



Activity Report Caisse Française de Financement Local as of September 30, 2017

This free translation of the quarterly activity report published in French is provided solely for the convenience of English-speaking readers.

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 a second mission, 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 under credit agreements:

- 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, in order to diversify its financing sources, SFIL is an issuer of short-maturity (certificates of deposit) and long-maturity (bonds). On the French State Agencies segment, SFIL gradually set up its signature by launching a first benchmark issue in the last quarter of 2016, followed by two new benchmark issues, including one in USD, in 2017.

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 September 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 with the objective to support French exports in terms of financial competitiveness, in accordance with a public refinancing plan comparable to that of other OECD countries. In this context, SFIL signed a protocol agreement governing relations with 20 commercial banks, thereby confirming relations with almost all the banks active in the French export credit market.

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.

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

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 refinancing 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 nine months of 2017

2.1 – THE COVERED BOND MARKET

As of September, 30, 2017, the volume issued on euro benchmark covered bonds amounted to EUR 95 billion against EUR 108 billion in 2016, i.e. a decrease of 12%. Since the beginning of the year, EUR 101 billion were repaid, bringing the net offer to a negative amount of EUR 11 billion. The gross offer remained dominated by French and German issuers who represented respec-

tively 24% and 17% of the volumes issued. Long maturities, 10 year and over, were the more sought by the issuers in order to respond to investors' search for yield, in an environment of persistently low interest rates.

During the third quarter of 2017, the activity on the euro covered bond primary market stayed dynamic with an amount of EUR 25 billion which was consistent with 2016. Spreads against sovereigns bonds – in particular concerning the French covered bonds – have regained sufficient value to enable an active presence of traditional investors. Furthermore, the covered bonds market in euros has continued to benefit from the strong support brought by the third Covered Bonds Purchase Program of the Eurosystem (CBPP3).

In this context, during the quarter, Caisse Française de Financement Local added, in September 2017, a new ten years issue (this is the second issue on this maturity this year) to its reference curve in an amount of EUR 750 million. In addition to this public offering, Caisse Française de Financement Local took advantage of investor demand to provide additional liquidity to one of its reference issue *via* a tap (2026). Caisse Française de Financement Local was also particularly active on private placements segment with EUR 395 million of issuances with maturities comprised between five and 30 years.

In total, Caisse Française de Financement Local raised EUR 5.9 billion during the first nine months of 2017. The average maturity of this program was close to 11 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 September 30, 2017, 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 – REFINANCING OF PUBLIC SECTOR LOANS GRANTED BY LA BANQUE POSTALE

In its first line of business, Caisse Française de Financement Local refinances loans granted by LBP to French local government and public hospitals.

In this context, as of September 30, 2017, Caisse Française de Financement Local acquired a total of EUR 2.9 billion in loans, which is 16% more than the volume acquired from La Banque Postale during the first nine months of 2016 (EUR 2.5 billion). Since the beginning of the partnership, loans acquired through LBP have accounted for almost EUR 11.8 billion.

2.4 – EXPORT CREDIT REFINANCING

In its second line of business, Caisse Française de Financement Local grants loans to SFIL to refinance large export credits it has granted. Such loans benefit from an unconditional and irrevocable 100% guarantee by the French State. This business line helps bring Caisse Française de Financement Local closer to the French State without modifying the risk profile of its cover pool.

After the first year of launching the activity in 2016, Caisse Française de Financement Local granted SFIL, in the first nine months of 2017, refinancing loans for a total of EUR 2.9 billion, compared to EUR 0.6 billion in 2016. Drawing of these loans is generally carried out over several years.

2.5 – 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.) 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

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). Since the beginning of 2013, outstanding sensitive loans have been reduced by 82%, from EUR 8.5 billion to EUR 1.5 billion.

b. Significant decrease in the number of lawsuits

As of September 30, 2017, the number of borrowers who had brought suit totalled 31, down from 39 as of December 31, 2016 and 131 as of December 31, 2015.

Since the creation of SFIL, 180 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.

Since the entry into effect on July 30, 2014, of the law on securing structured loan contracts signed by public sector entities, 30 legal decisions in favor of Dexia Credit Local and Caisse Française de Financement (including two decisions made in the context of an interlocutory proceeding) were rendered by the Tribunal de grande instance de Nanterre, the Tribunal de commerce de Nanterre and the Cour d'appel de Versailles, and only two decisions, relating to fixed-rate loans, were in whole or in part unsatisfactory, being noted these are first-instance judgments which are not yet final.

3. Changes in main balance sheet items

EUR billions - value after currency swaps	12/31/2015	12/31/2016	9/30/2017	Change Sep. 2017 / Dec. 2016
Cover pool	60,0	58,2	58,1	(0,1)%
Loans	50,5	47,0	47,4	0,7%
Securities	7,0	7,5	7,3	(2,2)%
Cash deposit in central bank	2,5	3,7	3,5	(6,3)%
Privileged debt	53,0	51,7	51,9	0,4%
<i>Obligations foncières *</i>	51,6	50,4	51,2	1,6%
Cash collateral received	1,4	1,3	0,7	(43,9)%
Non-privileged debt	5,5	5,2	5,1	(1,6)%
Parent company	5,5	5,2	5,1	(1,6)%
Banque de France	-	-	-	-
Equity IFRS (excluding unrealized gains and losses)	1,5	1,4	1,5	1,6%

*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 3.5 billion at the end of September 2017, versus EUR 3.7 billion at the end of December 2016. The cash surplus invested in securities represents a total of EUR 1.3 billion at the end of September 2017, versus EUR 0.9 billion at the end of December 2016.

As of September 30, 2017, the cover pool totalled EUR 58.1 billion, excluding accrued interest not yet due. It represented EUR 58.2 billion at the end of 2016, i.e. a decrease of EUR 0.1 billion (-0.1%). 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 51.9 billion, and increased by 0.4% in comparison with December 2016.

The debt contracted with the parent company totalled EUR 5.1 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 nine months of 2017 corresponded to an decrease in assets in the amount of EUR 0.1 billion. This change is explained by the following items.

(EUR billions)	Q3 2017	
1- Acquisition of loans from La Banque Postale		2,9
Loans to the French public sector (vanilla loans in euros)	2,9	
2- Export credits drawings		0,2
Loans to SFIL to refinance export credit guaranteed by the French State	0,2	
3- Reduction of loan sensitivity		0,2
Sensitive structured loans eliminated	-0,3	
Refinancing loans (vanilla loans in euros)	0,3	
New loans (vanilla loans in euros)	0,2	
4- Amortization of portfolio of loans and securities		-3,5
5- Early reimbursements		-0,1
6- Changes in treasury		0,2
Net change in securities investments	0,4	
Net change in Banque de France cash deposit	-0,2	
7- Other changes		0,0
Net change in the cover pool		-0,1

In 2017, Caisse Française de Financement Local has so far acquired a total of EUR 2.9 billion in loans to the French local public sector and public hospitals originated by La Banque Postale.

Drawings on refinancing loans of large export credits granted to SFIL became effective during the first nine months of 2017 in the amount of EUR 0.2 billion. These loans benefit from an unconditional and irrevocable 100% guarantee by the French State.

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 0.3 billion through their replacement with fixed rate loans. They were accompanied by new fixed rate loans in the amount of EUR 0.3 billion.

The natural amortization of the portfolio of loans and securities represented EUR 3.5 billion in the first nine months of 2017. There were no divestments, in the first nine 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 increased by EUR 0.2 billion over the first nine months of 2017.

4.2 – OUTSTANDING ASSETS AS OF SEPTEMBER 30, 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	9/30/2017
Loans and bonds to the public sector	53,8	54,0
Treasury (deposits at the Banque de France)	3,7	3,5
Replacement assets	0,7	0,6
Total	58,2	58,1

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 3.5 billion, EUR 0.7 billion and EUR 0.6 billion as of September 30, 2017.

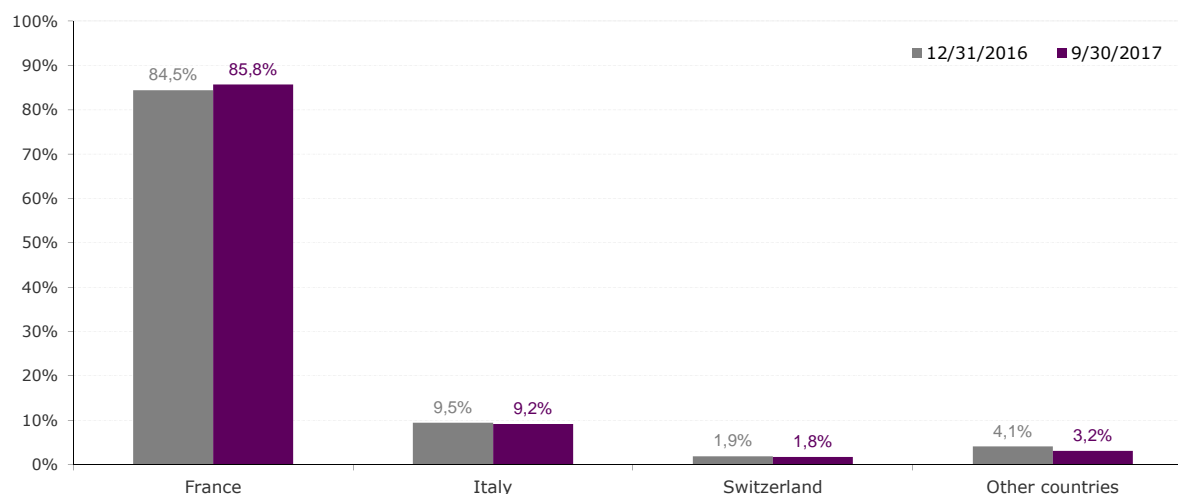
a. Public sector loans and securities (excluding replacement assets and treasury)

1. Geographic breakdown

At the end of September 2017, French public sector credits are predominant in the cover pool (85.8%), and their percentage is expected to rise in the future. Among them, loans acquired through La Banque Postale since 2013 accounted for almost EUR 10.5 billion, representing 23%, and loans guaranteed by the French State granted to SFIL for the refinancing of export credits represented less than 1%, i.e. EUR 0.2 billion.

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.

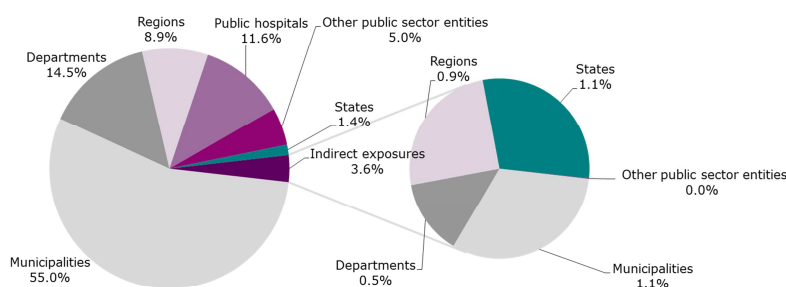


Exposures to Other countries as of September 30, 2017, are broken down by country in the section Bonds and public sector loans, which is presented at the end of this management report.

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 2.4% 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. The total amount of replacement assets is limited to 15% of debt benefiting from the legal privilege (*obligations foncières* and registered covered bonds). As of September 30, 2017, replacement assets represented 1.2% 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	06/30/2017
Step 1 credit rating				
Covered Bonds	France	Divers	26	166
Other bank bonds	France	Divers	120	439
Step 2 credit rating				
Bank bonds (maturity < 100 days)	France	Other	500	160
Bank account's balances	Other	Other	4	9
TOTAL			650	773

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 no assets with a bank counterparty. In the last three fiscal year, in the regular tests framework of its operational procedures to access for Banque de France financings, Caisse Française de Financement Local assigned in guarantee to the Banque de France assets with a small unitary amount.

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.

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

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 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 0.2 billion, with a EUR 0.9 billion increase in non-structured loans (vanilla) and a decrease of EUR 0.7 billion in structured loans (see the definition above).

EUR billions	12/31/2016	09/30/2017	% cover pool	Number of customers*
Sensitive loans not in the charter	0,7	0,7	1,1%	69
Sensitive loans (3E/4E/5E)	1,0	0,8	1,5%	166
SENSITIVE LOANS	1,7	1,5	2,6%	235
Structured loans benefiting from the derogatory mechanism of the support fund	0,7	0,5	0,9%	78
Other structured loans	4,0	3,7	6,3%	1 362
STRUCTURED LOANS	6,4	5,7	9,8%	1 675
Vanilla loans	38,4	39,3	67,7%	13 806
TOTAL French public sector loans	44,8	45,0	77,5%	15 481
COVER POOL	58,2	58,1	100,0%	

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

As of September 30, 2017, structured loans on the balance sheet of Caisse Française de Financement Local represented EUR 5.7 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 1.5 billion at the end of September 2017, compared to EUR 1.7 billion at the end of 2016. The EUR 0.2 billion decrease in these outstanding loans was mainly due to proactive efforts to reduce the sensitivity of the outstanding.

As of September 30, 2017, the most sensitive structured loans (loans not in the charter) represented EUR 0.7 billion, or 1.1% of the cover pool and 69 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		09/30/2017	
	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	0,3	38
Regions and departments	0,1	9	0,1	9
Public hospitals	0,3	17	0,3	14
Other customers	0,0	3	0,0	2
TOTAL	0,7	85	0,7	69

The 69 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 charter" number 6, and the outstanding loans concerned by these municipalities total almost zero.

As of September 30, 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

Between SFIL's date of creation and September 30, 2017, the number of customers holding sensitive loans decreased from 879 to 235, and the outstanding sensitive loans dropped from EUR 8.5 billion to EUR 1.5 billion (less than 2.6% of the cover pool), i.e. a decrease of 82%. This decrease includes EUR 0.5 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 38 customers, i.e. 0.3% of the cover pool and 0.2% of the total of the French customers.

5. Debt benefiting from the legal privilege

As of September 30, 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	9/30/2017
Cash collateral received	1,3	0,7
<i>Obligations foncières</i> and registered covered bonds	50,4	51,2
Total	51,7	51,9

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 0.7 billion at the end of September 2017.

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 September 30, 2017, Caisse Française de Financement Local achieved a volume of issues of EUR 5,9 billion by enhancing its reference curve with four new points, by increasing the amount of several of its existing *souches* (taps) and by continuing to work in the private placement segment.

Caisse Française de Financement Local raised money in the primary market on three occasions for a total amount of EUR 4.0 billion:

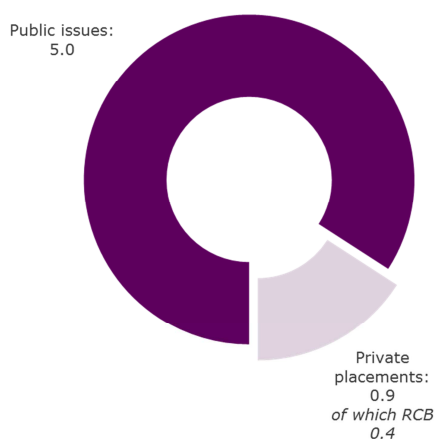
- a 10-year issue in January for EUR 1.5 billion;
- a dual tranche issue (7 and 15 years) in May for a total amount of EUR 1.75 billion;
- a 10-year issue in September for EUR 0,75 billion.

At the same time, Caisse Française de Financement Local provided additional liquidity for several of its reference issues via six taps in 2017 for the amount of EUR 1.0 billion.

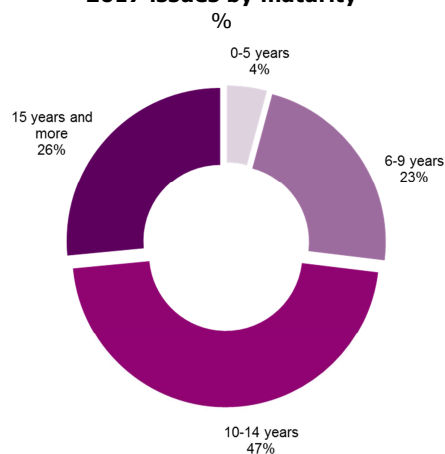
In addition to these public transactions, Caisse Française de Financement Local remained active in the private placement segment and especially with the registered covered bond (RCB) format, thus making it possible to respond to investors' search for long and very long maturities. Altogether, EUR 0.9 billion 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.

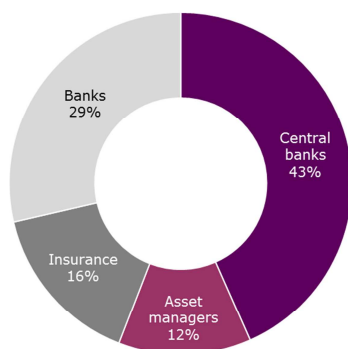
2017 issues by format
EUR billion



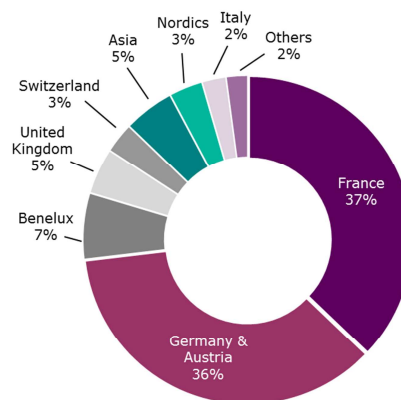
2017 issues by maturity



2017 public issues by investor category
%



2017 public issues by geographic zone
%

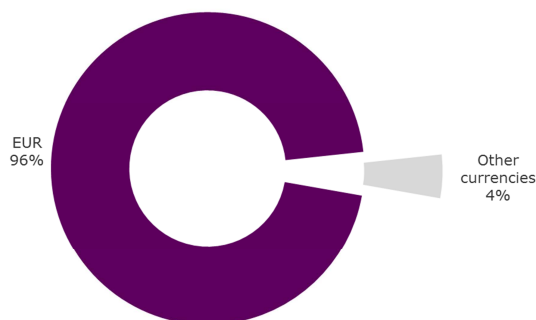


b. Outstanding debt as of September 2017

Outstanding *obligations foncières* and registered covered bonds totaled EUR 51.2 billion in swapped value at the end of September 2017. This includes new issues of *obligations foncières* for EUR 5.9 billion and amortization of issues maturing in 2017 for EUR 5.2 billion.

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

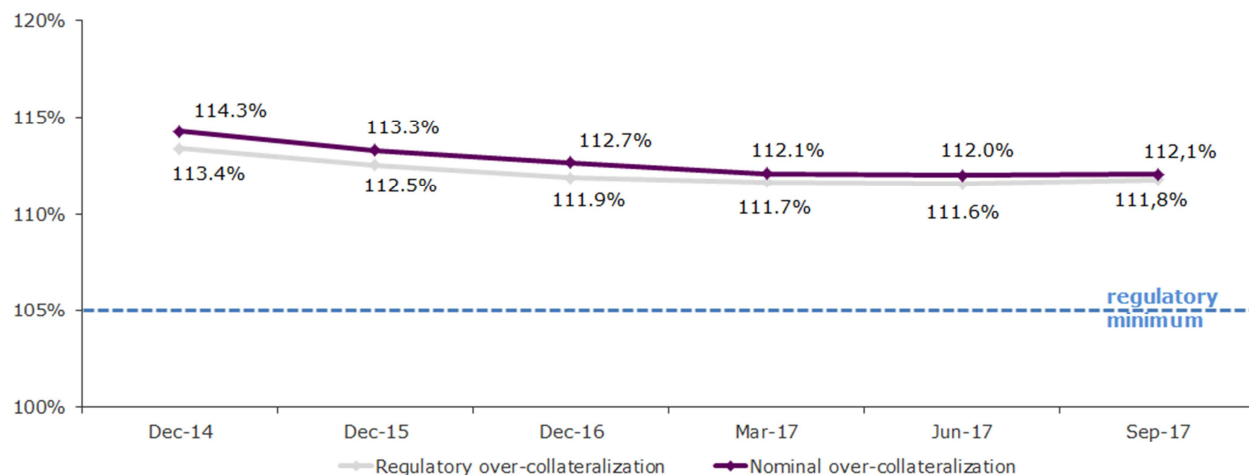
As of September 30, 2017, issues can be broken down by currency as follows:



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.

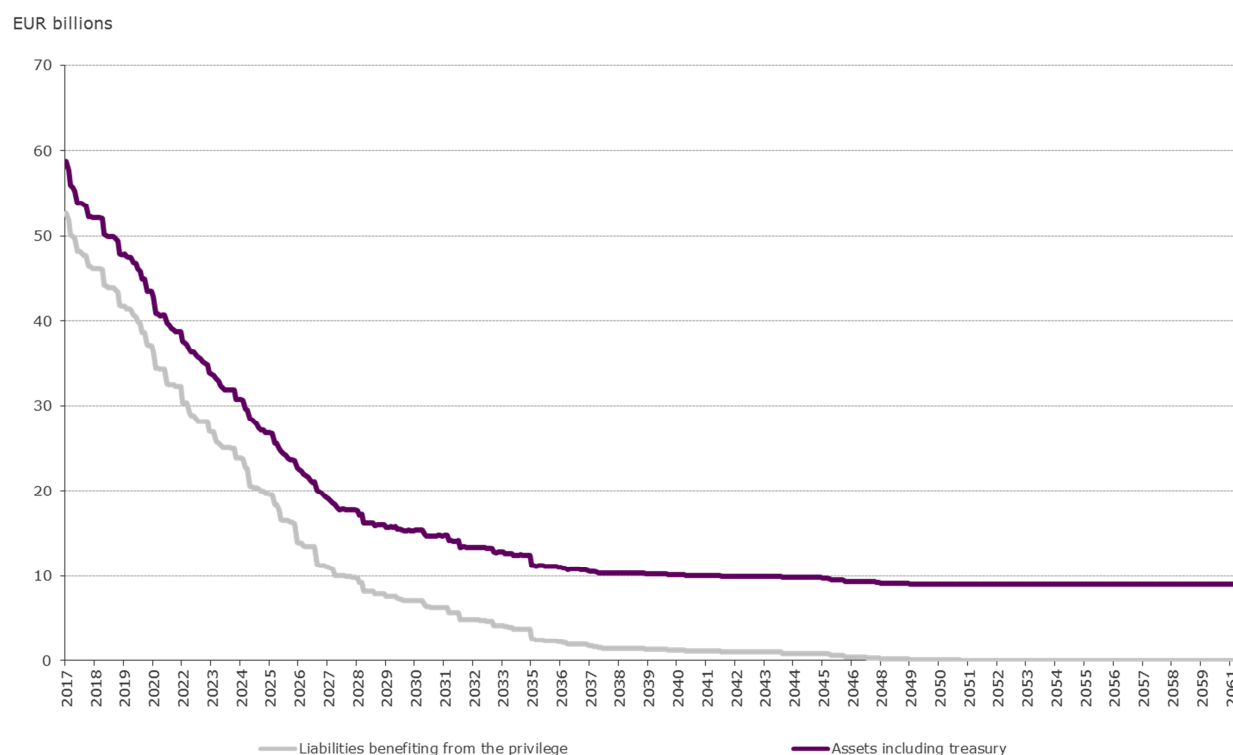


Regulatory over-collateralization may differ from nominal over-collateralization. In fact, it is calculated on the basis of the rules determined by the Autorité de contrôle prudentiel et de résolution (ACPR). In particular, these rules require different weighting levels according to the assets. The assets 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 September 30, 2017.

Amortization of assets and liabilities as of September 30, 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 September 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	9/30/2017
Parent company	5,2	5,1
Banque de France	-	-
Total	5,2	5,1

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.

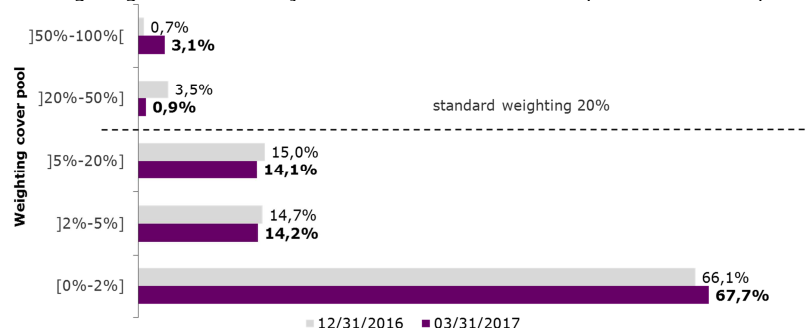
a. Breakdown of exposures according to risk weighting

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 September 30, 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 September 30, 2017



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

- 81.9% of the portfolio has a weighting of less or equal 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 4.0% of the portfolio has a weighting of more than 20%.

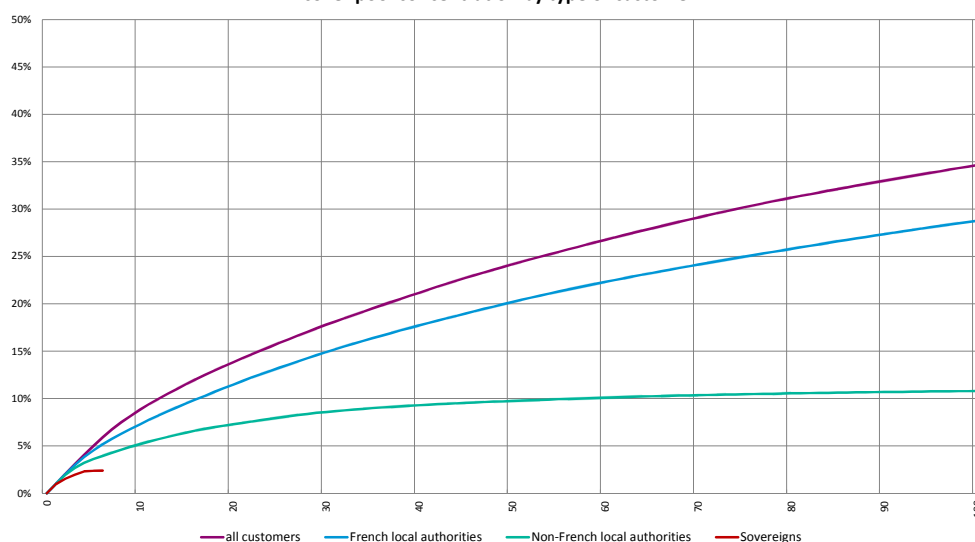
Combined with its high level of regulatory equity, the credit quality of Caisse Française de Financement Local's assets enabled the Company to post a phased-in Basel III solvency ratio of 23.9% as of September 30, 2017, compared to 25.1% as of December 31, 2016. The fully loaded Common Equity Tier 1 ratio in Basel III was 23.0% as of September 30, 2017, compared to 23.3% 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 September 30, 2017, all categories combined, the 20 largest exposures (excluding replacement assets and cash investments) represented 13.8% of the total cover pool (compared to 14.2% as of December 31, 2016). The largest exposure ac-

counted for only 1.0% of the total cover pool and the twentieth exposure 0.4%.

c. Non-performing loans, litigious loans, provisions

Since Caisse Française de Financement Local does not publish quarterly accounts, but only half-year and annual accounts, the following presentation concern, as a reminder, the accounts as of June 30, 2017.

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*.

As of June 30, 2017, 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. For the record, 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. Since 2016, the non-performing and litigious loans have 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. Over the first half 2017 the decrease continued at a slower pace.

As of June 30, 2017, arrears were at EUR 85 million; they dropped by 36% in comparison with December 31, 2015 (EUR 133 million) and have slightly increased since the end of 2016 (EUR 81 million), but they are concentrated on a few counterparties. In addition, customers who have signed a financial settlement agreement and for which payment schedules have been made meet their deadlines.

As of June 30, 2017, the non-performing and litigious loans stood at EUR 549 million and decreased by 18% in comparison with December 31, 2015, (EUR 673 million) and by 1% compared to EUR 557 million on December 31, 2016.

EUR millions	12/31/2015	12/31/2016	06/30/2017
Non-performing loans and litigious loans	673	557	549
% of cover pool	1.1%	1.0%	0.9%
Arrears	133	81	85

Non-performing and litigious loans consist of:

- EUR 523 million of non-performing loans, which correspond to loans granted to customers of which the total unpaid outstanding amounts total EUR 59 million (of which EUR 51 million 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 26 million in loans classified as litigious, corresponding to unpaid interests on structured loans subject to litigations for customers with a good financial health.

Non-performing and litigious loans EUR millions	12/31/2016		06/30/2017	
	Non-performing loans	Litigious loans	Non-performing loans	Litigious loans
FRANCE				
State	-	-	-	-
Regions	54	-	53	-
Departments	70	-	72	-
Groups of municipalities	117	14	121	9
Municipalities	268	12	256	13
Public sector entities	21	1	21	4
TOTAL NON-PERFORMING AND LITIGIOUS	530	27	523	26
of which arrears on structured loans	46	27	51	26
of which arrears on other loans	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 loans and litigious loans (number of customers)	2016		2017	
	Non-performing loans	Litigious loans	Non-performing loans	Litigious loans
Beginning of the year	74	35	49	14
New	17	4	18	-
Outgoing	42	25	9	4
END OF PERIOD	49	14	58	10

The number of customers affected by non-performing loans slightly increased in the first half of 2017 due to:

- transfer of clients initially considered as litigious for their structured loans and,
- the entry into this category of customers with few arrears for vanilla loans.

The total amount of provisions at the end of June 2017 is presented in the table below.

EUR millions	12/31/2016	06/30/2017
Specific impairment	60	41
Collective impairment	46	45
TOTAL	106	86

Specific provisions totaled EUR 41 million at the end of June 2017. This change *vis-à-vis* the end of 2016 reflected a recovery of EUR 19 million in specific provisions, in the first half of 2017, subsequent to the use of more accurate methods to estimate recoverable flows of doubtful loans³.

In addition, collective provisions are calculated on the different portfolios of Loans and advances. They totaled EUR 45 million at the end of June 2017, as compared with EUR 46 million at the end of 2016.

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 0.6 billion (see 4.2.b. Replacement assets);
- bank account balances in euros and other currencies, representing a very small amount (see 4.2.b. Replacement assets), 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). In 2017, Caisse Française de Financement Local has begun to modify these contracts to take into account the recent changes in the regulation (Variation margin amendments). 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 (or variation margin), 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 September 2017, Caisse Française de Financement Local was exposed (positive fair value of the swaps) on nine banking counterparties, height of these paid cash collateral of EUR 0.7 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 September 30, 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	-	16,5	19,4%	(1,7)	-	-	1
Other counterparties	46,4	68,9	80,6%	(2,4)	0,7	0,7	25
Total	46,4	85,4	100,0%	(4,1)	0,7	0,7	26

The swaps negotiated with external counterparties represented 80.6% of outstanding long-term swaps and those signed with SFIL 19.4%. The long-term swaps signed with the five largest counterparties represented a total of 43.3% of notional amounts. Short-term swaps (Eonia) were all contracted with external counterparties.

³ Within the framework of the success in 2016 of the policy to reduce the sensitivity of interest rates and the confirmation of legal decisions favorable to the cause, Caisse Française de Financement Local was able to hone, in a reasonable and prudent manner, the methods it uses to estimate the recoverability of flows of doubtful loans on its balance sheet in order to account for, in particular, the impact of the extension of payments. The implementation of this approach, which is in compliance with IFRS, means that it is no longer systematically necessary to estimate the total amount of interest to account for hypotheses of future recovery. Thus, the net interest rate expense is improved through a recovery of provisions in the amount of EUR 19 million, recorded as of June 30, 2017.

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 the first stage of hedging) 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.

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

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

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

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 September 30, 2017.

Breakdown of outstanding swaps	Notional * (EUR billions)	SFIL (%)	Other counterparties (%)
Euribor against Eonia			
Macro-hedges	46,4	0,0%	100,0%
Total short-term swaps	46,4	0,0%	100,0%
Fixed rate swaps against Euribor			
Micro-hedges on obligations foncières	42,0	19,1%	80,9%
Micro-hedges on loans and debt securities	22,7	10,6%	89,4%
Macro-hedges on loans	14,8	28,6%	71,4%
Subtotal	79,5	18,5%	81,5%
Currency swaps			
Micro-hedges on obligations foncières	2,3	42,7%	57,3%
Micro-hedges on loans	3,0	20,3%	79,7%
Micro-hedges on debt securities	0,6	43,3%	56,7%
Subtotal	5,9	31,5%	68,5%
Total long-term swaps	85,4	19,4%	80,6%

* 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 at the latest 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)".

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

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	9/30/2016	12/31/2016	3/31/2017	6/30/2017	9/30/2017
Cover pool	7,50	7,22	7,35	7,02	7,23
Privileged liabilities	6,26	6,10	6,32	6,36	6,45
Gap in asset-liability duration	1,24	1,13	1,03	0,67	0,77
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)	9/30/2016	12/31/2016	3/31/2017	6/30/2017	9/30/2017
Cover pool	7,78	7,71	7,88	7,63	7,82
Privileged liabilities	6,47	6,47	6,75	6,86	6,93
Gap in asset-liability weighted average life	1,31	1,24	1,13	0,77	0,88

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:

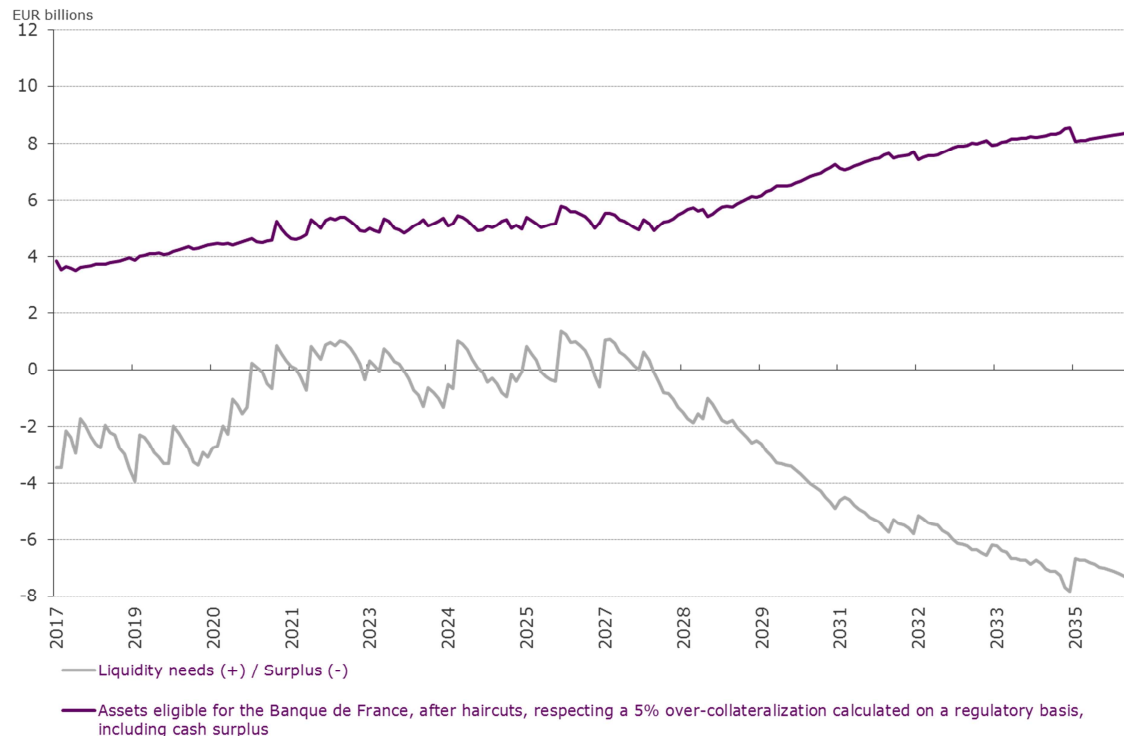
- either by using, in its own name, the refinancing possibilities offered by the European Central Bank through the Banque de France;
- or by using interbank financing in the form of repurchase agreements.

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.

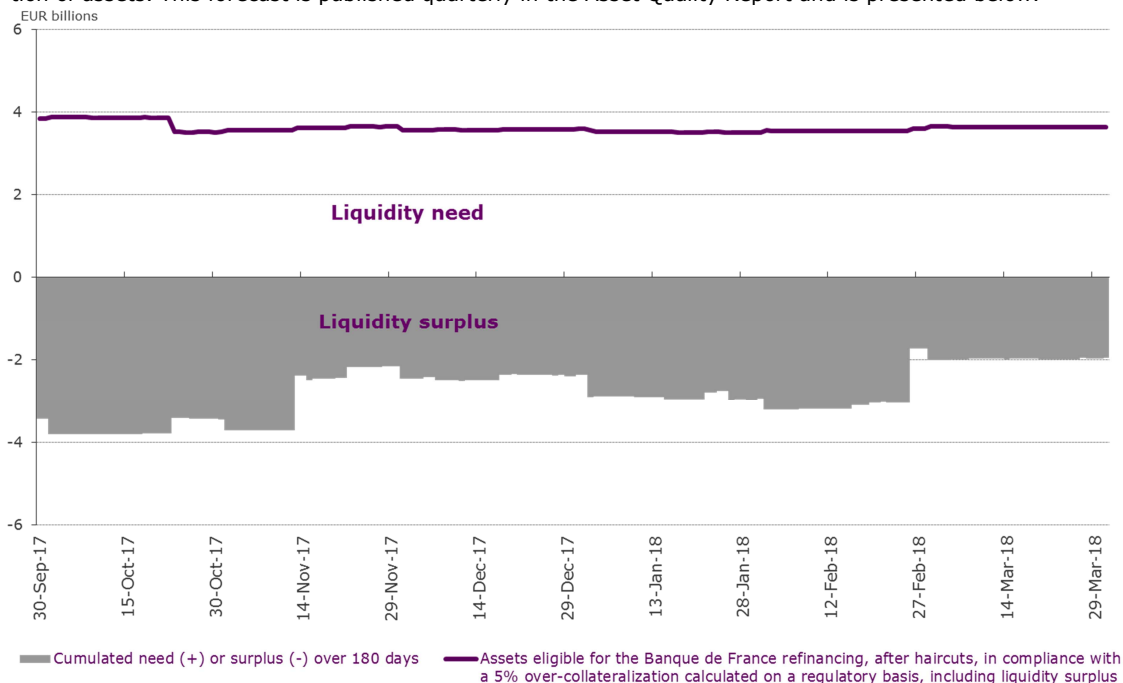
The forecast of the cumulative need for liquidity, and eligible assets to cover this need as defined above, is presented in the

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 September 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 2.5 – 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 assumptions used to calculate the amount set aside in the IFRS accounts.

So as to preserve its rights on the tax assessment currently disputed, French tax authorities have opened a procedure to investigate on the consequences of the previous procedure on the fiscal income tax exercises from 2014 to 2016.

No other new development has occurred.

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 the end of 2017

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

- maintained 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);
- enhanced their role in refinancing banks that work with French exporters for their large export credits.

In addition, the bulk of the loan sensitivity activity has been carried out and the riskiest contracts, those indexed to EUR/CHF currencies, have decreased to a minimum. The important reduction in the number of legal proceedings as of September 30, 2017 should pursue its reducing trend during the next months.

To cover its financing needs, Caisse Française de Financement Local issued over the first nine months of 2017 EUR 5.9 billion of *obligations foncières*, with a long average maturity adapted to the profile of the new assets, i.e. almost all of its annual issuance program (EUR 6 billion).

Public sector loans and bonds as of September 30, 2017

EUR millions	9/30/2017				12/31/2016	
	Direct exposure		Indirect exposure		Total	Total
COUNTRY	Loans	Bonds	Loans	Bonds		
France						
State :						
- refinancing of large export credits			203		203	-
- others	7		113		120	98
Banque de France	3 454	-	-	-	3 454	3 685
Regions	1 863	325	264	-	2 452	2 051
Departments	7 026	-	188	-	7 214	6 986
Municipalities	15 906	20	451	-	16 377	16 648
Groups of municipalities	11 025	89	158	-	11 272	11 004
Public sector entities :						
- health	6 256	-	-	-	6 256	6 310
- social housing	1 324	-	-	-	1 324	1 421
- others	884	243	1	-	1 128	945
Credits institutions	6	443	-	-	449	650
Subtotal	47 751	1 120	1 378	-	50 249	49 797
Germany						
Länder	-	275	-	-	275	515
Subtotal	-	275	-	-	275	515
Austria						
Länder		-	188	-	188	191
Subtotal	-	-	188	-	188	191
Belgium						
Regions	8	-	25	-	33	44
Communities		-	-	-	-	50
Public sector entities	55	-	-	-	55	60
Credits institutions		50	-	-	50	-
Subtotal	63	50	25	-	138	154
Canada						
Provinces	-	-	-	-	-	22
Communities	161	-	-	-	161	172
Public sector entities	129	-	-	-	129	129
Subtotal	290	-	-	-	290	323
Spain						
State		200	-	-	200	200
Regions		65	-	-	65	104
Municipalities	87	-	-	-	87	88
Subtotal	87	265	-	-	352	392
United States						
Federated States	-	251	-	-	251	252
Subtotal	-	251	-	-	251	252

EUR millions	9/30/2017				12/31/2016	
	Direct exposure		Indirect exposure			
PAYS	Loans	Bonds	Loans	Bonds	Total	Total
Italy						
State		543	-	-	543	541
Regions		2 008	-	-	2 008	2 043
Provinces		538	-	-	538	566
Municipalities	8	1 885	-	-	1 893	1 973
Subtotal	8	4 974	-	-	4 982	5 123
Japan						
Municipalities	-	25	-	-	25	25
Subtotal	-	25	-	-	25	25
Portugal						
Municipalities	19	-	-	-	19	20
Public sector entities	5	-	-	-	5	6
Subtotal	24	-	-	-	24	26
United Kingdom						
State	-	-	-	254	254	320
Subtotal	-	-	-	254	254	320
Sweden						
Municipalities	18	-	-	-	18	18
Credits institutions	-	100	-	-	100	-
Subtotal	18	100	-	-	118	18
Switzerland						
Cantons	293	-	72	-	365	386
Municipalities	502	-	-	-	502	556
Public sector entities	91	-	-	-	91	91
Subtotal	886	-	72	-	958	1 033
Supranational						
International organizations	28	-	-	-	28	32
Subtotal	28	-	-	-	28	32
TOTAL COVER POOL	49 155	7 060	1 663	254	58 132	58 201

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.