



CAFFIL Activity Report

For the period from January 1st to March 31, 2019

This free translation of the quarterly financial 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 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.

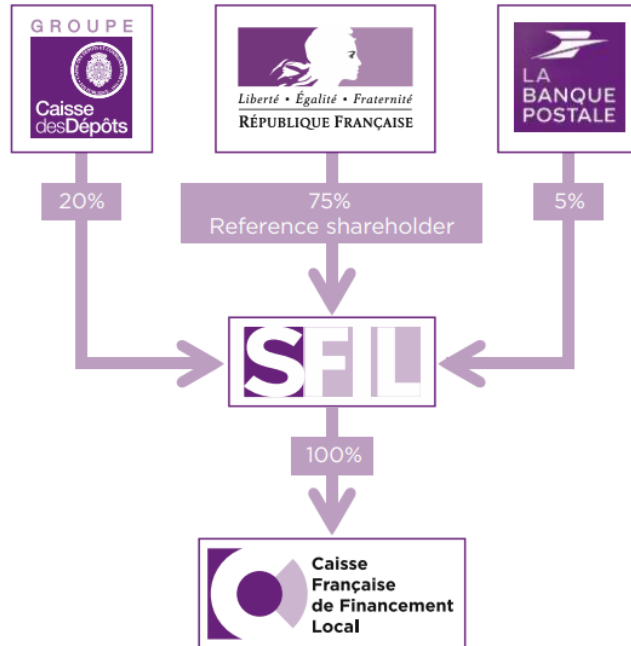
Sociétés de crédit foncier, which were created by the law of June 1999, are now well-known in the world of bond issuers and investors. They issue covered bonds called *obligations foncières* and contract other covered debt negotiable or not in regulated markets. All these instruments are characterized 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.

Since 2015, the French State has entrusted SFIL and Caisse Française de Financement Local with a second mission that is the responsibility to refinance large export credits with the guarantee of the State (see 1.3.2.). 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 irreplaceable 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.



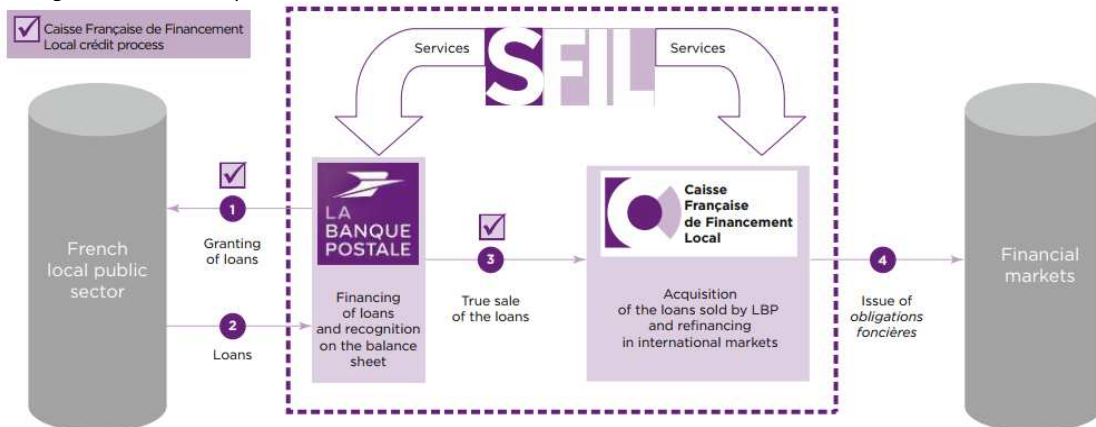
The French State is the “reference shareholder” of SFIL and Caisse Française de Financement Local for ACPR, underlining its commitment to ensure oversight and to influence strategic decisions, as well as its determination to ensure Caisse Française de Financement Local’s and SFIL’s ongoing financial transactions and to comply with regulatory requirements, if so required.

On November 15, 2018, as part of the project to create a major public finance hub centered around CDC and La Poste, the French State and CDC announced that they had entered into discussions with a view to entrusting the control of SFIL, Caisse Française de Financement Local’s parent company, to CDC. SFIL’s shareholder base will remain – as today – fully public. Its shareholders will ensure that SFIL’s financial solidity is preserved and its economic base protected, and will continue to provide it with the necessary support, in accordance with the applicable regulations. This change in shareholding structure is expected to take place at the same time as the changes to that of La Poste and CNP Assurances.

1.3 – ECONOMIC MODEL OF CAISSE FRANÇAISE DE FINANCEMENT LOCAL

1.3.1. Financing 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.

- Before a loan is originated, an initial analysis of the counterparty is carried out 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*.

1.3.2. 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: to 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 25 commercial banks, thereby confirming relations with almost all the banks active in the French export credit market. SFIL may acquire all or a part of the participation of each of these banks in an export credit.

In this context, Caisse Française de Financement Local grants 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 export refinancing 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 refinancing activity will increase gradually and will only become significant in several years. This share may reach 15% within four to five years.

1.3.2.1. 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 French State.
- After the export contract finalization, 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).

Usual operational diagram of export credit refinancing by SFIL-CAFFIL



1.3.2.2. French State export guarantees

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

(1) The enhanced guarantee was introduced by law 2012-1510 of December 29, 2012, and decree 2013-693 of July 30, 2013, as amended by decree 2018-1162 of December 17, 2018, relating to the granting of the State's guarantee for transactions that are likely to contribute to the development of France's foreign trade or are of strategic interest for its overseas economy.

directly by the State, demonstrating its support for exporters, and are intended to promote, support and secure French exports financed over the medium and long term as well as French overseas investment:

- 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 manages the State guarantees in strict compliance with the international rules of the WTO, the European Union and the OECD.
- 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.

1.3.3. Servicing and financing provided by SFIL

The role of SFIL primarily involves the following:

- to ensure the complete operational management of the Company, 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 non-privileged funding and some of the derivatives it needs to carry out its activities.

SFIL obtains the resources needed to fund Caisse Française de Financement Local's activity (financing of overcollateralization and derivatives) from the markets by issuing short-dated (certificates of deposit) and long-dated (bonds) debt. It has gradually established its signature in the French agency segment by launching benchmark EMTN issues in euros and dollars.

SFIL can also fund these liquidity requirements by entering into loan agreements with its shareholders:

- Caisse des Dépôts et Consignations for needs related to transactions booked before SFIL's acquisition date (January 31, 2013) and to the export credit refinancing activity;
- La Banque Postale for needs related to the loans it grants to French local government entities and public hospitals.

Since 2016, shareholder refinancing has been largely replaced by the financing that SFIL has obtained on the financial markets; it nevertheless remains available, particularly in the event of liquidity needs arising under stressed circumstances.

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 2018 – 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.

1.3.4. Other management agreements

Specific individual agreements have been established with entities that, in the past, have transferred assets to the *société de crédit foncier*, and continue to ensure partly or totally the management of these agreements for their national clientele. These assets are now managed in a run-off mode. At the end of March 2019, 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.

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

As of March 31, 2019, Caisse Française de Financement Local's issuance program was rated by three international rating agencies: Moody's, Standard & Poor's (S&P) and DBRS.

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 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.).

SFIL is currently rated at the same level as France by S&P and one notch below it by Moody's and DBRS. The agencies have given SFIL these excellent ratings because they consider it to be a French government-related entity. They reflect the strong probability that if necessary the French State would provide extraordinary support to SFIL because of the strategic importance of the public service responsibilities entrusted to it, the State's commitments and its influence on SFIL's governance.

Note that S&P caps the rating of Caisse Française de Financement Local's *obligations foncières* at one notch above that of SFIL and, consequently, one notch above that of the French State, because some of its derivative contracts do not comply with the agency's methodological criteria (counterparties not rated by S&P or absence of a replacement clause).

Lastly, based on the Company's performance in terms of social and environmental responsibility, Caisse Française de Financement Local's *obligations foncières* benefit also from very good ratings from extra-financial rating agencies.

See part 2.3 for the current ratings.

2. Highlights of the first quarter of 2019

2.1 – THE COVERED BOND MARKET

The primary market for euro-denominated public covered bond issues (benchmark public issues) was very active over the first quarter of 2019, with EUR 62 billion of new issues (rising sharply in comparison with the first quarter of 2018 and 2017 with EUR 48 billion for these two years). This level of activity has been well absorbed by investors in spite of a positive net offer of EUR 27 billion over the period and the significant decrease of purchase program by the European Central Bank on the primary market. The higher level of spread compared with 2018, in particular at the beginning of this year, combined with the anticipation of a more accommodating monetary policy from the European Central Bank have aroused investor demand. During the first quarter, German and French issuers represented 35 % of the euro primary market offer and the Dutch issuers 11 %; Canadian issuers, with almost 9 %, took advantage of this market to access financing conditions more favorable to them in euro than in dollar. Nordic countries (Norway, Finland and Sweden) represented 20 % of primary offer while among issuers from peripheral countries, Italy was the most active with 7 %.

In this context, Caisse Française de Financement Local decided to enter the euro benchmark primary market two-time. In January, with an issue of EUR 1.25 billion composed by two *tranches* with a maturity of 6 (for EUR 0.75 billion) and 15 years (for EUR 0.5 billion). Then, in February, for its first thematic social bond issue for an amount of EUR 1 billion with a maturity of 8 years. This transaction, which is the first social issue in Europe dedicated exclusively to financing public hospitals, was launched following investors meetings organised in Europe and was judged like a real success by market observers. Furthermore, Caisse Française de Financement Local also took advantage of investor appetite for a long-dated issues to conduct private placements of EUR 330 million and to provide additional liquidity for its existing 2033 and 2038 *souches* via a tap in the amount of EUR 150 million for each one. With these taps, the amount of each public issue has stood at EUR 650 million. The average maturity of the financing raised over the first quarter of 2019 was 10.8 years.

2.2 – HARMONIZATION OF THE EUROPEAN LEGAL FRAMEWORK FOR COVERED BONDS

Several significant steps concerning the harmonization of the legal frameworks of European covered bonds (project of directive and amendment of Article 129 of the Capital Requirements Regulation - CRR) took place over the first quarter of 2019:

- a political agreement has been reached between the European Commission, the European Parliament and the European Council on 26 February 2019 in the context of the trilogue negotiations;
- then, the European Council's Committee of Permanent Representatives approved on 20 March 2019 the text agreed;
- European Parliament's Committee on Economic and Monetary Affairs (ECON) voted in favor of the text on 1st April 2019. The European Parliament also approved this text during its plenary session on 18 April 2019.

A final vote of the European Parliament and the Council is expected in the summer of 2019. Therefore, the final text is expected to be published in the European Official Journal in the autumn of 2019. From that date, Member States will have 18 months to transpose the Directive into national law. Amendments to CRR Article 129 will have to entry into force at the same date.

At this stage, Caisse Française de Financement Local has not identified any significant positive or negative impact on its activities related to the implementation of this new directive and regulation.

2.3 – RATING OF OBLIGATIONS FONCIÈRES

The financial ratings of the obligations foncières issued by Caisse Française de Financement Local were not altered over the first quarter of 2019.

As of March 31, 2019, the ratings were as follows: Aaa (Moody's), AA+ (S&P) and AAA (DBRS). The outlook for each of these ratings is stable.

At the same date, extra-financial ratings were as follows:

- Prime for ISS-oekom;

- Positive-BBB for IMUG;
- AA for MSCI.

2.4 – 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 governments and public hospitals. Since 2015, the CAFFIL/SFIL/LBP network has been recognized as the largest provider of funding for the French local public sector.

In this context, during the first quarter 2019, Caisse Française de Financement Local acquired a total of EUR 1.2 billion in loans. Since the beginning of the partnership in 2013, loans acquired through LBP have accounted for EUR 16.9 billion.

2.5 – LARGE EXPORT CREDITS 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 new business brings Caisse Française de Financement Local closer to the French State without modifying the risk profile of its cover pool.

Caisse Française de Financement Local granted two new refinancing loans to SFIL for a total amount of EUR 0.3 billion.

Since the launch of this role in mid-2015, Caisse Française de Financement Local has granted refinancing loans to SFIL for a total volume of EUR 7.4 billion. As of March 31, 2019, the outstanding amount of these loans recorded in Caisse Française de Financement Local's balance sheet was EUR 1.5 billion. As a reminder, the disbursement of refinancing loans for large export credits is staggered over several years.

3. Change in cover pool and debts

EUR billions	12/31/2018	3/31/2019	Change 2019 / 2018
value after currency swaps			
Cover pool	56.9	57.8	1.5%
Loans	47.5	47.9	0.8%
Securities	8.1	8.4	3.4%
Cash deposit in central bank	1.3	1.5	19.3%
Assets removed from the cover pool	0.0	0.0	ns
Privileged debt	50.8	51.6	1.6%
Obligations foncières ⁽¹⁾	50.3	51.1	1.6%
Cash collateral received	0.5	0.5	6.7%
Non-privileged debt	4.9	5.2	4.7%
SFIL	4.9	5.2	4.7%
Equity IFRS (excluding unrealized gains and losses)	1.5	1.5	0.0%

(1) Including registered covered bonds

Caisse Française de Financement Local's cover pool grew by approximately 1.5% during the first quarter 2019. As of March 31, 2019, the cover pool excluding accrued interest not yet due amounted to EUR 57.8 billion.

Caisse Française de Financement Local's cover pool is composed of loans and debt securities and 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 1.5 billion at the end of March 2019, versus EUR 1.3 billion at the end of December 2018. The cash surplus invested in securities or lent to SFIL represents a total of EUR 3.7 billion as of March 31, 2019 versus EUR 3.3 billion at the end of December 2018.

As of March 31, 2019, no assets were 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.

As of this date, outstanding debt benefiting from the legal privilege, including cash collateral received, was EUR 51.6 billion, which increased by 1.6% in comparison with December 2018.

As of March 31, 2019, the debt contracted with the parent company totaled EUR 5.2 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 2019

The net change in the cover pool during the first quarter 2019 corresponded to an increase in assets in the amount of EUR 0.9 billion. This change is explained by the following items.

EUR billions	First quarter 2019
1- Acquisition of loans from La Banque Postale	1.2
Loans to the French public sector (vanilla loans in euros)	1.2
2- Export credits drawings	0.4
Loans to SFIL to refinance export credit guaranteed by the French State	0.4
3- Reduction of loan sensitivity	0.1
Sensitive structured loans eliminated	(0.1)
Refinancing loans (vanilla loans in euros)	0.1
New loans (vanilla loans in euros)	0.1
4- Amortization of portfolio of loans and securities	(1.2)
5- Early reimbursements	(0.2)
6- Changes in treasury	0.6
Net change in securities investments	0.4
Net change in Banque de France cash deposit	0.2
Net change in the cover pool	0.9

During the first quarter 2019, Caisse Française de Financement Local acquired a total of EUR 1.2 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 quarter 2019 in the amount of EUR 0.4 billion. These loans benefit from an irrevocable and unconditional 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 during the first quarter 2019 made it possible to decrease outstanding loans considered as sensitive by EUR 0.1 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 1.2 billion during the first quarter 2019, and early reimbursements represented EUR 0.2 billion.

Available cash increased by EUR 0.6 billion. It is deposited at the Banque de France, invested in bank bonds classified as replacement assets, in European public sector bonds or lent to SFIL.

There were no divestments, except for treasury investments, during the first quarter 2019.

4.2 – OUTSTANDING ASSETS AS OF MARCH 31, 2019

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	12/31/2018	03/31/2019
Loans and bonds to the public sector	52.8	53.1
<i>of which local public sector business line</i>	51.2	51.1
<i>of which large export credits refinancing business line ⁽¹⁾</i>	1.1	1.5
<i>of which treasury investment in public sector bonds ⁽³⁾</i>	0.5	0.5
Banque de France cash deposit ⁽³⁾	1.3	1.5
Replacement assets ⁽³⁾	2.8	3.2
COVER POOL	56.9	57.8
Financing commitments granted to refinance large export credits ⁽¹⁾⁽²⁾	6.0	5.9
Financing commitments granted to other public sector loans	0.0	0.0
FINANCING COMMITMENTS GRANTED	6.0	5.9

(1) For the record, loans refinancing large export credits concluded with SFIL benefit from an irrevocable and unconditional 100% guarantee granted by the French State (enhanced guarantee).

(2) In 2018 and 2019, commitments granted represented concluded contracts in drawing phase.

(3) The total amount of excess treasury increased from EUR 4,6 billion at the end of 2018 to EUR 5,2 billion at the end of first quarter 2019.

Caisse Française de Financement Local holds cash surpluses in its account at the Banque de France or invests them in either European public sector bonds or replacement assets (banking sector securities or short-term loans to SFIL, its parent company). They are mentioned with a⁽³⁾ in the table above.

The amount of financing commitments given came to EUR 5.9 billion as of March 31, 2019, It concerns loans to SFIL signed but not yet drawn, in connection with the refinancing of large export credits. As a reminder, these loans benefit from an irrevocable and unconditional 100% guarantee by the French State.

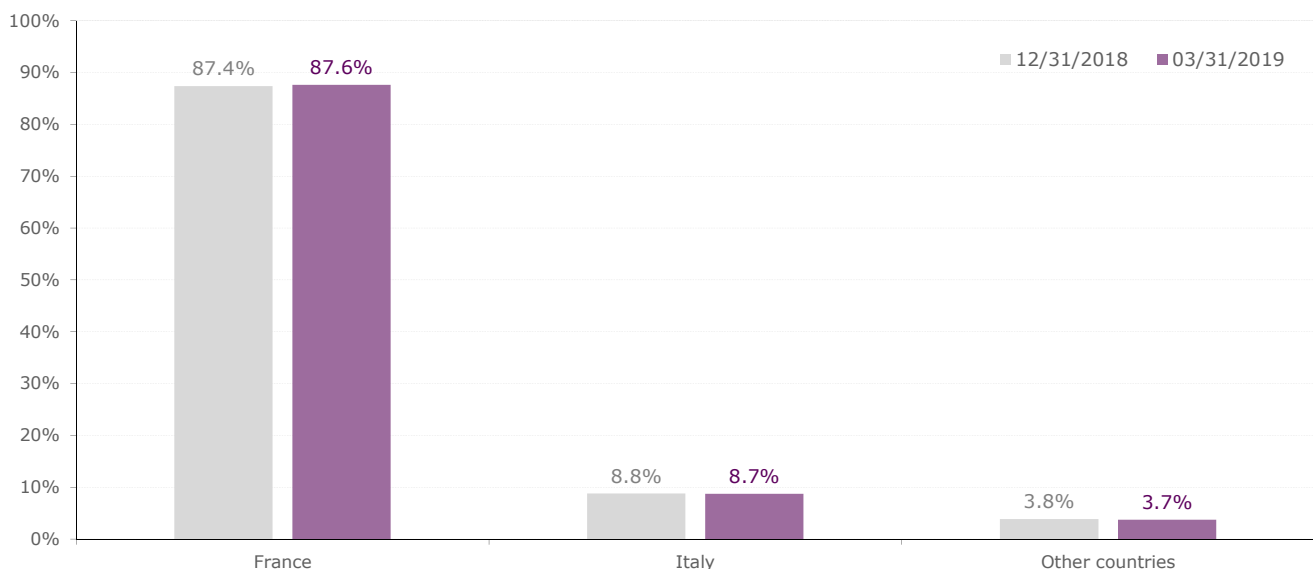
4.2.1. Public sector loans and bonds (excluding replacement assets and treasury placed with the Banque de France)

4.2.1.1. Geographic breakdown

As of March 31, 2019, French public sector loans made up the majority (87.6%) of the cover pool, a share due to increase in the future. They include loans amounting to EUR 14.1 billion acquired from La Banque Postale since 2013, which account for over 26% of public sector loans and bonds and nearly 32% of its loans to the French local public sector. The State-guaranteed loans granted to SFIL for the refinancing of large export credits (EUR 1.5 billion on balance sheet) represent approximately 3% of its public sector loans and bonds.

The other assets are managed in a run-off mode; they correspond to granular and geographically diversified exposures on foreign public sector entities.

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



As of March 31, 2019, Italian assets represented the largest share of non-French assets in run-off, with a total volume of EUR 4.6

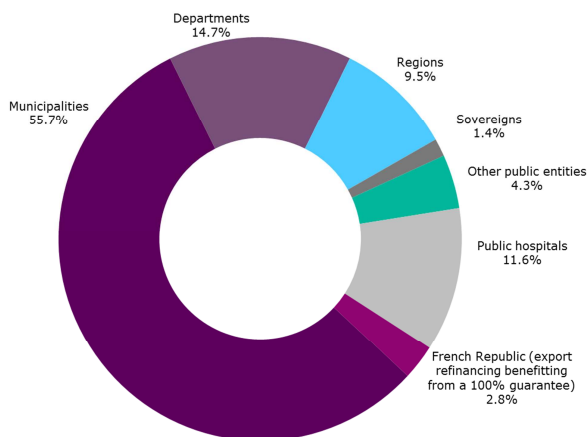
billion, or 8.7% of the cover pool (excluding replacement assets and Banque de France cash deposits). These assets are granular exposures (more than 200 counterparties consisting mainly of regional and municipal authorities) distributed throughout Italy.

Exposures to Other countries as of March 31, 2019, are broken down by country in the section Breakdown of cover pool, which is presented at the end of this management report.

4.2.1.2. Breakdown by type of counterparty

Caisse Française de Financement Local's portfolio is made up of:

- for 80%: exposures on municipalities, departments or regions;
- for 6%: sovereign exposures or commitments on other public sector entities;
- for 11%: exposures on public hospitals;
- for 3%: exposures 100% guaranteed by the French State in respect of loans granted to SFIL for the refinancing of large export credits;



4.2.1.3. Securitizations

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

4.2.2. 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 *obligations foncières* and registered covered bonds. As of March 31, 2019, replacement assets represented 6.3% of *obligations foncières* and registered covered bonds.

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) or lent to SFIL. In this case, bank exposures are classified as replacement assets, broken down below based on the rating of the issuers. In addition, Caisse Française de Financement Local granted loans to SFIL to invest its surplus cash. These loans are also included in the replacement assets.

Replacement assets	Country	12/31/2018	03/31/2019
EUR millions			
Step 1 credit rating			
Covered bonds			
	France	278	473
	Other countries	677	727
Other bank bonds			
	France	417	486
	Other countries	219	590
Loans to parent company, SFIL	France	800	800
Step 2 credit rating			
Bank bonds (maturity < 100 days)			
	France	285	45
	Other countries	122	50
Bank accounts balances	France and Other countries	3	4
TOTAL		2,801	3,175

4.2.3. Assets removed from the cover pool

Thanks to 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.

During the last three fiscal years, in the context of the regular tests of its operational procedures for accessing refinancing from the Banque de France or bank counterparties, Caisse Française de Financement Local has mobilized assets of very small unit amounts.

Caisse Française de Financement Local may also withdraw assets that it holds from the cover pool if they have become ineligible, pending their disposal or maturity.

4.2.4. Structured loans

4.2.4.1. Definition

Certain loans to French counterparties in Caisse Française de Financement Local's cover pool may be classified as structured loans. The Gissler charter, the code of conduct adopted by banking institutions and local government entities, which is available on the French Ministry of the Interior's website, defines structured loans as:

- all loans with structures classified in categories B to E;
- all "not in the charter" loans, i.e. that the charter prohibits from being marketed because of their structure (leverage > 5, etc.), their underlying index(es) (foreign exchange, etc.) or their currency (denominated in CHF, JPY, etc.).

4.2.4.2. Part of structured loans in the cover pool

EUR billions	Outstanding				Number of customers ⁽¹⁾		
	12/31/2018	03/31/2019	Change	% cover pool	12/31/2018	03/31/2019	Change
French public sector loans	44,3	44,4	0,1	76,9%	14 615	14 275	(340)
Vanilla loans	39,9	40,1	0,2	69,5%	13 168	12 849	(319)
Structured loans	4,4	4,3	(0,1)	7,4%	1 447	1 426	(21)

During the first quarter 2019, outstanding loans to the French local public sector increased by EUR 0.1 billion. Structured loans on Caisse Française de Financement Local's balance sheet amounted to EUR 4.3 billion, representing 7.4% of the cover pool.

4.2.4.3. Sensitive loans and reduction in loan sensitivity

The most structured loans according to the Gissler classification (categories 3E, 4E and 5E as well as "not in the charter" loans) may be classified as "sensitive". As of March 31, 2019, they now represent only EUR 1.0 billion (1.8% of the cover pool) compared with EUR 8.5 billion on SFIL's inception at the end of 2012, i.e. a fall of more than 88%. The number of customers holding sensitive loans fell over the same period from 879 to 196.

Given the transactions of reduction in loan sensitivity already signed, the sensitive structured loans outstanding will decrease to a maximum amount of EUR 0.9 billion by end 2019 and to EUR 0.5 billion for local communities only. On this same basis, sensitive loans with a rate exceeding 5% will amount by end 2019 to less than EUR 0.2 billion and concern 29 customers, i.e. 0.3% of the cover pool and 0.2% of French local public sector customers. The scope of sensitive structured loans is therefore extremely limited and the associated risk is no longer material for Caisse Française de Financement Local.

5. Debt benefiting from the legal privilege

As of March 31, 2019, 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	31/12/2018	3/31/2019
Cash collateral received	0.5	0.5
<i>Obligations foncières</i> and registered covered bonds	50.3	51.1
Total	50.8	51.6

5.1 – CHANGE IN CASH COLLATERAL

Cash collateral received by Caisse Française de Financement Local remains stable compared with the situation at the end of December 2018. Its level stood at EUR 0.5 billion at the end of March 2019.

5.2 – CHANGE IN ISSUES

Within the recurrent annual program of EUR 4 to 6 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. Meanwhile, as part of the implementation of the SFIL Group’s social and environmental policy and in order to diversify its sources of financing, CAFFIL issued its first thematic “social” bond issue in February 2019. This issue is the first step in the SFIL Group’s strategy to use of “social” and “green” bond issues.

5.2.1. New issues in 2019

Over the first quarter of 2019, Caisse Française de Financement Local raised EUR 2.9 billion through benchmark public issues, as well as tap issues, while at the same continuing to work on the private placements segment.

Caisse Française de Financement Local raised money in the public primary market two times, for a total amount of EUR 2.25 billion:

- a dual tranche issue (6 and 15 years) in January for a total amount of EUR 1.25 billion;
- first “social” bond issue (8 years) in February for an amount of EUR 1 billion.

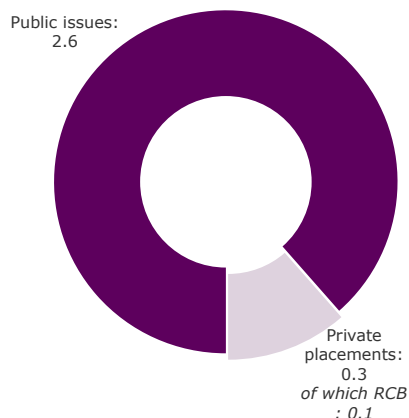
Caisse Française de Financement Local also provided additional liquidity on two of its reference issues via taps for a cumulative amount of EUR 0.3 billion.

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’ demand for long and very long maturities. Altogether, it raised EUR 0.3 billion in this market segment.

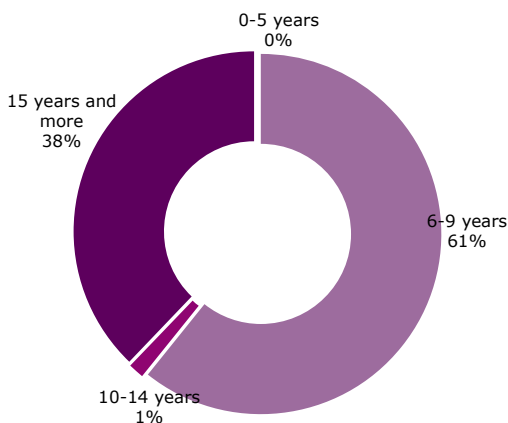
The weighted average life of the financing raised over the first quarter of 2019 was 10.8 years.

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.

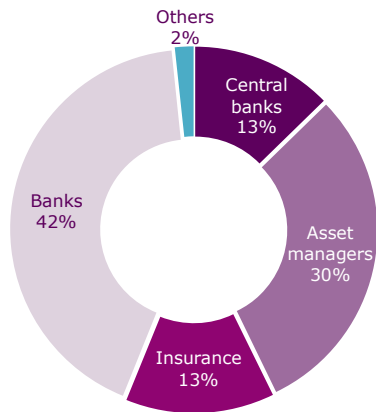
Breakdown of 2019 issues by format
EUR billions



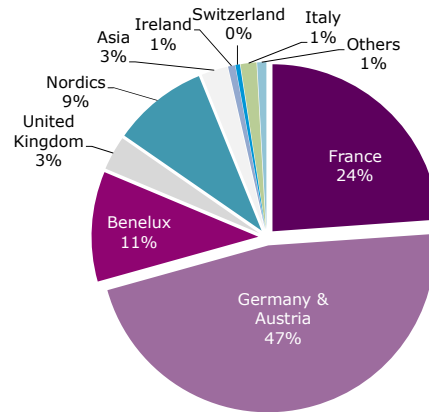
Breakdown of 2019 issues by maturity (%)



Breakdown of 2019 public issues by investor category (%)



Breakdown of 2019 public issues by geographic zone (%)



5.2.2. Outstanding debt at the end of March 2019

Outstanding *obligations foncières* and registered covered bonds totaled EUR 51.1 billion in swapped value at the end of March 2019. This includes new issues of *obligations foncières* for EUR 2.9 billion and amortization of issues maturing in the first quarter 2019 for EUR 2.1 billion.

EUR billions, value after currency swaps	2018	Q1 2019
BEGINNING OF THE PERIOD	49.0	50.3
Issues	4.9	2.9
Amortizations	(3.6)	(2.1)
Buyback	-	-
END OF THE PERIOD	50.3	51.1

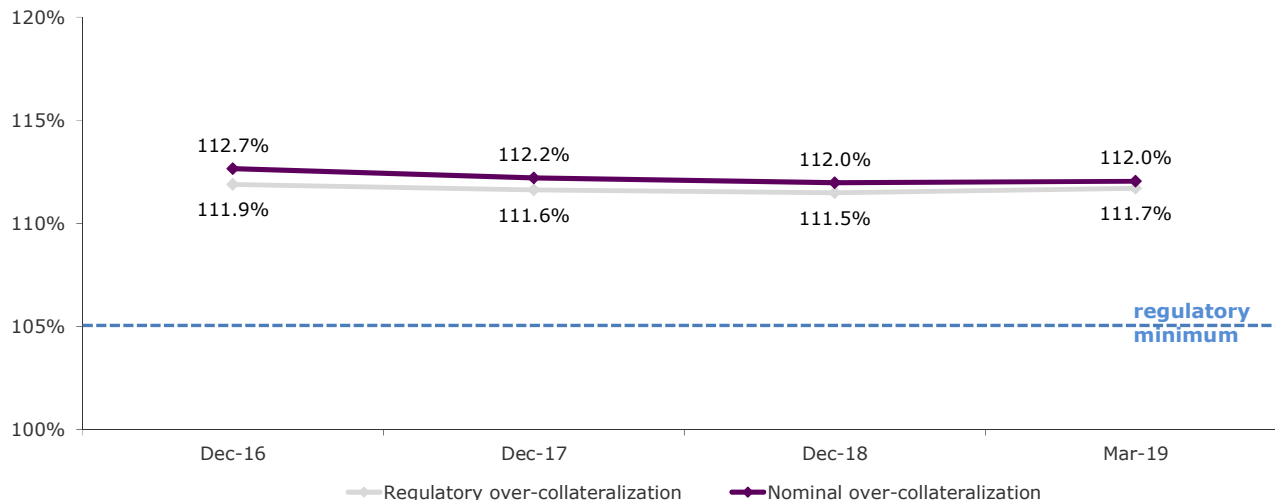
As of March 31, 2019, issues can be broken down by currency as follows:



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.

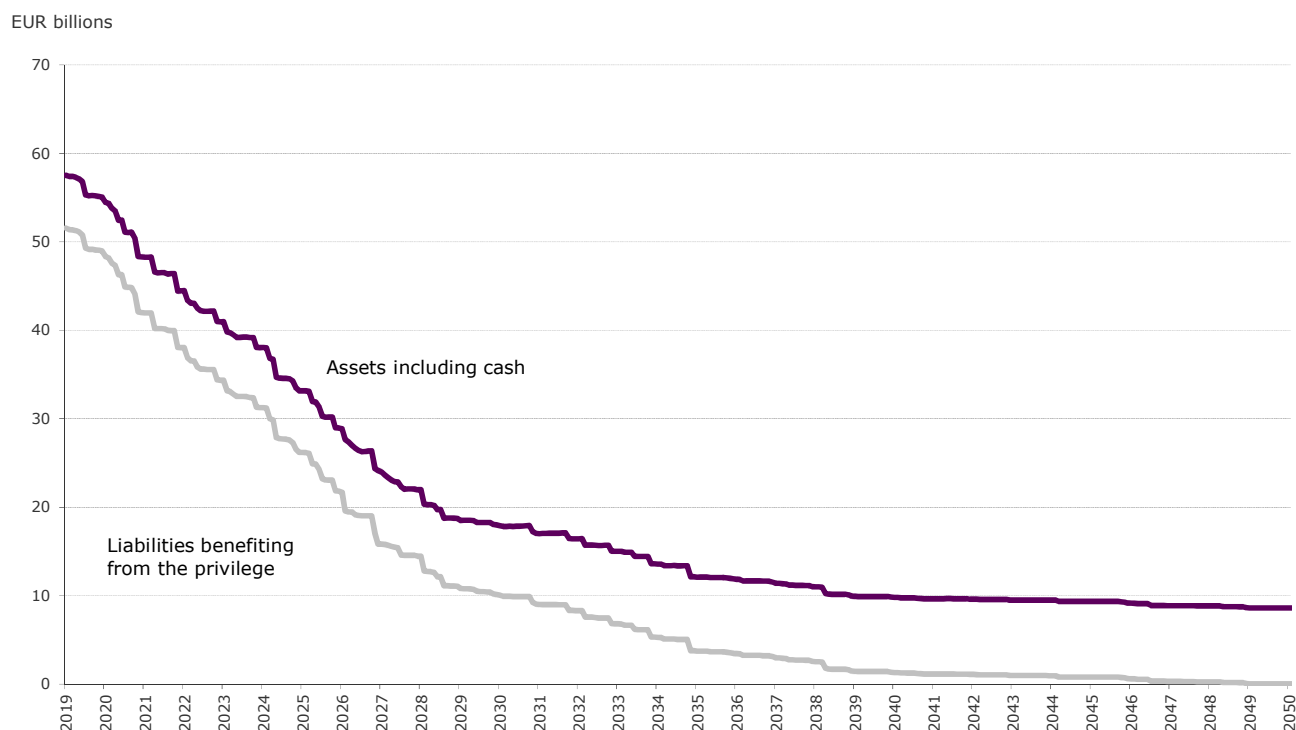


Regulatory over-collateralization may differ from nominal over-collateralization. In fact, it is calculated on the basis of the rules determined by the Autorité de contrôle prudentiel et de résolution (ACPR). In particular, these rules require different weighting levels according to the assets. The assets 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 liabilities benefiting from the privilege. The following graph presents the curves as of March 31, 2019.

Amortization of assets and liabilities as of March 31, 2019



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 2019, 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. Since the creation of SFIL, except when it used small sums to test the access procedure for such funding, Caisse Française de Financement Local has not contracted any loans from the Banque de France or 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	12/31/2018	3/31/2019
SFIL	4.9	5.2
Banque de France	-	-
TOTAL	4.9	5.2

8. Caisse Française de Financement Local's main risks

8.1 – CREDIT RISK

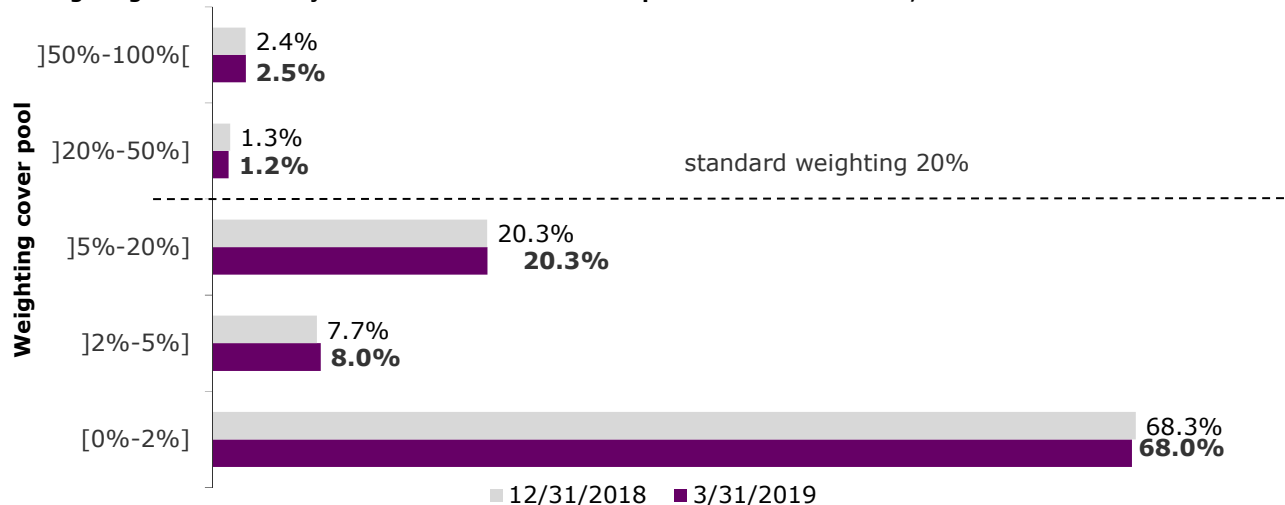
8.1.1. Definition

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.

8.1.2. Breakdown of exposures according to risk weighting

The quality of Caisse Française de Financement Local's portfolio is illustrated by the risk weighting assigned to its assets (Risk Weighted Assets) for the calculation of the bank's solvency ratio. This reflects the fact that for most of its assets SFIL has opted for the advanced method of calculating regulatory capital requirements. 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, 2019, 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, 2019



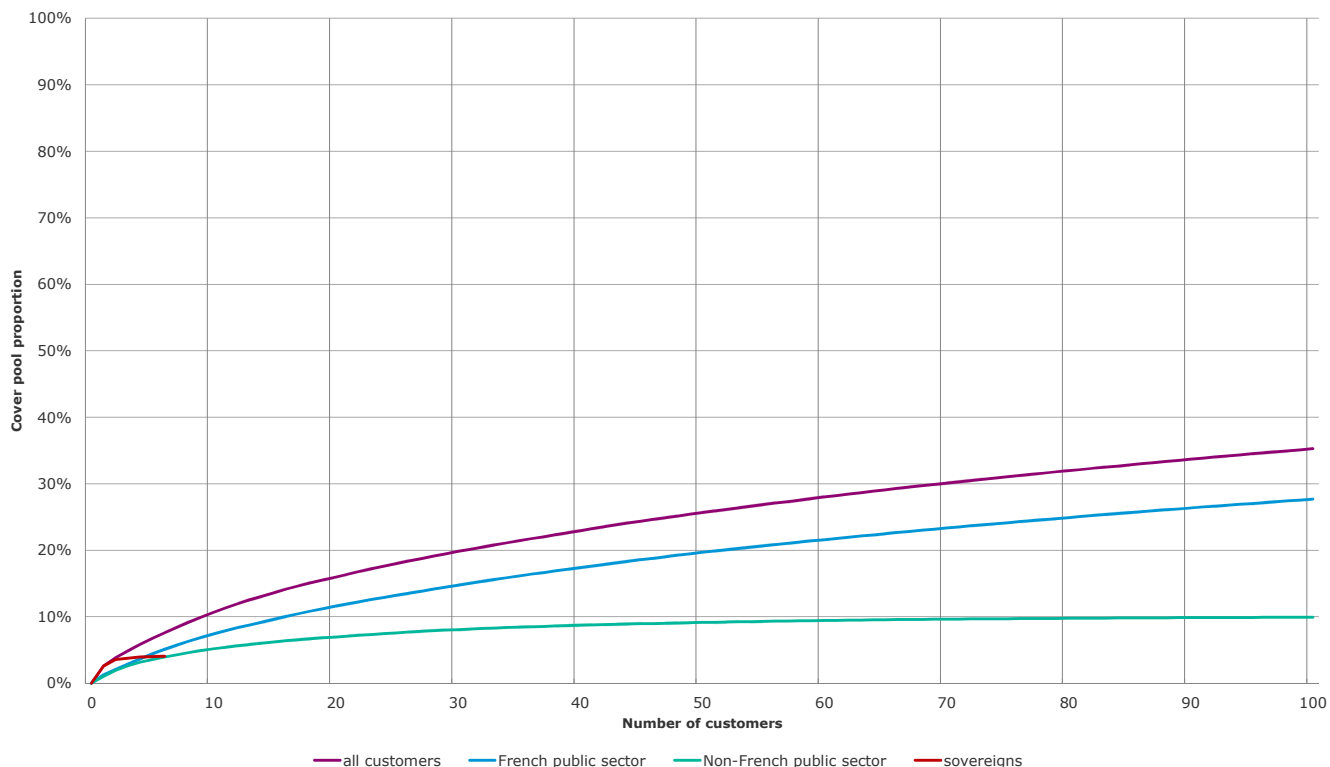
This analysis confirms the excellent quality of the assets in Caisse Française de Financement Local's portfolio:

- 76% of the portfolio has a weighting of 5% or less;
- the average risk weighting of the cover pool assets is 6.1%, versus 20% for European local governments according to the Basel II/III standard method;
- less than 4% of the portfolio has a weighting of more than 20%.

8.1.3. 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 chart below presents the concentration of cover pool by type of counterparty. It confirms the great diversity of Caisse Française de Financement Local's portfolio of assets.



As of March 31, 2019 the 20 largest exposures (excluding replacement assets and cash deposits in Central Bank), all categories combined, represented 16% of the cover pool. The biggest exposure represented 2.6% of the cover pool and the 20th 0.4%.

8.1.4. Non-performing loans, litigious loans, provisions

Caisse Française de Financement Local does not publish quarterly accounts, but only half-year and annual accounts. Therefore, information concerning Non-performing loans, litigious loans and provisions is not available in this activity report. Last updated information about these issues was disclosed in the management report of the annual financial report 2018 which is available on the website of the Company.

8.1.5. 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 two types of exposure to banks:

- replacement assets in the amount of EUR 3.2 billion (see 4.2.2.);
- 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 amended these contracts to take into account recent regulatory changes (signing of variation margin amendments). 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 (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 March 2019, Caisse Française de Financement Local was exposed (positive fair value of the swaps) on nine bank counterparties, all of these paid cash collateral of EUR 0.5 billion, offsetting total exposure.

All derivative exposures as of March 31, 2019, are listed below.

EUR billions	Short-term notional amounts	Long-term notional amounts	% of long-term notional amounts	Mark to Market		Collateral received	Number of counterparties
				-	+		
SFIL	-	15.3	19.4%	(1.3)	-	-	1
Other counterparties	33.4	63.5	80.6%	(2.4)	0.5	0.5	25
Total	33.4	78.8	100.0%	(3.6)	0.5	0.5	26

The swaps negotiated with external counterparties represented 81% of outstanding long-term swaps and those signed with SFIL 19%. The long-term swaps signed with the five largest counterparties represented a total of 44% of notional amounts.

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

8.2 – MARKET RISK

Market risk is defined as the potential risk of loss (through income statement or directly through other comprehensive income) resulting from fluctuations in the prices of financial instruments that make up a particular portfolio. If the transactions of a portfolio are entered into for trading purposes, regulatory market risk requires daily monitoring of risks and results indicators of that portfolio. Changes in the value of trading portfolios directly impact the income statement.

Caisse Française de Financement Local, as a *société de crédit foncier*, is not authorized to hold a trading or stocks investment portfolio and is therefore not exposed to regulatory market risk.

Caisse Française de Financement Local's banking book positions and activities that pose a risk to its accounting income and equity result from its exposure to market volatility, and are monitored under non-regulatory market risks. These are mainly market risks resulting from fluctuation of assets recognized at fair value through profit or loss and those recognized at fair value through other comprehensive income, or the provision for placement securities under French GAAP. These are also risks resulting from the export credit activity (monitoring of the value changes of the indicator specific to export credit and, for USD-denominated loans, the change in the valuation of currency swaps hedging this activity). Changes in accounting valuation adjustments on derivatives, such as credit valuation adjustments (CVA) and debit valuation adjustments (DVA) are also considered as non-regulatory market risks.

8.3 – ALM RISK

8.3.1. Liquidity risk

8.3.1.1. Definition and liquidity risk management

Liquidity risk is defined as the risk that the institution may not be able to find the necessary liquidity, on a timely basis and at a reasonable cost, to cover the financing needs related to its activity.

Liquidity risk management

Caisse Française de Financement Local's liquidity risk mainly reflects how able it is to reimburse certain debts benefiting from the legal privilege on a timely basis in the event of an excessive lag between the repayment of its assets and that of its debt benefiting from the legal privilege. It relates to the fact that SFIL is responsible for most of the funding requirement associated with the Caisse Française de Financement Local's over-collateralization⁽¹⁾.

Caisse Française de Financement Local has two main types of liquidity need:

- financing of the assets that cover the *obligations foncières* it issues;
- financing of the liquidity requirements related to compliance with regulatory ratios, specific *sociétés de crédit foncier* ratios and the rating agency methodologies used to meet a rating target.

The sources of financing used to meet these requirements, other than the entity's equity, are:

- debt benefiting from the legal privilege, i.e. *obligations foncières* and registered covered bonds and the cash collateral received by Caisse Française de Financement Local ;
- refinancing arising from the loan agreement entered into with SFIL to cover the financing requirements related to Caisse Française de Financement Local's over-collateralization.

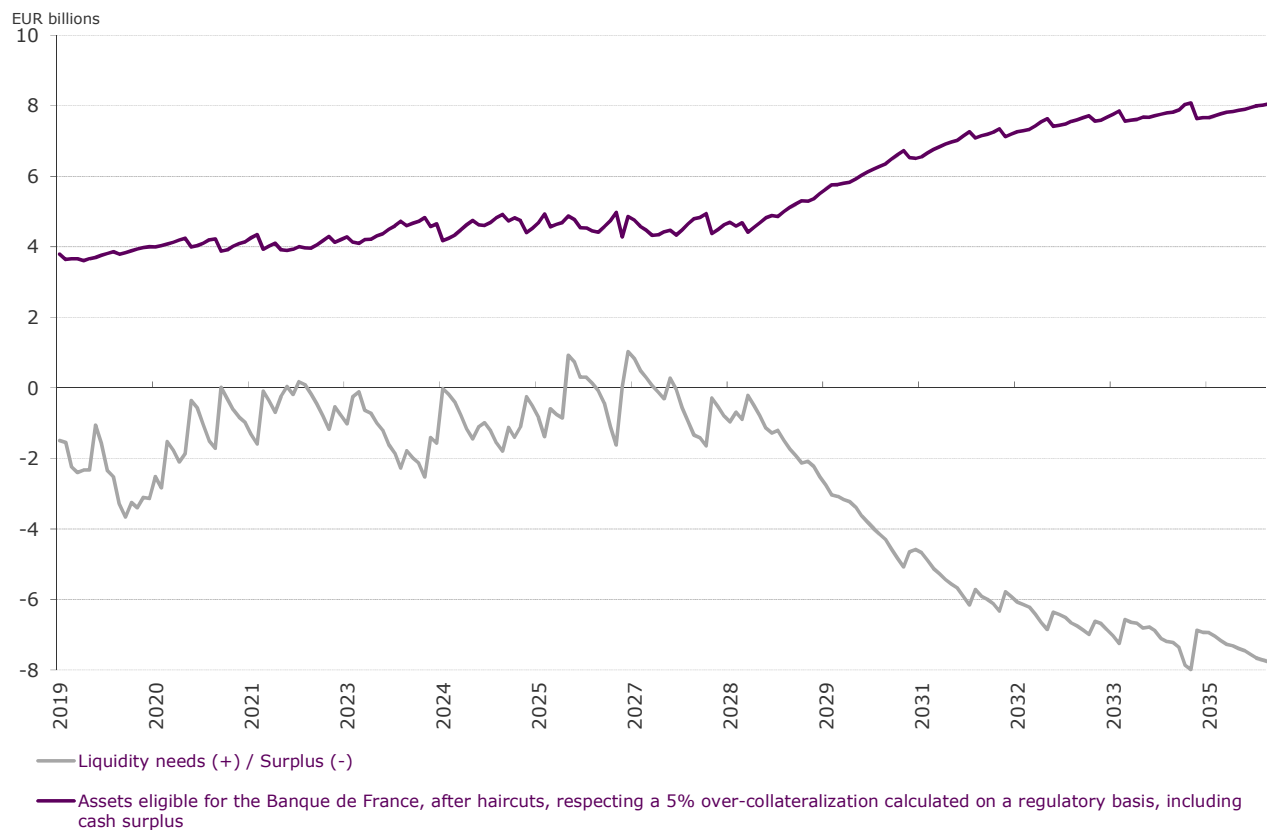
Furthermore, Caisse Française de Financement Local has a large stock of assets eligible for European Central Bank refinancing via the Banque de France. In addition to access to the central bank in its own name, Caisse Française de Financement Local can also mobilize certain of its assets by using interbank financing in the form of repurchase agreements. If necessary, these transactions would easily cover its cash flow requirements. There were no transactions of this type as of end-March 2019.

The aggregate maximum liquidity requirement that Caisse Française de Financement Local could face in the future in a run-off situation in which it was unable to issue new *obligations foncières* is lower than the maximum funding already occasionally obtained on a one-off basis from the central bank in the past. It is also lower than the Caisse Française de Financement Local's refinancing poten-

(1) A part of Caisse Française de Financement Local's over-collateralization is financed by its equity.

tial with the Banque de France, measured by the amount of eligible assets after haircut that would be available while complying with the minimum over-collateralization required by the regulations.

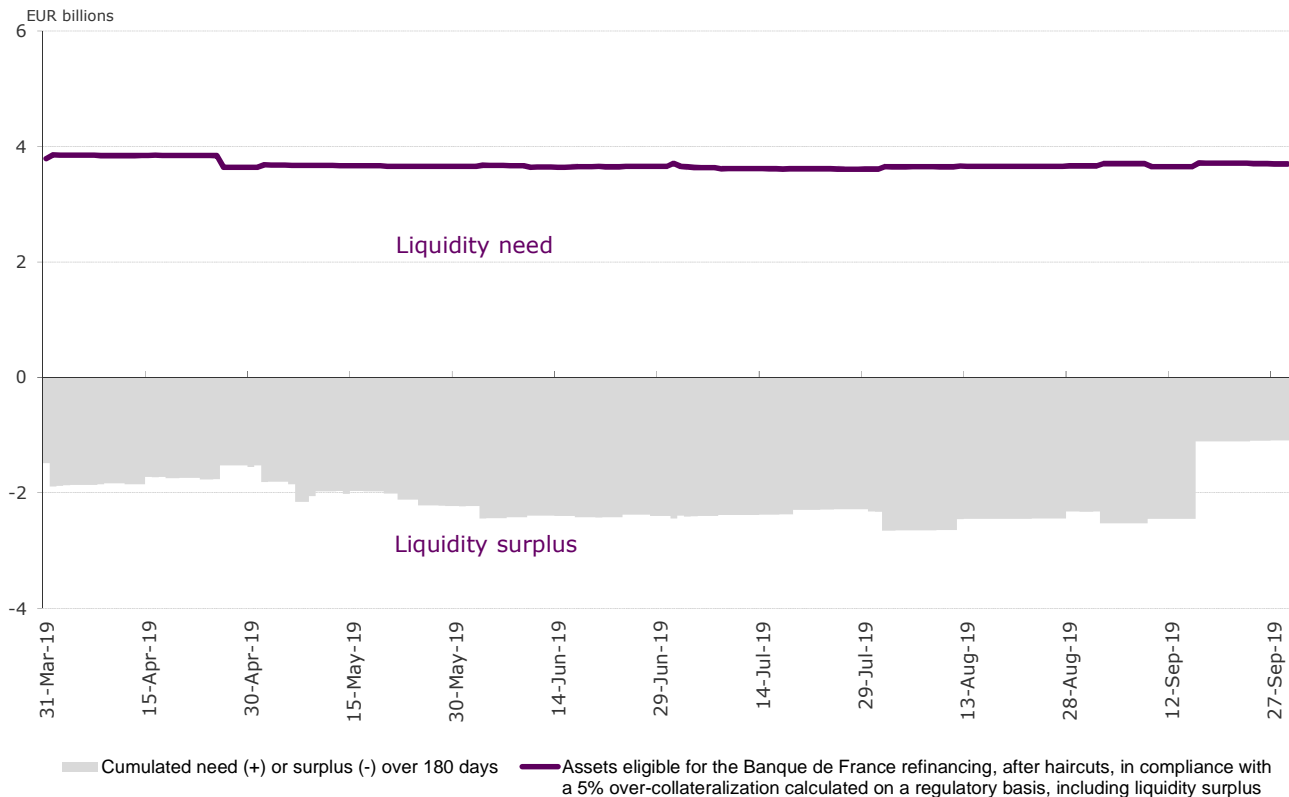
The chart below shows the forecast aggregate liquidity requirement and the assets needed to cover this requirement.



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).

Meanwhile, Caisse Française de Financement Local manages its liquidity risk using the following indicators:

- Regulatory indicators specific to *sociétés de crédit foncier (SCF)*:
 - the regulatory coverage ratio (or over-collateralization ratio): this represents the ratio between assets and debts benefiting from the legal privilege, and must be at least 105% (see section 6.);
 - the maximum gap of 1.5 years between the average maturity of debt benefiting from the legal privilege and that of assets eligible to make up the minimum amount necessary to meet the regulatory coverage ratio (see the specific section on transformation risk below).
 - forecast cash needs at 180 days: Caisse Française de Financement Local ensures that, at any times, its cash needs over a period of 180 days are covered by replacement assets and assets eligible for Banque de France's credit operations. Cash needs include repayments of *obligations foncières* and registered covered bonds, debt not benefiting from the legal privilege and forecast repayments of cash collateral received, after deduction of cash flows from amortization of assets. This forecast is published quarterly in the Asset Quality Report, and is shown below. At the end of March 2019, there was a liquidity surplus for the whole period.



- The regulatory liquidity indicators applicable to credit institutions, in particular the liquidity coverage ratio (LCR). As of 31 March, 2019, Caisse Française de Financement Local's LCR was 768%.
- Internal liquidity indicators:
 - the management coverage ratio (or over-collateralization ratio), which targets an over-collateralization level consistent with the Caisse Française de Financement Local's target rating (see section 6.);
 - the difference in duration between assets and debts benefiting from the legal privilege (limited to three years): this is published every quarter and came to -0.09 year as of March 31, 2019 (see the specific section on transformation risk below);
 - the one-year survival horizon in stressed conditions;
 - the sensitivity of the net present value of the static liquidity gap adjusted for regulatory constraints (compliance with the LCR and the over-collateralization ratio);
 - the consumption of the spread and EUR/USD basis risk appetite by the various maturities of refinancing loans for large export credits.

Lastly, dynamic liquidity forecasts (taking into account new assets and refinancing assumptions) are carried out regularly in normal and stressed conditions, aimed at:

- defining the amounts and maturities of the various sources of financing that could be raised;
- assessing the capacity of Caisse Française de Financement Local and the SFIL Group to withstand a liquidity shock.

8.3.1.2. Definition of the transformation risk contained in the specific components monitored in connection with liquidity risk

Transformation risk is part of liquidity risk. It corresponds to the differences in maturity between assets and the resources used to refinance them.

Caisse Française de Financement Local manages this risk using the following two indicators:

- Duration gap
- Weighted average life gap

Duration gap

The difference in maturity between assets and liabilities can lead to liquidity risk. As interest rate risk is controlled (see section 8.3.2.3.), Caisse Française de Financement Local ensures that asset and liability maturities match by keeping the difference in duration between assets and debts benefiting from the legal privilege to three years or less.

Given the method used to hedge interest rate risk (see section 8.3.2.2.), assets and debts benefiting from the legal privilege are all recognized at floating rates after swaps. Caisse Française de Financement Local's balance sheet thus appears to have a single loan opposite a single borrowing. Durations are calculated as follows: "sum of the periods, weighted by the cash flows and discounted at the zero coupon curve rate for the period (t), over the sum of cash flows discounted at the interest rate of the zero coupon curve for

the 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 duration gap observed in practice remains under the three-year limit, as shown in the table below.

Duration in years	3/31/2018	6/30/2018	9/30/2018	12/31/2018	3/31/2019
Cover pool	7.64	6.71	6.82	6.78	6.79
Privileged liabilities	6.67	6.73	6.72	6.52	6.88
Gap in asset-liability duration	0.97	-0.02	0.10	0.26	-0.09
Duration gap limit	3	3	3	3	3

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)	3/31/2018	6/30/2018	9/30/2018	12/31/2018	3/31/2019
Cover pool	8.17	7.24	7.35	7.27	7.15
Privileged liabilities	7.12	7.19	7.19	6.96	7.21
Gap in asset-liability weighted average life	1.05	0.05	0.16	0.31	-0.06

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.

8.3.2. Interest rate risk

8.3.2.1. Definition

Interest rate structural risk is defined as the risk of loss incurred in the event of a change in interest rates that would lead to a loss in value of balance sheet and off-balance sheet transactions, excluding any trading portfolio transactions. Since Caisse Française de Financement Local does not have a trading portfolio, it is not concerned by this exception.

There are three different types of interest rate risk:

- the fixed interest rate risk that results from the difference in volume and maturity between fixed rate assets and liabilities, or adjustable rate assets and liabilities for which the interest rate has subsequently been fixed. This risk can result in yield curve parallel shifts, steepening, flattening or rotation;
- the basis risk that results from the gap that may exist in the matching of assets and liabilities indexed on variable rates of different types or index tenors;
- the fixing risk that results, for each index, from the gap between the adjustment dates applied to all the variable rate balance sheet and off-balance sheet items linked to the same tenor.

These risks are generally hedged using derivatives.

8.3.2.2. Hedging strategy

To limit its impact, interest rate risk is hedged in two stages by Caisse Française de Financement Local:

- 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 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. The residual risk is managed using macro-hedges with a management horizon of one week.

These hedges can be entered into either directly on the market by Caisse Française de Financement Local, or through SFIL, which in turn hedges its resulting position in the market.

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 Eonia 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.

These different types of interest rate risk are monitored, analyzed and managed through the production of gaps (fixed rate, basis and fixing), and/or net present value (NPV) sensitivity indicators.

More specifically, the following indicators are produced in a static view:

- the fixed rate gap, which corresponds to the difference between balance sheet and off-balance sheet assets and liabilities for fixed rate transactions or transactions for which the rate has been fixed. This gap is calculated every month until balance sheet extinction;
- index gaps, which correspond to the difference between balance sheet and off-balance sheet assets and liabilities for a given index tenor that has not yet been fixed. This gap is calculated every month until balance sheet extinction;
- basis gaps, which result from the matching of two index gaps. There are therefore as many basis gaps as there are index pairs;
- the fixing gap, which corresponds, for a given tenor index, to the difference between adjustable rate balance sheet and off-balance sheet assets and liabilities, by fixing date.

8.3.2.3. Limits governing interest rate risk

The sensitivity of residual positions in fixed rates and variable rates fixed for a determined period of time that remain after the two levels of hedging is monitored on a monthly basis. Limits provide a framework for this sensitivity and are designed to reduce the impact on the value of balance sheet items in the event of a shift in the yield curve or a move in sloping/rotation. They are calibrated so as not to lose more than EUR 80 million with a quantile of 99% calculated based on ten years historical data.

The net present value (NPV) sensitivity indicators are calculated for a rate shock of 100 x +1 basis point (bp), aiming to limit losses in value in the event of:

- a parallel yield curve shift (limit of EUR 25 million for a shock of 100 x 1bp) to limit the fixed rate or directional rate risk;
- sloping/rotation of the interest rate curve:
 - net present value sensitivity calculation and limiting by time bucket, using four buckets of distinct risks on the yield curve in order to limit risk between distant points on the curve (limit per bucket of EUR 10 million for a shock of 100 x 1bp);
 - net present value sensitivity in terms of absolute value calculation and limiting by time bucket, using four buckets of distinct risks on the yield curve in order to limit risk between near points on the curve, within each bucket (limit per bucket of EUR 20 million for a shock of 100 x 1bp).

Limiting directional risk

The measurement of sensitivity at the end of each quarter is presented below.

Directional risk

Total sensitivity

EUR millions	Limit	3/31/2018	6/30/2018	9/30/2018	12/31/2018	3/31/2019
Sensitivity	(25)/25	(1,5)	1,7	(2,0)	0,9	(0,2)

Measurement of the slope/rotation risk

The quarter-end sensitivity measurements are presented below.

Risk of slope between two distant points on the rate curve

Sum of sensitivities

EUR millions	Limit	3/31/2018	6/30/2018	9/30/2018	12/31/2018	3/31/2019
Short term	(10)/10	(7,1)	(4,3)	(5,5)	(5,8)	(5,5)
Medium term	(10)/10	(2,1)	(1,0)	(4,9)	0,0	(3,5)
Long term	(10)/10	5,6	4,6	4,6	2,5	5,3
Very long term	(10)/10	2,0	2,4	3,8	4,3	3,6

Risk of slope between two close points on the rate curve

Sum of sensitivities in absolute value

EUR millions	Limit	3/31/2018	6/30/2018	9/30/2018	12/31/2018	3/31/2019
Short term	20	11,5	8,8	10,3	9,2	15,0
Medium term	20	4,6	14,4	9,9	10,0	9,8
Long term	20	7,9	8,7	13,0	12,9	8,9
Very long term	20	10,5	10,8	14,1	13,3	12,8

8.3.2.4. 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, 2019.

Breakdown of outstanding swaps EUR billions	Notional Absolute value
Euribor against Eonia	
Macro-hedges	33.4
TOTAL SHORT-TERM SWAPS	33.4
Fixed rate swaps against Euribor	
Micro-hedges on <i>obligations foncières</i>	40.5
Micro-hedges on loans and debt securities	20.6
Macro-hedges on loans	13.2
Subtotal	74.4
Currency swaps	
Micro-hedges on <i>obligations foncières</i>	1.3
Micro-hedges on loans	2.6
Micro-hedges on debt securities	0.5
Subtotal	4.4
TOTAL LONG-TERM SWAPS	78.8

8.3.3. Foreign exchange risk

8.3.3.1. Definition

The foreign exchange risk is defined as the risk of a loss, 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.

8.3.3.2. Hedging Strategy

Caisse Française de Financement Local 's foreign exchange risk management policy is to incur no foreign exchange risk: it enters into cross-currency swaps against the euro for its issues and assets denominated in foreign currency, on initial recognition at the latest and until their final maturity, thereby ensuring that these balance sheet items' principal and interest rates are fully hedged. Floating rate exposures generated by this management policy are incorporated into interest rate risk management. Nonetheless, certain loans to refinance large credit exports denominated in USD may cause a very limited risk of foreign exchange during their drawing phase. This residual risk is handled through the calculation of a very low sensitivity limit.

Foreign exchange risk is monitored using the net foreign exchange position in each currency, calculated on all foreign currency balance sheet receivables, commitments and accrued interest not yet due. The net foreign exchange position per currency must be zero, with the exception of US dollars, in which a marginal position is tolerated for operational reasons.

8.4 – OTHER RISKS

8.4.1. Operational risk

The *arrêté* of November 3, 2014, defines operational risk as follows: "In accordance with definition 52 of section 1 of Article 4 of the above-mentioned Regulation (EU) No. 575/2013, the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, and includes legal risk. Operational risk includes, in particular, risks related to events of low probability of occurrence but with a high impact, the internal and external fraud risks defined in Article 324 of the above-mentioned Regulation (EU) No. 575/2013, and model risks."

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 9.2.4. of the Management Report of the Annual Financial Report 2018.

8.4.2. Legal and tax risks

8.4.2.1. Definition

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.

8.4.2.2. Legal risk

As regards litigation, there were 18 borrowers with disputed structured loans as of March 31, 2019 (18 as of December 31, 2018, 25 as of December 31, 2017, and 39 as of December 31, 2016). Since SFIL's creation, 205 borrowers have dropped their claims against the Group. A highlight of 2018 was a Court of Cassation ruling on March 28 confirming the validity of the structured loans recorded on Caisse Française de Financement Local's balance sheet. Thus, since the entry into force on July 30, 2014, of the law on securing of structured loan contract concluded by public sector entities, 40 court decisions have confirmed the validity of such contracts (27 Court of First Instance, 11 Appeal Court and 2 Court of Cassation judgments). However, two court decisions were unsatisfactory for Caisse Française de Financement Local, being noted that these decisions related to proceedings that are still ongoing.

As of March 31, 2019, to the best of Caisse Française de Financement Local knowledge, there were no other government, legal or arbitration proceedings against it that could have a material impact on its financial position.

8.4.2.3. Fiscal risk

For the record, in 2015, French tax authorities undertook a tax audit about the corporate income 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 safeguard its rights to the disputed adjustment, in 2017 the tax authority initiated a tax audit relating to the consequences of its previous assessment of taxable income for the 2014 to 2016 fiscal years. The two points of disagreement resulting from the former tax audit (FY 2012 and 2013) still held. Caisse Française de Financement Local had set aside a tax provision to cover the eventuality of an unfavorable outcome. However, since 2016 Caisse Française de Financement Local has contested the tax authority's position on the results of the former branch in Ireland, presenting its case within the legal recourse framework provided for under current laws and regulations.

As of the end of 2018, the tax authority had levied adjustments relating to the 2012 and 2013 tax audit. It nevertheless reduced the amount of the adjustment relating to the add-back of the results of the former branch in Ireland, but maintained the principle of taxation of these results in France. Caisse Française de Financement Local settled this adjustment and reversed the relevant provisions. It kept in its accounts the amount of the provision set aside in respect of sums not yet paid.

8.4.3. Risks of non-compliance

Article 10-p of the *arrêté* of November 3, 2014 on the internal control of banks defines non-compliance risk as « the risk of judicial, administrative or disciplinary sanction, of significant financial loss or loss of reputation resulting from failure to comply with the prevailing laws and regulations and professional and ethical standards relating to banking and financial activities or with instructions from the executive body issued in particular pursuant to directives from the decision-making body ».

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 non-compliance risks are described in the section 9.2.6. of the Management Report of the Annual Financial Report 2018.

9. Outlook for 2019

In 2019, Caisse Française de Financement Local and its parent company SFIL will aim to maintain their position as the recognized leader for their two activities entrusted by the French State:

- financing loans to French local government entities and public hospitals, within the framework of the system established with La Banque Postale;
- supporting French exporters by refinancing large export credits guaranteed by the State.

To cover its financing requirements, in 2019 Caisse Française de Financement Local plans to issue between EUR 4 billion and EUR 6 billion of *obligations foncières* with a long-dated average maturity, adapted to the profile of the assets financed. It will carry out this program mainly through a number of benchmark issues in euros and private placements adapted to the needs of its broad investor base. Meanwhile, as part of the implementation of the SFIL Group's social and environmental policy, following the successful of the first social bond issuance executed in February 2019 and in order to diversify its sources of financing, CAFFIL plans to continue its work in order to issue a "green" thematic bond in the near future. SFIL group plans to be regular issuer of "green" and "social" thematic bonds in the future in order to refinance public sector assets.

Meanwhile, from a macroeconomic point of view, as in 2018, the Group will closely monitor two important contextual elements in 2019:

- developments in the regulatory environment and, in particular, the project to harmonize the national covered bond framework at European level and its transposition into national law;
- the degree of market volatility in an environment influenced by the winding down of quantitative easing initiated by the European Central Bank, Brexit-related measures and the geopolitical environment.

Lastly, the assessment of the project transfer to CDC of the control of SFIL, Caisse Française de Financement Local's parent company, announced by the State and CDC on November 15, 2018, will continue in 2019 and is expected to be completed at the same time as the changes to the shareholding structure of La Poste and CNP Assurances.

SFIL's shareholder base will remain - as today - fully public. Its shareholders will ensure that SFIL's financial solidity is preserved

and its economic base protected, and will continue to provide it with the necessary support, in accordance with the applicable regulations.

Breakdown of cover pool as of March 31, 2019

EUR millions	3/31/2019				Total	12/31/2018 Total
	Direct exposure		Indirect exposure			
COUNTRY	Loans	Bonds	Loans	Bonds		
France						
State:						
- export refinancing	-	-	1 495	-	1 495	1 101
- others	5	-	-	-	5	120
Banque de France	1 517	-	-	-	1 517	1 271
Regions	1 874	199	252	-	2 325	2 410
Departments	6 839	55	170	-	7 064	6 980
Municipalities	15 067	36	356	-	15 459	15 513
Groups of municipalities	11 610	76	128	-	11 814	11 647
Public sector entities:						
- health	6 143	28	-	-	6 171	6 162
- social housing	1 138	-	-	-	1 138	1 164
- others	835	154	1	-	990	1 006
Credit institutions	804	1 005	-	-	1 809	1 783
Subtotal	45 832	1 553	2 402		49 787	49 157
Germany						
Länder	-	275	-	-	275	275
Subtotal	-	275	-	-	275	275
Austria						
Länder	-	-	181	-	181	183
Subtotal	-	-	181	-	181	183
Belgium						
Regions	4	-	15	-	19	19
Public sector entities	46	-	-	-	46	49
Credit institutions	-	174	-	-	174	176
Subtotal	50	174	15	-	239	244
Canada						
Communities	100	-	-	-	100	100
Public sector entities	35	-	-	-	35	35
Credit institutions	-	96	-	-	96	96
Subtotal	135	96	-	-	231	231
Denmark						
Credit institutions	-	91	-	-	91	91
Subtotal	-	91	-	-	91	91
Spain						
State	-	100	-	-	100	125
Regions	-	50	-	-	50	50
Municipalities	73	-	-	-	73	73
Credit institutions	-	-	-	-	-	-
Subtotal	73	150	-	-	223	248

EUR millions	3/31/2019				12/31/2017	
	Direct exposure		Indirect exposure		Total	Total
	Loans	Bonds	Loans	Bonds		
COUNTRY						
United States						
Federated States	-	253	-	-	253	253
Subtotal	-	253	-	-	253	253
Italy						
State	-	530	-	-	530	535
Regions	-	1 910	-	-	1 910	1 912
Provinces	-	474	-	-	474	479
Municipalities	7	1 708	-	-	1 715	1 733
Subtotal	7	4 622	-	-	4 629	4 659
Japan						
Municipalities	-	25	-	-	25	25
Subtotal	-	25	-	-	25	25
Norway						
Credit institutions	-	222	-	-	222	222
Subtotal	-	222	-	-	222	222
Netherlands						
Credit institutions	-	242	-	-	242	95
Subtotal	-	242	-	-	242	95
Portugal						
State	-	10	-	-	10	10
Municipalities	14	-	-	-	14	14
Public sector entities	3	-	-	-	3	4
Subtotal	17	10	-	-	27	28
United Kingdom						
State	-	-	-	114	114	138
Credit institutions	-	154	-	-	154	216
Subtotal	-	154	-	114	268	354
Sweden						
Municipalities	18	-	-	-	18	18
Credit institutions	-	387	-	-	387	122
Subtotal	18	387	-	-	405	140
Switzerland						
Cantons	257	-	6	-	263	263
Municipalities	326	-	-	-	326	335
Public sector entities	60	-	-	-	60	60
Subtotal	643	-	6	-	649	658
Supranational						
International organizations	22	-	-	-	22	24
Subtotal	22	-	-	-	22	24
TOTAL COVER POOL	46 797	8 254	2 604	114	57 769	56 887

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.