



CAFFIL

Activity Report

for the period from January 1st to September 30, 2018

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 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 (see 1.3.1.).

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 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 and to comply with regulatory requirements, if so required.

On the 15th of November 2018, the French State announced that it enter into discussions with CDC regarding the transfer of control of SFIL to CDC. This announcement took place in relation with the creation of a major public financial unit with CDC and LBP as principle actors. Shareholding of SFIL would remain wholly public. This modification would be effective within the same timing than changes concerning shareholding of La Poste and CNP Assurances.

1.3 – ECONOMIC MODEL OF CAISSE FRANÇAISE DE FINANCEMENT LOCAL

1.3.1. 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*.

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 23 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 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 should be close to 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).

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 of, on behalf of, and under the control of the French State, pursuant to article L.432.2 of the Insurance Code. So the guarantee is directly granted by the French State demonstrating its support to export companies. These guarantees aim to encourage, support and secure French exports financed at medium and long term as well as French investments overseas:

- 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 ensures management of the guarantees in strict compliance with international rules of WTO, European Union and 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:

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

- 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.

The funds required to finance the activity of Caisse Française de Financement Local (financing of over-collateralization and inter-mediated derivatives) are obtained by SFIL on financial markets by issuing short-term debt (certificates of deposit) or long-term debt (bonds), in order to diversify its financing sources. In the French State Agencies segment, since 2016 SFIL gradually set up its signature by launching EMTN benchmark issues in EUR and USD.

In addition, SFIL may finance these needs in the framework of credit agreements signed with its shareholders:

- Caisse des dépôts et consignations (CDC) for the needs linked to operations booked prior to the date of acquisition of SFIL (January 31, 2013) and to the new export refinancing activity;
 - La Banque Postale (LBP) for the needs related to loans to French local public sector and public hospitals that it originates.
- Since 2016, refinancings brought by shareholders have been substituted by financings obtained through SFIL on financial markets. Nevertheless, shareholders' refinancings continue to be available if necessary in particular in the event of a need for liquidity during a stress context.

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 2017 – 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 September 2018, 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

At the end of September 2018, the issuance program of Caisse Française de Financement Local is rated by four international rating agencies – Moody's, Standard & Poor's, DBRS and Fitch.

In addition, SFIL and Caisse Française de Financement Local decided to no longer request a rating from Fitch beyond the end of 2018. As a result, from 2019 onwards, the rating agencies retained by Caisse Française de Financement Local for its issuance activity will be Moody's, Standard & Poor's and DBRS.

The ratings of the covered bonds issued by Caisse Française de Financement Local are at the highest level of credit quality (Step 1) for all the rating agencies. This requires that the quality of the cover pool and strict management rules be consistent with the criteria and approaches of the four 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, DBRS 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 to SFIL 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.

It should be noted that the uplift of covered bonds' rating is limited by S&P to one notch above the rating of SFIL and consequently to one notch above the rating of the French State, by reason of the non-conformity of certain derivative contracts with the agency's methodological criteria (counterparties not rated by S&P or absence of a replacement clause).

Lastly, the *obligations foncières* issued by Caisse Française de Financement Local benefit from a Prime rating by the extra-financial rating agency ISS-oekom and a positive-BBB rating by the extra-financial rating agency IMUG based on the Company's performance in terms of social and environmental responsibility.

2. Highlights of the nine first months of 2018

2.1 – THE COVERED BOND MARKET

At the end of September 2018, primary market issuance of benchmark euro-denominated covered bonds reached EUR 118 billion, i.e. an increase of 24% compared with the end of September 2017. At the same time, EUR 69 billion were reimbursed leading the net offer to a positive amount of EUR 49 billion. French and German issuers were the most active on this market with respectively 21% and 19% of new issuances raised at the end of September.

During the third quarter of 2018, primary market issuance of benchmark euro-denominated covered bonds was very high, with EUR 29 billion raised compared with EUR 16 billion in the third quarter of 2017. Covered bonds spreads against sovereign remained stable, in particular for French covered bonds. This allowed simultaneously to maintain an active presence of investors and to contain spreads widening caused by a gradual reduction in the European Central Bank's purchases as it tightened its monetary policy.

During the third quarter, Caisse Française de Financement Local did not launch new public euro-denominated covered bonds issue but remained active in the private placement segment with EUR 0.1 billion of new issuance, especially on long maturities of 20 and 30 years. The average maturity of Caisse Française de Financement Local's issues since the beginning of 2018 is more than twelve years.

2.2 – HARMONISATION OF THE EUROPEAN LEGAL FRAMEWORKS FOR COVERED BONDS

As part of the efforts to harmonize the legal frameworks in Europe for covered bonds and following publication of the European Banking Authority's recommendations on December 20, 2016, the European Commission published a draft text (directive and amendment of Article 129 of the Capital Requirements Regulation - CRR) on March 12, 2018:

- The main aims of the draft directive are to define covered bonds, list this instrument's specific structural characteristics and detail the regulator's related supervisory arrangements.
- The draft amendment to CRR Article 129 defines the types of assets eligible for the cover pool as well as the minimum level of overcollateralization. These two combined elements enable covered bonds investors to benefit from a preferential weighting for solvency calculations using the standardized method.

Since the publication of the European Commission's draft texts, the work of the European Council and the European Parliament has started and continues in accordance with the adopted schedule: a vote by these two bodies is expected by the end of 2018 or in early 2019. The implementation objective is set within maximum 2 years.

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 these draft texts.

2.3 – INTERNATIONAL CONTEXT

The nine first month of 2018 were marked by the following three major international events:

- continued Brexit negotiations between the European Union and the United Kingdom;
- general elections in Italy leading to the formation of a coalition government;
- tensions relating to the increase in customs duties on certain goods between the United States and China initially, and then between the United States and the European Union.

These three events increased financial market volatility but did not significantly affect the covered bond market or Caisse Française de Financement Local's issuance capacity.

2.4 – FIRST-TIME APPLICATION OF IFRS 9

IFRS 9 came into force on January 1, 2018. It includes three main components: the classification and measurement of financial instruments, the provisioning of loans, securities and financing commitments, and hedge accounting, for which Caisse Française de Financement Local has chosen to continue to apply IAS 39 pending the entry into force of the future macro-hedging standard.

The first-time application of IFRS 9 had a limited impact on Caisse Française de Financement Local's equity. Accordingly, as of January 1, income of EUR 77 million before corporate income tax (EUR 50 million after tax) was recognized in equity, which led, all other things being equal and after prudential adjustments, to an 126-basis point increase in the fully loaded CET1 ratio. Most of this impact relates to the classification and measurement component, which represented income before corporate income tax of EUR 86 million, while the provisioning component represented a charge before corporate income tax of EUR 9 million. In addition, Caisse Française de Financement Local decided not to use the option of spreading over time the impact on prudential capital associated with the standard's first-time application and relating to the provisioning component.

Lastly, this first-time application of IFRS 9 also impacts future results, due in particular to the change in the value of assets now recognized at fair value through profit or loss (non-SPPI assets). This standard therefore increases net banking income volatility in a way unrelated to Caisse Française de Financement Local's activity, as its business model involves holding all loans until their contractual maturity. This impact is isolated in order to restate it in the analyses of the Company's performance.

2.5 – RATING OF OBLIGATIONS FONCIÈRES

On the September 10 of 2018, DBRS assigned a AAA to covered bonds issued by Caisse Française de Financement Local. During 2018, SFIL and Caisse Française de Financement Local examined their situation with respect to credit ratings and decided to man-

date the international credit rating agency DBRS to complement the ratings provided by Moody's and Standard & Poor's. In addition, SFIL and Caisse Française de Financement Local decided to no longer request a rating from Fitch beyond the end of 2018. As a result, from 2019 onwards, the rating agencies retained by SFIL Group for its issuance activity will be Moody's, Standard & Poor's and DBRS.

The ratings of the *obligations foncières* issued by Caisse Française de Financement Local were not altered over the nine first months of 2018 for the three historical rating agencies (Moody's, Standard & Poor's and Fitch).

So, As of September 30, 2018, the ratings were as follows: Aaa by Moody's, AA+ by Standard and Poor's AAA by DBRS, and AA by Fitch. The outlook associated with each of these ratings is stable.

2.6 – 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.

In this context, over the nine first months of 2018, Caisse Française de Financement Local acquired a total of EUR 2.6 billion in loans (EUR 2.9 billion over the same period in 2017). Since the beginning of the partnership, loans acquired through LBP have accounted for almost EUR 14.8 billion.

2.7 – 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.

Over the nine first months of 2018, Caisse Française de Financement Local granted SFIL two new refinancing loans for a total amount of EUR 1.7 billion (EUR 2.6 billion over the same period in 2017).

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 5.0 billion. As of September 30, 2018, the outstanding amount of these loans recorded in Caisse Française de Financement Local's balance sheet was EUR 0.7 billion. Indeed, it is reminded to the reader that the drawing of refinancing large export credits loans is staggered over a number of years.

3. Changes in main balance sheet items

EUR billions	12/31/2016	12/31/2017	9/30/2018	Change 2018 / 2017
value after currency swaps				
Cover pool	58.2	55.8	56.4	1.2%
Loans	47.0	46.9	47.3	0.9%
Securities	7.5	7.2	8.0	12.4%
Cash deposit in central bank	3.7	1.7	1.1	(38.3)%
Assets removed from the cover pool	-	-	0.0	ns
Privileged debt	51.7	49.7	50.4	1.4%
Obligations foncières ⁽¹⁾	50.4	49.0	50.0	1.9%
Cash collateral received	1.3	0.7	0.4	(38.4)%
Non-privileged debt	5.2	4.8	5.0	2.9%
SFIL	5.2	4.8	5.0	2.9%
Equity IFRS (excluding unrealized gains and losses)	1.4	1.5	1.4	(2.7)%

The size of Caisse Française de Financement Local's balance sheet has increased by approximately 1.2% over the nine first months of 2018.

Cover pool excluding accrued interest not yet due thus amounted to EUR 56.4 billion as of September 30, 2018 (increasing compared with December 31, 2017). It 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, invested in bank or European public sector securities or lent to SFIL, the parent Company of Caisse Française de Financement Local. The cash surplus, placed with the Banque de France, represents EUR 1.1 billion at the end of September 2018, versus EUR 1.7 billion at the end of December 2017. The cash surplus invested in securities or lent to SFIL represents a total of EUR 3.1 billion as of September 30, 2018 versus EUR 1.6 billion at the end of December 2017.

As of September 30, 2018, 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 50.4 billion, increasing in comparison with December 2017.

As of September 30, 2018, the debt contracted with the parent company totaled EUR 5.0 billion and does not benefit from the legal privilege. It mainly corresponds to the financing of the over-collateralization of the cover pool which is at a significantly higher level than the amount required by regulators and the rating agencies.

4. Cover pool

4.1 – CHANGE IN ASSETS IN 2018

The cover pool over the first nine months of 2018 increased by EUR 0.6 billion compared to December 31, 2017. This change is explained by the following items.

EUR billions	nine first months of 2018
1- Acquisition of loans from La Banque Postale	2.6
Loans to the French public sector (vanilla loans in euros)	2.6
2- Export credits drawings	0.5
Loans to SFIL to refinance export credit guaranteed by the French State	0.5
3- Reduction of loan sensitivity	0.1
Sensitive structured loans eliminated	(0.2)
Refinancing loans (vanilla loans in euros)	0.2
New loans (vanilla loans in euros)	0.1
4- Amortization of portfolio of loans and securities	(3.4)
5- Early reimbursements	(0.1)
6- Changes in treasury	0.9
Net change in securities investments	1.5
Net change in Banque de France cash deposit	(0.6)
7- Other changes	(0.0)
Net change in the cover pool	0.6

Over the nine first months of 2018, Caisse Française de Financement Local acquired a total of EUR 2.6 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 nine first months of 2018 in the amount of EUR 0.5 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 over the nine first months of 2018 made it possible to decrease outstanding loans considered as sensitive by EUR 0.2 billion through their replacement with fixed rate loans. They were accompanied by new fixed rate loans in the amount of EUR 0.1 billion.

The natural amortization of the portfolio of loans and securities represented EUR 3.4 billion in the nine first months of 2018.

Available cash increased by EUR 0.9 billion (for pre-financing activity). It is deposited at the Banque de France, invested in bank bonds classified as replacement assets, invested in European public sector bonds or lent to SFIL.

There were no divestments over the first nine months of 2018.

4.2 – COVER POOL COMPOSITION

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	12/31/2017	9/30/2018
Loans and bonds to the public sector	53,2	53,2
<i>of which local public sector business line</i>	52,2	51,5
<i>of which large export credits refinancing business line ⁽¹⁾</i>	0,2	0,7
<i>of which treasury investment in public sector bonds ⁽³⁾</i>	0,7	1,0
Banque de France cash deposit ⁽³⁾	1,7	1,1
Replacement assets ⁽³⁾	0,9	2,1
COVER POOL	55,8	56,4
Financing commitments granted to refinance large export credits ⁽¹⁾⁽²⁾	3,0	4,3
Financing commitments granted to other public sector loans	0,1	0,0
FINANCING COMMITMENTS GRANTED	3,1	4,3

(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 2017 and 2018, commitments granted represented concluded contracts in drawing phase.

(3) The total amount of excess treasury (cash or cash investments) increased from EUR 3.3 billion to EUR 4.2 billion over the nine first months of 2018.

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 securities or in replacements assets (securities issued by banks or loans to SFIL, its parent company). These cash or cash equivalent are detailed in the above table (see note 3).

The amount of financing commitments given came to EUR 4.3 billion as of September 30, 2018. They represented 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.

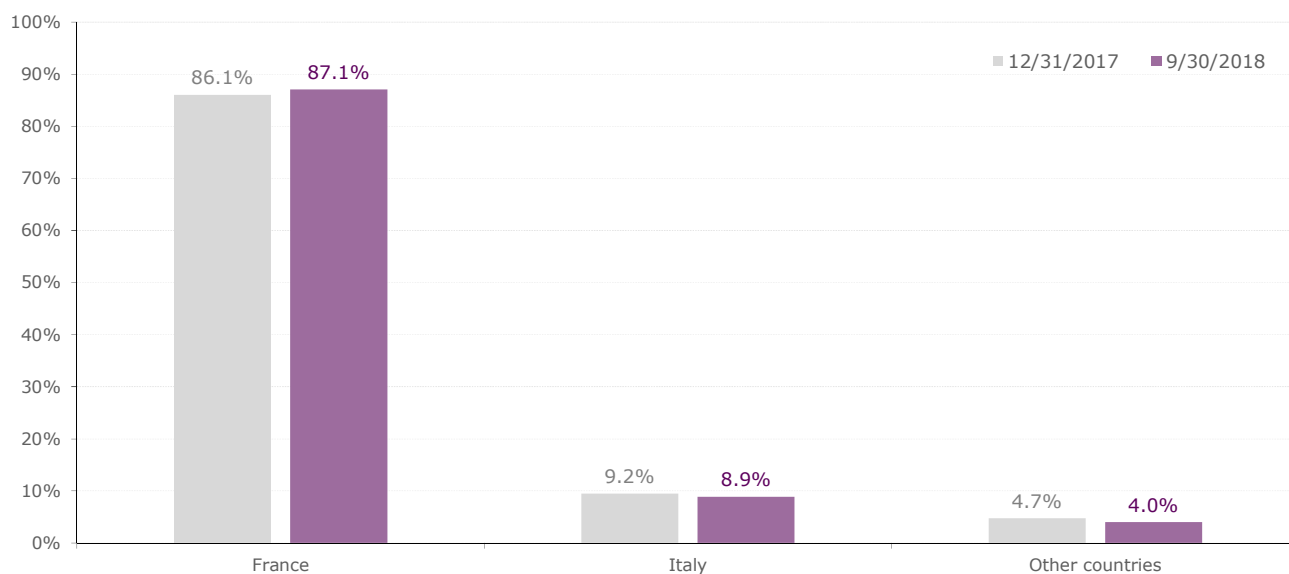
4.2.1. Public sector loans and securities (excluding replacement assets and treasury placed with the Banque de France)

4.2.1.1. Geographic breakdown

At the end of September 2018, French public sector loans and bonds made up the majority (87.1%) of the cover pool, a share due to increase in the future. They include loans acquired from La Banque Postale since 2013 for 23% (EUR 12.5 billion) and State-guaranteed loans granted to SFIL to refinance large export credits for 1.3% (EUR 0.7 billion).

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.



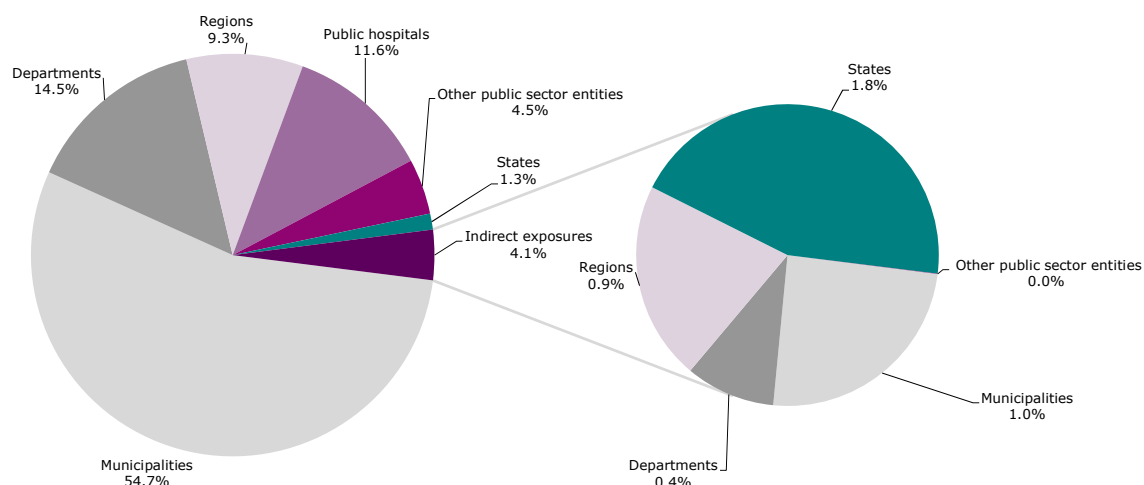
As of September 30, 2018, Italian assets represented the biggest share of non-French run-off managed loans with a total volume of EUR 4.7 billion, or 8.9% of the cover pool (excluding replacement assets and Banque de France cash deposits). These assets are granular exposures (more than 200 counterparties, consisting mainly of regional and local government authorities) distributed throughout Italy.

Exposures to Other countries as of September 30, 2018, are broken down by country in the section "Breakdown of cover pool", which is presented at the end of this activity report.

4.2.1.2. 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 public social housing).



Indirect exposures are composed of exposures guaranteed by public sector entities. Large export credits refinancing exposures are listed in the category of indirect exposures guaranteed by States. Their share will increase in the future, considering that drawing phase of these loans is staggered over a number of years.

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 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 September 30, 2018, replacement assets represented 4.1% 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	12/31/2017	9/30/2018
EUR millions			
Step 1 credit rating			
Covered bonds			
	France	176	155
	Other countries	127	458
Other bank bonds			
	France	148	183
	Other countries	100	160
Loans to parent company, SFIL	France	360	800
Step 2 credit rating			
Bank bonds (maturity < 100 days)			
	France	-	145
	Other countries	-	150
Bank accounts balances	France and Other cou	10	5
TOTAL		921	2,056

4.2.3. 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.

During the last 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.

Some assets held by Caisse Française de Financement Local may also be removed from the cover pool if they become non-eligible, before being sold or matured.

4.2.4. Structured loans

4.2.4.1. Definition

Certain loans to French public sector entities in the cover pool of Caisse Française de Financement Local may be qualified as structured loans. Structured loans, according to the charter of good practices, which can be consulted on the Internet site of the French Ministry of the Interior and signed by several organizations that represent local governments in France, 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.).

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.

4.2.4.2. Part of structured loans in the cover pool

EUR billions	Outstanding				Number of customers ⁽¹⁾		
	12/31/2017	09/30/2018	Change	% cover pool	12/31/2017	09/30/2018	Change
French public sector loans	45.0	45.3	0.3	80.2%	15,366	14,731	(635)
Vanilla loans	39.6	40.7	1.1	72.0%	13,720	13,259	(461)
Structured loans	5.4	4.6	(0.8)	8.2%	1,646	1,472	(174)
Sensitive loans not in the charter	0.6	0.5	(0.1)	0.8%	64	54	(10)
Sensitive loans (3E/4E/5E)	0.8	0.6	(0.2)	1.1%	162	150	(12)
Subtotal sensitive loans:	1.4	1.1	(0.3)	2.0%	226	204	(22)
Structured loans benefiting from the derogatory mechanism of the support fund	0.5	0.4	(0.0)	0.8%	71	64	(7)
Other structured loans	3.5	3.1	(0.5)	5.4%	1,349	1,204	(145)

(1) considering the customer in the category with its most highly structured loan

In 2018, outstanding loans to the French public sector have increased by EUR 0.3 billion, with a 1.1 billion increase in non-structured loans (vanilla) and a decrease of EUR 0.8 billion in structured loans (see the definition above).

At the end of September 2018, structured loans on the balance sheet of Caisse Française de Financement Local represented

EUR 4.6 billion.

4.2.4.3. Sensitive loans

Sensitive loans, which are the most structured, totaled EUR 1.1 billion as of September 30, 2018, compared with EUR 1.4 billion as of December 31, 2017. Among these loans, those considered to be the most sensitive (outside the charter) represented EUR 0.5 billion, or 0.8% of the cover pool and 54 customers as of September 30, 2018 (64 customers as of December 31, 2017). These 54 customers are mostly municipalities with a population of more than 10,000 inhabitants and groups of municipalities, and to a lesser extent, public hospitals.

4.2.4.4. Reduction in loan sensitivity

Proactive sensitivity reduction measures, the use of support funds and, to a lesser extent, the maturing of certain loans made it possible to reduce the number of sensitive customers by 675 between SFIL's launch and September 30, 2018 (204 customers as of September 30, 2018, against 879 clients at SFIL's launch). At the same time, the outstanding sensitive loans dropped from EUR 8.5 billion to EUR 1.1 billion (2.0% of the cover pool), i.e. a decrease of 87%. In addition, at the end of September 2018, more than 94% of the borrowers with loans indexed on EUR/CHF saw loan sensitivity disappear completely, and of this number, 96% were small local governments and hospitals. These decrease include EUR 0.4 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.

Lastly, based on transactions already entered into, total sensitive structured loans will be reduced to EUR 1.0 billion by the end of 2019, of which a maximum of EUR 0.5 billion relating solely to local government entities. On the same basis, by end-2019, sensitive loans with a rate exceeding 5% will amount to less than EUR 0.2 billion and will concern 31 customers, i.e. 0.4% of the cover pool and 0.2% of customers in the French local public sector.

5. Debt benefiting from the legal privilege

As of September 30, 2018, 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	12/31/2017	9/30/2018
Cash collateral received	0.7	0.4
<i>Obligations foncières</i> and registered covered bonds	49.0	50.0
Total	49.7	50.4

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 2017. Its level stood at EUR 0.4 billion at the end of September 2018.

5.2 – CHANGE IN ISSUES

Within the recurrent annual program of EUR 4 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-dated maturities that are consistent with its needs. This requires an active presence in the private placement market through the EMTN program or by issuing registered covered bonds, which are designed for German investors. As part of this diversification, Caisse Française de Financement Local announced its intention to launch a social covered bond-themed public issue.

5.2.1. Issues in 2018

Over the nine first months of 2018, Caisse Française de Financement Local raised EUR 4.6 billion through benchmark public issues and tap issues enabling it to extend its reference curve, while at the same continuing to work on the private placements segment.

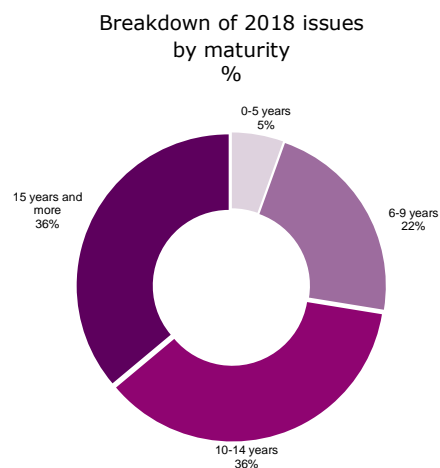
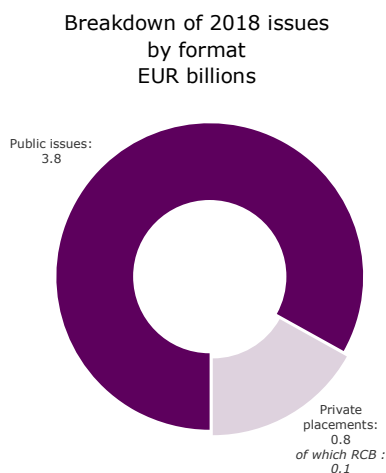
Caisse Française de Financement Local raised money in the primary public market three times in 2018, for a total amount of EUR 3.5 billion:

- a dual tranche issue (8 and 15 years) in January for a total amount of EUR 1.5 billion;
- a 10-year issue in April for an amount of EUR 1.5 billion;
- a 20-year issue in September for an amount of EUR 0.5 billion; this particularly long-dated public issue extended Caisse Française de Financement Local's reference curve by three years.

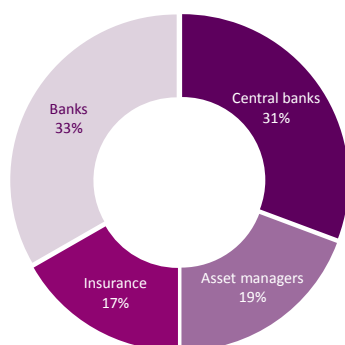
At the same time, Caisse Française de Financement Local provided additional liquidity for two of its benchmark issues via taps for a cumulative amount of EUR 0.3 billion.

In addition to these public transactions, Caisse Française de Financement Local remained active in the private placement segment, particularly on EMTNs and registered covered bonds (RCB), allowing it to meet investor demand for long and very long-dated maturities. Some EUR 0.8 billion was raised in this market segment in total.

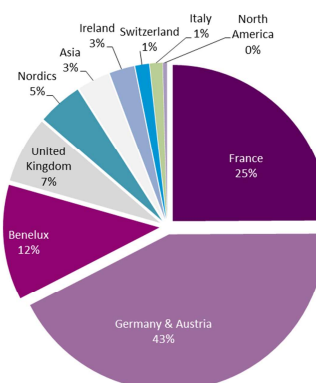
The breakdown of new issues by public/private format and maturity is presented below, as well as the breakdown of public issues by investor category and geographic zone.



Breakdown of 2018 public issues
by investor category
%



Breakdown of 2018 public issues
by geographic zone
%

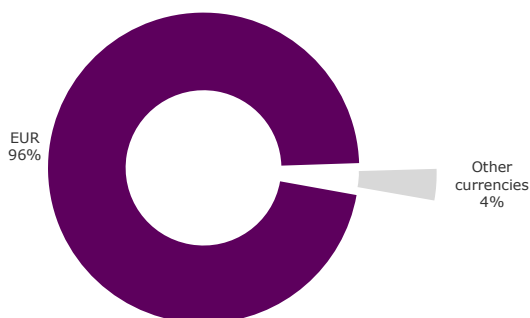


5.2.2. Outstanding debt at the end of September 2018

Outstanding *obligations foncières* and registered covered bonds totaled EUR 50.0 billion in swapped value at the end of September 2018. This includes new issues of *obligations foncières* for EUR 4.6 billion and amortization of issues maturing during the first three quarters for EUR 3.6 billion.

EUR billions, value after currency swaps	2017	2018
BEGINNING OF THE PERIOD	50.4	49.0
Issues	6.0	4.6
Amortizations	(7.2)	(3.6)
Buyback	(0.2)	-
END OF THE PERIOD	49.0	50.0

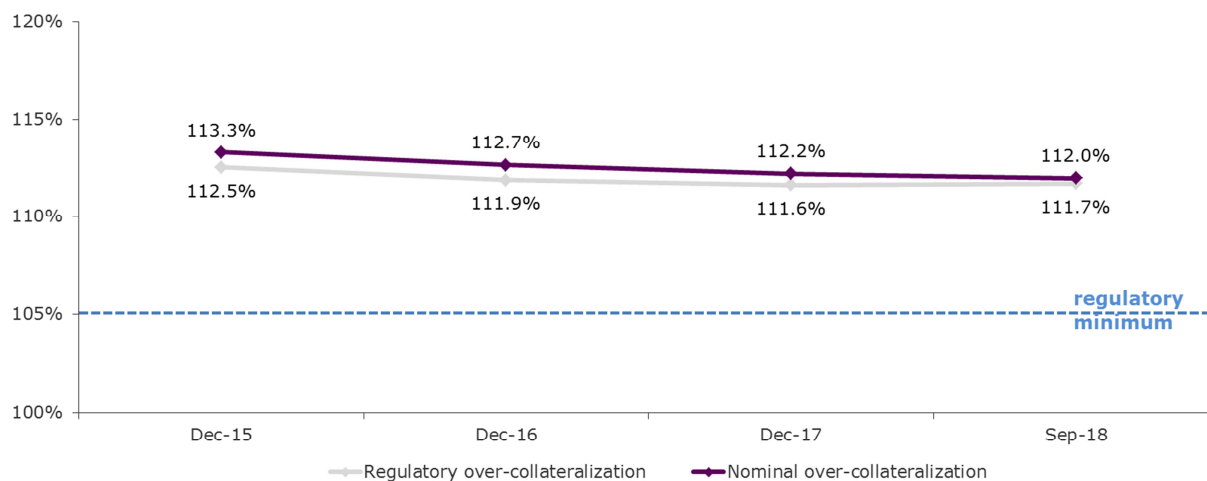
As of September 30, 2018, issues can be broken down by currency as follows:



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.

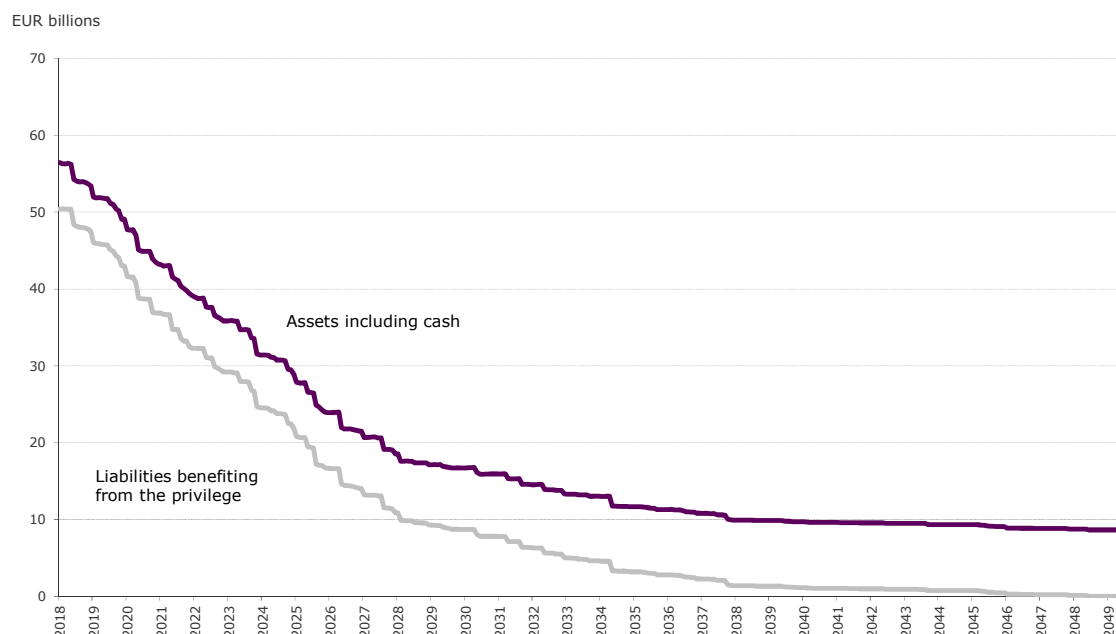


Regulatory over-collateralization may differ from nominal over-collateralization. In fact, it is calculated on the basis of the rules determined by the Autorité de contrôle prudentiel et de résolution (ACPR). In particular, these rules require different weighting levels according to the assets. The assets in Caisse Française de Financement Local's cover pool are all 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 September 30, 2018.

Amortization of assets and liabilities as of September 30, 2018



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 2018, 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. This fund does not benefit from the privilege stipulated in the law on *sociétés de crédit foncier*, but it is 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	12/31/2017	9/30/2018
SFIL	4.8	5.0
Banque de France	-	-
TOTAL	4.8	5.0

8. Caisse Française de Financement Local's main risks

8.1 – CREDIT RISK

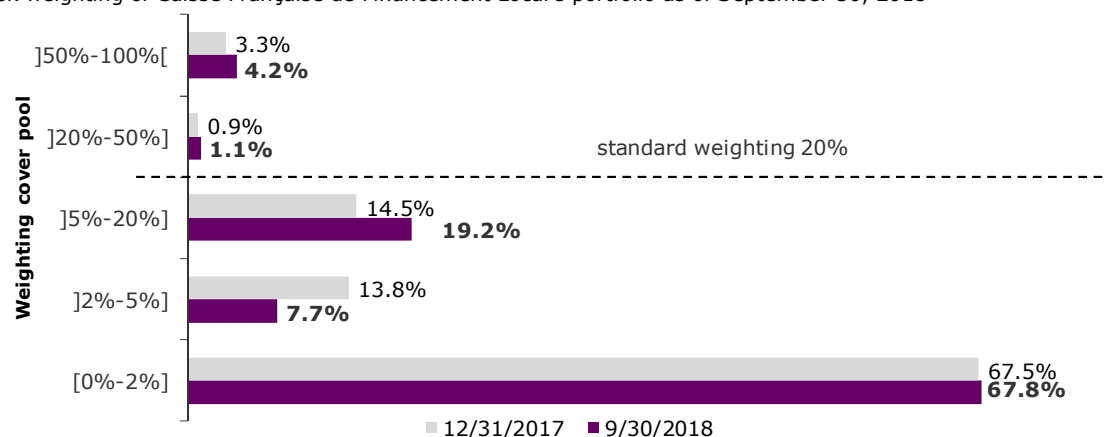
8.1.1. Definition

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 September 30, 2018, 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, 2018



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

- more than 75% of the portfolio has a weighting of less or equal to 5%;
- the average risk weighting of the cover pool assets is 7.2%, versus 20% for European local governments according to the Basel II/III standard method;
- only 5% of the portfolio has a weighting of more than 20%.

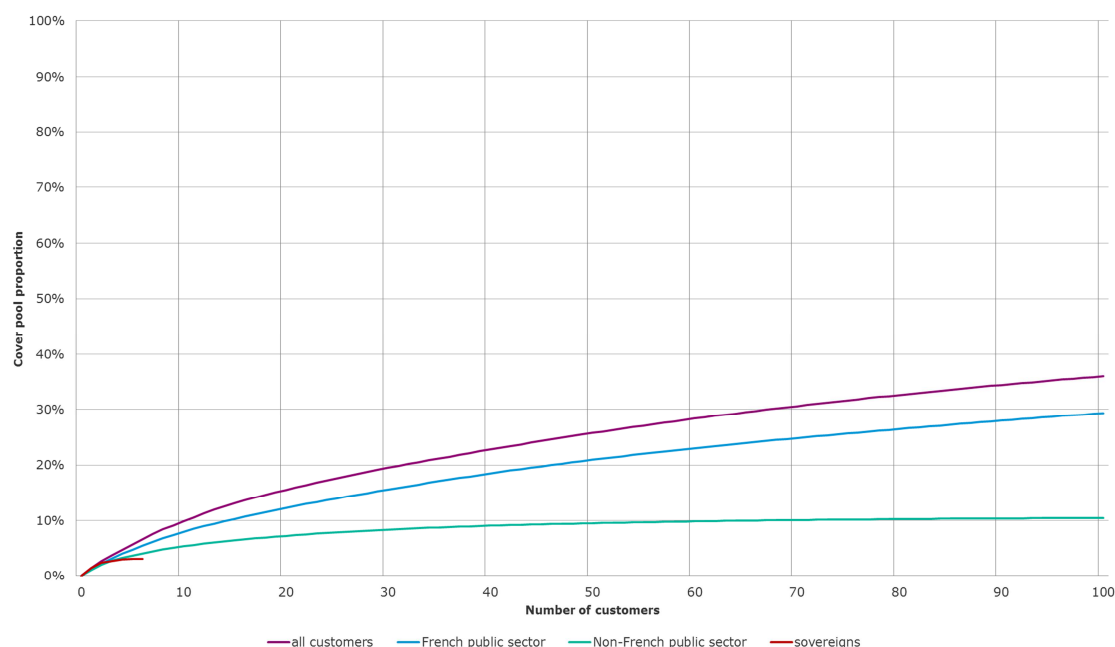
Since December 31, 2017, change in weighting is mainly due to methodological changes within internal rating models of Caisse Française de Financement Local.

As of September 30, 2018, weighted exposure with respect to credit risk amounted to EUR 4,983 million. Including weighted assets associated with the credit valuation adjustment (CVA) volatility risk and with operational risk (there being no risk weighted assets associated with market risk), total risk weighted assets came to EUR 5,659 million.

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 diversity of Caisse Française de Financement Local's portfolio of assets.



As of September 30, 2018, all categories combined, the 20 largest clients (excluding replacement assets and cash investments) represented 15.5% of the global cover pool. The largest client accounted for only 1.4% of the cover pool and the twentieth client 0.4%.

8.1.4. Arrears, non-performing loans, litigious loans and impairments

Caisse Française de Financement Local does not publish quarterly accounts, but only half-year and annual accounts. Consequently, non-performing loans', litigious loans' and impairments' informations are not available in this quarterly activity report. The last up-to-date information has been disclosed through the management report of the 2018 half-year financial report of Caisse Française de Financement Local that is available on its internet website.

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 three types of exposure to banks:

- replacement assets in the amount of EUR 2.1 billion (see 4.2.2.);
- bank account balances in euros and other currencies, representing EUR 5 million, excluding cash deposited on the Banque de France account;
- its derivative contracts, entered into within the framework of its management of interest rate and foreign exchange risks.

All of Caisse Française de Financement Local's derivative operations are conducted within the framework of standard ISDA or FBF (Fédération bancaire française) contracts with major international banks. These contracts have particular characteristics, since they must meet the standards set by rating agencies for *sociétés de crédit foncier* (and other issuers of covered bonds). In 2017, Caisse Française de Financement Local amended these contracts to take into account recent regulatory changes (signature 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 never 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 2018, Caisse Française de Financement Local was exposed (positive fair value of the swaps) on eight banking counterparties which all paid cash collateral of EUR 0.4 billion, offsetting total exposure.

All derivative exposures as of September 30, 2018, 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	-	15.7	19.4%	(1.4)	-	-	1
Other counterparties	44.8	65.2	80.6%	(2.3)	0.4	0.4	25
Total	44.8	80.9	100.0%	(3.8)	0.4	0.4	26

The swaps negotiated with external counterparties represented almost 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 the long-term swaps 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 portfolio positions and activities that pose a risk to its accounting income and equity as a result of exposure to market volatility are monitored as non-regulatory market risks. These are mainly market risks resulting from fluctuation of valuation of assets recognized through at fair value profit or loss and those recognized at fair value through other comprehensive income, or the provision for placement securities under French GAAP, as well as 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), debit valuation adjustments (DVA) and funding valuation adjustments (FVA) 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.

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 (EUR 47.3 billion in loans, EUR 8.0 billion in securities, and EUR 1.1 billion in cash deposited with the Banque de France) 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 (EUR 1.4 billion), are:

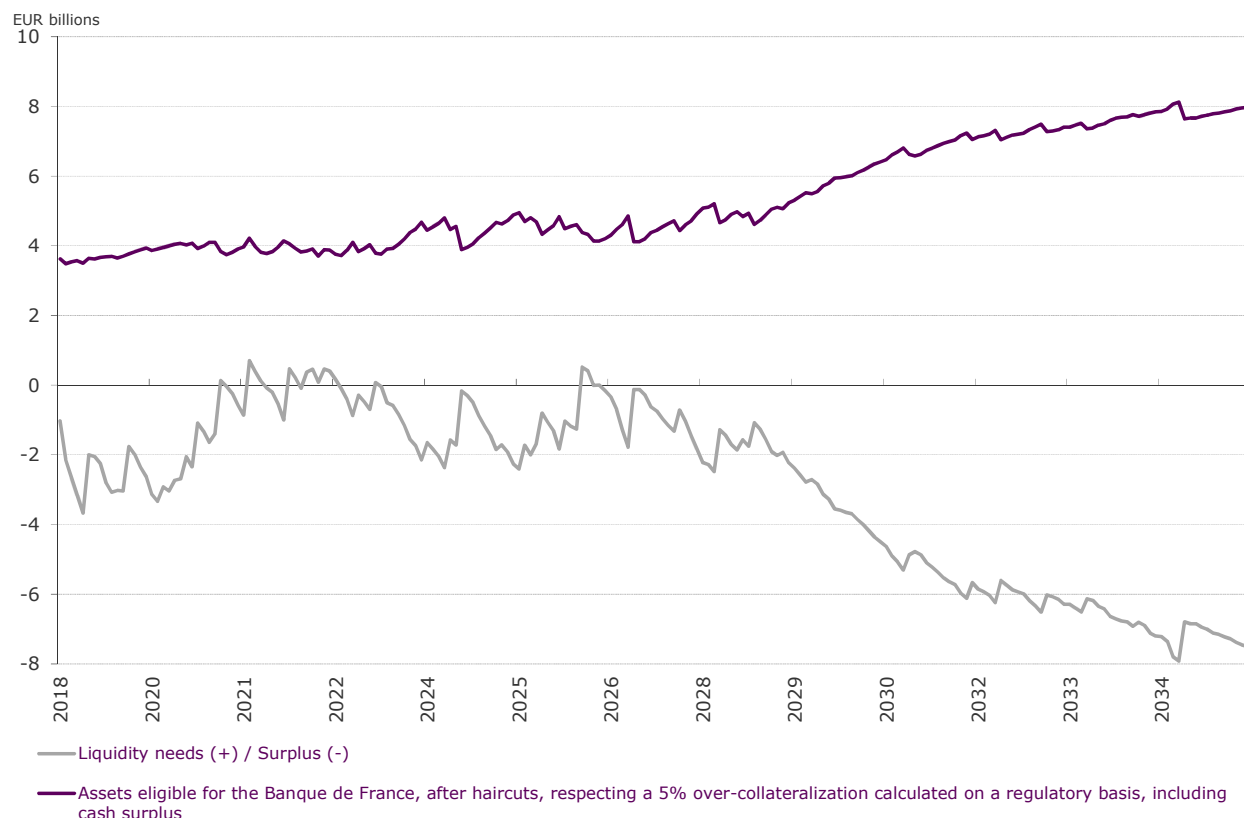
- debt benefiting from the legal privilege, i.e. *obligations foncières* and registered covered bonds (EUR 50.0 billion) and the cash collateral received by Caisse Française de Financement Local (EUR 0.4 billion);
- refinancing arising from the loan agreement entered into with SFIL to cover the financing requirements related to Caisse Française de Financement Local's over-collateralization (EUR 5.0 billion).

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 in 2018.

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 potential 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.

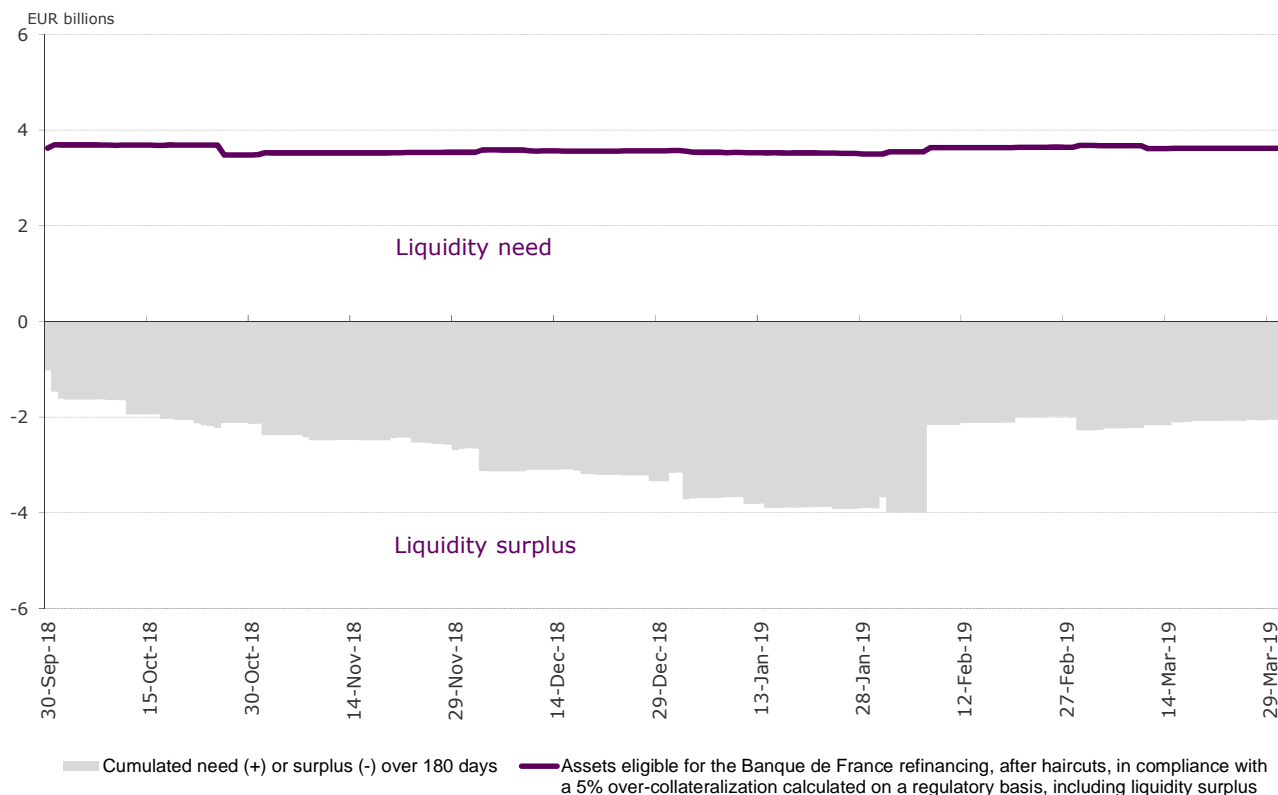
(1) A part of Caisse Française de Financement Local's over-collateralization is refinanced by its equity.



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*:
 - 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 September 2018, 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 September 30, 2018, Caisse Française de Financement Local's LCR was 747%.

- Internal liquidity indicators:

- the liquidity projections for the short term (three months) and long term (two years);
- 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 0.1 year as of September 30, 2018 (see the specific section on transformation risk below);
- the maximum difference between assets and liabilities maturing within the same year, this limit being reviewed annually;
- 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 indicators related to refinancing of large export credits activity: consumption of the spread and EUR/USD basis risk appetite by the various maturities of refinancing loans for large export credits, monitoring of geographical and sector limits and relating to firm offers over one year.

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 8.3.2.2.), 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)":

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

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 largely under the three-year limit, as shown in the table below.

Duration in years	9/30/2017	12/31/2017	3/31/2018	6/30/2018	9/30/2018
Cover pool	7.23	7.44	7.64	6.71	6.82
Privileged liabilities	6.45	6.49	6.67	6.73	6.72
Gap in asset-liability duration	0.77	0.95	0.97	-0.02	0.10
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)	9/30/2017	12/31/2017	3/31/2018	6/30/2018	9/30/2018
Cover pool	7.82	7.99	8.17	7.24	7.35
Privileged liabilities	6.93	6.93	7.12	7.19	7.19
Gap in asset-liability weighted average life	0.88	1.06	1.05	0.05	0.16

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 over a sliding period of maximum 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. 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 6% of equity (i.e. EUR 80 million) with a quantile of 99% calculated based on 2007-2017 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	9/30/2017	12/31/2017	3/31/2018	6/30/2018	9/30/2018
Sensitivity	(25)/25	1.0	1.5	(1.5)	1.7	(2.0)

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	9/30/2017	12/31/2017	3/31/2018	6/30/2018	9/30/2018
Short term	(10)/10	(1.7)	0.2	(7.1)	(4.3)	(5.5)
Medium term	(10)/10	(2.4)	(4.6)	(2.1)	(1.0)	(4.9)
Long term	(10)/10	3.8	3.1	5.6	4.6	4.6
Very long term	(10)/10	1.3	2.7	2.0	2.4	3.8

Risk of slope between two close points on the rate curve

Sum of sensitivities in absolute value

EUR millions	Limit	9/30/2017	12/31/2017	3/31/2018	6/30/2018	9/30/2018
Short term	20	10.2	11.6	11.5	8.8	10.3
Medium term	20	10.9	14.8	4.6	14.4	9.9
Long term	20	7.1	3.6	7.9	8.7	13.0
Very long term	20	6.5	6.9	10.5	10.8	14.1

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 September 30, 2018.

Breakdown of outstanding swaps EUR billions	Notional Absolute value
Euribor against Eonia	
Macro-hedges	44.8
TOTAL SHORT-TERM SWAPS	44.8
Fixed rate swaps against Euribor	
Micro-hedges on <i>obligations foncières</i>	41.1
Micro-hedges on loans and debt securities	21.2
Macro-hedges on loans	14.1
Subtotal	76.4
Currency swaps	
Micro-hedges on <i>obligations foncières</i>	1.3
Micro-hedges on loans	2.7
Micro-hedges on debt securities	0.5
Subtotal	4.5
TOTAL LONG-TERM SWAPS	80.9

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, in the event of a delay of drawing dates initially planned and hedged. 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. Caisse Française de Financement Local's ALM unit and Market and Balance Sheet Risks division ensure that it has no net foreign exchange positions.

8.4 – OTHER RISKS

8.4.1. Operational risk

Operational risk represents the risk of loss resulting (i) from the lack of adaptation or failure on the part of internal processes, staff, systems or (ii) external events. It includes the risks linked to the security of IT systems, as well as legal and fiscal and compliance risks, but it excludes strategic risk.

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 2017.

8.4.2. Legal and tax risks

8.4.1.1. 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.

8.4.1.2. Legal risk

As of September 30, 2018, the number of borrowers in litigation for structured loans was 19, compared with 25 as of December 31, 2017. Since SFIL's creation, 204 borrowers have dropped their claims against the Group.

Since the entry into force on July 30, 2014 of the law on the securing of structured loan contracts taken out by common law legal

entities, the Nanterre Court of First Instance, the Nanterre Commercial Court, the Versailles Court of Appeal and the Court of Cassation have handed down 35 court decisions, regarding structured loans, ruling in favor of Dexia Crédit Local, SFIL and Caisse Française de Financement Local. The Court of Cassation has confirmed, by a judgment on March 28, 2018, the analysis of the Court of Appeal and the validity of structured loans concerned. Only one unfavorable decision, concerning a single non-structured loan, has been handed down, being noted this is a first-instance judgment which is not yet final. Caisse Française de Financement Local, SFIL and Dexia Crédit Local have appealed this decision.

As of September 30, 2018, there were no other lawsuits or disputes considered as significant between Caisse Française de Financement Local and its borrowers.

8.4.1.3. Tax risk

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 safeguard its rights to the disputed adjustment, in 2017 the tax authority initiated a verification procedure 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 2015 assessment still held following this tax audit. There were no other new developments.

In order to take into account the risk of an unfavorable outcome in these proceedings, Caisse Française de Financement Local recorded a provision for income tax in 2015. However, Caisse Française de Financement Local does not agree with the position of the tax authorities and started an appeal since 2016 within the framework of legal recourse allowed by current tax regulations. Neither the discussions that took place with the tax authorities nor the new tax audit called into question the assumptions used to calculate the amount provisioned in the accounts.

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 2017.

9. Outlook for the end of 2018

In 2018, Caisse Française de Financement Local and its parent company SFIL aimed to:

- maintain their role as a major player in the market for loans to French local governments and public hospitals, within the partnership with La Banque Postale;
- continue their key role as refinancer of partner banks of French exporters, for large export credits.

The bulk of the sensitivity reduction work has been completed and by end-2018 the most at-risk outstandings, i.e. those indexed on EUR/CHF, will be reduced to a marginal level. This activity, which generally involves granting new loans to the local government entities concerned, is now being scaled down.

In addition, as announced on March 8, 2018, SFIL's refinancing export credit system may be expanded to loans designed to finance projects considered strategic for France without necessarily having to be linked to an underlying export. These projects will benefit from a new guarantee of the French State, and may be refinanced by Caisse Française de Financement Local through an enhanced guarantee arrangement.

To cover its financing requirements, in 2018 Caisse Française de Financement Local issued since the beginning of 2018 almost EUR 4.6 billion of *obligations foncières* through a number of benchmark issues in euros and private placements adapted to the needs of its broad investor base. As part of the diversification of its financing sources, Caisse Française de Financement Local plans also to launch a social covered bond-themed issue in the coming months.

SFIL and Caisse Française de Financement Local decided to appoint the international rating agency DBRS which assigned SFIL an AA (high) rating to SFIL and an AAA rating to covered bonds issued by CAFFIL. SFIL and Caisse Française de Financement Local also decided to no longer apply for a rating from Fitch beyond the end of 2018. As a result, from 2019 onwards, the financial rating agencies retained by the SFIL Group for its issuance activity will now be Moody's, Standard & Poor's and DBRS.

On the 15th of November 2018, the French State announced that it enter into discussions with CDC regarding the transfer of control of SFIL to CDC. This announcement took place in relation with the creation of a major public financial unit with CDC and LBP as principle actors. Shareholding of SFIL would remain wholly public. This modification would be effective within the same timing than changes concerning shareholding of La Poste and CNP Assurances.

Lastly, from a macro-economic point of view two significant background issues will be closely monitored by the end of 2018:

- developments in the regulatory environment (including the harmonization of the European legal framework for covered bonds);
- market volatility in a context influenced by the perspectives for a quantitative easing exit strategy announced by the European Central Bank, the provisions linked to Brexit and the geopolitical environment.

Breakdown of cover pool as of September 30, 2018

	09/30/2018				12/31/2017
EUR millions	Direct exposure		Indirect exposure		Total
COUNTRY	Loans	Bonds	Loans	Bonds	
France					
State:					
- export refinancing	-	-	682	-	218
- others	5	-	113	-	118
Banque de France	1,053	-	-	-	1,707
Regions	1,913	524	255	-	2,399
Departments	6,800	206	181	-	7,018
Municipalities	15,233	68	387	-	16,165
Groups of municipalities	11,418	83	140	-	11,172
Public sector entities:					
- health	6,128	58	-	-	6,219
- social housing	1,193	-	-	-	1,291
- others	873	163	1	-	1,119
Credit institutions	805	483	-	-	694
Subtotal	45,421	1,585	1,759		48,120
Germany					
Länder	-	275	-	-	275
Subtotal	-	275	-	-	275
Austria					
Länder	-	-	183	-	187
Subtotal	-	-	183	-	187
Belgium					
Regions	4	-	19	-	30
Public sector entities	50	-	-	-	54
Credit institutions	-	57	-	-	57
Subtotal	54	57	19	-	141
Canada					
Communities	100	-	-	-	161
Public sector entities	35	-	-	-	35
Credit institutions	-	41	-	-	-
Subtotal	135	41	-	-	196
Denmark					
Credit institutions	-	91	-	-	-
Subtotal	-	91	-	-	-
Spain					
State	-	150	-	-	200
Regions	-	65	-	-	65
Municipalities	79	-	-	-	80
Credit institutions	-	30	-	-	-
Subtotal	79	245	-	-	345

EUR millions	09/30/2018				12/31/2017	
	Direct exposure		Indirect exposure		Total	Total
COUNTRY	Loans	Bonds	Loans	Bonds		
United States						
Federated States	-	253	-	-	253	253
Subtotal	-	253	-	-	253	253
Italy						
State	-	535	-	-	535	543
Regions	-	1,942	-	-	1,942	1,975
Provinces	-	494	-	-	494	522
Municipalities	7	1,769	-	-	1,776	1,851
Subtotal	7	4,740	-	-	4,747	4,891
Japan						
Municipalities	-	25	-	-	25	25
Subtotal	-	25	-	-	25	25
Norway						
Credit institutions	-	222	-	-	222	70
Subtotal	-	222	-	-	222	70
Netherlands						
Credit institutions	-	90	-	-	90	-
Subtotal	-	90	-	-	90	-
Portugal						
State	-	10	-	-	10	-
Municipalities	15	-	-	-	15	17
Public sector entities	4	-	-	-	4	5
Subtotal	19	10	-	-	29	22
United Kingdom						
State	-	-	-	162	162	232
Credit institutions	-	60	-	-	60	-
Subtotal	-	60	-	162	222	232
Sweden						
Municipalities	18	-	-	-	18	18
Credit institutions	-	177	-	-	177	100
Subtotal	18	177	-	-	195	118
Switzerland						
Cantons	257	-	25	-	282	303
Municipalities	355	-	-	-	355	493
Public sector entities	60	-	-	-	60	90
Subtotal	672	-	25	-	697	886
Supranational						
International organizations	24	-	-	-	24	28
Subtotal	24	-	-	-	24	28
TOTAL COVER POOL	46,429	7,871	1,986	162	56,448	55,789

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.