

Rating Action: Moody's downgrades Dexia Municipal Agency's covered bonds

Global Credit Research - 16 Dec 2011

London, 16 December 2011 – Moody's Investors Service has downgraded to Aa1 on review for downgrade from Aaa on review for downgrade the covered bonds issued by Dexia Municipal Agency (the issuer), under the French SCF law. Today's rating action is prompted by the downgrade of Dexia Credit Local, acting as the sponsor bank, to Baa1 on review for downgrade from A3 on review for downgrade.

RATINGS RATIONALE

Today's rating action on the covered bonds is prompted by Moody's Financial Institutions Group's rating action on Dexia Credit Local's senior unsecured and short-term ratings (now Baa1/Prime 2). For further information, please refer to "Moody's downgrades Dexia Credit Local and Dexia Banque Internationale à Luxembourg to Baa1 from A3, on review for downgrade" published on 15 December 2011. Moody's decision also reflects the rating agency's concerns as to the delay in implementing the sale of majority of the shares in the issuer to the Caisse des Dépôts and La Banque Postale, as initially announced on 20 October 2011. Moody's notes that if Dexia Credit Local's long-term senior unsecured rating is downgraded below Baa1, the Timely Payment Indicator (TPI) framework could further constrain the corresponding covered bond ratings.

During the review of the covered bonds, Moody's will consider the possible negative rating impact in two steps:

(a) Expected Loss: During its review, Moody's will assess the effect of Dexia Credit Local's downgrade on the covered bonds. The analysis will include (i) a review of the swap arrangements currently in place, as entities within Dexia Group provide several of these swaps, (ii) a legal review of the sponsor bank's engagement to provide over-collateralisation, and (iii) a detailed analysis of the credit quality of the substitute assets comprised in the cover pool, as some of them constitute credit exposures to Dexia Group entities.

(b) TPI: The TPI framework will limit the covered bond ratings, if the senior unsecured rating of the sponsor bank is downgraded below a certain level. Based on the current TPI of "Probable-High", if Dexia Credit Local's senior unsecured long-term rating is further downgraded, the covered bond rating may be downgraded.

KEY RATING ASSUMPTIONS/FACTORS

Covered bond ratings are determined after applying a two-step process: expected loss analysis and TPI framework analysis.

EXPECTED LOSS: Moody's determines a rating based on the expected loss on the bond. The primary model used is Moody's Covered Bond Model (COBOL) which determines expected loss as a function of the issuer's probability of default, measured by the issuer's rating, and the stressed losses on the cover pool assets following issuer default.

TPI FRAMEWORK: Moody's assigns a "timely payment indicator" (TPI) which indicates the likelihood that timely payment will be made to covered bondholders following issuer default. The effect of the TPI framework is to limit the covered bond rating to a certain number of notches above the issuer's rating.

For Dexia Municipal Agency's covered bonds, Moody's has assigned a TPI of "Probable High."

SENSITIVITY ANALYSIS

The robustness of a covered bond rating largely depends on the credit strength of the issuer.

The TPI Leeway measures the number of notches by which the issuer's rating may be downgraded before the covered bonds are downgraded under the TPI framework.

Based on the current TPI of "Probable High," there is no TPI Leeway for this programme, meaning that the covered bonds might be downgraded as a result of a TPI cap if Dexia Credit Local is downgraded below Baa1, all other variables being equal.

A multiple-notch downgrade of the covered bonds might occur in certain limited circumstances. Some examples might be (i) a sovereign downgrade negatively affecting both the issuer's senior unsecured rating and the TPI; (ii) a multiple notch downgrade of the issuer; or (iii) a material reduction of the value of the cover pool.

As noted in Moody's comment "Rising Severity of Euro Area Sovereign Crisis Threatens Credit Standing of All EU Sovereigns" (28 November 2011), the risk of sovereign defaults or the exit of countries from the Euro area is rising. As a result, Moody's could lower the maximum achievable rating for covered bonds transactions in some countries, which could result in rating downgrades.

RATING METHODOLOGY

The principal methodology used in this rating was "Moody's Approach to Rating Covered Bonds" published in March 2010. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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