



Activity Report
Caisse Française de Financement Local
as of March 31, 2017

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*, it engages in transactions that 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 on 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 on 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 are key elements in the financing of local governments and public hospitals in France. The organization, introduced by the French State in 2013, 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 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 inter-

mediated derivatives) are mainly 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.
- Furthermore, SFIL is an issuer of short- and long-maturity securities in the bond markets. In October 2016, SFIL launched its first public bond issue in the amount of EUR 1 billion with a maturity of 8 years.

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 (LBP) and its joint venture LBP/CDC, 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. These assets are now managed in a run-off mode. At the end of March 2017, there were agreements with the following entities: Kommunalkredit Austria (Austria), Belfius Banque et Assurances (Belgium), and Dexia Crediop (Italy). These agreements already existed in previous years.

Starting in 2015, management of new registered covered bonds (RCB) is entrusted to Landesbank Baden-Württemberg (LBBW). Dexia Kommunalbank Deutschland continues to manage registered covered bonds issued prior to 2015.

c. Refinancing of loans to the French local public sector and public hospitals in partnership with La Banque Postale

In early 2013, Caisse Française de Financement Local and La Banque Postale signed an exclusive sale agreement to fund the needs of the French local public sector and public hospitals. The arrangement, set up under the aegis of the French State, works as follows: La Banque Postale markets loans to the French local public sector and public hospitals, then sells them to Caisse Française de Financement Local, which refinances them by issuing *obligations foncières* (covered bonds). The loans originated are exclusively in euros with a vanilla interest rate. 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 sale if the asset no longer meets the criteria.

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

d. Refinancing of large export credits

In addition to their mission of refinancing French local governments and public hospitals, SFIL and Caisse Française de Financement Local have been entrusted with a second mission by the French State: refinance large French export contracts. In this context, 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 (enhanced guarantee⁽¹⁾). This business brings Caisse Française de Financement Local closer to the French State, without modifying the risk profile of its cover pool.

These new loans, like the new French public sector loans marketed by La Banque Postale, are added to the portfolio of Caisse 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 this new activity will increase gradually and will only become significant in several years. This share may rise to 12% within five years, based on an annual production of large export credits between EUR 1.5 billion and EUR 2.5 billion.

1. Organization

The system functions as follows:

- SFIL contributes 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. Then, these banks sell a part of the loans (and the attached rights) to SFIL and keep at least the share of the export credit not covered by the insurance (usually 5%);
- Caisse Française de Financement Local grants a loan to SFIL to enable it to refinance the acquired export credit. This refinanc-

¹The enhanced guarantee was introduced by law 2012-1510 of December 29, 2012, and the decree 2013-693 of July 30, 2013.

ing loan benefits from an irrevocable and unconditional 100% guarantee by the French State, referred to as an enhanced guarantee;

Loans granted by Caisse Française de Financement Local to SFIL to refinance the purchased export credits 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 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).

2. French State export guarantees

Previously granted by Coface on behalf and under the control of the French State, these guarantees have been taken over by the French State since late 2016. The guarantees are now issued and managed by Bpifrance Assurance Export, in the name of, on behalf of, and under the control of the French State, pursuant to article L.432.2 of the Insurance Code.

- Guarantee-granting decisions are made by the Minister in charge of the Economy and Finances after instruction by Bpifrance Assurance Export and the opinion of the French Export Credit and Guarantee Commission (*Commission des garanties et du crédit au commerce extérieur*).
- Bpifrance Assurance Export issues insurance policies, as well as enhanced guarantees, in accordance with the decision made. In this context, Bpifrance Assurance Export is also tasked with collecting insurance and guarantee premiums, managing risks, payments, and collections on behalf of the French State.
- The risks related to these guarantees are borne by the French State and all financial flows (premiums, payments, repayments) are recorded in separate accounting entries by Bpifrance Assurance Export. Premiums and collections are received directly on the account of the French State, and payments are made directly from the same account, without passing through the accounts of Bpifrance Assurance Export.

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 (S&P), 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. They take into account a strong probability that the French 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 two notches above that of France.

Besides, the rating of *obligations foncières* is 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 three months of 2017

2.1 – THE COVERED BOND MARKET

Over the first three months of 2017, the market for public sector issues of covered bonds in euros was active, with an offer in the primary market of EUR 48 billion (compared to EUR 64 billion in 2016 and EUR 42 billion in 2015). The primary offer was mainly concentrated on January (EUR 27 billion) in anticipation of the forthcoming political events which were identified as volatility sources by financial markets: the legislative election in the Netherlands, the Brexit official demand by the United Kingdom and the French presidential election. However, these events did not affect the strength of the covered bonds market in euros which continued to benefit from the support brought by the third Covered Bonds Purchase Program carried out by the Eurosystem (CBPP3).

In this context, 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 with a maturity of 10 years. In addition to this public offering, Caisse Française de Financement Local took advantage of investor demand for long maturities to conduct private placements of EUR 325 million and to reopen its 2031 issue for EUR 150 million (it now stands at EUR 650 million). The average maturity of the financing raised by CAFFIL in the 1st quarter is more than 12 years.

2.2 – RATING OF OBLIGATIONS FONCIÈRES

The ratings of the *obligations foncières* issued by Caisse Française de Financement Local were not altered in 2017.

As of December 31, 2016, the ratings were as follows: AA+ by Standard and Poor's, Aaa by Moody's and AA by Fitch. The outlook associated with each of these ratings is stable.

2.3 – SENSITIVITY REDUCTION AND DECREASE IN LITIGATION RELATED TO STRUCTURED LOANS

Caisse Française de Financement Local has, in its portfolio, some structured loans considered as sensitive (see 4.2.d.1. Definition) which had been granted to French clients by Dexia Credit Local before the acquisition of Caisse Française de Financement Local by SFIL. Certain of these customers initiated legal proceedings against Dexia Credit Local, Caisse Française de Financement Local and/or SFIL.

a. Reduction in outstanding sensitive structured loans

For the record, SFIL's application of its policy to reduce the sensitivity of the structured loans of Caisse Française de Financement Local was particularly effective in 2015 and 2016. Consequently, most of the sensitive structured loan problems have been solved. As announced at the end of 2016, the efforts to reduce the sensitivity of the outstanding loans have continued at a slower pace since the beginning of 2017.

Since the beginning of 2013, outstanding sensitive loans have been reduced by 81%, from EUR 8.5 billion to EUR 1.6 billion, as the result of the following:

- proactive operations conducted by SFIL to reduce loan sensitivity with the help of the support funds, including the operations already accomplished with a post-closing value date;
- the natural amortization of the loans;
- the use by certain customers of the derogatory mechanism of the support funds. In point of fact, 85 customers chose to keep their structured loans temporarily while still having the opportunity to benefit from the assistance of the support fund for local governments in the event that the structured component of their loan would be activated (assistance in paying interest at a degraded rate as anticipated by the rules governing the support fund). The outstanding loans for these customers represent EUR 0.7 billion.

At the same time, 628 customers (71%) definitively moved out of the category of sensitive customers. The reduction in sensitivity was even more marked for the customers with the most sensitive exposure; more than 91% of borrowers with loans initially indexed on EUR/CHF no longer have any, and among them 94% of local governments and hospitals which had such loans.

On the basis of the operations conducted at the end of March 2017 with an effective date after March 31, 2017, and subsequent to the deduction of outstanding loans benefiting from assistance in paying degraded coupons. Outstanding sensitive loans will be at most EUR 1.4 billion by the end of 2017 (a decrease of at least EUR 7.1 billion since December 31, 2012, or 84%) for 231 customers.

b. Significant decrease in the number of lawsuits

As of March 31, 2017, 178 borrowers who had brought lawsuits signed a financial settlement agreement with SFIL, Caisse Française de Financement Local and Dexia Credit Local, thereby putting an end to legal litigation.

At the same time, the number of borrowers who had brought suit totalled 38, down from 39 as of December 31, 2016 and 131 as of December 31, 2015. Among these 38 suits, 14 cases have been tried in first instance and 5 were judged in the court of appeal. All of these rulings dismissed all the claims of the borrowers except for two cases concerning vanilla loans which gave rise to the *in solidum* conviction of Dexia Credit Local and Caisse Française de Financement Local.

3. Changes in main balance sheet items

EUR billions - value after currency swaps	12/31/2015	12/31/2016	3/31/2017	Change Jun. 2016 / Dec. 2015
Cover pool	60,0	58,2	57,3	(1,5)%
Loans	50,5	47,0	47,9	1,9%
Securities	7,0	7,5	7,6	1,0%
Cash deposit in central bank	2,5	3,7	1,8	(50,9)%
Assets assigned in guarantee to Banque de France	-	-	-	-
Privileged debt	53,0	51,7	51,1	(1,1)%
<i>Obligations foncières</i> *	51,6	50,4	50,1	(0,4)%
Cash collateral received	1,4	1,3	1,0	(23,4)%
Non-privileged debt	5,5	5,2	5,0	(5,0)%
Parent company	5,5	5,2	5,0	(5,0)%
Banque de France	-	-	-	-
Equity IFRS (excluding unrealized gains and losses)	1,5	1,4	1,4	0,0%

*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 put aside to anticipate the forthcoming repayment of *obligations foncières* or the refinancing of new export loans. This cash is deposited at the Banque de France, or invested in bank or European public sector securities. The cash surplus placed with the Banque de France represents EUR 1.8 billion at the end of March 2017, versus EUR 3.7 billion at the end of December 2016. The cash surplus invested in securities represents a total of EUR 1.0 billion at the end of March 2017, versus EUR 0.9 billion at the end of December 2016.

As of March 31, 2017, the cover pool totaled EUR 57.3 billion, excluding accrued interest not yet due. It represented EUR 58.2 billion at the end of 2016, i.e. a decrease of EUR 0.9 billion (-1.5%). As of this date, no assets are 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 51.1 billion, which decreased 1.1% in comparison with December 2016.

The debt contracted with the parent company totaled EUR 5.0 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 2017

The net change in the cover pool in the first three months of 2017 corresponded to a decrease in assets in the amount of EUR 0.9 billion. This change is explained by the following items.

(EUR billions)	03/31/2017	
1- Acquisition of loans from La Banque Postale		1,8
Loans to the French public sector (vanilla loans in euros)	1,8	
2- Reduction of loan sensitivity		0,1
Sensitive structured loans eliminated	-0,2	
Refinancing loans (vanilla loans in euros)	0,2	
New loans (vanilla loans in euros)	0,1	
3- Amortization of portfolio of loans and securities		-1,1
4- Early reimbursements		0,0
5- Changes in treasury		-1,7
Net change in securities investments	0,2	
Net change in Banque de France cash deposit	-1,9	
6- Other changes		0,0
Net change in the cover pool		-0,9

In 2017, Caisse Française de Financement Local has so far acquired a total of EUR 1.8 billion in loans to the French local public sector and public hospitals 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 in 2017 made it possible to decrease outstanding loans considered as sensitive by EUR 0.2 billion through their replacement with fixed rate loans. They were accompanied by new fixed rate loans in the amount of EUR 0.1 billion.

The natural amortization of the portfolio of loans and securities represented EUR 1.1 billion in the first three months of 2017. There were no divestments, in the first three months of 2017.

Available cash is deposited at the Banque de France or invested in bank bonds classified as replacement assets or in European public sector bonds. It decreased by EUR 1.7 billion over the first three months of 2017.

4.2 – OUTSTANDING ASSETS AS OF MARCH 31, 2017

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

EUR billions	12/31/2016	03/31/2017
Loans and bonds to the public sector	53,8	54,7
Treasury (deposits at the Banque de France)	3,7	1,8
Replacement assets	0,7	0,8
Total	58,2	57,3

Surplus cash is deposited in an account opened by Caisse Française de Financement Local at the Banque de France or invested in European public sector or bank (replacement assets) securities, respectively amounting to EUR 1.8 billion, EUR 0.2 billion and EUR 0.8 billion as of March 31, 2017.

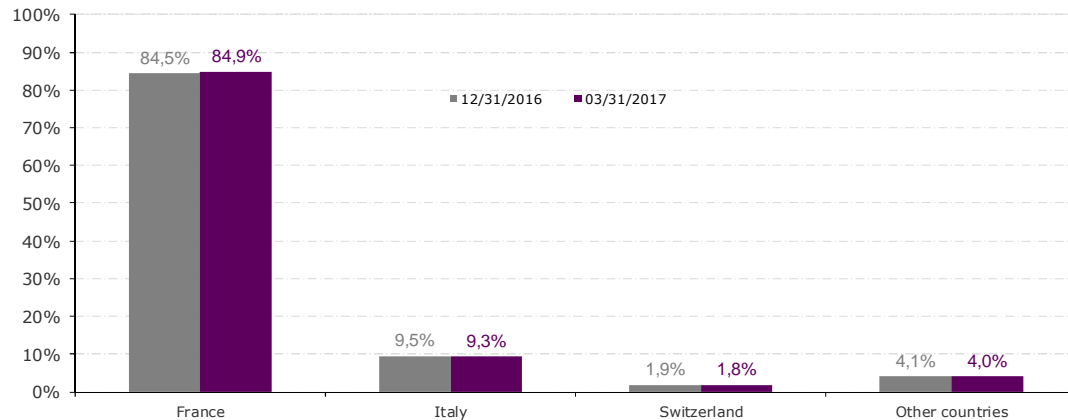
a. Public sector loans and securities (excluding replacement assets and treasury)

1. Geographic breakdown

French assets are predominant in the cover pool (84.9%), and their percentage is expected to rise in the future. Loans acquired through La Banque Postale since 2013 accounted for almost EUR 9.8 billion as of December 2016, representing 21.4% 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 on 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.

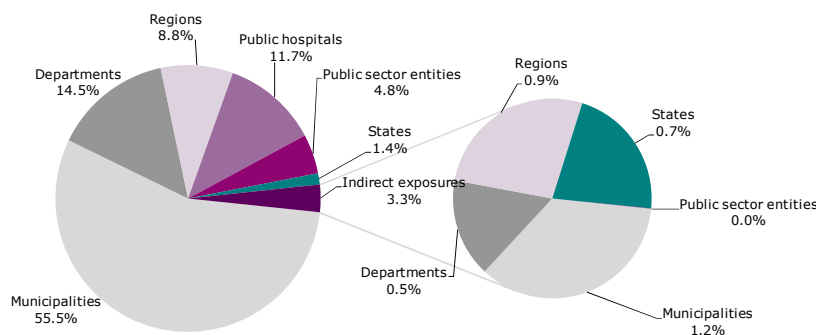


Exposures to Other countries as of March 31, 2017, are broken down by country in the section Bonds and public sector loans, which is presented at the end of this management report.

2. Breakdown by type of counterparty

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

- for 81%, direct or indirect exposures on municipalities, departments or regions;
- for 12%, exposures on public hospitals;
- for 7%, sovereign exposures or commitments on other public sector entities (including 2.6% on 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 CRR / CRD IV regulation requirements.

b. Replacement assets

Assets considered by law as replacement assets correspond to exposures on credit institutions benefiting from 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, 2017, replacement assets represented 1.6% of debt benefiting from the legal privilege.

The Caisse Française de Financement Local's cash surplus can be invested in banking sector securities (in addition to deposits at the Banque de France and investments in European public sector securities). In this case, bank exposures are classified as replacement assets, broken down below based on the rating of the issuers.

Replacement assets	Country	Issuer	EUR millions	
			12/31/2016	03/31/2017
Step 1 credit rating				
Covered Bonds	France	Divers	26	44
Other bank bonds	France	Divers	120	183
Step 2 credit rating				
Bank bonds (maturity < 100 days)	France	Other	500	570
Bank account's balances	Other	Other	4	14
TOTAL			650	811

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. The loans or securities assigned in guarantee with the central bank in order to obtain financing on the occasion of tenders organized by the Banque de France are then taken out of 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 three 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 may be 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 Internet site of the French Ministry of the Interior⁽²⁾. This document 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 the loans with structures belonging to Gissler charter categories B to E;
- all the loans "outside the charter", the commercialization of which is excluded by the charter, either because of their structure (leverage > 5, etc.), their underlying index(es) (foreign exchange, etc.), or their currency (loans denominated in CHF, JPY, etc.);
- to the exclusion of all the loans of which the structured phase is terminated and the interest rate is definitively a fixed rate or a simple variable rate.

The most structured loans according to the Gissler classification (categories 3E, 4E and 5E as well as loans which the charter does not allow to be marketed) may be qualified as "sensitive".

2. 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 eliminating their structured loans. Caisse Française de Financement Local contributed EUR 150 million to support local governments and EUR 38 million to support hospitals.

These funds were fully operational as of 2015: in the second half of 2015 and the first half of 2016 they notified the amount of aid to the local governments and public hospitals that sought their assistance. Based on the amounts reported, 86% of Caisse Française de Financement Local clients who sought the assistance of the local government support fund were eventually approved. Thus, these two funds made it possible to conduct sensitivity reduction operations at a sustained pace, and resulted in a

²http://www.interieur.gouv.fr/content/download/3021/30417/file/Charte_de_bonne_conduite_entre_les_etablissemments_bancaires_et_les_collectivites_territoriales.pdf

significant reduction in the number of lawsuits.

3. Structured loans and sensitive loans

In 2017, outstanding loans to the French public sector have increased by EUR 1.0 billion, with a EUR 1.2 billion increase in non-structured loans (vanilla) and a decrease of EUR 0.2 billion in structured loans (see the definition above).

EUR billions	12/31/2016	03/31/2017	% cover pool	Number of customers*
Sensitive loans not in the charter	0,7	0,7	1%	75
Sensitive loans (3E/4E/5E)	1,0	0,9	2%	176
SENSITIVE LOANS	1,7	1,6	3%	251
Structured loans benefiting from the derogatory mechanism of the support fund	0,7	0,7	1%	85
Other structured loans	4,0	3,9	7%	1 395
STRUCTURED LOANS	6,4	6,2	11%	1 731
Vanilla loans	38,4	39,6	69%	14 194
TOTAL French public sector loans	44,8	45,8	80%	15 925
COVER POOL	58,2	57,3		

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

As of March 31, 2017, structured loans on the balance sheet of Caisse Française de Financement Local represented EUR 6.2 billion (compared to EUR 6.4 billion at the end of 2016).

The most structured loans according to the Gissler classification (categories 3E, 4E and 5E as well as loans which the charter does not allow to be marketed) may be qualified 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 1.6 billion at the end of 2016, compared to EUR 1.7 billion at the end of 2016. The EUR 0.1 billion decrease in these outstanding loans was mainly due to proactive efforts to reduce the sensitivity of the outstanding.

As of March 31, 2017, the most sensitive structured loans (loans not in the charter) represented EUR 0.7 billion, or 1.2% of the cover pool and 75 customers. In particular, this portfolio included loans indexed on the EUR/CHF exchange rate. This portfolio concerns the following customer categories.

Sensitive loans not in the charter	12/31/2016		31/03/12/2017	
	Amounts EUR billions	Number of customers	Amounts EUR billions	Number of customers
Municipalities with fewer than 10,000 inhabitants	0,0	6	0,0	6
Municipalities with more than 10,000 inhabitants and groups of municipalities	0,3	50	0,2	43
Regions and departments	0,1	9	0,2	9
Public hospitals	0,3	17	0,3	15
Other customers	0,0	3	0,0	2
TOTAL	0,7	85	0,7	75

The 75 customers are mostly municipalities with more than 10,000 residents and groups of municipalities, and to a lesser extent, public hospitals. Municipalities with less than 10,000 residents with a sensitive loan "not in the charte" number 6, and the outstanding loans concerned by these municipalities total almost zero.

As of March 31, 2017, more than 91% of the borrowers with loans indexed on EUR/CHF saw loan sensitivity disappear completely, and of this number, 94% were small local governments and hospitals holding such loans.

4. Reduction in loan sensitivity

These measures made it possible to eliminate entirely the sensitivity of outstanding loans to 628 customers between SFIL's date of creation and March 31, 2017. The number of customers holding sensitive loans decreased from 879 to 251, and the outstanding sensitive loans dropped from EUR 8.5 billion to EUR 1.6 billion (less than 3% of the cover pool), i.e. a decrease of more than 81%. This decrease includes EUR 0.7 billion that represents outstanding loans for which the customers chose to maintain their sensitive loan temporarily, while having the option of receiving aid from the local government support fund if the structured component of their loan becomes activated (system for helping pay interest at a degraded rate provided for by the support fund doctrine). The loans concerned by this option mainly correspond to loans with an interest rate based on leverage and which are, at this time, most often at fixed rates because the structured component is not or has never been activated.

Based on the operations already conducted, the outstanding sensitive loans for which the structured component is activated and the rate is above 5% will represent at the end of 2017 less than EUR 0.2 billion and will concern 35 customers, i.e. 0.3% of the cover pool and 0.2% of the total customers.

5. Debt benefiting from the legal privilege

As of March 31, 2017, 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 counterparties in derivative transactions.

EUR billions	12/31/2016	3/31/2017
Cash collateral received	1,3	1,0
<i>Obligations foncières</i> and registered covered bonds	50,4	50,1
Total	51,7	51,1

5.1 – CHANGE IN CASH COLLATERAL

Cash collateral received by Caisse Française de Financement Local decreased compared with the situation at the end of December 2016. Its level stood at EUR 1.0 billion at the end of March 2016.

5.2 – CHANGE IN ISSUES

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 implies an active presence in the market of private placements within the framework of the EMTN program or the issue of registered covered bonds.

a. New issues in 2017

As of March 31, 2017, Caisse Française de Financement Local achieved a volume of issues of EUR 2.0 billion by enhancing its reference curve with one new point, by increasing the amount of existing *souches* (taps) and by continuing to work in the private placement segment.

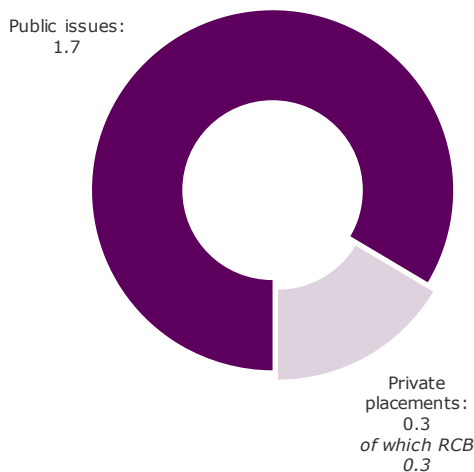
Caisse Française de Financement Local raised money in the primary market for one 10-year transaction of EUR 1.5 billion.

At the same time, Caisse Française de Financement Local provided additional liquidity for one of its reference issues via one tap in 2017 for the amount of EUR 150 million.

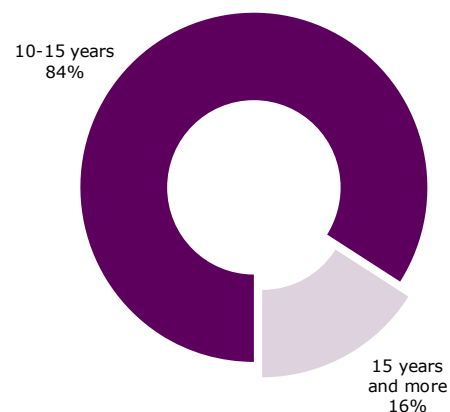
In addition to these public transactions, Caisse Française de Financement Local remained active in the private placement segment and especially with the registered covered bond (RCB) format, thus making it possible to respond to investors' search for long and very long maturities. Altogether, EUR 325 million was raised in this market segment.

The breakdown of new issues by public/private format and maturity is presented below, as well as the breakdown of public issues by investor category and geographic zone.

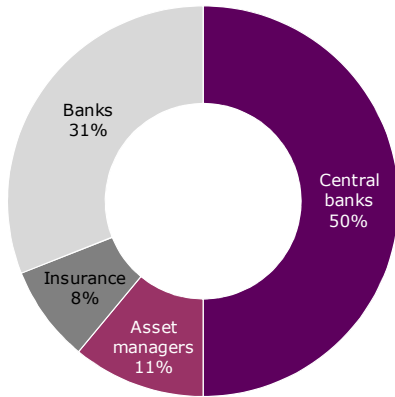
2017 issues by format



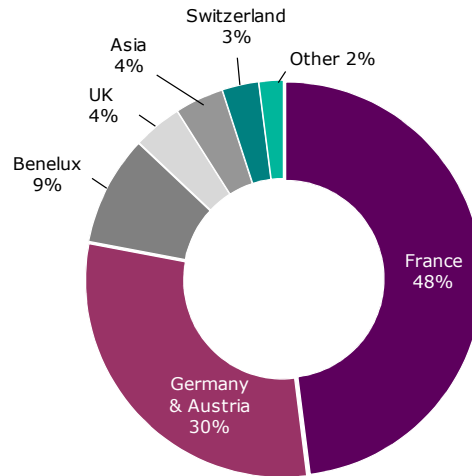
2017 issues by maturity



January 2017 public issue by investor category



January 2017 public issue by geographic zone

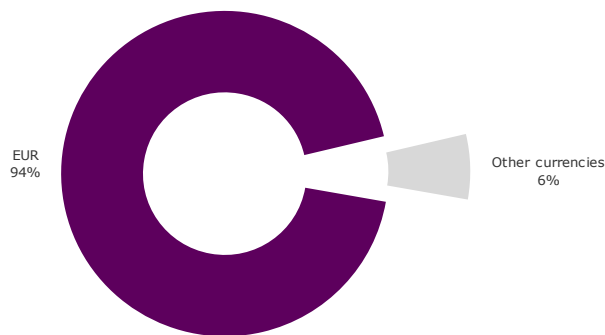


b. Outstanding debt as of March 2017

Outstanding *obligations foncières* and registered covered bonds totaled EUR 50.1 billion in swapped value at the end of March 2017. This includes new issues of *obligations foncières* for EUR 2.0 billion and amortization of issues maturing in 2017 for EUR 2.3 billion.

EUR billions - swapped value	2016	2017
Beginning of the year	51,6	50,4
Issues	5,9	2,0
Amortizations	-7,0	-2,3
Buyback	-0,1	0,0
End of the year	50,4	50,1

As of March 31, 2017, issues can be broken down by currency as follows:

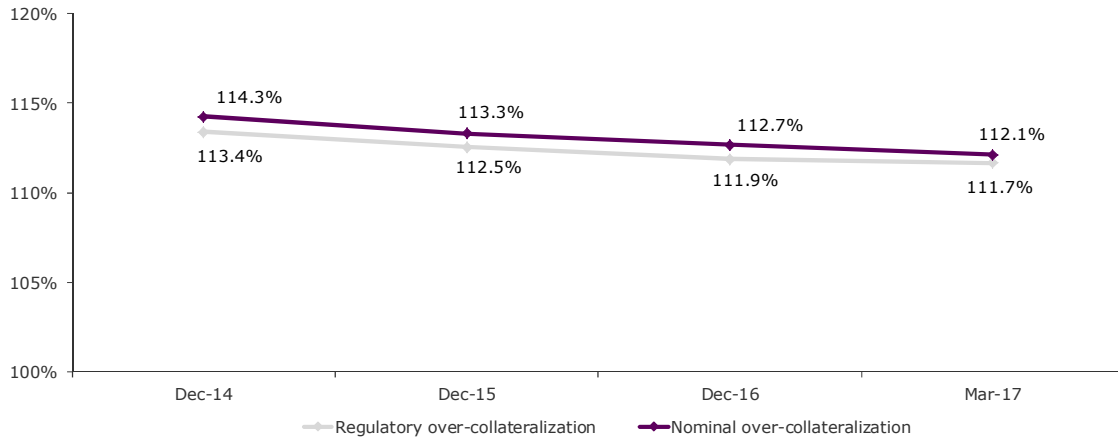


6. Changes in the over-collateralization ratio

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 level of 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.

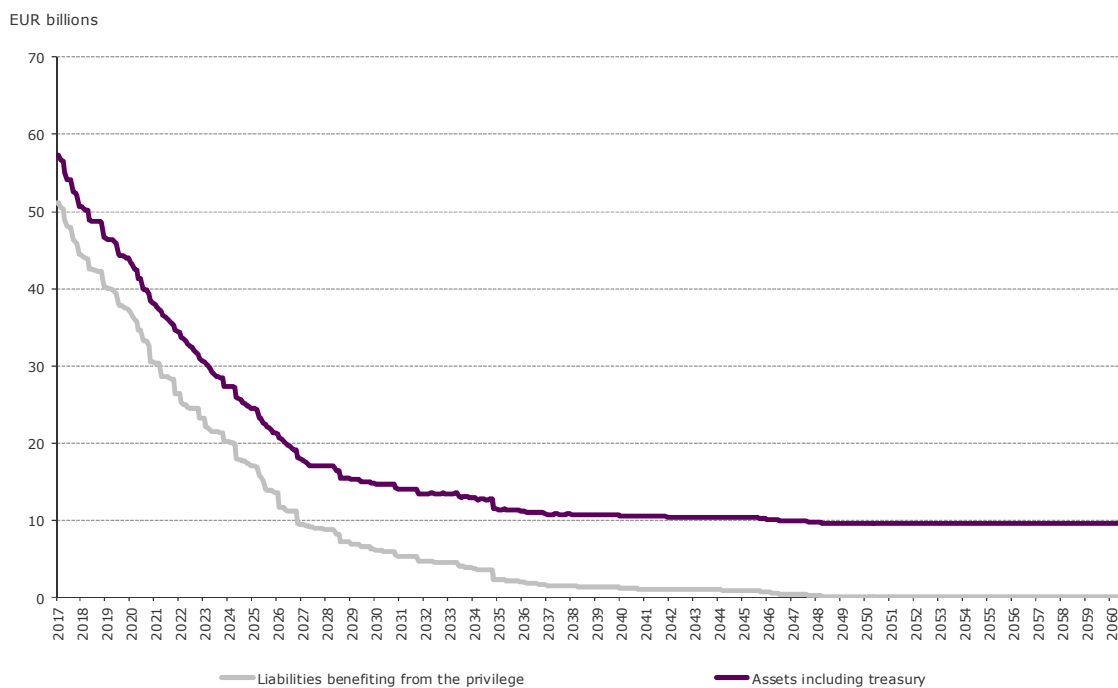


Regulatory over-collateralization may differ from nominal over-collateralization. In fact, it is calculated on the basis of the rules determined by the Autorité de contrôle prudentiel et de résolution (ACPR). In particular, these rules require different weighting levels according to the assets. The assets in Caisse Française de Financement Local’s cover pool are weighted at 100%. The small difference between the two ratios can be explained by the accrued interest not yet due taken into account in the regulatory over-collateralization ratio.

Any assets that Caisse Française de Financement Local may have assigned in guarantee to borrow funds 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, 2017.

Amortization of assets and liabilities as of March 31, 2017



In this graph, the assumption is made that excess cash generated over time is included in the cover pool.

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 2017, 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 funds do not benefit from the privilege stipulated in the law on *sociétés de crédit foncier*, but they are guaranteed by loans and securities assigned for this purpose in the account of Caisse Française de Financement Local at Banque de France. 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	12/31/2016	3/31/2017
Parent company	5,2	5,0
Banque de France	-	-
Total	5,2	5,0

The decrease in debt not benefiting from the legal privilege was the result of the decrease in the size of the cover pool and the change in the level of over-collateralization in 2017.

8. Risk management

8.1 – CREDIT RISK

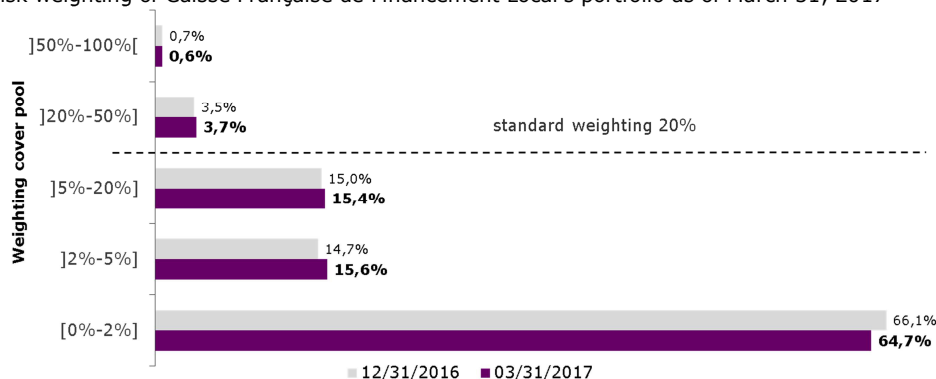
Credit risk represents the potential loss that Caisse Française de Financement Local may incur as the result of the decline in a counterparty's solvency.

a. Breakdown of exposures according to risk weighting

The quality of Caisse Française de Financement Local's portfolio can 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 regulators 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, 2017, 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, 2017



This analysis confirms the excellent quality of the assets in Caisse Française de Financement Local's portfolio:

- more than 80% of the portfolio has a weighting of less than 5%;
- the average risk weighting of the cover pool assets is 6.3%, versus 20% for European local governments according to the Basel II/III standard method;
- only 4% of the portfolio has a weighting of more than 20%.

Combined with its high level of regulatory equity, the credit quality of Caisse Française de Financement Local's assets enabled

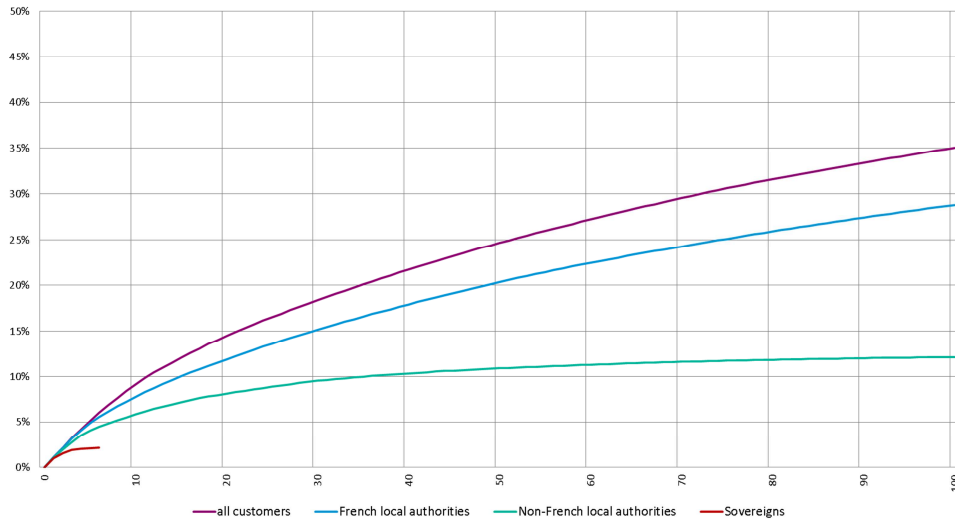
the Company to post a phased-in Basel III solvency ratio of 25.0% as of March 31, 2017, compared to 25.1% as of December 31, 2016. The phased-in Common Equity Tier 1 Ratio in Basel III was 24.7% as of March 31, 2017, compared to 24.8% on December 31, 2016.

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.

cover pool concentration by type of customer



As of March 31, 2017, all categories combined, the 20 largest exposures (excluding replacement assets and cash investments) represented 14.5% of the global cover pool (compared to 14.2% as of December 31, 2016). The largest exposure accounted for only 1.1% of the cover pool and the twentieth exposure 0.5%.

c. Non-performing loans, litigious loans, provisions

Caisse Française de Financement Local does not publish quarterly accounts as of March 31, 2017, (only half-year and annual accounts), the following presentation concerns, as a reminder, the accounts as of December 31, 2016.

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 and, if necessary, are hedged for 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 probability of default and loss given default. This model is regularly tested *a posteriori*.

The non-performing and litigious loans constitute less than 1.0% of the Caisse Française de Financement Local cover pool; this is proof of the good quality of its portfolio. They had increased between 2013 and 2015, in particular because of the increase in the outstanding debt connected to lawsuits over structured loans, but also due to the more conservative approach of Caisse Française de Financement Local after the shareholder change. In 2016, the non-performing and litigious loans decreased significantly. Indeed, the growing number of financial settlement agreements signed with local governments and public hospitals within the framework of the strategy to reduce loan sensitivity made it possible to settle many outstanding debts and thus reduce the amounts and number of non-performing and litigious loans.

Also, the outstanding debts decreased by 39% in a year, dropping from EUR 133 million to EUR 81 million at the end of 2016. At the same time, the non-performing and litigious loans decreased by EUR 116 million from EUR 673 million to EUR 557 million, i.e. more than 17%.

EUR millions	12/31/2015	12/31/2016
Non-performing and litigious loans	673	557
% of cover pool	1,1%	1,0%
Arrears	133	81

Non-performing and litigious loans consist of:

- EUR 530 million of non-performing loans, which correspond to loans granted to customers of which the total unpaid outstanding amounts total EUR 54 million (of which EUR 46 million unpaid amounts relating to structured loans). When a customer is classified as being in default in terms of credit risk, the total amount of their outstanding loans is classified as non-performing by contagion.
- EUR 27 million in loans classified as litigious, corresponding to unpaid interests on structured loans for which a lawsuit is ongoing.

Non-performing and litigious loans EUR millions	12/31/2015		12/31/2016	
	Non-performing loans	Litigious loans	Non-performing loans	Litigious loans
FRANCE				
State	-	-	-	-
Regions	-	1	54	-
Departments	-	11	70	-
Groups of municipalities	104	42	117	14
Municipalities	352	19	268	12
Public sector entities	140	4	21	1
TOTAL NON-PERFORMING AND LITIGIOUS	596	77	530	27
<i>of which arrears on structured loans</i>	48	77	46	27
<i>of which arrears on other loans</i>	8	-	8	-

The change in the number of customers with non-performing loans and with a part of their outstanding amounts involved in litigation (unpaid maturities of sensitive loans) is presented in the table below.

Non-performing and litigious loans (number of customers)	2015		2016	
	Non-performing loans	Litigious loans	Non-performing loans	Litigious loans
Beginning of the year	90	52	74	35
New	29	14	17	4
Outgoing	45	31	42	25
END OF THE YEAR	74	35	49	14

The increasing number of agreements signed with local governments resulted in a decrease in the amount and number of non-performing and litigious loans. The number of customers with non-performing and litigious loans concerned 63 customers at the end of 2016, compared with 109 at the end of 2015, representing a decrease of 46 customers. In 2016, twenty-two litigious files were resolved after the payment of the sums due and three litigious files were reclassified as non-performing.

The total amount of provisions at the end of December 2016 is presented in the table below.

EUR millions	12/31/2015	12/31/2016
Specific impairment	66	60
Collective impairment	63	46
TOTAL	129	106

Specific provisions for non-performing loans decreased by EUR 6 million since the beginning of the year. This decline is primarily due to the repayment of unpaid interest and to the drop in non-performing loans.

In 2016, the review of the loan portfolios and associated risks required an adjustment of the collective provisions with a reversal of EUR 17 million which is notably the result of the reduction of the sensitive loans, which made it possible to reassess the legal risk associated with customers who took Caisse Française de Financement Local to court.

Consequently, at the end of 2016, the cost of risk became positive at EUR 18 million, which mainly corresponds to the reversal of the collective provisions.

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:

- replacement assets in the amount of EUR 0.8 billion (see 4.2.b. Replacement assets);
- bank account balances in euros and other currencies, representing EUR 14 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 except for some which benefit from the agencies' highest short-term rating.

At the end of March 2017, Caisse Française de Financement Local was exposed (positive fair value of the swaps) on 11 banking counterparties, ten of these paid cash collateral of EUR 1.0 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, 2017, are listed below.

EUR billions	Short Term notional amounts	Long Term notional amounts	% Long Term notional amounts	Mark to Market		Collateral received	Number of counterparties
				-	+		
SFIL	-	16,4	19,0%	(1,6)	-	-	1
Other counterparties	45,2	69,7	81,0%	(2,8)	1,0	1,0	28
Total	45,2	86,1	100,0%	(4,5)	1,0	1,0	29

The swaps negotiated with external counterparties represented 81.0% of outstanding long-term swaps and those signed with SFIL 19.0%. The long-term swaps signed with the five largest counterparties represented a total of 40.5% 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 stages 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. Loans granted individually or bond issues can be micro- or macro-hedged. Hedging of assets and liabilities is more often obtained in using new interest rate swaps, but the same effect can also be obtained whenever possible by the cancelation of swaps of opposite direction.
- 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 re-fixing 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.

Limiting directional risk

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	Limit	6/30/2016	9/30/2016	12/31/2016	3/31/2017
Sensitivity	25,0	-3,7	-5,6	-0,5	-0,1

Limiting the slope risk

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	Limit	6/30/2016	9/30/2016	12/31/2016	3/31/2017
Short term	10,0	-1,5	-1,9	-0,9	0,1
Medium term	10,0	-1,8	-2,3	0,3	2,0
Long term	10,0	-0,5	-2,6	0,1	-2,6
Very long term	10,0	0,1	1,2	0,1	0,4

- *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	Limit	6/30/2016	9/30/2016	12/31/2016	3/31/2017
Short term	20,0	4,5	2,6	4,4	3,3
Medium term	20,0	14,5	12,1	4,3	5,1
Long term	20,0	10,7	11,0	8,1	4,9
Very long term	20,0	6,4	7,4	5,9	5,3

4. Outstanding 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, 2017.

Breakdown of outstanding swaps	Notional * (EUR billions)	SFIL (%)	Other counterparties (%)
Euribor against Eonia			
Macro-hedges	45,2	0,0%	100,0%
Total short-term swaps	45,2	0,0%	100,0%
Fixed rate swaps against Euribor			
Micro-hedges on <i>obligations foncières</i>	41,6	16,9%	83,1%
Micro-hedges on loans and debt securities	23,5	10,7%	89,3%
Macro-hedges on loans	15,8	27,2%	72,8%
Subtotal	80,9	17,1%	82,9%
Currency swaps			
Micro-hedges on <i>obligations foncières</i>	3,2	49,7%	50,3%
Micro-hedges on loans	1,3	45,9%	54,1%
Micro-hedges on debt securities	0,7	46,3%	53,7%
Subtotal	5,2	48,3%	51,7%
Total long-term swaps	86,1	19,0%	81,0%

* 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 curren-

cies 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 to indicate that there is a single loan vis-à-vis a 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	3/31/2016	6/30/2016	9/30/2016	12/31/2016	3/31/2017
Cover pool	7,50	7,27	7,50	7,22	7,35
Privileged liabilities	5,92	6,11	6,26	6,10	6,32
Gap in asset-liability duration	1,58	1,16	1,24	1,13	1,03
Duration gap limit	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)	3/31/2016	6/30/2016	9/30/2016	12/31/2016	3/31/2017
Cover pool	7,58	7,78	7,71	7,71	7,88
Privileged liabilities	6,32	6,47	6,47	6,47	6,75
Gap in asset-liability weighted average life	1,27	1,31	1,24	1,24	1,13

3. Regulatory limit

Current regulations impose 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.

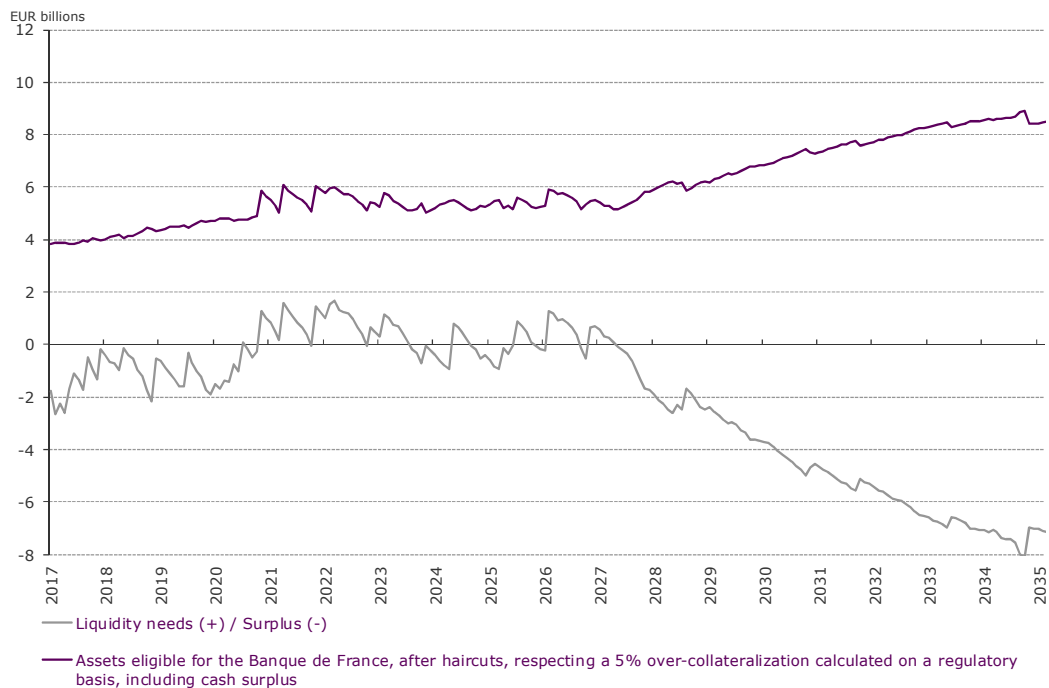
Since it is a credit institution, Caisse Française de Financement Local can post these eligible assets:

- 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).

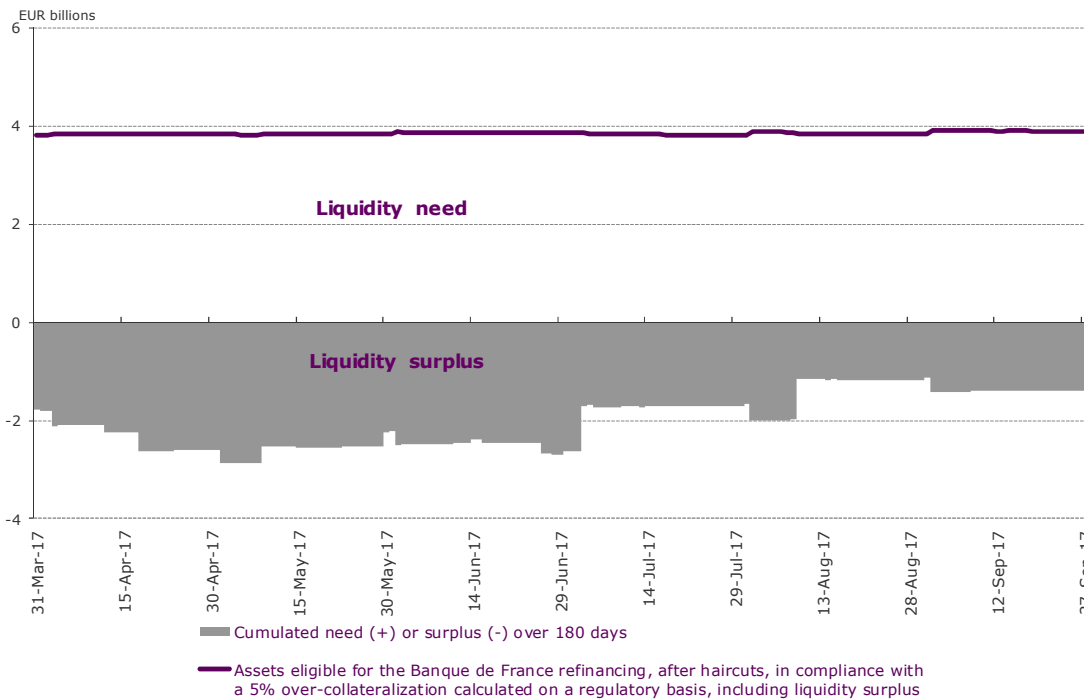
The maximum cumulated liquidity that Caisse Française de Financement Local might need in the future, in a run-off situation and if it were not able to issue new *obligations foncières*, is less than the maximum financing already occasionally obtained from the Banque de France in the past. This need is 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 the cumulative need for liquidity, and eligible assets to cover this need 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 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 need over a period of 180 days is covered by replacement assets and assets eligible for credit operations with the Banque de France. Cash needs are defined as repayments of *obligations foncières* and registered covered bonds, 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 2017, 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 sections 2.3 – b. and 8.3 – b.

b. Fiscal risks

For the record, 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 was closed in 2013, 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 recorded a provision for additional income tax in the amount of EUR 38 million in its 2015 IFRS financial statements. However, Caisse Française de Financement Local does not agree with the position of the tax authorities and started an appeal in 2016 within the framework of legal recourse allowed by current tax regulations. In 2016, discussions with tax authorities did not result in a change in the amount set aside in the IFRS accounts.

b. 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 2016 annual financial report entitled Supplemental information – Report of the Chairman of the Supervisory Board.

c. Security and means of payment

Caisse Française de Financement Local does not make any means of payment available to its customers.

9. Outlook for 2017

In 2017, Caisse Française de Financement Local and its parent company SFIL aim to:

- maintain their role as a major player in the market for loans to French local governments and public hospitals within the partnership with La Banque Postale (leader in this market in 2015 and 2016);
- enhance their 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 decreased by 80% since the beginning of 2013). This activity is generally accompanied by new loans granted to the local governments concerned and will continue at a slower pace than in 2015 and 2016, now that the notices of assistance for the support funds have been disclosed and most of the sensitive structured loan problems have been solved.

Caisse Française de Financement Local will thus see new loans enter its portfolio of assets in 2017. They will represent exposures on the French local public sector and the French State.

To cover its financing needs, Caisse Française de Financement Local plans to issue approximately EUR 6.0 billion of *obligations foncières* in 2017 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.

Public sector loans and bonds as of March 31, 2017

EUR millions	3/31/2017				12/31/2016	
	Direct exposure		Indirect exposure		Total	Total
COUNTRY	Loans	Bonds	Loans	Bonds		
France						
State	5	-	96	-	101	98
Banque de France	1 809	-	-	-	1 809	3 685
Regions	1 801	95	268	-	2 164	2 051
Departments	7 066	-	196	-	7 262	6 986
Municipalities	16 263	21	469	-	16 753	16 648
Groups of municipalities	11 113	89	171	-	11 373	11 004
Public sector entities :						
- health	6 384	-	-	-	6 384	6 310
- social housing	1 397	-	-	-	1 397	1 421
- others	920	35	1	-	956	945
Credits institutions	14	797	-	-	811	650
Subtotal	46 772	1 037	1 201	-	49 010	49 798
Germany						
Länder	-	515	-	-	515	515
Subtotal	-	515	-	-	515	515
Austria						
Länder	-	-	190	-	190	191
Subtotal	-	-	190	-	190	191
Belgium						
Regions	13	-	31	-	44	44
Communities	-	50	-	-	50	50
Public sector entities	57	-	-	-	57	60
Subtotal	70	50	31	-	151	154
Canada						
Provinces	-	-	-	-	-	22
Communities	172	-	-	-	172	172
Public sector entities	129	-	-	-	129	129
Subtotal	301	-	-	-	301	323
Spain						
State	-	200	-	-	200	200
Regions	88	-	-	-	88	88
Municipalities	-	104	-	-	104	104
Subtotal	88	304	-	-	392	392
United States						
Federated States	-	251	-	-	251	252
Subtotal	-	251	-	-	251	252

EUR millions	3/31/2017				12/31/2016	
	Direct exposure		Indirect exposure		Total	Total
PAYS	Loans	Bonds	Loans	Bonds		
Finland						
Municipalities	-	-	-	-	-	0
Public sector entities	-	-	-	-	-	-
Subtotal	-	-	-	-	-	0
Italy						
State	-	537	-	-	537	541
Regions	-	2 041	-	-	2 041	2 043
Provinces	-	560	-	-	560	566
Municipalities	9	1 942	-	-	1 951	1 973
Subtotal	9	5 080	-	-	5 089	5 123
Japan						
Municipalities	-	25	-	-	25	25
Subtotal	-	25	-	-	25	25
Portugal						
Municipalities	20	-	-	-	20	20
Public sector entities	5	-	-	-	5	6
Subtotal	25	-	-	-	25	26
United Kingdom						
State	-	-	-	298	298	320
Subtotal	-	-	-	298	298	320
Sweden						
Municipalities	18	-	-	-	18	18
Subtotal	18	-	-	-	18	18
Switzerland						
Cantons	293	-	93	-	386	386
Municipalities	530	-	-	-	530	556
Public sector entities	91	-	-	-	91	91
Subtotal	914	-	93	-	1 007	1 033
Supranational						
International organizations	30	-	-	-	30	32
Subtotal	30	-	-	-	30	32
TOTAL COVER POOL	48 227	7 262	1 515	298	57 302	58 202

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 after specific impairments. In addition to these impairments, Caisse Française de Financement Local makes collective and sectorial impairments.