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Research Update:

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

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Overview

- We consider that there is an almost certain likelihood that Agence Francaise de Developpement (AFD) would receive timely and sufficient extraordinary support from the French government in case of financial distress.
- We therefore equalize our long-term rating on AFD with our long-term sovereign rating on France.
- Consequently, we are affirming our 'AA/A-1+' ratings on the agency.
- The stable outlook reflects that on the sovereign.

Rating Action

On Feb. 20, 2018, S&P Global Ratings affirmed its 'AA' long-term and 'A-1+' short-term issuer credit ratings on Agence Francaise de Developpement (AFD). The outlook is stable.

Rationale

We equalize our ratings on AFD with those on France (unsolicited: AA/Stable/A-1+) because, based on our view of AFD's critical role for and integral link with the French government, we consider that there is an almost certain likelihood that the government would provide timely and sufficient extraordinary support to AFD in the event of financial distress.

Moreover, we do not see the likelihood of government support as subject to transition risk. As a result, we expect that the ratings and outlook on AFD will move in line with those on France. Furthermore, we consider the French government's contingent liabilities limited and unlikely to constrain its capacity and willingness to support AFD in a timely manner in case of financial distress. More generally, we consider the French government's general propensity to support the GRE sector is not in doubt.

Our opinion of an almost certain likelihood of government support reflects our view that AFD:

- Plays a critical role for France as the legally mandated agency for the French government's strategic policy of bilateral aid and concessionary lending to developing countries and French overseas territories, lending to the public sector and to the private sector mainly through its core subsidiary, Société de Promotion et de Participation pour la Cooperation Economique (Proparco); and
- Has an integral link with the French government as a fully owned, directly controlled public financial institution.

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AFD is a state public industrial and commercial agency ("Établissement Public à Caractère Industriel et Commercial d'État"; EPIC d'Etat). AFD's public service-focused activities cannot be carried out on a commercial basis, in our view. Because AFD is an EPIC, we view the French government as ultimately responsible for its solvency. Its status also prevents AFD from being subject to bankruptcy proceedings; if it were dissolved, all assets and liabilities would be transferred to the French state or a state-designated body. Moreover, if needed, we understand that the state could intervene swiftly, most likely through its public debt fund (Caisse de la Dette Publique; CDP), which can buy AFD's debt. This would provide continued funding if it were difficult to gain access to the capital markets. We do not expect AFD's EPIC status to change within our outlook horizon.

We also consider that the French government's direct monitoring of AFD, and its financial and operational involvement with AFD, will remain important. The Ministry for Foreign Affairs and International Development and the Ministry of Economy and Finance provide strong and broad state supervision of AFD. AFD signs multiyear management contracts with the government that lay out its objectives, including financial and activity targets. A new contract is under construction and we expect it to reflect the expected increase in AFD's activity in the coming years. AFD's current activity targets are ambitious and include a €1 billion increase of annual commitments to €12.7 billion by 2020, with a strong emphasis on climate change projects. AFD is planning to be 100% compatible with the Paris Agreement by 2022. We expect these targets to grow further, given the French president's decision to increase France's public development aid to 0.55% of gross national income (GNI) by 2022. We expect AFD to play a pivotal role in achieving this target.

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 also benefits from a reserve account ("compte de reserve) financed by the French government to cover sovereign risks. The French state also demonstrated its ongoing support to AFD in December 2016, when it turned €2.4 billion subordinated loans (Tier 2) into Common Equity Tier 1 (CET1) Capital to allow AFD to abide by regulatory capital rules while supporting its growing activity. In 2018, AFD will receive the last disbursement in respect of the third annual tranche of €280 million Additional Tier 1 (subordinated debt) subscribed by the state. We also expect the French government to continue provide subordinated loans (Tier 2) on an annual basis to AFD through French Treasury loans ("Ressources à Conditions Spéciales"). Total capital ratio was 16.82% in 2016, well above minimum requirement. This should give AFD flexibility to extend its lending capacity, especially to its most important borrowers.

On June 30, 2017, the European Central Bank (ECB) approved the change in AFD's banking licence from specialized credit institution ("établissement de credit spécialisé") to finance company ("société de financement"). As a consequence, AFD's supervising authority became the French regulator ACPR ("Autorité de Contrôle Prudentiel et de Résoltion") instead of the ECB. As a result, AFD can no longer access EBC refinancing--which it never used, in practice--and its issuances are no longer eligible as high quality liquid assets. AFD is still required to reach the regulatory solvency ratio determined by ACPR, but we note the liquidity requirement will be weaker. These changes do not affect our view of AFD's role for and link with France.

When reviewing AFD on a stand-alone basis, we note that its activity is primarily in speculative-grade countries (rated 'BB+' and lower) and concentrated on a small number of counterparties. Foreign exchange risk and interest rate risk are almost fully hedged, but concentration risk appears material. On sovereign exposure, we understand the French state carries the credit risk of loans, as the French Treasury directly negotiates restructuring with sovereign creditors. In 2017, we understand that sovereign rating downgrades in African countries eroded the quality of the nonsovereign portfolio, but nonperforming loans (NPL) remain limited (it was just 2.5% in 2016). We also note that new loan loss provisions were exceptionally low in 2017 (with reversal provision registered in the first half of 2017). We expect assets and revenues to keep increasing as AFD expands its activity.

Without a deposit base, AFD relies mostly on wholesale funding. However, we believe that funding is overall well matched to assets and the state's ultimate responsibility for AFD's solvency allows access to cheap funding.

Outlook

The stable outlook on AFD reflects our stable outlook on France. We believe that AFD will retain its critical role for and integral link with France. We therefore expect the ratings on AFD to move in line with those on the sovereign.

We could lower our ratings on AFD following a similar rating action on France. We could also lower the ratings if we believe that AFD no longer has an integral link with the government, for example, if AFD were to lose its EPIC status; or if AFD's role were to diminish, for instance, because the state decided to rely solely on multilateral banks for international aid or concessional loans. However, we currently view these developments as unlikely.

Conversely, we could raise the rating if France's credit quality were to improve and the likelihood of support for AFD remained almost certain.

Related Criteria And Research

Related Criteria

- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology - July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings - April 07, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions - March 25, 2015
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions - July 17, 2013
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions - November 09, 2011

- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009

Related Research

- Research Update: Societe de Promotion et de Participation pour la Cooperation Economique Rated 'AA/A-1+'; Outlook Stable - February 16, 2018
- Research Update: France 'AA/A-1+' Ratings Affirmed; Outlook Stable - October 6, 2017

Ratings List

	Rating	
	To	From
Agence Francaise de Developpement		
Issuer Credit Rating		
Foreign and Local Currency	AA/Stable/A-1+	AA/Stable/A-1+
Certificate Of Deposit		
Local Currency	AA/A-1+	AA/A-1+
Senior Unsecured		
Foreign and Local Currency	AA	AA
Short-Term Debt		
Foreign and Local Currency	A-1+	A-1+

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. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.