticipate the agency's objectives for 2020.

We expect loan commitments to increase in subsequent years in light of the 2020 objectives, although there is some uncertainty about the agency's near-term operational capacity to achieve this goal. Furthermore, AFD's lending has nearly reached the set exposure limit in a few countries. Given the slowdown of growth in developing countries and rise of public debt in sub-Saharan Africa, AFD may have difficulty reaching its annual loan commitment target. This could somewhat affect AFD's profitability, but profit maximization is not an objective. We note that AFD has consistently posted profits over the past 15 years.

The 'A+' rating on AFD's €500 million undated deferrable subordinated debt is two notches below the long-term rating on AFD. In accordance with our criteria in "Bank Hybrid Capital and Nondeferrable Subordinated Debt Methodology and Assumptions," published Jan. 29, 2015, the 'A+' rating results from notching down from the 'AA' rating on AFD because we consider that AFD, as an EPIC entity, will receive financial support from the French government that would prevent loss absorption by the hybrid capital instrument while AFD is a going concern. The EU's Bank Recovery and Resolution Directive doesn't prevent the government from intervening before the resolution point. The two-notch difference reflects the deduction of:

- One notch for debt subordination risk; and
- A further notch to reflect the standard risk of coupon non-payment.

Outlook

The negative outlook on AFD reflects that on France.

We could lower our ratings on AFD following a similar rating action on France. We may also lower the ratings if we believed that AFD no longer had an integral link with the government, for example, if the state's ongoing financial support were to weaken, particularly regarding the significant increase in lending envisaged in the reform plan; or if AFD's role were to diminish, for instance because the state decided to rely on multilateral banks only for international aid or concessional loans. We view this last scenario as very unlikely, especially given the reform, which highlights the importance of bilateral aid.

We could revise the outlook to stable and affirm the ratings if we were to take a similar action on France.

Related Criteria And Research

Related Criteria

- General Criteria: Rating Government-Related Entities: Methodology And Assumptions - March 25, 2015
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions - January 29, 2015
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions - November 09, 2011
- Criteria - Financial Institutions - Banks: Bank Capital Methodology And Assumptions - December 06, 2010

Ratings List

	Rating	
	To	From
Agence Francaise de Developpement		
Issuer Credit Rating		

Ratings List Continued...

Foreign and Local Currency	AA/Negative/A-1+	AA/Negative/A-1+
Certificate Of Deposit		
Local Currency	AA/A-1+	AA/A-1+
Senior Unsecured		
Foreign and Local Currency	AA	AA
Junior Subordinated		
Local Currency	A+	A+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information.

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