Moody's Investors Service

Credit Opinion: Crédit Logement

Global Credit Research - 11 Mar 2010

Paris, France

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Aa2
Subordinate -Dom Curr	Aa3
Jr Subordinate -Dom Curr	A1
Preferred Stock -Dom Curr	A2

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Key Indicators

Credit Logement

	[1]2008	2007	2006	2005	2004	Avg.
Total assets (EUR billion)	11.67	11.44	10.35	8.49	6.21	[2]17.69
Total capital (EUR billion)	10.48	10.29	9.37	5.91	4.40	[2]23.18
Return on average assets	0.74	0.73	0.70	0.83	0.96	0.79
Recurring earnings power [3]	1.16	1.12	1.17	1.30	1.48	1.25
Net interest margin	0.85	0.59	0.70	0.68	0.83	0.73
Cost/income ratio (%)	20.55	21.16	22.67	25.34	25.09	22.96
Problem loans % gross loans	0.00	0.00	0.00	0.00	0.00	0.00
Tier 1 ratio (%)	4.60	4.16	4.69	4.53	4.90	4.57

[1] As of December 31. [2] Compound annual growth rate. [3] Preprovision income % average assets.

Opinion

RECENT CREDIT DEVELOPMENTS

On 26 February 2010, Moody's confirmed Credit Logement's Aa2 long-term issuer rating and downgraded its ratings of certain hybrid securities in February 2010 in line with its revised guidelines for Rating Bank Hybrids and Subordinated debt published in November 2009.

SUMMARY RATING RATIONALE

The Aa2 issuer rating of Crédit Logement (CL) reflects the credit institution's key role and established market position within the French banking sector as the leading provider of guarantees for French non-mortgage backed residential housing loans (known as "prêts cautionnés").

CL's shareholders are the main French credit institutions that offer "prêts cautionnés". They are committed through their statutes and towards the French regulator to maintain CL's solvency at all times up to a certain amount, which provides the institution with some significant loss absorption capacity even in an economic downturn and translates into a very solid ownership and support structure.

Moody's views CL as a relatively low credit risk given notably its shareholders' commitment to support CL's solvency if necessary, the mutual guarantee system in place, the overall good creditworthiness of CL's shareholders and the historically good quality of CL's underlying assets.

Although CL has the status of a credit institution and is regulated by the Commission Bancaire, it is not strictly speaking a bank; hence, Moody's does not assign it a BFSR.

Credit Strengths

- Established leadership position as provider of guarantees for French residential non-mortgage loans

- Solid shareholder support mechanisms

- Long-term track record as efficient service provider

- Low overall risk profile

- Low market risk appetite

Credit Challenges

- Continue to strengthen its franchise

- Maintain the attractiveness of guarantee products despite mortgage reforms

- Revenue generation restricted by service provider role and by the recent decrease of CL's pricing policy

- Continue to control risks

- Maintain its good asset quality despite the deterioration of the French residential housing market

- Maintain good coverage of credit risk despite the contraction of fees charged to borrowers

Rating Outlook

The stable outlook on Credit Logement's ratings reflects the low risk of its business, its substantial cushion to absorb potential losses and the strong support mechanism in place with highly-rated large French banks.

What Could Change the Rating - Up

CL's issuer rating could improve if it were to strengthen its franchise while continuing to contain and manage risks and if it were to increase its efficiency as a service provider. However given the high level of CL's issuer rating and the deterioration of the French residential housing market and the slower pace of housing loan production, Moody's views a significant improvement of CL's franchise value as unlikely.

What Could Change the Rating - Down

CL's issuer rating would be negatively affected by a significant deterioration in its asset quality as well as in its shareholders' credit quality, and/or any change in the guarantee mechanism in place and/or a substantial deterioration in credit, ALM or operational risks. Such scenarios are currently unlikely.

Recent Results and Company Events

CL's outstanding off-balance sheet loans, representing principal due on current guarantees, amounted to EUR 155.4 billion at end-2008(EUR 139.5 billion at end-2007), while its net profit stood at EUR 85 million (end-2007: EUR 80million).

DETAILED RATING CONSIDERATIONS

Detailed considerations for CL's currently assigned rating are based on the 2008 year-end financial report. Quantitative scores are based on the three-year averages for the years 2006-08.

Factor 1: Franchise Value

CL continues to exhibit a dominant franchise as an expert and efficient provider of housing guarantees - "prêts cautionnés" - and as a recognised player in credit monitoring and loan recovery. At end-2008, CL had a market share of around 50% of the housing guarantee market in France and reportedly guarantees around 30% of the new production of residential housing loans in France and 20% to 25% of the entire stock.

CL's business volumes have grown rapidly in 2000-2006, but expanded at a slower pace since 2007, reflecting the significant slowdown of the French residential housing loan market.

We note that CL's business volumes continue to benefit from the relatively low demand for mortgages in France, due to the comparably costly and slow processes of registering mortgage deeds and foreclosures. The expansion of automated processes between CL and its partner banks allows for a comparatively smooth and rapid process and creates barriers to entry for competitors.

The mortgage reform enacted in 2006, which lowered mortgage costs and allowed for reverse and rechargeable mortgages, and the decrease in notary costs related to rechargeable mortgages, could have created enhanced competition, but CL quickly reacted by cutting its fees and announcing that it would launch a rechargeable guarantee product. Therefore, no significant change in the structure of the market has occurred.

Overall, and despite the deterioration of the French residential housing market, Moody's continues to view CL's franchise as very solid.

Factor 2: Risk positioning

CL's shareholders are the main French financial institutions that offer "prêts cautionnés". The bulk of the French banking sector is represented in CL's shareholding structure. Individual shareholder stakes are capped at 16.5% of voting rights and Tier 1 and Tier 2 capital may be adjusted twice a year if additional capital is required, in proportion to each shareholder's level of guarantees outstanding.

In particular, each partner bank and shareholder confirms its capital commitment semi-annually upon the replenishment of CL's Mutual Guarantee Fund (MGF) - accounted as Tier 1 capital. In the event of bankruptcy of one of the shareholders, the others would be required to make up for the resulting MGF or equity shortfall in proportion of their individual stakes.

Moody's therefore believes that CL's solid ownership structure, its mutual support mechanism and the MGF in place together translate into a relatively low institutional risk for CL.

Moody's also notes that CL has a risk-averse culture stemming from its service provider's mission. In recent years, it has reorganised its risk management and strengthened its risk management policies and tools and notably:

- implemented a credit-scoring model and the computation of default and loss given default data to support the monitoring of credit risk and the assessment of capital requirements under Basel II;

- introduced new liquidity management rules aiming at flattening interest rate fluctuations over time; and

- implemented a business continuity plan and an operational data base to quantify operational risk.

Moody's views CL's liquidity position as sound. CL's business of guaranteeing residential housing loans generates liquidity; therefore, its liquidity risk is limited to potential imbalances between its liquidity investment policy and the requirements resulting from its business as a guarantor. Moody's also notes that CL only invests its existing resources. CL's capital - including the MGF - is prudently invested mainly in term deposits or securities issued by highly rated French and European Banks.

Participating shareholder loans are lent back to the shareholders through the interbank market on a fully matched basis.

CL's industry concentration is high given its specialisation in the French residential housing market. In Moody's opinion, however, the high granularity of CL's guarantees (the average amount guaranteed stood at EUR 153,810 in 2008), which are intended to cover mainly French residential owner-occupied housing loans (i.e. assets with a relatively low risk profile historically), significantly mitigates the industry concentration risk.

In addition, Moody's notes that CL's market risk is very limited. CL is neither active in the derivative product nor forward financial instrument markets and it has only very marginal risks on equities. CL's market risk is limited to interest rate risk, which has historically been prudently managed. In 2008, CL's Net Present Value's sensitivity to a drop in rates of 200 bps amounted to 8.90% of its share capital.

Overall, Moody's views CL risk profile as relatively strong and its risk management as quite prudent and conservative.

Factor 3: Regulatory environment

All French financial institutions are subject to the same score on the regulatory environment. This factor does not address financial institution-specific issues. Instead, it evaluates whether or not regulatory bodies are independent and credible, demonstrate enforcement powers and adhere to global standards of best practices for risk control. Please refer to Moody's Banking System Outlook on France, published in July 2009, to obtain a detailed discussion of the regulatory environment.

Factor 4: Operating Environment

This factor is common to all French financial institutions. Please refer to Moody's Banking System Outlook on France, published in July 2009, to obtain a detailed discussion of the operating environment.

Factor 5: Profitability

As a service provider to its shareholders, CL is not a profit maximiser. The institution has two main sources of revenue: commissions on the "prêts cautionnés" paid by individual borrowers and income from the placement of its free capital funds into relatively low-risk securities instruments. Its earnings generation capacity is therefore driven by its pricing policy and business volumes, and interest rate movements.

CL's operating income primarily comprises fees and commissions from guarantees (39% of its operating income in 2008 versus 43% in 2007) and interest income (57% in 2008 versus 41% in 2007).

Going forward, Moody's expect CL's revenues and more specifically fee and commission income to grow at a slower place as a result of weaker demand for housing loans. However, in our view, profitability for service providers such as CL is not as relevant as other factors.

Factor 6: Liquidity

CL's liquidity position is strong. According to Moody's calculations, liquid assets represented 97% of CL's total assets, which mainly comprise term deposits with highly rated banks.

CL keeps an ample cash position at less than one year. Cash must represent at least three-quarters of disbursement from the MGF. The one-month regulatory liquidity ratio always stands above the regulatory threshold of 100%. At year-end 2008, the ratio was 142%.

Factor 7: Capital adequacy

CL reported a Tier 1 capital ratio of 4.60% in 2008 versus 4.16% in 2007 and a total capital ratio of 8.20% in 2008 versus 8.18% in 2007. These ratios have been broadly stable over time. CL's Tier 1 comprises share capital contributions, undated deeply subordinated notes (issued in November 2004 and March 2006), reserves and the MGF (EUR 2.44 billion in 2007 versus 2.23 billion in 2006).

CL has been actively managing its capital through the implementation of a synthetic securitisation programme aimed at transferring credit risk associated with guaranteed loan portfolios to achieve capital relief. Between 2004 and year-end 2007, CL completed six synthetic RMBS transactions totalling EUR 26 billion, known in the market by the name of French Residential Assets. The programme aimed at reinforcing CL's capitalization before the full implementation of Basel II.

Moody's notes that CL has chosen the advanced approach - validated in April 2007 by the French regulator - to determine capital requirements related to its portfolio of guarantees while using the standard approach for its investment portfolio and operational risk. The rating agency expects CL to largely benefit from the transition to Basel II through the drop of its risk-weighted commitments which will result in much higher capital adequacy ratios.

Overall, and considering the predictability of CL's underlying business and the statutory obligation of its shareholders to support CL's solvency, Moody's views the institution's capital ratios as satisfactory.

Factor 8: Efficiency

Moody's notes that, over the years, CL's costs have been contained and that they continue to remain at a reasonable and satisfactory level. The cost-to-income ratio decreased to 20.6% in 2008 from 21.16% in 2007.

Given CL's role as a service provider, Moody's, does not consider this factor to be particularly relevant given that the company is not a profit maximiser.

Factor 9: Asset quality

CL's main risk to date, credit risk, arises from the risk of default of individual borrowers' "prêts cautionnés". After a period of three to five months past due, CL takes over the servicing from the originating bank and starts a recovery process.

Credit risk has historically been low. Non-performing exposures represented 0.21% of total guaranteed exposures in 2008 (0.15% in 2007) and actual losses 0.038% of these exposures (0.021% in 2007), and Moody's expects those numbers to increase further, but to remain at very low levels, helped by CL's credit-scoring model, strict origination criteria and effective credit monitoring and recovery process. Moody's notes that in 2008, the average term of the guranteed loans was 18 years and 3 months, and that only 15% of the loans were for buy-to-let purposes. However, Moody's cautions that the average Outstanding Loan To Price for loans originated in 2008 which stands at 80% is relatively high, albeit fairly stable and mitigated by the significant part of guarantees provides to borrowers securing the loan with already owned real-estate properties.

The risk-sharing mechanism, aimed at covering missed payments and credit losses, implemented through the MGF is also an important mitigant to CL's credit risk. Individual borrowers benefiting from CL's guarantee are required to contribute to the MGF, while CL's shareholders are required to make up for any MGF shortfall. In 2008, the MGF amounted to EUR 2.5 billion - after payment of bad debt - and covered 1.62% of outstanding guaranteed exposures (1.71% in 2007), without taking the securitisation into account.

Overall, and considering the historically relatively low incidence of default associated with residential housing loans, the risk-sharing mechanisms in place involving both individual borrowers and shareholders and CL's strong support mechanisms, which provide enhanced protection against unexpected risk, Moody's is not overly concerned about the potential effect of the French housing market's deterioration on CL's historically good asset quality.

Notching Considerations

The ratings for the Bank's hybrid obligations are notched off the BCA according to "Moody's Guidelines for Rating Bank Hybrid Securities and Subordinated Debt" released on 17 November 2009.

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