



Activity Report  
Caisse Française de Financement Local  
as of March 31, 2016

CAFFIL

# 1. Reminder of shareholding structure, economic model and ratings of Caisse Française de Financement Local

## 1.1 – NATURE AND ACTIVITIES OF THE COMPANY

Caisse Française de Financement Local (also known by its acronym CAFFIL) is a credit institution active in the refinancing of loans to public sector entities through the issue of covered bonds, which are called *obligations foncières*.

It is a specialized credit institution authorized to operate as a *société de crédit foncier*. As a credit institution, the Company is subject to all legal and regulatory provisions that apply to credit institutions. It conducts banking transactions in its ordinary course of business. As a *société de crédit foncier*, these transactions are specialized and have an exclusive purpose, as defined in articles L.513-2 and following of the Monetary and Financial Code.

In the case of Caisse Française de Financement Local, this specialization is exclusively limited to transactions with public sector entities or entities they guarantee as specified in its October 1, 1999, authorization by the Autorité de contrôle prudentiel et de résolution (ACPR) and its own by-laws.

- The authorization mentions that the Company “is approved as a *société de crédit foncier* the activities of which exclusively concern the granting or acquisition of loans to public sector entities or those they guarantee, as well as the holding of securitization units or shares of similar entities when the assets in these securitizations are for at least 90% composed of assets of the same nature as the above-mentioned loans, in accordance with article 94-II and III of law 99-532”.
- The purpose of the Company (article 2 of the by-laws) specifies that the exclusive purpose of the Company is:
  - to grant or to acquire exposures to public sector entities as defined in article L.513-4 of the Monetary and Financial Code as well as securitization units or shares of similar entities considered as exposures to public sector entities as defined in article L.513-5 of the Monetary and Financial Code;
  - to hold securities and other assets under the conditions set by decree to be considered as replacement assets.

*Sociétés de crédit foncier*, which were created by the law of June 1999, are now well-known in the world of bond issuers and investors. They issue covered bonds called *obligations foncières* and contract other covered debt negotiable or not in regulated markets. All these instruments are characterized by the legal privilege that primarily affects cash flows from the Company’s assets to pay the interest and reimbursement of the *obligations foncières*. *Sociétés de crédit foncier* may also issue or contract non-covered debt.

*Obligations foncières* constitute a significant element in the international covered bond market.

## 1.2 – SHAREHOLDING STRUCTURE OF THE COMPANY

Caisse Française de Financement Local and its parent company SFIL (formerly Société de Financement Local) are key elements in the financing of local governments and public hospitals in France introduced by the French State in 2013. This organization is based on a commercial activity developed by La Banque Postale with refinancing provided by Caisse Française de Financement Local.

In 2015, the French State entrusted SFIL and Caisse Française de Financement Local with the responsibility to refinance large export credits with the guarantee of the State (see 1.3.d). The objective is to enable large export credits as well as French local governments and public hospitals to benefit from optimal financing conditions through a high rating and irreproachable risk management.

The capital of Caisse Française de Financement Local is 100% held by SFIL, which also manages the Company in accordance with article L.513-15 of the Monetary and Financial Code. SFIL is a credit institution approved by the Autorité de contrôle prudentiel et de résolution (ACPR). Its shareholders are the French State (75%), Caisse des Dépôts et Consignations (20%) and La Banque Postale (5%). SFIL’s shareholders are thus firmly anchored in the public sphere, reflecting the missions the French State assigned it.

The French State is the “reference shareholder” of SFIL and Caisse Française de Financement Local for the Autorité de contrôle prudentiel et de résolution (ACPR) underlining its commitment to ensure oversight and to influence strategic decisions, as well as its determination to ensure Caisse Française de Financement Local’s and SFIL’s ongoing financial transactions if so required.

## 1.3 – ECONOMIC MODEL OF CAISSE FRANÇAISE DE FINANCEMENT LOCAL

### a. Servicing and financing provided by SFIL

The role of SFIL primarily involves the following:

- to ensure the complete operational management of the Company (day-to-day management as well as the operational management of the reduction in the sensitivity of the structured loans on the balance sheet of Caisse Française de Financement Local), as defined by the regulations applicable to *sociétés de crédit foncier*, in particular article L.513-15 of the Monetary and Financial Code;
- to provide Caisse Française de Financement Local with the derivatives and non-privileged funding it needs to carry out its activities.

The funds required to finance the activity of Caisse Française de Financement Local (financing of over-collateralization and in-

mediated derivatives) are lent to SFIL by its shareholders:

- Caisse des Dépôts et Consignations (CDC) for all the needs linked to operations booked prior to the date of acquisition (January 31, 2013) and to the new export refinancing activity;
- La Banque Postale (LBP) for all the needs related to loans to French local governments and public hospitals that it originates.

In addition to commitments of the French State as the reference shareholder, on January 31, 2013, SFIL signed a declaration of support of Caisse Française de Financement Local, which is reproduced in this annual financial report – General information.

It should be noted that SFIL also supplies services for the business of lending to French public sector entities engaged by La Banque Postale and its joint venture La Banque Postale Collectivités Locales. These services concern activities involving commercial support, financial oversight, the supply of data for risk analysis and back office operations.

## b. Other management agreements

Specific individual agreements have been established with entities that have transferred assets to the *société de crédit foncier*, and continue to ensure management for their national clientele. At the end of 2015, there were agreements with the following entities: Kommunalcredit Austria (Austria), Belfius Banque et Assurances (Belgium), and Dexia Crediop (Italy). These agreements already existed in previous years.

The management of registered covered bonds (RCB) for German investors is entrusted to Landesbank Baden-Württemberg (LBBW) for contract issued since 2015 while Dexia Kommunalbank Deutschland continues to manage registered covered bonds issued prior to 2015.

## c. Partnership between La Banque Postale and Caisse Française de Financement Local

Since the end of 2012, La Banque Postale markets loans to the French local public sector and public hospitals. The loans originated are exclusively in euros with a vanilla interest rate.

Within the framework of the new organization of the financing of the French local public sector and public hospitals, Caisse Française de Financement Local and La Banque Postale signed a partnership agreement. La Banque Postale committed to propose to Caisse Française de Financement Local all the loans that would be eligible for its cover pool.

This partnership enables Caisse Française de Financement Local to maintain its control of the credit risk through a two-stage analysis:

- When the loan is originated, the initial analysis of the counterparty is carried out simultaneously at the two entities. The loans that do not meet the credit and eligibility criteria of Caisse Française de Financement Local cannot be transferred to its balance sheet. Caisse Française de Financement Local's eligibility criteria are strictly monitored by internal management policies and limit eligible counterparties to French local public sector entities and public hospitals.
- Before loans originated by La Banque Postale are sold to Caisse Française de Financement Local, a new analysis of the assets is conducted, and Caisse Française de Financement Local may refuse a loan prior to the transfer if the asset no longer meets the criteria.

As required by law, the acquisition of loans by Caisse Française de Financement Local is carried out by using a transfer form (*bordereau*) that is specific to *sociétés de crédit foncier*.

## d. Refinancing of export credit

All of the authorizations required to expand the activities of SFIL and Caisse Française de Financement Local to include the refinancing of large export credits were obtained in 2015. Since then, Caisse Française de Financement Local may grant loans to SFIL in order to refinance its export credits. Such loans benefit from an irrevocable and unconditional 100% guarantee by the French State.

This new business will bring Caisse Française de Financement Local closer to the French State without modifying the risk profile of its cover pool.

The system will function as follows:

- SFIL will contribute to the financial proposal made by one or more banks in the banking syndicate granting the buyer credit covered by the export credit insurance guaranteed by the State<sup>(1)</sup>. Then, these banks will sell all or part of the loans (and the attached rights) to SFIL and will keep at least the share of the export credit not covered by the insurance (usually 5%).
- Caisse Française de Financement Local will grant a loan to SFIL to enable it to refinance the acquired export credit. This refinancing loan will benefit from an irrevocable and unconditional 100% guarantee by the French State, referred to as an "enhanced guarantee<sup>(2)</sup>". Loans granted by Caisse Française de Financement Local to SFIL to refinance the purchased export credits will thus constitute exposures that are totally guaranteed by the French State and eligible for the cover pool of a *société de crédit foncier*. These loans will also comply with the European CRR regulation (article 129, which specifies the assets authorized for inclusion in a cover pool to ensure that the covered bonds will benefit from the best prudential treatment).

These new loans, like the new French public sector loans marketed by La Banque Postale, will be added to the portfolio of Caisse

<sup>1</sup>Public guarantees for foreign trade, which in particular cover export credit insurance operations, are granted by the Minister in charge of the Economy, once approved by the Guarantees and Foreign Trade Credit Commission. They were formerly managed by Coface, but since the amended 2015 finance law, they are entrusted to an entity the State has asked to manage and deliver these guarantees, under the State's control, on its behalf and in its name. This public entity also manages and delivers enhanced guarantees under the State's control, on its behalf and in its name.

<sup>2</sup>The enhanced guarantee was introduced by law 2012-1510 of December 29, 2012, and the decree 2013-693 of July 30, 2013.

Française de Financement Local, which is financed by the issue of *obligations foncières*. Given the current size of the cover pool and the growth of its traditional line of business, the percentage share of these activities will increase little by little and will only become significant in several years. This share should reach 11% based on an annual production of export credit refinancing number between EUR 1.5 and 2.0 billion.

## **1.4 – RATINGS OF THE OBLIGATIONS FONCIÈRES ISSUED BY CAISSE FRANÇAISE DE FINANCEMENT LOCAL**

The issuance program of Caisse Française de Financement Local is rated by the three main rating agencies – Standard & Poor’s, Moody’s and Fitch.

The ratings of the bonds issued by Caisse Française de Financement Local are at the highest level of credit quality (Step 1). This requires that the quality of the cover pool and strict management rules be consistent with the criteria and approaches of the three agencies.

The principle by which each agency rates *obligations foncières* (and covered bonds in general) involves taking as a starting point the issuer’s rating or that of the parent company if the issuer is not rated, and enhancing this rating by one or more notches in function of the current safeguards (legal framework, quality of assets, asset/liability management, over-collateralization, etc.).

The rating of SFIL is now set at the same level as that of France for S&P and one notch below France for Moody’s and Fitch. These very good ratings have been attributed because the agencies consider SFIL as an entity that is linked to the French government. These take into account a strong probability that the State will provide extraordinary support if necessary because of the strategic importance of the public service responsibilities SFIL was entrusted with, State commitments and the State’s influence on SFIL’s governance.

The close relationship between Caisse Française de Financement Local and the French State, due to its shareholding structure and support, but also to its mostly French cover pool, creates a link between the rating of *obligations foncières* and the rating of France for Fitch and S&P. Fitch’s rating may thus not be higher than the sovereign rating; otherwise Fitch would apply an ultra-stressed rating scenario (an 80% default rate, with recoveries limited to 20%), making it necessary to have a level of over-collateralization that would be incompatible with the profitability of the business model. S&P’s rating is limited to one notch above that of France.

The rating of *obligations foncières* is also limited by S&P to one notch above the rating of SFIL, by reason of the non-conformity of certain derivative contracts with the agency’s most recent methodological criteria (counterparties not rated by S&P or absence of a replacement clause).

## **2. Highlights of the first quarter of 2016 and post-closing events**

### **2.1 – THE COVERED BOND MARKET**

In the first quarter of 2016, issuing activity on the primary market was very strong for covered bonds in euros with a benchmark size, with more than seventy transactions for a total of EUR 64 billion, compared to EUR 41 billion in the first quarter of 2015. January saw an abundant offering, which allowed investors to be demanding in terms of new issue premiums; as a result, the widening of spreads that was seen in the secondary market in the last quarter of 2015 intensified. This significant widening of spreads has made the covered bond product attractive once more, and since February, traditional investors have gradually returned to buying in a market that, as an added benefit, continues to be supported by the Eurosystem, which launched its 3rd covered bond program. The end of the quarter was marked by a rapid and significant tightening of secondary spreads in the wake of the announcement of the strengthening of non-standard monetary policy instruments by the central banks of the Eurosystem.

In this evolving market, Caisse Française de Financement Local decided to enter the market very early in the year. At the very beginning of January, it successfully launched an issue of EUR 1.5 billion, comprised of two tranches with different maturities, 6 years and 15 years. In addition to this public offering, CAFFIL took advantage of investor demand for long maturities to conduct private placements of EUR 266 million and to reopen its 2035 issue for EUR 350 million (it now stands at EUR 1 billion). The average maturity of the financing raised by CAFFIL in the 1st quarter is more than 11 years.

### **2.2 – EVENTS AFFECTING THE RATINGS OF OBLIGATIONS FONCIÈRES**

The ratings of the *obligations foncières* issued by Caisse Française de Financement Local were not altered in 2016. As of March 31, 2016, the ratings were as follows: AA+ by Standard and Poor’s, Aaa by Moody’s and AA by Fitch.

### **2.3 – LITIGATION RELATED TO STRUCTURED LOANS**

In its portfolio, Caisse Française de Financement Local has structured loans considered as sensitive (see 4.2.d.1 for definition) that were granted to French customers of Dexia Credit Local. Some of these customers initiated legal proceedings against Dexia Credit Local, Caisse Française de Financement Local and/or SFIL.

### **a. Decrease in outstanding sensitive structured loans**

The policy applied by SFIL since its creation at the beginning of 2013 made it possible to effect a significant reduction in the size of the portfolio of sensitive structured loans of Caisse Française de Financement Local (see 4.2.d.2).

### **b. Creation of support funds contributing to the cost of sensitivity reduction**

The two support funds created by the French government in 2013 and 2014 allow local governments and public hospitals eligible for this arrangement to finance the cost of doing away with their structured loans. These funds were fully operational as of 2015. In the second half of the year, notifications of the amounts of assistance provided by the funds began to be sent to local governments and public hospitals that had requested such help. This made it possible to maintain a sustained pace of sensitivity reduction and resulted in a major decrease in the number of lawsuits.

The capacity for intervention of these funds was significantly increased in the first quarter of 2015 in order to cover the additional cost linked to the appreciation of the Swiss franc so that the early reimbursement penalties borne by customers holding loans indexed on the EUR/CHF exchange rate would not be greater, after assistance from the funds, than they would have been before the decision of the Swiss National Bank (SNB) in January 2015 to put an end to the floor rate of exchange of the Swiss franc (CHF). The fund earmarked for local governments now totals EUR 3.0 billion and the one for public hospitals EUR 400 million. Likewise, the ceiling of the assistance made available was significantly raised from 45% to 75% of penalties owed by the most fragile local governments.

Caisse Française de Financement Local made a voluntary contribution to the local government support fund in the amount of EUR 150 million and to the hospital support fund for EUR 38 million.

To prepare its 2013, 2014 and 2015 annual financial statements, Caisse Française de Financement Local took into account the hypothesis that the solutions announced by the government would in fact rapidly be made available. It was notably a question of defining a legal base for other structured loan agreements contracted by public sector entities (which took effect on July 30, 2014), creating a support fund for local governments and then for public hospitals and finally the measures taken in 2015 to counter the major rise in the exchange value of the Swiss franc decided by the Swiss National Bank so that the support funds would remain at least as attractive as before the SNB decision for local governments and hospitals holding loans indexed on the EUR/CHF exchange rate (rise in the two support funds and increase in the maximum rate of assistance granted).

### **c. Significant decline in the number of lawsuits**

As of March 31, 2016, the number of borrowers who had brought suit totaled 90, down from 131 as of December 31, 2015, a decline of 41 borrower litigation.

The law that created a legal basis to secure structured loan agreements subscribed by public sector entities took effect on July 30, 2014. Since then, a bank can no longer be condemned for reasons linked to the annual rate of charge (TEG) of structured loan agreements, in particular the formal absence of the TEG in the facsimile which had preceded the signing of the contract, which had motivated the decision of the Tribunal de grande instance de Nanterre (TGI) on February 8, 2013, concerning the loans granted to the Département de la Seine-Saint-Denis.

The Département de la Seine-Saint-Denis which had been the cause of this lawsuit decided to put an end to the litigation within the framework of a financial agreement that made it possible to eliminate its debt sensitivity.

Since this first ruling in February 2013, a limited number of disputes were the subject of court decisions : four rulings in 2014 before the law creating a legal basis to secure structured loan agreements subscribed by public entities took effect, which Dexia Credit Local and Caisse Française de Financement Local appealed, and three in 2015.

Of the three rulings of the Tribunal de grande instance de Nanterre handed down in 2015, one ruling gave rise to a conviction against Dexia Credit Local and Caisse Française de Financement Local for the failure of Dexia Credit Local to provide adequate information and sufficient warning when it marketed the loan. This same ruling condemned the borrower to reimburse Caisse Française de Financement Local for all the unpaid sums and to pay the contractual interest rate for the remaining life of the contract.

As of March 31, 2016, all these rulings were being heard in appeal before the Cour d'appel de Versailles, except for litigation in which a financial agreement had been reached. At the same time, 126 borrowers who had brought suit signed a financial settlement agreement with SFIL, Caisse Française de Financement Local and Dexia Credit Local, thereby putting an end to legal litigation.

Besides, two rulings have been handed down since March 31, 2016 :

- the first one concerning vanilla loans condemned both Dexia Crédit Local and CAFFIL in application of case-law following the February 8, 2013 decision on TEG ;
- the second one concerning structured loans, dismissed all the claims of the borrower.

Since March 31, 2016, desensitization activities have continued, bringing the number of litigants to 65 as of May 20, 2016.

### 3. Changes in main balance sheet items

EUR billions - value after currency swaps	12/31/2014	12/31/2015	3/31/2016	Change Mar. 2016 / Dec. 2015
<b>Cover pool</b>	<b>62.3</b>	<b>60.0</b>	<b>59.6</b>	<b>(0.7)%</b>
Loans	51.6	50.5	51.1	1.1%
Securities	10.2	7.0	6.9	(0.9)%
Cash deposit in central bank	0.5	2.5	1.6	(36.9)%
<b>Assets assigned in guarantee to Banque de France</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Privileged debt</b>	<b>54.6</b>	<b>53.0</b>	<b>52.8</b>	<b>(0.3)%</b>
Obligations foncières *	52.2	51.6	51.5	(0.1)%
Cash collateral received	2.4	1.4	1.3	(10.4)%
<b>Non-privileged debt</b>	<b>6.2</b>	<b>5.5</b>	<b>5.4</b>	<b>(2.5)%</b>
Parent company	6.2	5.5	5.4	(2.5)%
Banque de France	-	-	-	-
<b>Equity IFRS (excluding unrealized gains and losses)</b>	<b>1.5</b>	<b>1.5</b>	<b>1.5</b>	<b>0.0%</b>

\*Including registered covered bonds

Caisse Française de Financement Local's cover pool is composed of loans and debt securities; it also includes the temporary cash surplus, deposited at the Banque de France or invested in short-term French sovereign securities for a total amount of EUR 1.6 billion at the end of March 2016 versus EUR 2.5 billion as of the end of 2015.

As of March 31, 2016, the cover pool amounted EUR 59.6 billion, excluding accrued interest not yet due. As of December 31, 2015, the total was EUR 60.0 billion; the decrease was therefore EUR 0.4 billion (-0.7%). At that time, no asset was excluded from the cover pool in order to be sold to a bank in a repurchase agreement or assigned in guarantee to the Banque de France. Outstanding debt benefiting from the legal privilege, including cash collateral received, was EUR 52.8 billion, which decreased (-0.3%) in comparison with December 2015.

The debt vis à vis the parent company totaled EUR 5.4 billion and does not benefit from the legal privilege. It mainly corresponds to the financing of the over-collateralization of the cover pool, which is at a significantly higher level than the amount required by regulators and the rating agencies.

### 4. Cover pool

#### 4.1 – CHANGE IN ASSETS IN 2016

The net change in the cover pool in the first quarter of 2016 corresponded to a decrease in assets in the amount of EUR 0.4 billion. This change is explained by the following items.

(EUR billions)	Q1 2016	
<b>1- Acquisition of loans from La Banque Postale</b>		<b>1.3</b>
Loans to the French public sector (vanilla loans in euros)	1.3	
<b>2- Reduction of loan sensitivity</b>		<b>0.6</b>
Sensitive structured loans removed	-0.5	
Refinancing loans (vanilla loans in euros)	0.5	
New loans (vanilla loans in euros)	0.6	
<b>3- Amortization of portfolio of loans and securities</b>		<b>-1.3</b>
<b>4- Early reimbursements</b>		<b>-0.1</b>
<b>5- Changes in treasury</b>		<b>-0.9</b>
Change in short maturity securities investments (French sovereign)	0.0	
Change in Banque de France cash deposit	-0.9	
<b>Net change in the cover pool</b>		<b>-0.4</b>

In 2016, Caisse Française de Financement Local has so far acquired a total of EUR 1.3 billion in loans to the French local public sector originated by La Banque Postale.

In application of the policy of reduction of loan sensitivity in effect since the beginning of 2013, the operations conducted by SFIL with an effective date in the first quarter of 2016 made it possible to decrease outstanding loans considered as sensitive by EUR 0.5 billion by replacing them with fixed rate loans. They were accompanied by new fixed rate loans in the amount of EUR 0.6 billion. After amortization, outstanding loans considered as sensitive diminished by EUR 0.6 billion in the first quarter of 2016.

The natural amortization of the portfolio of loans and securities represented EUR 1.3 billion in the first quarter 2016, and early reimbursements EUR 0.1 billion.

There was no divestment in the first quarter of 2016.

Available cash deposited at the Banque de France or invested in short-term French sovereign securities decreased by EUR 0.9 billion.

#### 4.2 – OUTSTANDING ASSETS AS OF MARCH 31, 2016

Caisse Française de Financement Local's pool of assets is exclusively composed of exposures to, or guaranteed by, public sector entities, and replacement assets (within the limits specified by current legislation).

EUR billions	12/31/2015	3/31/2016
Loans and bonds to the public sector	55.2	55.8
Treasury (sight accounts and short-term investments)	2.5	1.6
Replacement assets	2.3	2.2
<b>Total</b>	<b>60.0</b>	<b>59.6</b>

Surplus cash is deposited in an account opened by Caisse Française de Financement Local at the Banque de France or invested in short-term French sovereign securities, respectively amounting to EUR 1.6 billion and zero as of March 31, 2016.

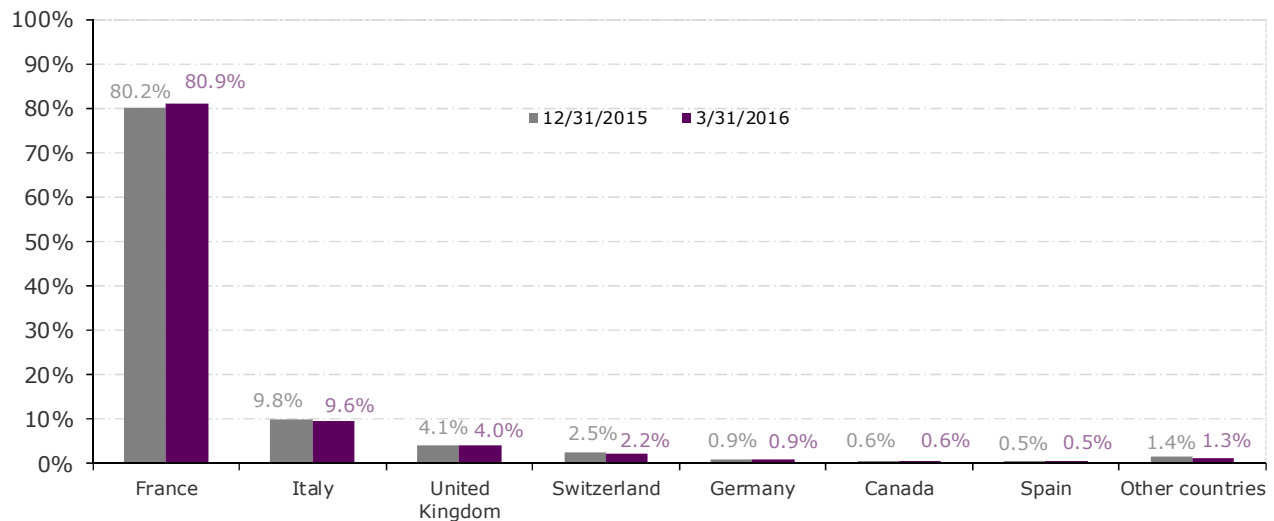
##### a. Public sector loans and securities (excluding replacement assets and treasury)

###### 1. Geographic breakdown

French assets are predominant in the cover pool (80.9%), and their percentage is expected to rise in the future. Loans acquired through La Banque Postale since 2013 accounted for EUR 6.9 billion as of March 31, 2016, representing 15.2% of French public sector loans included in the cover pool.

The other assets are managed in a run-off mode; they correspond to granular and geographically diversified exposures to foreign public sector entities. They were originated in the past by subsidiaries of the Dexia Group.

The relative proportion of the total assets can be broken down as follows.

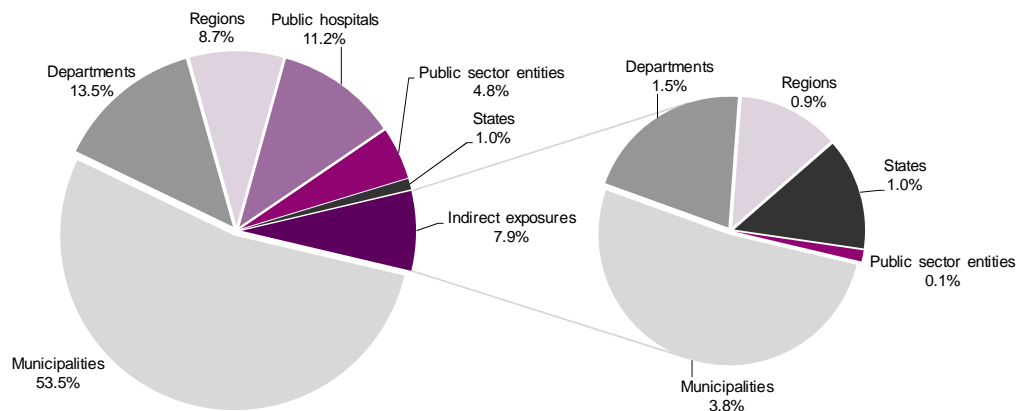


Exposures to Other countries as of March 31, 2016, are broken down by country in the section Bonds and public sector loans, which is presented at the end of this activity report.

###### 2. Breakdown by type of counterparty

The portfolio of Caisse Française de Financement Local is made up of the following items:

- for 82%, direct or indirect exposures to municipalities, departments or regions;
- for 11%, exposures to public hospitals;
- for 7%, sovereign exposures or commitments to other public sector entities (including public social housing).



Indirect exposures are composed of exposures guaranteed by public sector entities, most of which are local.

### 3. Securitizations

There are no securitization units in the cover pool of Caisse Française de Financement Local (since July 2013). Its *obligations foncières* respect the conditions of eligibility for refinancing by the European Central Bank and the new CRR / CRD IV requirements.

### 4. Exposures to sovereign countries

Caisse Française de Financement Local has stable and limited exposure to sovereign countries.

EUR millions	Ratings **	12/31/2015	3/31/2016	in % of the cover pool ***
France*	AA/Aa1/AA+	189	182	0.3%
United Kingdom	AAA/Aa1/AA+	403	383	0.7%
Italy	BBB/Baa2/BBB+	568	562	1.0%
<b>TOTAL</b>		<b>1,160</b>	<b>1,127</b>	<b>2.0%</b>

\* Excluding treasury (Banque de France sight account and short-term sovereign bonds)

\*\* S&P, Moody's and Fitch ratings at the publication date of this report

\*\*\* Excluding treasury and replacement assets

Most of these exposures are concentrated on countries that benefit from very good ratings as of March 31, 2016, and which guarantee these loans.

#### b. Replacement assets

Assets considered by law as replacement assets correspond to exposures to credit institutions benefiting of at least a Step 1 rating, or a Step 2 rating when their remaining maturity does not exceed 100 days, and their total amount is limited to 15% of debt benefiting from the legal privilege (*obligations foncières* and registered covered bonds).

As of March 31, 2016, the replacement assets of Caisse Française de Financement Local were comprised of a long-term loan to SFIL, which benefits from a Step 1 rating (rated AA by S&P, Aa3 by Moody's and AA- by Fitch), as well as bank account balances usually with a Step 2 rating. Replacement assets represented 4.2% of the privileged debt (*obligations foncières* and registered covered bonds) of Caisse Française de Financement Local at the end of March 2016.

Replacement assets	Country	Issuer	EUR millions	
			12/31/2015	3/31/2016
<b>Step 1 credit rating</b>				
Loans to parent company	France	SFIL	2,339	2,213
<b>Step 2 credit rating</b>				
Bank account balances	Other	Other	4	4
<b>TOTAL</b>			<b>2,343</b>	<b>2,217</b>

#### c. Assets removed from the cover pool

Because of its status as a credit institution, Caisse Française de Financement Local has access to refinancing operations offered



to banks by the Banque de France within the Eurosystem. In steering its cover pool and its over-collateralization or in order to meet the need for temporary liquidity, Caisse Française de Financement Local may thus convert a portion of its assets into cash. Loans or securities that are pledged as collateral to the central bank in order to obtain financing on the occasion of tenders organized by the Banque de France are then removed from the cover pool and replaced by the cash thus obtained.

The same treatment would be applied to the assets in the cover pool if they were mobilized in interbank repurchase agreements in the event of a need for liquidity.

In the last two fiscal years, Caisse Française de Financement Local mobilized or pledged no assets with the Banque de France or a bank counterparty.

#### d. Structured loans

##### 1. Definition

Certain loans to French public sector entities in the cover pool of Caisse Française de Financement Local are qualified as structured loans. To define this notion, Caisse Française de Financement Local refers to the charter of good practices signed by banks and local governments (the Gissler charter), which can be consulted on the website of the French Ministry of the Interior<sup>(3)</sup>. This document, prepared at the request of the Government by Mr. Eric Gissler, Inspector General of Finance, was signed on December 7, 2009, by several organizations that represent local governments in France (Association des maires de France, Fédération des maires des villes moyennes, Association des petites villes de France, Association des maires de grandes villes de France and Assemblée des communautés de France) as well as certain banks.

Therefore, structured loans are defined as:

- all loans whose structures fall into categories B to E of the Gissler charter;
- all loans "outside the charter", the commercialization of which is excluded by the charter, either because of their structure (i.e. leverage > 5, etc.), their underlying index(es) (i.e. foreign exchange), or the currency of the exposure (loans denominated in CHF, JPY, etc.);
- excluding all loans of which the structured phase is terminated and the interest rate is definitively a fixed rate or a simple variable rate.

##### 2. Structured loans and sensitive loans

Since the beginning of 2016, outstanding loans to the French public sector are on the rise, with an increase of EUR 1.6 billion in non-structured loans (vanilla) and a decrease of EUR 0.7 billion in structured loans (see the definition above).

EUR billions	31/12/2015	3/31/2016	% cover pool	Number of customers*
Sensitive loans not in the charter	2.4	2.0	3.3%	210
Sensitive loans (3E/4E/5E)	2.2	2.0	3.4%	293
<b>SENSITIVE LOANS</b>	<b>4.6</b>	<b>4.0</b>	<b>6.8%</b>	<b>503</b>
Other structured loans	4.6	4.5	7.5%	1,373
<b>STRUCTURED LOANS</b>	<b>9.2</b>	<b>8.5</b>	<b>14.2%</b>	<b>1,876</b>
Vanilla loans	34.4	36.0	60.4%	14,901
<b>TOTAL French public sector loans COVER POOL</b>	<b>43.6</b>	<b>44.5</b>	<b>74.6%</b>	<b>16,777</b>

\* considering the customer in the category with its most highly structured loan.

As of March 31, 2016, structured loans on the balance sheet of Caisse Française de Financement Local represented EUR 8.5 billion (compared to EUR 9.2 billion at the end of 2015).

The most structured loans according to Gissler classification (categories 3E, 4E and 5E as well as loans outside the charter) may be classified as "sensitive". They are closely monitored and specific measures are taken to reduce their sensitivity. They benefit from support from funds set up by the French government in order to allow customers to convert sensitive loans into fixed rate vanilla loans. These loans represented a total of EUR 4.0 billion at the end of March 2016 compared to EUR 4.6 billion at the end of 2015. The EUR 0.6 billion decrease in these outstanding loans was due to proactive efforts to reduce the sensitivity of the outstanding loans for EUR 0.5 billions and to the contractual amortization of these loans for EUR 0.1 billion.

As of March 31, 2016, the most sensitive structured loans (loans not in the charter) represented 3.3% of the cover pool and 210 customers (270 customers as of December 31, 2015). In particular, this portfolio included loans indexed on the EUR/CHF exchange rate. These loans concern the following customer categories.

<sup>3</sup>[http://www.interieur.gouv.fr/content/download/3021/30417/file/Charte\\_de\\_bonne\\_conduite\\_entre\\_les\\_etablissemments\\_bancaires\\_et\\_les\\_collectivites\\_territoriales.pdf](http://www.interieur.gouv.fr/content/download/3021/30417/file/Charte_de_bonne_conduite_entre_les_etablissemments_bancaires_et_les_collectivites_territoriales.pdf)  
Activity report

Sensitive loans not in the charter	Amounts EUR billions	Number of customers
Municipalities with fewer than 10,000 inhabitants	0.1	24
Municipalities with more than 10,000 inhabitants and groups of municipalities	1.1	122
Regions and departments	0.3	13
Public hospitals	0.4	40
Other customers	0.1	11
<b>TOTAL</b>	<b>2.0</b>	<b>210</b>

### 3. Reduction in loan sensitivity

The policy implemented by SFIL since 2013 to reduce the sensitivity of outstanding loans on the balance sheet of its subsidiary Caisse Française de Financement Local was carried out in accordance with the schemas validated by the Supervisory Board. The method used consists in reducing the sensitivity of loans definitively by converting them into fixed rate loans. To this end, Caisse Française de Financement Local may allocate if necessary new liquidity at cost for loans refinancing the early reimbursement penalties and for new loans granted at market price.

These measures made it possible to eliminate entirely the sensitivity of outstanding loans to 376 customers between SFIL's date of creation and March 31, 2016. The number of customers holding sensitive loans decreased from 879 to 503, and the outstanding sensitive loans dropped from EUR 8.5 billion to EUR 4.0 billion.

The two support funds created by the government and now operational accelerated this process of reduction in loan sensitivity in 2015 and to be continued in 2016, by helping local governments and public hospitals to finance the cost of disengaging themselves from their structured loans. Since September 2015, the local governments concerned have progressively received a notification of the amount of financial assistance they will receive.

## 5. Debt benefiting from the legal privilege

As of March 31, 2016, debt benefiting from the legal privilege is composed of *obligations foncières* and registered covered bonds issued by Caisse Française de Financement Local as well as of cash collateral received from derivative counterparties.

EUR billions	12/31/2015	3/31/2015
Cash collateral received	1.4	1.3
<i>Obligations foncières</i> and registered covered bonds	51.6	51.5
<b>Total</b>	<b>53.0</b>	<b>52.8</b>

### 5.1 – CHANGE IN CASH COLLATERAL IN 2016

Cash collateral received by Caisse Française de Financement Local decreased compared to the situation at the end of December 2015. Its level stood at EUR 1.3 billion at the end of March 2016.

### 5.2 – CHANGE IN ISSUES IN 2016

Within the recurrent annual program of EUR 5 billion to EUR 7 billion, the issuance policy of Caisse Française de Financement Local primarily aimed to construct a coherent yield curve in the euro market while keeping an eye on the good performance of its benchmarks in the secondary market. The diversification of its sources of financing is necessary to achieve long maturities coherent with its needs. This is achieved by an active presence in the private placement market within the framework of the EMTN program or by issuing registered covered bonds.

#### a. New issues in 2016

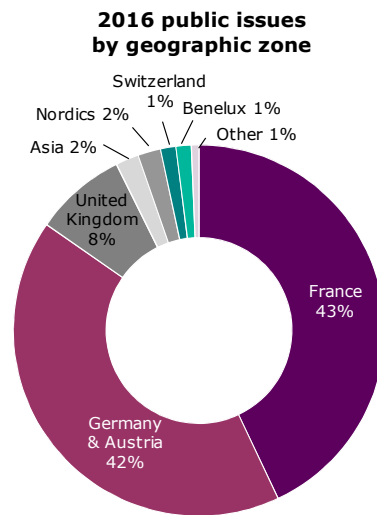
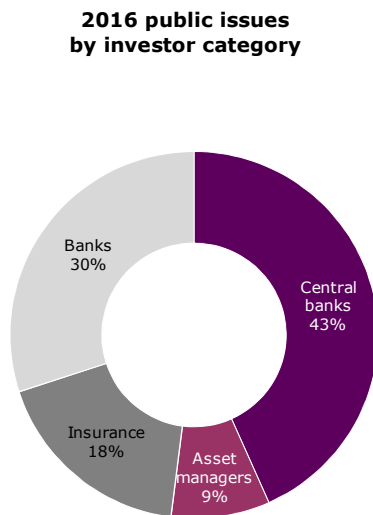
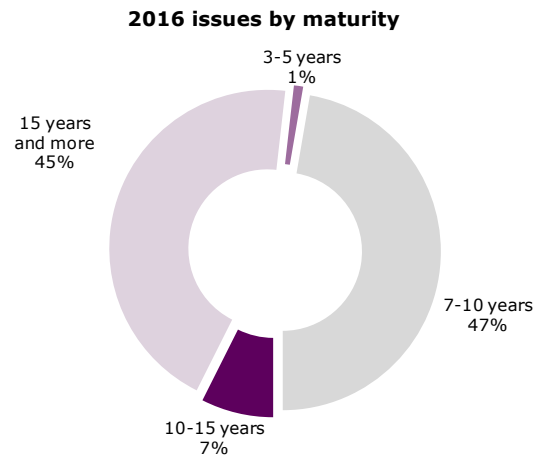
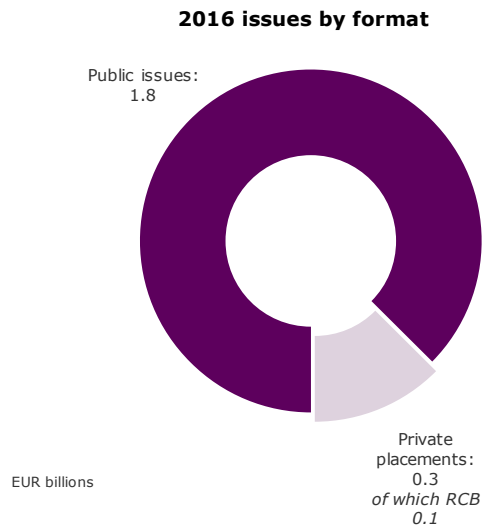
In the first quarter of 2016, Caisse Française de Financement Local achieved a volume of issues of EUR 2.1 billion by enhancing its reference curve with two new points, by increasing the amount of existing *souches* (tap) and by developing its presence in the private placement segment.

Caisse Française de Financement Local came to the primary market for a dual-tranche issue (6 and 15 years) for a total amount of EUR 1.5 billion.

At the same time, Caisse Française de Financement Local provided additional liquidity for one of its 2035 issue via a tap for an amount of EUR 350 million.

In addition to these public transactions, Caisse Française de Financement Local remained active in the private placement segment and especially under the registered covered bond (RCB) format, thus making it possible to respond to investors' search for long and very long maturities. Altogether EUR 266 million was raised in this market segment.

The breakdown of new issues by public/private format and maturity is presented below.

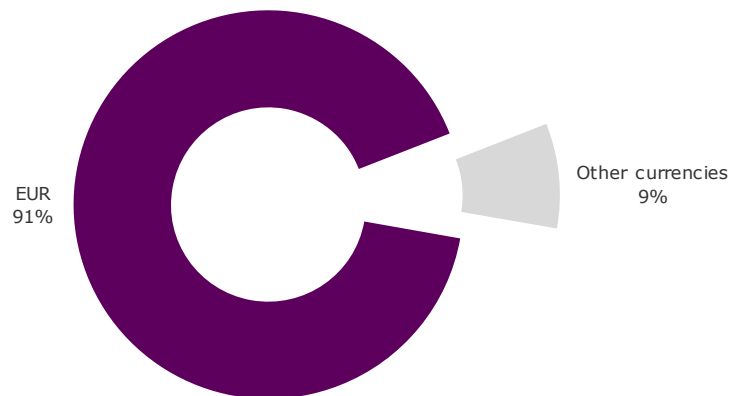


**b. Outstanding debt as of March 2016**

Outstanding *obligations foncières* and registered covered bonds totaled EUR 51.5 billion in swapped value at the end of March 2016. This include new issues of *obligations foncières* for EUR 2.1 billion and amortization of issues maturing for EUR 2.2 billion.

EUR billions - swapped value	2015	Q1 2016
<b>Beginning of the year</b>	<b>52.2</b>	<b>51.6</b>
Issues	6.2	2.1
Amortizations	-6.8	-2.2
Buyback	0.0	0.0
<b>End of period</b>	<b>51.6</b>	<b>51.5</b>

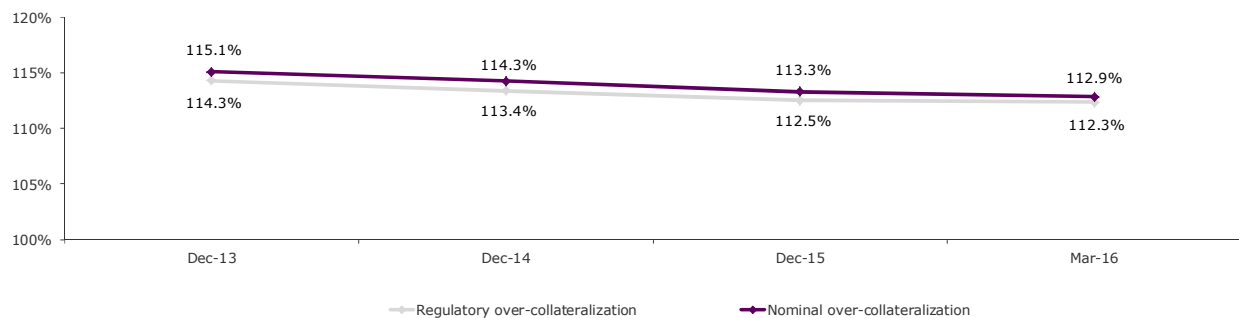
As of March 31, 2016, issues can be broken down by currency as follows.



## 6. Changes in the over-collateralization ratio in 2016

The over-collateralization ratio, which is calculated on the basis of regulatory standards governing *sociétés de crédit foncier*, is the ratio between the assets and the resources benefiting from the legal privilege. The legal minimum threshold is set at 105% and corresponds to the minimum level that Caisse Française de Financement Local had committed to maintain since its creation.

In practice, the over-collateralization ratio is regularly higher than 105%. To maintain an adequate credit rating, a level of over-collateralization of more than 5% may be required. This requirement depends on the method applied by each of the rating agencies and on the new assets and liabilities on Caisse Française de Financement Local's balance sheet and it may vary over time. Caisse Française de Financement Local takes these particular requirements into account in the management of its activity in order to make sure they are constantly met and strives to maintain its over-collateralization at a relatively stable level, as can be seen in the following graph.

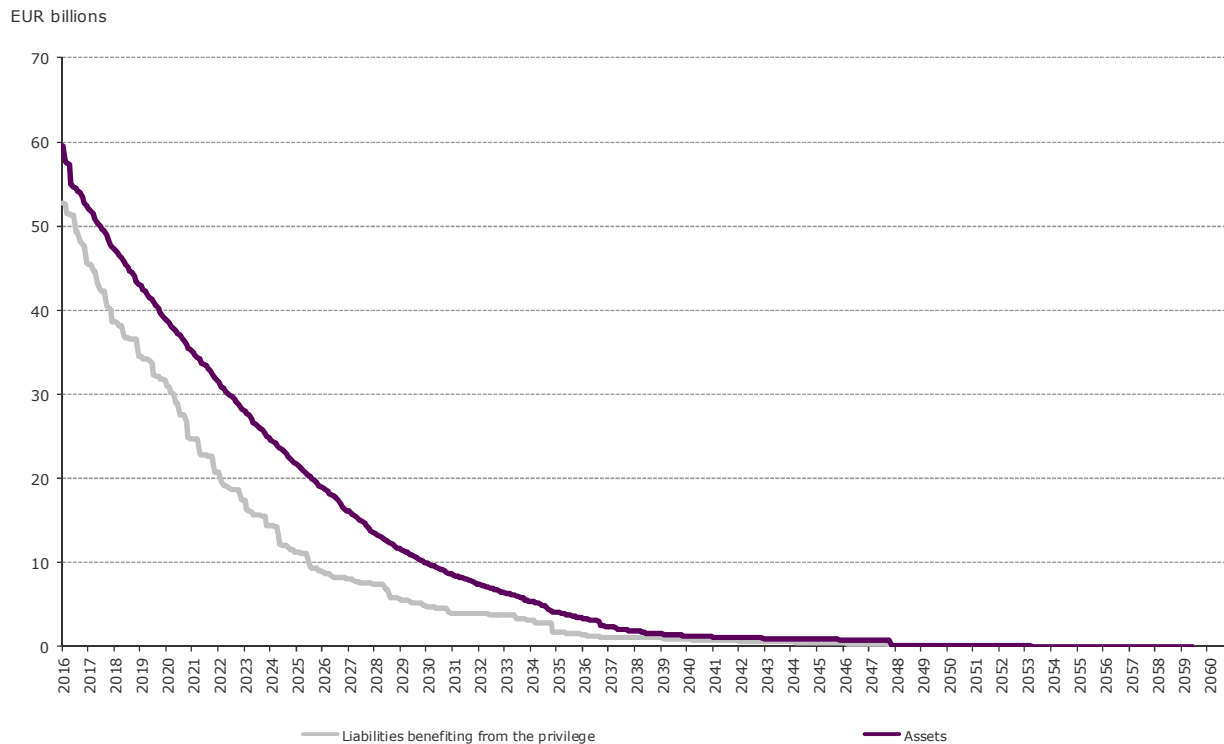


Regulatory over-collateralization may differ from nominal over-collateralization. In fact, it is calculated in accordance with the rules determined by the Autorité de contrôle prudentiel et de résolution (ACPR). In particular, these rules require different weighting levels according to the assets. The assets in Caisse Française de Financement Local's cover pool are generally weighted at 100%.

Any assets that Caisse Française de Financement Local may have been pledged as collateral to borrow funding from the Banque de France or any other banking institution would be excluded from the calculation of over-collateralization.

Over-collateralization may also be illustrated by the gap between the amortization curves of the assets and issues benefiting from the privilege. The following graph presents the curves as of March 31, 2016.

### Amortization of assets and liabilities as of March 31, 2016



## 7. Change in debt that does not benefit from the legal privilege

The asset surplus (assets exceeding *obligations foncières* and registered covered bonds) and miscellaneous needs are financed by equity and debt that does not benefit from the privilege of the law on *sociétés de crédit foncier*.

Such financing is obtained through the parent company. At the end of March 2016, the funds borrowed from SFIL within the framework of the financing agreement were made up of different loans with maturities that could initially run from one day to ten years with an Euribor or Eonia index.

Temporary financing may also be obtained from the Banque de France. These debts do not benefit from the privilege stipulated in the law on *sociétés de crédit foncier*, but they are guaranteed by loans and/or securities assigned for this purpose in the account of Caisse Française de Financement Local at the central bank. Caisse Française de Financement Local had already used such financing in the past. Since the creation of SFIL, Caisse Française de Financement Local has not contracted any loans from the Banque de France, except when it used small sums to test the access procedure for such funding. Neither did it contract any loans from credit institutions other than its parent company.

The change in financing that does not benefit from the legal privilege, excluding accrued interest not yet due, can be presented as follows.

EUR billions	12/31/2015	3/31/2015
Parent company	5.5	5.4
Banque de France	-	-
<b>Total</b>	<b>5.5</b>	<b>5.4</b>

The decrease in debt not benefiting from the legal privilege was the result of the decrease of the cover pool and the change in the level of over-collateralization in the first quarter of 2016.

## 8. Risk management

### 8.1 – CREDIT RISK

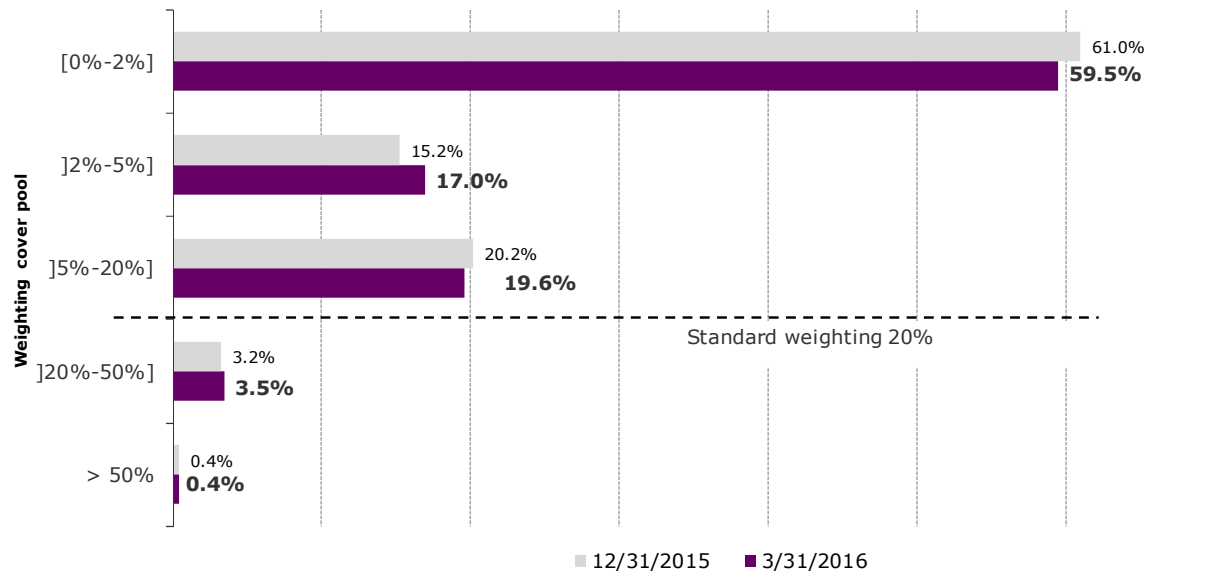
Credit risk represents the potential loss that Caisse Française de Financement Local may incur as the result of the decline in a counterparty's solvency.

### a. Breakdown of cover pool exposures according to risk weighting

The quality of Caisse Française de Financement Local's portfolio can also be seen in the weighting of its assets within the framework of the calculation of the solvency ratio. SFIL chose the advanced method within the framework of the calculation of the solvency ratio and capital adequacy. Banking regulator authorized the Company to use the advanced internal models developed for the consolidated calculation and reporting of capital requirements for credit risk. The calculation of such weighting in particular combines the probability of default (PD) and loss given default (LGD) of the counterparty.

This enables Caisse Française de Financement Local to present an analysis of its exposure as of March 31, 2016, broken down by risk weighting, such as used for the calculation of capital requirements for credit risk.

#### Risk weighting of Caisse Française de Financement Local's portfolio as of March 31, 2016



This analysis confirms the excellent quality of the assets in Caisse Française de Financement Local's portfolio, since only 3.9% of the portfolio has a weighting of more than 20%. The average risk weighting of the cover pool is 6.6%, versus 20% for European local governments according to the Basel II / III standard method.

Combined with its high level of regulatory equity, the credit quality of Caisse Française de Financement Local's assets enabled the Company to post a phased-in Basel III solvency ratio of 23.2% as of March 31, 2016, compared to 24.0% as of December 31, 2015. The phased-in Common Equity Tier One ratio in Basel III was 22.4% as of March 31, 2016.

### b. Concentration by customer

The risk of concentration refers to exposure to a limited number of counterparties. Diversification can make it possible to avoid this problem, and it is a risk management tool to protect from any loss in capital.

The table below presents the concentration on large counterparty portfolios (amounts and percentages of the portfolios). It confirms the great diversity of Caisse Française de Financement Local's portfolio of assets.

EUR millions	% cover pool	Top 5	Top 20	Top 100
<b>Sovereigns</b>	2%	1,127	1,127	1,127
		100%	100%	100%
<b>French Local Authorities</b>	81%	2,225	5,319	12,693
		4.9%	11.8%	28.2%
<b>Non French Local Authorities</b>	17%	2,334	5,193	7,825
		24.0%	53.4%	80.5%
<b>Total</b>	100%	2,732	8,060	19,940
		4.6%	13.5%	33.5%

As of March 31, 2016, all categories combined, the 20 largest exposures (excluding replacement assets and cash investments) represented 13.5% of the global cover pool (compared to 13.6% as of December 31, 2015). The largest exposure accounted for only 1.0% of the cover pool and the twentieth exposure 0.4%.

### c. Non-performing loans, litigious loans, provisions

Since Caisse Française de Financement Local did not publish financial statements as of March 31, 2016, the following remarks concern, as a reminder, the accounts as of December 31, 2015.

Loans and most of the bonds held by Caisse Française de Financement Local are classified in the Loans and advances portfolio according to IFRS, corresponding to its intention to hold them until maturity. They are valued at their historical cost plus, if necessary, variations in the fair value of the risk covered (if there is a fair value hedge); they are subject to provisions for impairment when there is a risk of non-payment.

In addition, collective impairment is calculated on the different portfolios of loans and advances. In the absence of specific depreciation, it covers the risk of loss in value when there is an objective indication of the probability of loss in certain segments of the portfolio or in other commitments involving outstanding loans at the end of the period. These losses are estimated on the basis of each segment's past performance and trends, each borrower's rating, and the borrower's economic environment. To this end, Caisse Française de Financement Local uses a credit risk model based on an approach that combines probabilities of default and loss given default. This model is regularly tested a posteriori.

The limited amount of non-performing loans observed indicates the portfolio's overall high quality. Nonetheless, non-performing loans have increased significantly in recent years. The reason for this rise lies in the growth of unpaid commitments linked to litigation on sensitive structured loans, but also reflects a more conservative approach since the change in Caisse Française de Financement Local's shareholder. Thus, from 2013 to 2015, there was a rise in the number of customers the Company classified in default. With several of them, there was already litigation concerning their structured loans and in addition they encountered financial difficulties. For customers in default in terms of credit risk, the total amount of their outstanding loans is classified as non-performing by contagion.

Changes in the number of customers with non-performing loans and customers with part of their outstanding commitments classified as litigious (past-due of sensitive loans) are presented below.

Non-performing loans and litigious loans (number of customers)	2014		2015	
	Non-performing loans	Litigious loans	Non-performing loans	Litigious loans
Beginning of the year	47	53	90	52
New	53	13	29	14
Outgoing	10	14	45	31
<b>End of the year</b>	<b>90</b>	<b>52</b>	<b>74</b>	<b>35</b>

Non-performing and litigious loans concerned 109 customers at the end of 2015 compared to 142 at the end of 2014, representing a decrease of 33 customers. In 2015, seventeen litigious files were resolved after the payment of the sums due and fourteen litigious files were reclassified as non-performing.

At the end of December 2015, non-performing and litigious loans totaled EUR 673 million, approximately 1.1% of the total cover pool (EUR 60 billion). These loans can be broken down as follows.

- EUR 596 million in loans qualified as non-performing, corresponding to loans to customers with total unpaid amounts of EUR 56 million (of which EUR 48 million were unpaid on structured loans);
- EUR 77 million in loans qualified as litigious, corresponding to unpaid interest on structured loans that are subject to litigation.

Non-performing loans and litigious loans EUR millions	12/31/2014		12/31/2015	
	Non-performing loans	Litigious loans	Non-performing loans	Litigious loans
<b>FRANCE</b>				
State	-	-	-	-
Regions	-	-	-	1
Departments	-	4	-	11
Groups of municipalities	85	30	104	42
Municipalities	189	31	352	19
Public sector entities	122	2	140	4
<b>Total</b>	<b>396</b>	<b>67</b>	<b>596</b>	<b>77</b>

The total amount of provisions at the end of December 2015 is presented in the following table.

EUR millions	12/31/2014	12/31/2015
Specific impairment	47	66
Collective impairment	63	63
<b>Total</b>	<b>110</b>	<b>129</b>

Specific provisions for non-performing loans increased by EUR 19 million in 2015. This rise corresponds, for an amount of EUR +26 million, to the mandatory impairment of unpaid or accrued interest on non-performing loans, the outstanding amount of which increased, and for EUR -7 million to the reversal of provisions on the nominal amount of non-performing loans.

The review of the portfolio and its associated risks did not entail any change in collective impairment

The provisions were determined by taking into account the comprehensive set of measures decided by the French government to provide a solution to the problem of structured loans. The hypotheses adopted are presented in section 2.3 of this management report.

At the end of December 2015, the cost of risk, retreated from the contribution to the support fund for public hospitals, presented a gain of EUR 7 million, reflecting a reversal on specific impairment.

#### d. Bank counterparty risk

Counterparty risk refers to the risk of loss on an exposure linked to the default of a counterparty. It is naturally in function of the amount of the exposure, the probability of default on the part of the counterparty, and the portion of the loan that cannot be recovered in the event of default.

Caisse Française de Financement Local holds three types of exposure to banks:

- loans to SFIL, the parent company of Caisse Française de Financement Local, which are considered as replacement assets in the amount of EUR 2.2 billion (see 4.2.b);
- bank account balances in euros and other currencies, representing EUR 4 million, excluding cash deposited on the Banque de France account;
- its derivative contracts, entered into within the framework of its management of interest rate and foreign exchange risks.

All of Caisse Française de Financement Local's derivative operations are conducted within the framework of standard ISDA or FBF (Fédération bancaire française) contracts with major international banks. These contracts have particular characteristics, since they must meet the standards set by rating agencies for *sociétés de crédit foncier* (and other issuers of covered bonds). These interest rate and currency swaps all benefit from the same legal privilege as *obligations foncières*. For this reason, Caisse Française de Financement Local does not pay its derivative counterparties any collateral, whereas they have to pay Caisse Française de Financement Local unless they benefit from the agencies' highest short-term rating.

At the end of March 2016, Caisse Française de Financement Local was exposed (positive fair value of the swaps) on 11 banking counterparties. 10 of these paid cash collateral of EUR 1.3 billion, offsetting total exposure, and one paid no collateral because of its very good short-term rating. This counterparty represented a limited exposure (EUR 9 million).

All derivative exposures as of March 31, 2016, are listed below.

EUR billions	ST notional amounts	LT notional amounts	% LT notional amounts	Mark to Market		Collateral received	Number of counterparties
				-	+		
SFIL	0.0	20.1	21.3%	(2.6)	-	-	1
Other counterparties	54.7	74.5	78.7%	(4.1)	1.3	1.3	28
<b>Total</b>	<b>54.7</b>	<b>94.6</b>	<b>100.0%</b>	<b>(6.7)</b>	<b>1.3</b>	<b>1.3</b>	<b>29</b>

The swaps negotiated with external counterparties represented 78.7% of outstanding long-term swaps and those signed with SFIL 21.3%. Long-term swaps signed with the five largest counterparties represented a total of 37.1% of notional amounts.

Short-term swaps (Eonia) were all contracted with external counterparties.

## 8.2 – OTHER BALANCE SHEET RISKS

### a. Interest rate risk

#### 1. Definition

Interest rate risk corresponds to the risk of financial loss that may occur in the case of interest rate fluctuations in the market that would lead to a loss in value of certain items on the bank's balance sheet (or off-balance sheet).

Three types of interest rate risk can be distinguished:

- the risk related to long-term interest rates, which results from the gap in volume and maturity between the fixed rate assets and liabilities, the initial maturity of which is greater than a year;
- the basis risk, which results from the gap that may exist in the backing of assets and liabilities with a floating rate in the same currency but with different tenors;
- the fixed rate risk, which results from the variation in the rate of an asset or a liability with a floating interest rate pre-fixed over the period in which the adjustable index is fixed.

These risks are generally hedged using derivative instruments.

#### 2. Hedging strategy

The policy applied by Caisse Française de Financement Local makes it possible to be protected from interest rate risk because



any acquisition of assets or issue of liabilities is systematically hedged in a variable rate from the beginning.

There are two steps in the hedging process of interest rate risk.

- In the first stage, all the assets and the liabilities benefiting from the privilege which do not naturally have a floating rate are hedged against Euribor until maturity as soon as they are recorded on the balance sheet. In practice, acquisitions of loan portfolios (in which the unit amount is generally small) are usually macro-hedged whereas loans granted individually or bond issues are micro-hedged. Hedging of assets is more often obtained in using interest rate swaps, but the same effect may be obtained whenever possible by the cancelation of liability swaps.
- In the second stage, Euribor lending and borrowing flows (naturally or after hedges) are swapped against Eonia generally over a sliding period of two years in order to eliminate the basis risk generated by differences in the tenor (Euribor 1, 3, 6 or 12 months) and the fixing risk due to refixing dates of reference indices that differ for the assets and the liabilities.

Non-privileged debt is not concerned by these hedging operations. In fact, debt contracted by Caisse Française de Financement Local with its shareholder to finance over-collateralization is borrowed either directly with a monetary index and does not need to be swapped, or with a Euribor index and thus finances assets also indexed on Euribor. Short-term debt owed the Banque de France with a fixed rate (if any) is not hedged, but finances fixed rate assets.

### 3. Limits on interest rate risk

The sensitivity of residual positions that remain after the two levels of hedging is monitored carefully and kept within strict limits. Limits on interest rate risk were calibrated in order to guarantee, with 99% probability, a maximum one year loss of less than EUR 80 million in the event of a change in interest rates of 200 basis point (bp), equivalent to a maximum loss set at EUR 40 million (3% of equity) for a fluctuation in interest rates of 100 bp. This calibration was based on a directional shift in rates corresponding to a 1% probability at one year observed over the period 2005-2013, which was approximately 200 bp. A set of three limits makes it possible to have a grasp of the slope risk, as well as the directional risk. These limits control the sensitivity of the fixed rate risk and together guarantee the maximum losses mentioned above. The limits are as follows.

#### Directional risk management

The limit in total sensitivity for a shift in rates of 100 bp of all points in the yield curve is set at EUR 25 million. The measurement of sensitivity at the end of each quarter is presented below.

#### Directional risk

##### Total sensitivity

EUR millions, end of quarter	Limit	6/30/2015	9/30/2015	12/31/2015	3/31/2016
<b>Sensitivity</b>	<b>25.0</b>	<b>10.5</b>	<b>0.0</b>	<b>0.1</b>	<b>0.6</b>

#### Slope risk management

The slope risk benefits from specific limits applied to four segments of maturity on the yield curve (short, medium, long and very long).

- *Limiting the slope risk between two points of maturity distant from one another on the curve:* sensitivity to a shift in rates of 100 bp is limited to EUR 10 million by segment of maturity. Measurement of sensitivity at the end of each quarter is presented below.

#### Risk of slope between two distant points on the rate curve

##### Sum of sensitivities

EUR millions, end of quarter	Limit	6/30/2015	9/30/2015	12/31/2015	3/31/2016
<b>Short term</b>	<b>10.0</b>	<b>2.0</b>	<b>3.5</b>	<b>0.6</b>	<b>0.0</b>
<b>Medium term</b>	<b>10.0</b>	<b>5.6</b>	<b>-0.8</b>	<b>-0.4</b>	<b>1.0</b>
<b>Long term</b>	<b>10.0</b>	<b>6.3</b>	<b>-0.5</b>	<b>1.9</b>	<b>-0.7</b>
<b>Very long term</b>	<b>10.0</b>	<b>-3.4</b>	<b>-2.2</b>	<b>-2.0</b>	<b>0.3</b>

- *Limiting the slope risk between two points of maturity close to one another on the curve:* in each segment, the sum in absolute value of the sensitivities of points on the yield curve (grouped in several points of reference) is limited to EUR 20 million per segment. Measurement of sensitivity at the end of each quarter is presented below.

#### Risk of slope between two close points on the rate curve

##### Sum of sensitivities in absolute value

EUR millions, end of quarter	Limit	6/30/2015	9/30/2015	12/31/2015	3/31/2016
<b>Short term</b>	<b>20.0</b>	<b>7.6</b>	<b>5.2</b>	<b>6.2</b>	<b>4.8</b>
<b>Medium term</b>	<b>20.0</b>	<b>13.4</b>	<b>8.4</b>	<b>4.5</b>	<b>10.7</b>
<b>Long term</b>	<b>20.0</b>	<b>8.9</b>	<b>4.9</b>	<b>3.7</b>	<b>5.8</b>
<b>Very long term</b>	<b>20.0</b>	<b>7.6</b>	<b>3.8</b>	<b>3.8</b>	<b>6.5</b>

### 4. Outstanding hedging derivatives

The strategies employed to hedge interest rate risk and foreign exchange risk are illustrated by notional outstanding swaps analyzed in the following table, broken down between external counterparties and an internal counterparty (SFIL), as of March 31, 2016.

Breakdown of outstanding swaps	Notional * (EUR billions)	SFIL (%)	Other counterparties (%)
<b>Euribor against Eonia</b>			
Macro-hedges	54.7	0.0%	100.0%
<b>Total short-term swaps</b>	<b>54.7</b>	<b>0.0%</b>	<b>100.0%</b>
<b>Fixed rate swaps against Euribor</b>			
Micro-hedges on <i>obligations foncières</i>	45.2	15.8%	84.2%
Micro-hedges on loans and debt securities	24.3	12.5%	87.5%
Macro-hedges on loans	18.2	33.4%	66.6%
<b>Subtotal</b>	<b>87.7</b>	<b>18.6%</b>	<b>81.4%</b>
<b>Currency swaps</b>			
Micro-hedges on <i>obligations foncières</i>	4.5	59.3%	40.7%
Micro-hedges on loans	1.6	49.7%	50.3%
Micro-hedges on debt securities	0.8	50.0%	50.0%
<b>Subtotal</b>	<b>6.9</b>	<b>56.0%</b>	<b>44.0%</b>
<b>Total long-term swaps</b>	<b>94.6</b>	<b>21.3%</b>	<b>78.7%</b>

\* Absolute value

## b. Foreign exchange risk

The foreign exchange risk is defined as the risk of volatility in result, be it observed or latent, linked to a change in the exchange rate of currencies vis-à-vis a reference currency. The reference currency of Caisse Française de Financement Local is the euro. The foreign exchange risk reflects a change in the value of assets and liabilities denominated in a currency other than the euro by reason of fluctuations of this same currency vis-à-vis the euro.

Its risk management policy consists in not taking any foreign exchange risk: all issues and assets denominated in foreign currencies are hedged as soon as they are recognized on the balance sheet and until their final due date, by a cross-currency swap against the euro. Floating rate exposures generated by this management policy are incorporated into interest rate risk management.

## c. Transformation risk

The transformation risk arises from the fact that the assets are financed in part by resources with a different maturity.

### 1. Duration gap

The difference in maturity or amortization profile between the assets and the liabilities may create a liquidity risk.

With the interest rate risk under control as presented above, Caisse Française de Financement Local manages the congruence of maturities between the assets and the liabilities by maintaining the duration gap between the assets and the liabilities within a maximum limit of three years.

From the point of view of the method, since both the assets and the resources benefiting from the privilege have a floating rate after swaps, Caisse Française de Financement Local's balance sheet appears as though it consists of one single loan in front of one single borrowing. Duration (D) is calculated as follows: "sum of the periods weighted by the cash flows and discounted at the interest rate of the zero coupon curve for period (t) / sum of the cash flows discounted at the interest rate of the zero coupon curve for period (t)".

$$D = \frac{\sum_{t=1}^T [(t \times Cft) / (1 + st)^t]}{\sum_{t=1}^T [Cft / (1 + st)^t]}$$

The duration gap between the assets and the liabilities is closely monitored since it is sensitive to fluctuations in interest rates used to calculate the net present value and to significant changes in assets and liabilities.

The management policy of Caisse Française de Financement Local is a commitment not to exceed three years for the duration gap between the assets in the cover pool and the resources benefiting from the privilege. In practice, the actual duration gap is maintained below this limit, and was significantly reduced in the period, as can be seen in the following table.

Duration in years	3/31/2015	6/30/2015	9/30/2015	12/31/2015	3/31/2016
Cover pool	7.36	7.08	7.41	7.17	<b>7.50</b>
Privileged liabilities	5.61	5.40	5.70	5.52	<b>5.92</b>
<b>Gap in asset-liability duration</b>	<b>1.75</b>	<b>1.68</b>	<b>1.71</b>	<b>1.64</b>	<b>1.58</b>
<i>Duration gap limit</i>	3	3	3	3	3

### 2. Weighted average life gap

Changes in the gap in weighted average life can differ from the changes in the gap in duration over the same period, for the evolution in the duration gap is partly attributable to movements in the interest rate curve. The gap in the weighted average life of the cover pool and the liabilities benefiting from the legal privilege is presented below.

Weighted average life (in years)	3/31/2015	6/30/2015	9/30/2015	12/31/2015	3/31/2016
Cover pool	7.71	7.81	8.06	7.84	<b>7.94</b>
Privileged liabilities	5.83	5.86	6.11	5.95	<b>6.21</b>
<b>Gap in asset-liability weighted average life</b>	<b>1.88</b>	<b>1.95</b>	<b>1.94</b>	<b>1.89</b>	<b>1.72</b>

### 3. Regulatory limit

The regulatory changes in May 2014 imposed a limit of one and a half years on the weighted average life gap between the cover pool, considered on the basis of the minimum amount required to satisfy the legal over-collateralization ratio of 105% and the resources benefiting from the privilege. Caisse Française de Financement Local respects this limit.

### d. Liquidity risk

The liquidity risk can be defined as the risk that Caisse Française de Financement Local may not be able to settle privileged debt commitments at the due date owing to the fact that there is too great a gap between the reimbursement of the assets and the reimbursement of its privileged resources.

By limiting the duration gap between assets and resources to three years, Caisse Française de Financement Local maintains control over its future needs for liquidity.

To meet its liquidity needs, Caisse Française de Financement Local makes use of the following resources:

- first of all, the cash flows from the amortization of the assets in the cover pool or from the issue of new *obligations foncières* to replace those that arrive at maturity and the reimbursement of which creates the need for liquidity;
- funds granted by its parent company. Caisse Française de Financement Local has at its disposal in any case the support of its parent company formalized in a "declaration of support" (the full text is incorporated into the EMTN program and Caisse Française de Financement Local's annual financial report). This debt is contracted with SFIL through financing agreements between Caisse Française de Financement Local and its parent company.
- pledges of assets with the central bank or with other banks through repurchase agreements.

Because of the nature of the assets that make up its cover pool, Caisse Française de Financement Local has a large number of assets that are directly eligible for refinancing by the central bank, so that its need for cash can be easily covered.

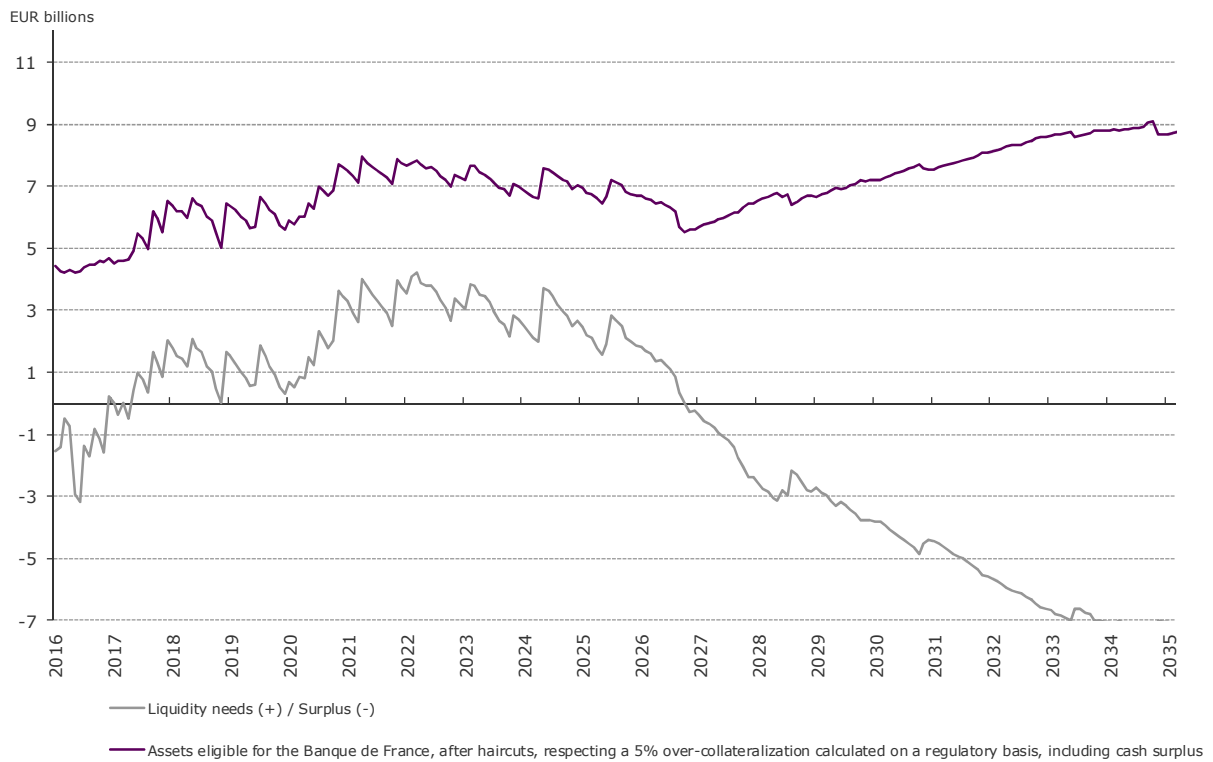
Since it is a credit institution, Caisse Française de Financement Local can post these eligible assets:

- either by using, in its own name, the refinancing possibilities offered by the European Central Bank through the Banque de France;
- or by using interbank financing in the form of repurchase agreements.

Caisse Française de Financement Local has its own autonomous resources that enable it to cover its temporary liquidity needs, even in the event of the default of its parent company, since any legal proceedings engaged for the bankruptcy or liquidation of its parent company cannot be extended to Caisse Française de Financement Local (article L.513-20 of the Monetary and Financial Code).

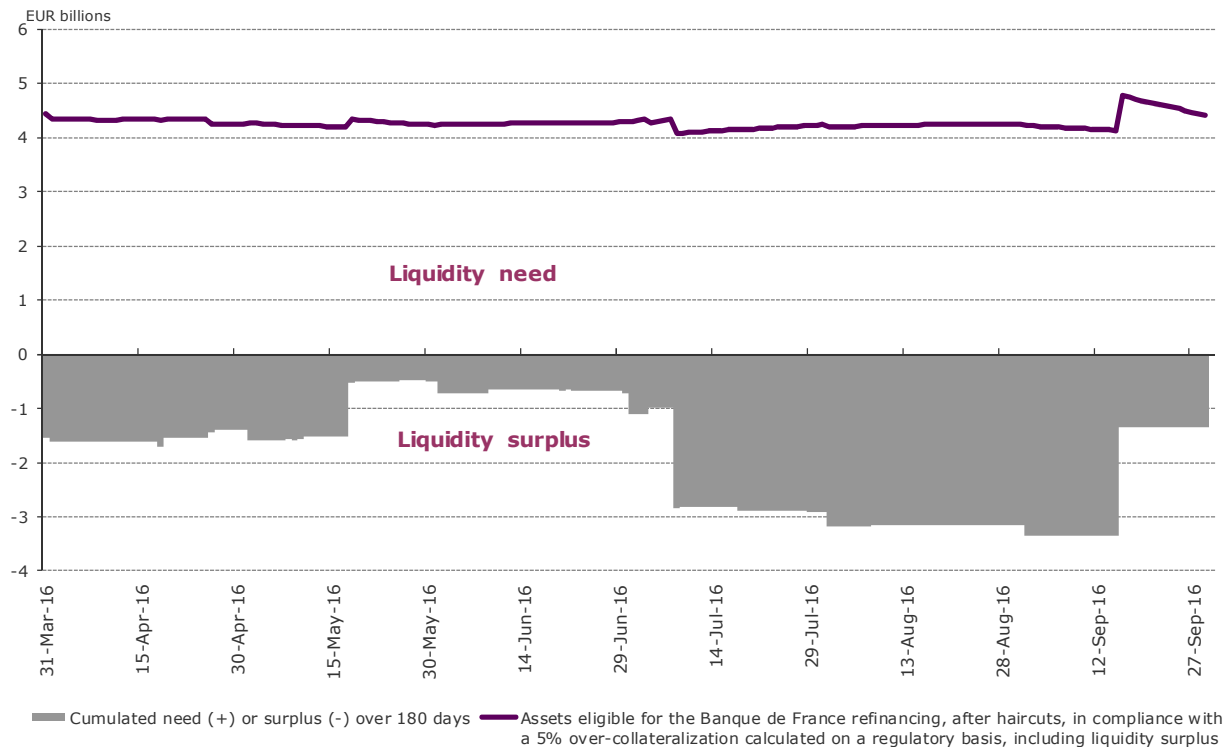
The maximum cumulated liquidity that Caisse Française de Financement Local might need in the future, in a run-off situation and if it were not able to issue new *obligations foncières*, is less than the maximum financing already occasionally obtained from the Banque de France in the past. This need is also less than Caisse Française de Financement Local's capacity to obtain refinancing from the Banque de France, measured by the amount of eligible assets after haircuts that would be available respecting the level of over-collateralization required by the regulation.

The forecast of cumulative liquidity needs, and eligible assets to cover those needs as defined above, is presented in the following graph.



In addition, Caisse Française de Financement Local manages its liquidity risk by means of the following three indicators:

- the Liquidity Coverage Ratio (LCR);
- the duration gap between the assets and the resources benefiting from the legal privilege (limited to three years), which is published quarterly, and the new regulatory limit on the weighted average life gap;
- projected cash needs over the next 180 days: Caisse Française de Financement Local ensures that at any time, its cash needs over a period of 180 days are covered by replacement assets and assets eligible for refinancing operations with the Banque de France. Cash needs are defined as repayments of *obligations foncières* and RCB, of debt that does not benefit from the legal privilege and forecasts of repayment of the cash collateral received, after deduction of cash flows from amortization of assets. This forecast is published quarterly in the Asset Quality Report and is presented below.



The movements observed for the next 180 days correspond to cash flows from amortization of *obligations foncières*, cash collateral, non-privileged liabilities and assets. As of March 2016, the liquidity situation showed a surplus over the whole period.

### 8.3. MANAGEMENT OF OTHER RISKS

#### a. Legal risks

Legal risk is the risk of any litigation with a counterparty resulting from any misunderstanding, lack or insufficiency that may be attributed to the Company in the exercise of its activities.

Caisse Française de Financement Local is involved in no significant litigation or suit other than those described in the year's highlights (2.3).

#### b. Fiscal risk

In 2015, French tax authorities investigated the income declared and the tax paid for 2012 and 2013. Following the tax assessment, the tax authorities expressed their disagreement with the tax treatment of the following two points: the taxation in Ireland of the income from the Dublin branch of Dexia Municipal Agency, which has now been closed, and the deductibility of provisions for non-performing loans.

In order to take into account the risk of an unfavorable outcome in these proceedings, Caisse Française de Financement Local has recorded a provision for additional income tax in the amount of EUR 38 million. Nonetheless, Caisse Française de Financement Local does not agree with the position of the tax authorities and will appeal within the framework of legal recourse allowed by current tax regulations.

#### c. Operational risks and permanent control

Operational risk is the risk of direct or indirect loss due to an inadequacy or lack in the bank's procedures (absent or incomplete analysis or control, procedures not secured), in its staff (errors, bad intention and fraud), in internal systems (computer crash, etc.) or external risks (flood, fire, etc.).

Caisse Française de Financement Local delegates to SFIL the functions of internal control, within the framework of a management agreement. The management processes applied to operational risks and permanent control are described in the section of the 2015 annual financial report entitled Supplemental information – Report of the Chairman of the Supervisory Board.

#### d. Security and means of payment

Caisse Française de Financement Local does not put means of payment at the disposal of its customers.

## 9. Outlook for 2016

For the year 2016, Caisse Française de Financement Local and its parent company SFIL aim to:

- confirm their role as a major player in the market for loans to French local government and public hospital within the framework of cooperation with La Banque Postale (leading lender in this market in 2015);
- give concrete shape to their new role in refinancing banks that work with French exporters for their large export credits.

In addition to these two responsibilities entrusted by the French State, within an operating framework approved by the European Commission, there is also the objective to reduce the volume of sensitive structured loans (already cut in half since the beginning of 2013). This activity, generally accompanied by new loans granted to the local governments concerned, has been very strong in the first months of 2016.

Caisse Française de Financement Local will thus see new loans enter its portfolio of assets in 2016. They represent exposures to the French local public sector and the French State.

To cover its financing needs, Caisse Française de Financement Local plan to issue approximately EUR 7.0 billion of *obligations foncières* in 2016 with a long average maturity adapted to the profile of the new assets. Its program will mainly be developed through several benchmark issues in euros and private placements adapted to the needs of its large investor base.

## Bonds and public sector loans as of March 31, 2016

EUR millions	3/31/2016				12/31/2015	
	Direct exposure		Indirect exposure		Total	Total
COUNTRY	Loans	Bonds	Loans	Bonds		
<b>France</b>						
State			182		182	189
Banque de France	1,574				1,574	2,496
Regions	1,691	100	277		2,068	2,102
Departments	6,641		216		6,857	6,530
Municipalities	16,194	23	535		16,752	16,437
Groups of municipalities	10,316	95	196		10,607	10,441
Public sector entities :						
- health	6,222				6,222	6,119
- social housing	1,450				1,450	1,545
- others	956		2		958	917
Credits institutions	2,217				2,217	2,343
<b>Subtotal</b>	<b>47,261</b>	<b>218</b>	<b>1,408</b>		<b>48,887</b>	<b>49,119</b>
<b>Germany</b>						
Länder		513			513	513
<b>Subtotal</b>		<b>513</b>			<b>513</b>	<b>513</b>
<b>Austria</b>						
Länder			193		193	194
<b>Subtotal</b>			<b>193</b>		<b>193</b>	<b>194</b>
<b>Belgium</b>						
Regions	22		41		63	63
Communities		50			50	50
Public sector entities	62				62	65
<b>Subtotal</b>	<b>84</b>	<b>50</b>	<b>41</b>		<b>175</b>	<b>178</b>
<b>Canada</b>						
Provinces		22			22	22
Communities	182				182	182
Public sector entities	129				129	129
<b>Subtotal</b>	<b>311</b>	<b>22</b>			<b>333</b>	<b>333</b>
<b>Spain</b>						
Regions		104			104	104
Municipalities	161				161	161
<b>Subtotal</b>	<b>161</b>	<b>104</b>			<b>265</b>	<b>265</b>
<b>United States</b>						
Federated States		250			250	253
<b>Subtotal</b>		<b>250</b>			<b>250</b>	<b>253</b>
<b>Finland</b>						
Municipalities	0				0	0
<b>Subtotal</b>	<b>0</b>				<b>0</b>	<b>0</b>

EUR millions	3/31/2016				12/31/2015	
	Direct exposure		Indirect exposure		Total	Total
PAYS	Loans	Bonds	Loans	Bonds		
<b>Italy</b>						
State		562			562	568
Regions		2,129			2,129	2,131
Provinces		604			604	610
Municipalities	10	2,069			2,079	2,100
<b>Subtotal</b>	<b>10</b>	<b>5,364</b>			<b>5,374</b>	<b>5,409</b>
<b>Japan</b>						
Municipalities		25			25	25
<b>Subtotal</b>		<b>25</b>			<b>25</b>	<b>25</b>
<b>Portugal</b>						
Municipalities	44				44	45
Public sector entities	6				6	6
<b>Subtotal</b>	<b>50</b>				<b>50</b>	<b>51</b>
<b>United Kingdom</b>						
State						
Counties			398		398	398
Districts			28		28	28
Municipalities			1,368		1,368	1,368
Public sector entities			56		56	56
<b>Subtotal</b>			<b>1,850</b>	<b>383</b>	<b>2,233</b>	<b>2,253</b>
<b>Sweden</b>						
Municipalities	19		6		25	29
<b>Subtotal</b>	<b>19</b>		<b>6</b>		<b>25</b>	<b>29</b>
<b>Switzerland</b>						
Cantons	293		237		530	656
Municipalities	605				605	614
Public sector entities	91				91	91
<b>Subtotal</b>	<b>989</b>		<b>237</b>		<b>1,226</b>	<b>1,361</b>
<b>Supranational</b>						
International organizations	34				34	36
<b>Subtotal</b>	<b>34</b>				<b>34</b>	<b>36</b>
<b>TOTAL COVER POOL</b>	<b>48,919</b>	<b>6,546</b>	<b>3,735</b>	<b>383</b>	<b>59,583</b>	<b>60,019</b>

Loans and securities are off premium / discount.

Loans and securities denominated in foreign currencies are recorded at their euro swapped value. Loans and bonds are presented net of specific impairments. In addition to these impairments, Caisse Française de Financement Local makes collective and sectorial impairments.