HALF-YEAR FINANCIAL REPORT 2017

Half-year financial report 2017

Contents

This free translation of the half-year financial report published in French is provided solely for the convenience of English-speaking readers.

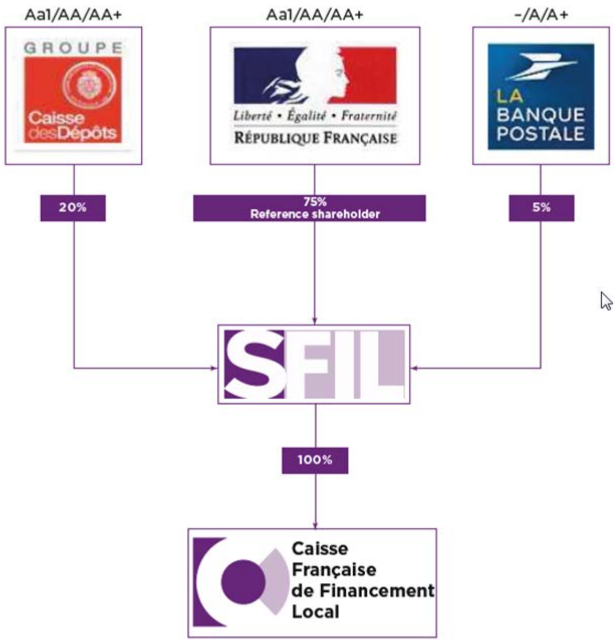
1. Half-year management report

Background

The corporate entity SFIL was approved as a bank by the Autorité de contrôle prudentiel et de résolution (ACPR) on January 16, 2013. Since SFIL was created, the French State plays a special role in this system by contributing 75% of SFIL's capital and, as the reference shareholder by providing prudential authority with a strong commitment for financial support, in keeping with current banking regulations. Caisse des dépôts et consignations and La Banque Postale respectively hold 20% and 5% of the Company's capital.

Since January 31, 2013, SFIL holds 100% of the capital of Caisse Française de Financement Local (CAFFIL), its sole subsidiary, a specialized financial institution with the status of a *société de crédit foncier* (SCF) governed by articles L.513-2 and following of the Monetary and Financial Code.

Capital structure of SFIL and its sole subsidiary



SFIL lies at the heart of a system that fulfills the State's determination to provide French local governments and public healthcare facilities with continuous and efficient access to long-term bank financing, in addition to the offers proposed by commercial banks and French and European public institutions operating in this sector. This system, which was launched within the framework of the European Commission's decision on December 28, 2012, makes it possible to refinance French local public sector loans from La Banque Postale and actively support these borrowers in their efforts to reduce their outstanding high-risk structured loans.

In 2015, the State entrusted SFIL with a second public interest mission to refinance buyer credits insured by Coface Garantie Publique (a mission now provided by Bpifrance Assurance Export in the name and on behalf of the French State), which helps increase the competitiveness of the large export contracts negotiated by French companies. The objective is to provide market financing with the volumes and maturities adapted to export credits of significant amounts and under conditions that match those of the best French issuers of covered bonds, relying on the capacities of SFIL and its subsidiary CAFFIL. This refinancing is available for all banks that are partners of French exporters for their buyer credits insured by Coface/ Bpifrance Assurance Export in the name and on behalf of the French State.

Over the course of the first half of 2017, SFIL successfully fulfilled its fundamental missions:

- the acquisition, within a strictly defined framework, of loans initially granted by La Banque Postale to eligible local governments and public health facilities[1];
- the providing of specialized services by SFIL to La Banque Postale and CAFFIL, allowing for the effective operation of the system;

[1] Eligibility as defined by the legislation on *sociétés de crédit foncier* in its definition of assets in the cover pool that may be recognized on the balance sheet as guarantee of *obligations foncières* issued.

- the ongoing policy of reduction in the sensitivity of certain structured loans contained in CAFFIL's balance sheet assets, which is now close to completion;
- the refinancing of major export credit contracts with the signing of two new contracts in the first half of the year.

The execution of these missions relies on the effective financing activity of SFIL and CAFFIL.

The governance of SFIL was also amended, as the Board of Directors meeting of March 23, 2017, decided to separate the functions of Chairman of the Board of Directors and Chief Executive Officer. The Board of Directors is now chaired by Chantal Lory, and Philippe Mills remains Chief Executive Officer.

Composition of the Board of Directors (June 30, 2017)

Chantal Lory **Chair of the Board of Directors** **Independent Member of the Board of Directors**	**Philippe Mills** **Chief Executive Officer** **Member of the Board of Directors**
French State Represented by **Jérôme Reboul**	**Patrick Galland** Member of the Board of Directors representing the employees
Jean-Pierre Balligand Independent Member of the Board of Directors	**Frédéric Guillemin** Member of the Board of Directors representing the employees
Serge Bayard Member of the Board of Directors representing La Banque Postale, shareholder	**Cathy Kopp** Independent Member of the Board of Directors
Catherine Boyaval Member of the Board of Directors representing the employees	**Françoise de Panafieu** Independent Member of the Board of Directors
Pascal Cardineaud Member of the Board of Directors representing the employees	**Antoine Saintoyant** Member of the Board of Directors proposed by the State
Delphine de Chaisemartin Member of the Board of Directors representing Caisse des dépôts et consignations, shareholder	**Pierre Sorbets** Independent Member of the Board of Directors
Lorraine Coudel Member of the Board of Directors representing the employees	

Operations in the first half

1. Refinancing by CAFFIL of local public sector loans originated by La Banque Postale

Local public sector loans originated by La Banque Postale are refinanced by SFIL's subsidiary, CAFFIL. In the first half of 2017, the latter acquired EUR 2.4 billion[(2)] in loans from La Banque Postale in three transfers, which is 35% more than the volume acquired from La Banque Postale during the first half of 2016 (EUR 1.8 billion). In June 2017, the total volume acquired increased to EUR 11.3 billion.

2. Refinancing export credits

The objective of the SFIL system is to support French exports in terms of financial competitiveness, in accordance with a public refinancing plan comparable to that of other OECD countries, in particular in northern Europe (Sweden, Finland).

It was based on a collaboration involving commercial banks from which SFIL proposes to buy back the insured part of the export credits they originate. During the financial tender phase, SFIL will communicate to the banks the conditions of its negotiation in terms of volume, duration and price. Since the banks are responsible for the structuring of the transaction and customer relations, they will then pass them on to the borrower, in their final conditions. When it signs the loan, SFIL will purchase the credit from the banks under the terms initially agreed upon. Once recorded on the balance sheet of SFIL, the export credit is refinanced via a loan from its subsidiary CAFFIL, which also receives an irrevocable and unconditional 100% guarantee granted by Bpifrance Assurance Export, in the name and on behalf of the State.

SFIL signed a protocol agreement governing relations with 20 commercial banks, thereby confirming relations with almost all the banks active in the French export credit market.

After a first year's activity in 2016, SFIL signed its third and fourth export credit refinancing operations in the first half of 2017 for a total of EUR 753 million.

An operation was signed in May 2017 to refinance, in the amount of EUR 124 million by SFIL, an export credit of EUR 172 million in the energy sector for an African customer.

Another operation in tour cruises was signed by SFIL in June 2017 to refinance EUR 629 million of the export credit of EUR 1.3 billion to finance two commissions by the cruise operator MSC.

The negotiation of these new major operations confirms the growing role of the SFIL system and its efficiency in improving French export credit conditions.

3. Services for La Banque Postale

SFIL provides services to La Banque Postale at all stages of loan issuance and management of medium- to long-term loans to the French local public sector (local governments and public health facilities). The indicators used to measure the quality of services rendered by SFIL reached a rate of 98% for the first half of 2017.

4. The refinancing of CAFFIL and SFIL

CAFFIL refinancing (covered bonds or *obligations foncières*)

Over the course of the first half of 2017, CAFFIL added three new issues to its reference curve as a regular issuer in the Euro-denominated public debt issue market. In January, a EUR 1.5 billion transaction with a 10-year maturity was launched followed in May by a EUR 1.75 billion dual tranche transaction offering a maturity of 7 years and 15 years.

In addition to these public benchmark issues, CAFFIL benefited from investor demand for long-dated private placements for a total amount of EUR 651 million and for taps of existing issues (2026, 2027 and 2031 maturities). The average maturity of the financing raised by CAFFIL in the first half was close to 12 years.

[(2)] The amount of EUR 2.4 billion included EUR 0.4 billion in loans transferred from December 2016 to January 2017.

SFIL refinancing

The debt raised by SFIL is mainly provided by Caisse des dépôts et consignations and La Banque Postale under credit agreements for amounts up to EUR 12.5 billion and EUR 1.25 billion, respectively. As of June 30, 2017, the financing that SFIL received from these two shareholders amounted to a total of EUR 6.3 billion. This amount decreased by EUR 0.4 billion between December 2016 and June 2017. This backing allowed SFIL fully to play its role as the parent company and sponsor of Caisse Française de Financement Local by giving it the liquidity required to finance its over-collateralization. This also allowed the institution to meet its own financing requirements relative to the cash collateral paid on its derivatives and liquidity reserves.

In addition, SFIL has continued to diversify its financing sources by maintaining its access to the short-term debt market (outstanding negotiable debt securities totaling EUR 582 million as of June 30, 2017) and pursuing the development of its signature in the French agency segment of the bond market. Since January 2017, SFIL has been included in the list of eligible issuers to the public sector purchase program (PSPP) of the European Central Bank. In June 2017, SFIL successfully launched its second public issuance, a transaction in USD with a 3-year maturity and a volume of USD 1 billion. This inaugural benchmark transaction in the USD market enabled SFIL to strengthen its positioning in the French agency segment and to amplify the diversification of the investor base of SFIL group.

5. Reduction in loan sensitivity

After a very high number of operations carried out in 2016 thanks to the assistance system implemented by the French government, SFIL's loan sensitivity mission continued during the first half of 2017 with the same scope and methodology.

Sensitive outstanding assets include those off the Gissler Charter (code of good conduct signed between the banks and the local authorities in December 2009) and those classified 3E, 4E and 5E according to the Charter.

The methodology used consists in permanently reducing the sensitivity of the sensitive structured loans. To this end, SFIL may, if necessary, allocate new liquidity to borrowers in the form of additional financing, or refinancing early repayment indemnity.

Since the set up of SFIL, sensitive outstanding amounted to EUR 8.5 billion and concerned 879 clients. As of June 30, 2017, 728 sensitivity reduction transactions have been signed with 626 clients for a total amount of EUR 5,105 million.

On the basis of the transactions concluded as of June 30, 2017, and after deduction of the loans benefiting from the financial assistance provided to downgrade installment amounts, the outstanding amount of sensitive structured loans should total no more than EUR 1.4 billion at the end of 2017. This represents a reduction of EUR 7.1 billon (84%) since December 31, 2012, for 232 borrowers (i.e. decrease of 74% in the number of clients with sensitive structured loans). The bulk of the mission should therefore have been accomplished by the end of 2017.

There was a marked decrease in the number of litigation cases: as of June 30, 2017, 36 borrowers remained in litigation regarding one or several CAFFIL sensitive structured loans, which represents a decrease of 84% in the number of cases. Since the creation of SFIL, 187 borrowers have withdrawn or abandoned their legal proceedings. A mutual agreement has been reached with 184 of them, the other three renounced their suit or the case was canceled.

Changes in main balance sheet items

The main items on the SFIL Group’s consolidated balance sheet (management data) as of June 30, 2017, are presented in the table below.

EUR billions, value after currency swaps

ASSETS	LIABILITIES
77.6	77.6
Main items, in nominal value after swaps 63.5	Main items, in nominal value after swaps 63.5
Cash assets *5.2*	*EMTN issued by SFIL* *1.9*
Loans *47.8*	*Refinancing by shareholders* *6.3*
Securities *8.1*	*Covered bonds* / Obligations foncières *51.9*
	Certificates of deposit *0.6*
Cash collateral paid *2.4*	*Cash collateral received* *1.4*
	Equity and other *1.4*

The assets on the SFIL Group’s balance sheet mainly consist of:

- the cash assets of SFIL and CAFFIL;
- the loans and securities on the CAFFIL balance sheet and assets held in the form of bonds on the SFIL balance sheet;
- cash collateral paid by SFIL on its derivative portfolio.

The liabilities on the SFIL Group’s balance sheet mainly consist of:

- *obligations foncières* in CAFFIL's liabilities;
- certificates of deposit issued by SFIL;
- EMTN issued by SFIL;
- the funds contributed by shareholders (Caisse des dépôts et consignations and La Banque Postale) in the SFIL liabilities;
- cash collateral received by CAFFIL and SFIL on its derivative portfolio;
- equity and other resources.

1. Main changes in assets in the first half of 2017

The net change in the SFIL Group's main assets during the first half of 2017 was EUR +1.5 billion.

This change can be analyzed as follows:

EUR billions, value after currency swaps	6/30/2017
BEGINNING OF YEAR	62.0
Purchase of loans from La Banque Postale	2.4
New loans paid out after reduction in sensitivity	0.2
New paid loans product of activity credit export	0.1
Cash collateral paid by SFIL	0.2

Amortization of loans and securities in the French public sector	(1.3)
Amortization of loans and securities outside the French public sector	(0.4)
Change in cash assets	0.3
Other	(0.0)
END OF PERIOD	**63.5**

- Through its subsidiary CAFFIL, SFIL acquired EUR 2.4 billion in loans marketed by La Banque Postale to the French local public sector.
- The transactions to reduce sensitivity resulted in EUR 0.2 billion in new payments on the balance sheet, considered as refinancing of early reimbursement indemnities and new investment financing.
- Export credit activity resulted in EUR 0.1 billion in drawdowns.
- As an intermediary in the derivative transactions between CAFFIL and some of its counterparties, SFIL paid a total of EUR 2.4 billion as of June 30, 2017, down EUR 0.2 billion from the end of 2016.
- The other changes in assets pertained mainly to the natural amortization of the loans and securities portfolio (EUR 1.7 billion) and to the EUR 0.3 billion change in the cash balance held with the French central bank (Banque de France).

It should be noted that SFIL held EUR 1.9 billion in cash management securities (banking securities and those of the European public sector) as of June 30, 2017.

2. Main changes in liabilities over the first half of 2017

The net change in the main liabilities of the SFIL Group during the first half of 2017 totaled EUR +1.5 billion.

This change can be analyzed as follows:

EUR billions, value after currency swaps	6/30/2017
BEGINNING OF YEAR	62.0
Covered bonds / *Obligations foncières*	1.5
Issues	*4.6*[(3)]
Amortizations	*(3.1)*
Buybacks	-
Change in cash collateral received	(0.5)
Senior unsecured refinancing	(0.5)
Issues by SFIL	0.9
Certificates of deposit	(0.0)
Equity and other items	0.0
END OF PERIOD	**63.5**

- Outstanding *obligations foncières* increased by EUR 1.5 billion, owing to the implementation of the new 2017 program to EUR 4.6 billion, and the amortization of the stock of covered bonds to EUR -3.1 billion.
- The cash collateral paid by the derivative counterparties of CAFFIL and SFIL decreased by EUR 0.5 billion.
- The EUR 0.5 billion decrease in refinancing by shareholders was counterbalanced by the increase in SFIL refinancing in the form of issues by SFIL in the amount of EUR 0.9 billion.

[(3)] EUR 4.7 billion after taking into account issues paid out after June 30, 2017 (EUR 0.1 billion).

Risk management

SFIL's portfolio, which is principally made up of exposures on public borrowers, has a particularly low risk profile. Risks involving the markets, ALM and liquidity are limited and operational risks remain under control.

Subsequent to the Supervisory Review and Evaluation Process (SREP), conducted by the European Central Bank (ECB) in 2016, equity (Tier I + Tier II) required on a consolidated basis for SFIL was set at 10% of RWAs as of January 1, 2017. Required Tier I equity was 8% of RWAs (including a conservation buffer of 1.25%).

As of June 30, 2017, SFIL's "phased" Core Equity Tier I (CET1) ratio amounted to 23.3% on a consolidated basis ("non-phased" ratio 22.6%), representing more than twice the required minimum set.

1. Credit risk

Credit risk represents the potential loss that may affect SFIL due to a counterparty's downgraded financial position.

1.1. BREAKDOWN OF EXPOSURES ACCORDING TO BASEL III RISK WEIGHTING

The quality of the SFIL and CAFFIL portfolio can also be seen in the weighting of risk-weighted assets (RWA) assigned to its assets in order to calculate the solvency ratio.

The Group has mainly chosen the advanced method to calculate its solvency ratio and capital adequacy for most of its exposures. It therefore uses its internal models approved by the regulator to calculate its equity requirements for the credit risk.

An average weighting of 6.62%, with no more than 4.27% of the portfolio being weighted higher than 20%, confirms the quality of SFIL's assets.

The amount of weighted exposure with respect to the credit risk amounts to EUR 5,011 million. By including market risks, the risk of volatility in the Credit Valuation Adjustment (CVA) and operational risks, the total weighted assets amount to EUR 5,614 million.

1.2. DOUBTFUL AND LITIGIOUS LOANS

Doubtful and litigious loans at the end of June 2017 totaled EUR 549 million, representing less than 1% of CAFFIL's total cover pool (i.e. EUR 59.2 billion), consisting of:
- EUR 523 million in loans qualified as doubtful, corresponding to customer loans of a total unpaid amount of EUR 59 million; and
- EUR 26 million in loans qualified as litigious, corresponding to unpaid interest on structured loans subject to litigation.

1.3. PROVISIONS

Specific provisions amounted to EUR 41 million at the end of June 2017. This change vis-à-vis the end of 2016 reflected a recovery of EUR 19 million in specific provisions subsequent to the use of more accurate methods to estimate recoverable flows of doubtful loans[4].

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

Through CAFFIL, SFIL incorporated the following contributions in its previous results: EUR 150 million (paid over 15 years) to the support fund for local governments and EUR 38 million to the support fund for public healthcare facilities. Given the payouts already effected, the only contribution remaining is to the support fund for local governments with an amount still payable of EUR 110 million, entirely covered by provisions.

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

(EUR millions)	6/30/2017
Collective provisions	45
Specific provisions	41
Contributions to support funds still payable	110
TOTAL	**196**

As of June 30, 2017, provisions covering risks on all portfolios stood at EUR 196 million.

Provisions remained at a low level (0.3% of CAFFIL's cover pool), confirming the quality of the portfolio and its low level of risk.

1.4. AFS RESERVE

The total amount of the AFS reserve as of June 30, 2017, before taxes stood at EUR -150 million as compared with EUR -159 million as of December 31, 2016. Italian sovereign securities contributed EUR -141 million to this reserve versus EUR -147 million at the end of 2016.

2. Market and the ALM risk

2.1. MARKET RISK

The institution does not carry out financial trading operations and is therefore not subject to the market risk in the regulatory sense of the term. Since the notion of regulatory market risk is limited to the market risk of the trading portfolio, it is recognized that the regulatory market risk is zero.

2.2. ALM RISK

The ALM policy of SFIL and its subsidiary CAFFIL is designed to protect the value of equity and limit income volatility while maintaining the equilibrium of their balance sheets.
Two noteworthy events can be cited for the first half of 2017:
• Basis and foreign exchange hedges of foreign currency export credit operations were realized.
• ECB stress tests (interest rate and liquidity) were carried out and sent to the ECB.

a. Foreign exchange risk

Foreign exchange risk is the verified or potential risk of income volatility related to adverse movements in foreign exchange rates.

The foreign exchange risk is measured by the foreign exchange position defined by the net balance of assets (assets less liabilities) in a given currency.

With regard to the management of the foreign exchange risk, the issues and assets denominated in foreign currencies give rise, at the latest when they are recorded on the balance sheet, to a cross-currency swap vis-à-vis the euro. The outstanding and the interest margins in foreign currencies involved in these operations are thus entirely transformed into euros, thereby ensuring perfect foreign exchange hedging of the nominal sum and the interest rate of these items on the balance sheet. In line with the bank's strategy, ALM guarantees the absence of any residual foreign exchange risk through the net foreign exchange position in each currency, calculated on all receivables, commitments and interest accrued but not yet due in the currency of the balance sheet. For SFIL, within the framework of export credit activities, it is tolerated to maintain a low interest margin in USD not hedged for operational reasons.

The foreign exchange risk management policy will aim to ensure that the bank's strategy is respected.

b. Interest rate risk

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

Three types of interest rate risk can be distinguished:
• the risk related to long-term interest rates, which results from the gap in volume and maturity between the fixed rate assets and liabilities, the initial maturity of which is greater than a year;
• the basis risk, which results from the gap that may exist in the backing of assets and liabilities with a floating rate in the same currency but with different tenors;
• the fixed rate risk, which results from the variation in the rate of an asset or a liability with a floating interest rate pre-fixed over the period in which the adjustable index is fixed.
These risks are generally hedged using derivative instruments.

For CAFFIL, these interest rate risks are measured and limited on the basis of indicators of the net present value sensitivity for an incident of 100 times the rate + 1 basis point (bp):

	Level as of June 30, 2017 (EUR millions)	Limit
Directional interest rate risk	(1.6)	< EUR 25 million
Sloping risk		
- Sensitivity by time bucket		
o Short bucket	0.4	< EUR 10 million
o Medium bucket	(4.5)	< EUR 10 million
o Long bucket	1.5	< EUR 10 million
o Very long bucket	1.1	< EUR 10 million
- Sensitivity by time bucket in absolute value		
o Short bucket	7.8	< EUR 20 million
o Medium bucket	12.4	< EUR 20 million
o Long bucket	3.5	< EUR 20 million
o Very long bucket	5.6	< EUR 20 million

For the parent company SFIL, this limit is expressed on the fixed rate gap. Its 0 value reflects its micro-hedge management strategy.

These indicators are calculated from a static view.

c. Liquidity risk

The liquidity risk can be defined as the risk that the institution may not be able to find the necessary liquidity to cover the financing needs related to its activity.

The SFIL Group's activity is primarily centered on managing its subsidiary CAFFIL, a *société de credit foncier*.

The Group's liquidity requirements are mainly of four types:

- the financing of CAFFIL's balance sheet assets (EUR 47.7 billion in loans, EUR 7.6 billion in securities and 3.9 billion in cash on deposit with the Banque de France);
- the financing of SFIL's balance sheet assets (EUR 0.5 billion in securities and EUR 1.3 billion in cash on deposit with the Banque de France);

- the financing of liquidity needs linked to compliance with regulatory ratios;
- the financing of the cash collateral of SFIL's hedging derivatives (EUR 1.88 billion).

The sources of financing used, other than the entity's equity, are as follows:

- privileged debt, i.e. the *obligations foncières* issued by CAFFIL (EUR 51.9 billion) and cash collateral received by CAFFIL (EUR 0.87 billion);
- the credit agreements signed in 2013 between SFIL and its shareholders: the financing provided by Caisse des dépôts et consignations and La Banque Postale totaled EUR 6.27 billion as of June 30th, 2017;
- the short-term debt securities issued by SFIL totaling EUR 2.48 billion as of June 30, 2017.

In addition, the SFIL Group has a large number of assets held by CAFFIL or SFIL that are directly eligible for refinancing by the central bank. The securities held by CAFFIL can be made available through European Central Bank refinancing operations, via the Banque de France. In the first half of 2017, there were no operations of this type, except for operational tests required for regulatory purposes.

Since the financing of the over-collateralization of CAFFIL is ensured by SFIL, especially by the credit agreements it has signed with its shareholders, the main liquidity risk entails the risk that CAFFIL may not be able to settle its privileged debt commitments by the due date because the gap between the repayment of its assets and privileged liabilities is too great. For SFIL, the liquidity risk lies in its ability to ensure financing of the over-collateralization of CAFFIL by recourse to its shareholders or by recourse to the market, and then to make the payment of the cash collateral of the swaps it has intermediated on behalf of CAFFIL.

Since the first half of 2017, SFIL is also required to ensure the refinancing of credit export transactions. Liquidity is provided by CAFFIL through the issuance of its *obligations foncières*.

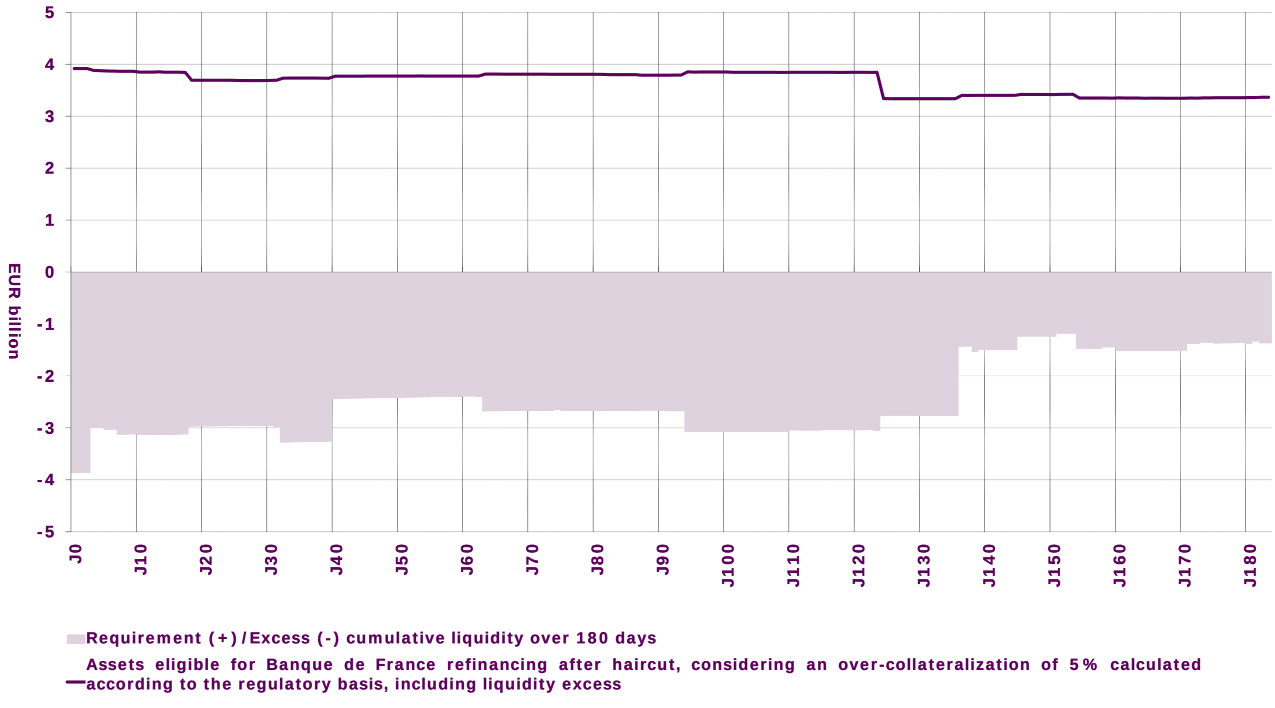
To reduce the liquidity risk, SFIL and CAFFIL mainly rely on static, dynamic and stress projections to ensure short- and long-term liquidity reserves, which allow them to meet their obligations.

SFIL and CAFFIL must also comply with regulatory liquidity ratios.

As of June 30, 2017, the situation was as follows:

For CAFFIL:

- LCR ratio: 462%
- Covering cash needs in 180 days:



- Gap between average life of the assets considered as pledged for the minimum amount to satisfy the regulatory coverage ratio and that of the liabilities: 0.1 year.

For SFIL:

LCR ratio: 840%

3. Legal and tax risks

3.1. LEGAL RISK

As of June 30, 2017, the number of ongoing legal proceedings involving public sector borrowers amounted to 36 versus 39 on December 31, 2016, 54 on June 30, 2016, 131 on December 31, 2015 and 210 on December 31, 2014.

Since the entry into effect on July 30, 2014, of the law on securing structured loan contracts signed by public sector entities, 27 legal decisions in favor of Dexia Credit Local and Caisse Française de Financement (including two decisions made in the context of an interlocutory proceeding) were rendered by the Tribunal de grande instance de Nanterre, the Tribunal de commerce de Nanterre and the Cour d'appel de Versailles, and only two decisions, relating to fixed-rate loans, were in whole or in part unsatisfactory, being noted these are first-instance judgments which are not yet final.

Alongside these legal proceedings, 179 borrowers signed settlement agreements with SFIL, Caisse Française de Financement Local and Dexia Credit Local, thus bringing litigation to a close.

3.2. TAX RISK

As of June 30, 2017, CAFFIL, a 100% subsidiary of SFIL, maintained a provision for additional income tax as established in 2015 following verification by French tax authorities concerning, for the fiscal years 2012 and 2013, taxation in Ireland of the income of the Dublin branch of Dexia Municipal Agency, which is now closed. The procedures and recourse related to CAFFIL's appeal of this decision remain in effect.

4. Operational risk and permanent control

4.1. OPERATIONAL RISK

Operational risk represents the risk of loss resulting from (i) the lack of adaptation or failure on the part of internal processes, staff, systems and (ii) external events. It includes risks linked to the security of IT systems, as well as legal and compliance risks. SFIL has chosen to incorporate the risk of reputation into this category but strategic risks are excluded. This definition is in line with the definition adopted by the Basel Committee. Management procedures for operational risks apply to all SFIL operating divisions. Equity requirements with regard to operational risks are calculated on the basis of the standard method. SFIL's policy with regards to the measurement and management of operational risks involves identifying and evaluating any and all risks as well as existing efforts to attenuate and control them in order to verify whether the level of residual risk is acceptable. This policy is complemented by: managing the security of IT systems, introducing a contingency plan to ensure business continuity, and, if required, insuring against certain risks.

The policy applied involves three main processes: the collection of operating incidents, the mapping of operational risks, and the monitoring of key operational risk indicators.

Executive officers and members of the Executive Committee and Board of Directors are regularly informed of changes in the mapping of operational risks, major operational incidents and key indicators of operational risks exceeding the alert thresholds, as well as corrective action plans defined to reduce the identified risks.

Considering the security measures in place, SFIL's information system has not been jeopardized by the ransomware viruses WannaCry and Petya which were disseminated around the world in May and June 2017.

4.2. PERMANENT CONTROL

Permanent control at SFIL ensures the efficiency and reliability of the risk control plan, the efficiency of the control of operations and internal procedures, the quality of accounting and financial information, and the quality of information systems. Permanent control measures apply to all bank divisions and activities.

Executive officers and members of the Executive Committee and Board of Directors are regularly informed of the results of permanent controls as well as corrective action plans defined when the results of the controls are not satisfactory.

5. Risk of non-compliance

The risk of non-compliance is the risk of a legal, administrative or disciplinary sanction, of financial loss or of damage to reputation as a result of non-respect of rules and regulations governing banking and financial activities, be they legislative or regulatory requirements, business practices, ethical standards or executive guidelines set in application of policy decisions taken by supervisory bodies.

The mission of the Compliance division is to ensure control of the risk of non-compliance as defined by article 10 of the *arrêté* of November 3, 2014, for all the activities of SFIL and Caisse Française de Financement Local.

Control of the risk of non-compliance aims to protect the reputation of the Group, its investors and its customers, promote good business practices, prevent conflicts of interest, safeguard the interest of customers and the integrity of the markets, fight against money laundering, corruption and the financing of terrorism, as well as respect financial embargos.

SFIL's Compliance division is autonomous, and independent of any operational entity, particularly commercial. It reports to the General Secretary, a member of SFIL's Executive Committee and designated as responsible for compliance by ACPR. Placed under the direct authority of the CEO, the General Secretary benefits from direct and independent access to the Risks and Internal Control Committee, as well as to the Board of Directors. It also acts as the correspondent for TRACFIN, within the framework of the requirements banks must respect concerning the fight against money laundering and the financing of terrorism.

Within the framework of these missions, Compliance implements a compliance control plan, ensures staff training in compliance control procedure, keeps watch to avoid risks to reputation, identifies incidents, infractions and dysfunctions through an *ad hoc* system and respects regulatory obligations in order to control the risk of money laundering and the financing of terrorism.

Operating results

Consolidated financial statements prepared in accordance with IFRS

The SFIL Group reported consolidated net income as of June 30, 2017, of EUR +25 million for a total balance sheet of EUR 77.6 billion at that date. The CET1 ratio of the Group stood at 23.3%, confirming its financial stability.

Income as of June 30, 2017, was impacted by items of adjustment of the valuation of the derivative portfolio for EUR +2 million before taxes and accounting for certain charges in application of IFRIC 21 for EUR -5 million.

EUR millions	6/30/2017				6/30/2016			
	Accounting income	*Fair value adjustments on hedging*	*Linearization of IFRIC 21 charges*	Recurring income	Accounting income	*Fair value adjustments on hedging*	*Linearization of IFRIC 21 charges*	Recurring income
Net banking income	**101**	*2*		**99**	**64**	*-33*		**97**
Operating expenses	**-61**		*-5*	**-55**	**-57**		*-4*	**-53**
Gross operating income	**40**	*2*	*-5*	**43**	**6**	*-33*	*-4*	**44**
Cost of risk	**1**			**1**	**7**			**7**
Income before taxes	**41**	*2*	*-5*	**44**	**13**	*-33*	*-4*	**51**
Corporate income tax	**-16**	*-1*	*1*	**-16**	**-6**	*11*	*1*	**-19**
Net income	**25**	*1*	*-4*	**28**	**7**	*-22*	*-4*	**32**

Restated [5] to account for these items, net income would be EUR +28 million, down EUR 4 million from June 30, 2016 [6].

A line-by-line analysis of this change, excluding items involving the adjustment of the valuations of derivatives and of the recognition of operating expenses, highlights the following points:

- net banking income stood at EUR +99 million for the first half of 2017, versus EUR 97 million in the first half of 2016. It was thus up EUR 2 million as compared with the previous year. This change accounts for a recovery of EUR 19 million in specific provisions subsequent to the improvement of the method of estimation of recoverable flows of doubtful commitments[7]. It should be recalled that income as of June 30, 2016, included a recovery of EUR +20 million linked to efforts to reduce the sensitivity of the structured loans and after the settlement of sums due. The balance of the change in net banking income is linked to the improvement in the margins related to balance sheet assets and liabilities;
- the Group's operating expenses and amortization totaled EUR -55 million, making progress in comparison with 2016 mainly buoyed by the rise in IT investments.;
- the cost of risk stood at EUR +1 million. As of June 30, 2016, the SFIL Group recorded a recovery of EUR 7 million on general provisions.

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[5] The restatements of non-recurrent items represented, as of June 30, 2017, a net amount after taxes of EUR 1.3 million for changes in the valuations of derivatives *vis-à-vis* Eonia, the valuation of risks covered and the IFRS 13 change in net income.

[6] The restatements of non-recurrent items represented, as of June 30, 2016, a net amount after taxes of EUR -21.8 million for changes in the valuations of derivatives vis-à-vis Eonia, the valuation of risks covered and the IFRS 13 change in net income.

[7] Within a context of the success of the policy to reduce sensitivity in 2016 and of confirmations of legal decisions favorable to the bank, SFIL was able to define in a reasonable and prudent manner the best method to estimate the recoverability of flows of doubtful loans on its balance sheet to take into account especially of the impact of the extension of payments over time. The application of this approach coherent with IFRS means that it is no longer systematically necessary to provision all the interest commitments in order to account for hypotheses of long-term recoveries. In this way, the net interest charge is improved by a recovery of provisions in the amount of EUR 19 million in the accounts as of June 30, 2017.

Outlook

During the first half of 2017, SFIL fully accomplished its fundamental missions and conducted new large export credit refinancing transactions. In this area, the acceleration of activity observed during the first half of 2017 with the negotiation of two new contracts is expected to continue during the second half of the year.
A new contract was signed at the end of July for three cruise ships to be delivered by STX to the American cruise line RCCL. SFIL's participation in this operation totals EUR 1.7 billion. For the whole year, SFIL will have contributed EUR 2.4 billion to the financing of EUR 4 billion in commissions for the STX ship building center in Saint-Nazaire, thereby playing a pivotal role in its operations.

Regarding the Group's refinancing, the second half of the year continued like the first half, with a program to issue CAFFIL's long-term bonds, which by mid-year had already achieved 2/3 of its annual program. During the first half of 2017, SFIL issued its first USD public bonds and should also issue EUR debt with a maturity above one year during the second half of 2017.

The bulk of the loan sensitivity activity has been carried out and the riskiest contracts, those indexed to EUR/CHF currencies, should decrease to a minimum by the end of 2017. The sharp drop in the number of legal proceedings as of June 30, 2017 (more than 80% drop), should pursue its reducing trend during the second half of the year.

SFIL entered the final stage of the project to simplify its information system launched in 2014. The project has moved forward as planned, with an objective to change the IT system at the beginning of 2018.

In the second half of 2017, SFIL will continue to define the goals of its strategic plan for 2021 with three main focuses. They involve maintaining the leadership acquired with LBP in the long-term financing of the local public sector, developing into a major player in export financing, and establishing long-term profitability in its activities.

2. Condensed consolidated financial statements in accordance with IFRS

Assets as of June 30, 2017

EUR millions	Note	12/31/2016	6/30/2017
Central banks		4,878	5,156
Financial assets at fair value through profit or loss		-	-
Hedging derivatives		6,441	5,191
Financial assets available for sale		2,037	2,748
Loans and advances due from banks	*2.1*	390	375
Loans and advances to customers	*2.2*	59,682	58,918
Fair value revaluation of portfolio hedge		3,053	2,656
Financial assets held to maturity		-	-
Current tax assets		0	8
Deferred tax assets		113	93
Property and equipment		7	6
Intangible assets		20	25
Accruals and other assets		2,316	2,459
TOTAL ASSETS		**78,937**	**77,635**

Liabilities as of June 30, 2017

EUR millions	Note	12/31/2016	6/30/2017
Central banks		-	-
Financial liabilities at fair value through profit or loss		4	4
Hedging derivatives		9,861	8,691
Due to banks	*3.1*	6,720	6,266
Customer borrowing and deposits		-	-
Debt securities	*3.2*	57,681	58,652
Fair value revaluation of portfolio hedge		1,198	1,004
Current tax liabilities		6	2
Deferred tax liabilities		-	-
Accruals and other liabilities		2,034	1,546
Provisions		45	46
Subordinated debt		-	-
EQUITY		**1,388**	**1,424**
Share capital		1,445	1,445
Reserves and retained earnings		53	71
Other comprehensive income		(128)	(117)
Net income		18	25
TOTAL LIABILIITES		**78,937**	**77,635**

Income statement

EUR millions	Note	First half 2016	First half 2017
Interest income	*5.1*	1,806	1,389
Interest expense	*5.1*	(1,715)	(1,297)
Fee and commission income		2	5
Fee and commission expense		(2)	(2)
Net result of financial instruments at fair value though profit or loss	*5.2*	(35)	5
Net result of financial assets		8	1
Other income		0	0
Other expense		(0)	(0)
NET BANKING INCOME		**64**	**101**
Operating expense	*5.3*	(55)	(58)
Depreciation and amortization of property and equipment and intangible assets		(3)	(3)
GROSS OPERATING INCOME		**6**	**40**
Cost of risk	*5.4*	7	1
OPERATING INCOME		**13**	**41**
Net gains (losses) on other assets		-	-
INCOME BEFORE TAX		**13**	**41**
Income tax		(6)	(16)
NET INCOME		**7**	**25**
Earnings per share (EUR)			
- Basic		0.72	2.67
- Diluted		0.72	2.67

Net income and unrealized or deferred gains and losses through equity

EUR millions		First half 2016	First half 2017
Net income		**7**	**25**
Items that may subsequently be reclassified as profit or loss		**(17)**	**11**
Unrealized or deferred gains and losses of financial assets available for sale		(21)	9
Unrealized or deferred gains and losses of cash flow hedges		(6)	8
Tax on items that may subsequently be reclassified as profit or loss		10	(6)
Items that may not be reclassified as profit or loss		-	-
Actuarial gains and losses on defined benefit plans	-	-	-
Tax	-	-	-
Total changes in unrealized gains and losses through equity		**(17)**	**11**
NET INCOME AND GAINS AND LOSSES THROUGH EQUITY		**(10)**	**36**

Consolidated statement of changes in equity

EUR millions	Share capital and reserves		Consolidated retained earnings	Total of gains and losses through equity		Net income	Total consolidated equity
	Share capital	Capital reserves		Net change in fair value of available for sale financial assets and pension plans with defined benefits, net of taxes	Net change in fair value of hedging derivatives, after tax		
EQUITY AS OF 12/31/2015	**1,445**	**-**	**113**	**(88)**	**(26)**	**(59)**	**1,385**
Capital increase	-	-	-	-	-	-	-
Issuance of preferred shares	-	-	-	-	-	-	-
Allocation of 2015 net income	-	-	(59)	-	-	59	-
Dividends paid on 2016 income	-	-	-	-	-	-	-
Subtotal of transactions with shareholders	***1,445***	-	***53***	**(88)**	**(26)**	**-**	***1,384***
Net income for the period	-	-	-	-	-	18	18
Changes in gains and losses through equity	-	-	-	(16)	2	-	(14)
EQUITY AS OF 12/31/2016	**1,445**	**-**	**53**	**(104)**	**(24)**	**18**	**1,388**
Capital increase	-	-	-	-	-	-	-
Issuance of preferred shares	-	-	-	-	-	-	-
Allocation of 2016 net income	-	-	18	-	-	(18)	-
Dividends paid on 2017 income	-	-	-	-	-	-	-
Subtotal of transactions with shareholders	***1,445***	**-**	***71***	**(104)**	**(24)**	-	***1,388***
Net income for the period	-	-	-	-	-	25	25
Changes in gains and losses through equity	-	-	-	5	6	-	11
EQUITY AS OF 6/30/2017	**1,445**	**-**	**71**	**(99)**	**(18)**	**25**	**1,424**

Cash flow statement

EUR millions	12/31/2016	6/30/2017
NET INCOME BEFORE TAXES	**49**	**75**
+/- Depreciation and write-downs	(18)	(13)
+/- Expense / income from investing activities	111	71
+/- Expense / income from financing activities	(69)	(100)
+/- Other non-cash items	297	7
= Non-monetary items included in net income before tax and other adjustments	***321***	***(35)***
+/- Cash from interbank operations	17	(436)
+/- Cash from customer operations	(958)	(704)
+/- Cash from financing assets and liabilities	1,920	(290)
+/- Cash from not financing assets and liabilities	343	(583)
- Income tax paid	(7)	(29)
= Decrease / (increase) in cash from operating activities	***1,315***	***(2,042)***
CASH FLOW FROM OPERATING ACTIVITIES (A)	**1,685**	**(2,002)**
CASH FLOW FROM INVESTING ACTIVITIES (B)	**(2)**	**-**
+/- Cash from or for shareholders	-	**(0)**
+/- Other cash from financing activities	(159)	2,283
CASH FLOW FROM FINANCING ACTIVITIES (C)	**(159)**	**2,283**
EFFECT OF CHANGES IN EXCHANGE RATES ON CASH (D)	**-**	**-**
INCREASE / (DECREASE) IN CASH EQUIVALENTS (A + B + C + D)	**1,524**	**281**
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD	**3,371**	**4,895**
Cash and balances with central banks (assets & liabilities)	3,361	4,878
Interbank accounts (assets & liabilities) and loans / sight deposits	10	17
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	**4,895**	**5,176**
Cash and balances with central banks (assets & liabilities)	4,878	5,156
Interbank accounts (assets & liabilities) and loans / sight deposits	17	20
CHANGE IN NET CASH	**1,524**	**281**

Notes to the condensed consolidated financial statements

1. Accounting policies and valuation methods

ACCOUNTING PRINCIPLES AND METHODS APPLIED

a. Scope of consolidation

The scope of consolidation for June 30, 2017, is the same as that of December 31, 2016.

b. Accounting policies and presentation rules

1. Applicable accounting standards

SFIL's half year consolidated statements as of June 30, 2017, have been prepared and presented in accordance with IAS 34 "*Interim Financial Reporting*". The accompanying notes relate to significant items of the half year and should therefore be read in conjunction with the audited consolidated accounts for the financial year ended December 31, 2016.

In addition, the Group's activities do not show any seasonal, cyclical or occasional aspects.

New accounting standards published but not yet applicable in the European Union

• IFRS 9 Financial Instruments: This standard, which will replace IAS 39, was adopted by the European Union on November 22, 2016, and will come into effect for fiscal years beginning on or after January 1, 2018. It sets out new principles for:

– classification and valuation of financial assets: accounting will be defined on the basis of the management model implemented, on the one hand, and the nature of the flows received (consisting exclusively of payments of principal and interest – "SPPI", or including other elements – "non-SPPI"), on the other hand;

– impairment for credit risk: the standard introduces a loss impairment model that requires to account for 12-month expected credit losses for all assets that enter into the balance sheet, and lifetime expected credit losses if the credit risk increased significantly since the initial recognition of the asset;

– hedge accounting, with the exception of macro-hedging transactions, which are to be the subject of a separate draft standard currently being studied by the IASB.

As for financial instruments recorded as liabilities on the balance sheet, the only change is the recognition of changes in fair value of one's own credit risk, for financial liabilities designated at fair value (fair value option). They will be recorded in shareholders' equity without any subsequent recycling in profit or loss.

Classification and Measurement

SFIL initiated in the second half of 2015 an analysis of the "classification and measurement" component of the new standard, with the aim of identifying potential impacts:

– a review of the instruments was carried out in order to identify the assets currently recognized at amortized cost which, owing to their contractual characteristics, will be recorded at fair value in the new framework;

– an analysis of the documentation of loan and bond contracts was carried out to identify the different contractual prepayment clauses and qualify them in relation to the future standard, which is the subject of a limited amendment proposal from the IASB on this point;

– the management model implemented has been formalized for the different portfolios of financial assets;

– on the basis of these first items, work is under way to evaluate the potential impacts of the entry into force of the new standard.

The main expected change relates to some loans that should be recorded at fair value through profit or loss, as they do not meet the cash flow criterion representing solely principal and interests. Work was carried out during the first half of 2017 to formalize the valuation methodology of these assets (which, given the absence of observable prices in an active market, will be based on a mark-to-model), and to assess:

– the expected impact on equity on the date of first application of the standard;

– the sensitivity of the result as of 2018, resulting from subsequent changes of credit spreads on these assets.

On the other hand, the policy implemented by SFIL to reduce loan sensitivity resulted in the transformation of a large number of loans with a structured ("non-SPPI") component into fixed or variable rate loans ("SPPI"). These transactions did not give rise to derecognition of the initial assets under IAS 39, as the financial conditions of the new loan comply with the principle of IAS 39 AG62. However, under IFRS 9, the terms of the restructured transaction are substantially different, as there is a change in the "SPPI" criterion, which is a key factor for the definition of the applicable accounting treatment. Since the application of the standard is retroactive, SFIL has therefore determined the impacts that would have resulted from derecognition of financial instruments on the date of the transformation. The corresponding impact (adjusted for the time-related amortization) will be recorded as a counterpart to equity on the date of first application of the standard.

Moreover, although SFIL's business model is essentially based on an asset holding activity in order to collect the contractual cash flows, a part of the securities portfolio, corresponding to the most liquid assets, may also be subject to sales. This sub-portfolio will be accounted for at fair value through other comprehensive income. The impact on equity on the date of first application of the standard will depend on the breakdown of the different portfolios between the two business models.

Impairment of Financial Assets

The analysis of the changes in the impairment methodology began in the first half of 2016. Work focused first on the definition of a significant increase of credit risk applied to the portfolio of loans to French local authorities, and on the assessment of the resulting impairment level.

SFIL plans to build on the advanced models it has defined for the prudential capital requirements for credit risk, supplementing them by taking into account additional information to integrate the forward-looking dimension.

Hedge accounting

In the case of hedge accounting, the standard leaves the choice, when first applying IFRS 9, to apply the new provisions or to maintain the provisions in force under IAS 39 until the entry into force of the future macro-hedging standard. SFIL has decided to maintain the provisions of IAS 39 for hedge accounting at the date of entry into force of IFRS 9. However, the Group will publish the financial information on hedge accounting that is required as a result of the amendments to IFRS 7 Financial Instruments: Disclosures.

Implementation of IFRS 9

The implementation of the new standard is based on a Steering Committee involving Executive Management, the Finance division, the Risks division, as well as the head of Information Systems.

Work on changes to the information systems related to this new standard has been integrated into the work plan and planning of the business teams and IT teams for 2017. All the components of the information system affected by the implementation of IFRS 9 are subject to tests which are partly integrated into the IT simplification and reinforcement program Oxygen.

The adaptation of the governance of SFIL and the integration of elements relating to the new standard into the existing procedures are in progress and will continue during the second half of 2017.

• <u>IFRS 15 Revenue from contracts with customers</u>: This standard, which deals with the accounting of income, was adopted by the European Union on September 22, 2016, and will apply from January 1, 2018.

2. Presentation of information and reporting date

The financial statements are prepared on a going concern basis. They are stated in millions of euros (EUR) unless otherwise specified.

The preparation of financial information requires management to resort to estimates and assumptions that affect the amounts reported. In order to make these assumptions and estimates, management uses the information available at the date of financial statement preparation and exercises its judgment. While management believes it has considered all available information when making these assumptions, actual results may differ from such estimates and the differences may have a material impact on the financial statements.

Judgments were principally made in the following areas:

- classification of financial instruments;
- determination of whether or not the market is active for financial instruments measured at fair value;
- hedge accounting;

- existence of a present obligation with probable outflows in the event of litigation;
- identification of impairment triggers.

These judgments are detailed in the corresponding sections of the applicable accounting standards.

Estimates were principally made in the following areas:

- determination of fair value for financial instruments measured at fair value;
- determination of the recoverable amount of impaired financial assets;
- estimates of future taxable profits for the recognition and measurement of deferred tax assets.

3. Accounting principles applied to the financial statements

Consolidation

The consolidated financial statements of SFIL include all entities under its control. Entities under control are fully consolidated.
The Group controls a subsidiary when the following conditions are met:
- the group has the power over the relevant activities of the entity, through voting rights or other rights;
- the group is exposed to or has rights to variable returns from its involvement with the entity; and
- the group has the ability to use its power over the entity to affect the amount of those returns.

The analysis of the level of control is reviewed when a change occurs in one of these criteria.
Subsidiaries are consolidated on the date that the Group gains control. All intra-group transactions and balances are eliminated on consolidation.

Offsetting financial assets and financial liabilities

Financial assets and financial liabilities are offset and the net amount is reported in the balance sheet when there is a legally enforceable right to set off the recognized amounts and there is an intention for both parties to settle on a net basis or realize the asset and settle the liability simultaneously.

Foreign currency transactions

Foreign currency transactions are accounted for using the exchange rate prevailing on the trade date. Monetary assets and liabilities denominated in foreign currencies are recognized at closing rates. Non-monetary assets and liabilities recognized at fair value and denominated in foreign currencies existing at the closing date are recorded at closing rates, whereas non-monetary assets and liabilities recognized at amortized cost are recorded at their historical rates.
Any resulting exchange differences from monetary assets and liabilities are recognized in the income statement, except for the foreign exchange impact of fair value adjustments on available-for-sale assets, which are recognized in equity. Foreign exchange differences from non-monetary assets and liabilities recognized at fair value are recorded as fair value adjustments.

Trade date and settlement date accounting

All purchases and sales of financial assets are recognized on settlement date, which is the date that a financial asset is received or delivered by the Group. Hedging instruments are recognized at fair value on trade date.

Financial assets

The management determines the appropriate classification of investments at their purchase. However, under certain circumstances, financial assets may be subsequently reclassified.

Loans and advances to banks and customers

Loans are defined as non-derivative financial assets with fixed or determinable payments that are not listed on an active market, other than:
- those that the entity intends to sell immediately or in the near future, which should be classified as held for trading, and those that the entity, upon initial recognition, designates as being at fair value through profit or loss;
- those that the entity, upon initial recognition, designates as available for sale; or
- those for which the holder may not recover substantially all of the initial investment for reasons other than the deterioration of credit, which should be classified as available for sale.

The Group recognizes loans and advances initially at fair value plus any directly attributable transaction costs.

Later estimates are made at amortized cost, less any impairment losses. Interest is calculated by the effective interest rate method and recognized in net interest income. The effective interest rate is the rate that exactly discounts expected future cash flows through the life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset. The calculation includes all fees paid or received by the Group that are an integral part of the effective interest rate of a financial asset, transaction costs and premiums or discounts.

Financial assets held to maturity

Listed securities with fixed maturity are classified as Financial assets held to maturity when management has both the intent and the ability to hold the assets to maturity.
Assets held to maturity are initially recognized at fair value (including transaction costs) and subsequently measured at amortized cost, less any impairment losses. Interest is recognized in net interest income using the effective interest rate method.

Financial assets available for sale

Assets intended to be held for an indefinite period of time and which may be sold in response to a need for liquidity or changes in interest rates, exchange rates or equity prices are classified as Available-for-sale financial assets.
Available-for-sale investments are initially recognized at fair value (including transaction costs). Interest on fixed income securities is recognized using the effective interest rate method in net interest income. Dividends received on variable income securities are recognized as Net gains (losses) on available-for-sale assets.
Unrealized gains and losses arising from fair value re-measurements are recognized in other comprehensive income. On disposal, the related accumulated fair value adjustments are reversed in the income statement in Net gains (losses) on available-for-sale assets.
When available-for-sale assets are restated as loans and advances at a later date on the basis of the October 2008 amendment to IAS 39, the reserve representative of changes in the fair value of available-for-sale financial assets as presented in the financial statements as of June 30, 2017, corresponds to the part of this reserve still to be amortized with regard to the securities restated as of October 1, 2008.

Financial assets held for trading

The Group does not hold any trading assets.

Financial assets designated at fair value through profit or loss

The Group does not use the option to designate its financial assets at fair value through profit or loss.

Realized gains and losses on sales of financial assets

For financial assets held at amortized cost, realized gains or losses on disposals are the differences between the proceeds received (net of transaction costs) and the costs or amortized costs of the assets. The cost is systematically determined based on the “first in, first out” approach (FIFO method) on a portfolio basis.
When available-for-sale assets are sold, cumulative gains and losses previously recognized in other comprehensive income are reversed in the income statement.

Accounting for prepayment penalties

The Group has determined the accounting principles applicable to the restructuring of loans in accordance with AG 62 of IAS 39 concerning financial liabilities.
Regarding the method of accounting for prepayment penalties, there are several possibilities depending on whether the prepayment is recognized as being a prepayment with refinancing or an extinguishment without refinancing.
<u>Prepayment with refinancing</u>
The method of accounting for prepayment penalties differs depending on whether the restructuring conditions are substantially different from those set initially.
In line with the principles of AG 62 of IAS 39, the Group considers that the conditions are substantially different when the net present value of the cash flows under the new conditions, including any fees paid net of any fees received, is more than 10% different from the discounted net present value of the cash flows remaining from the original loan.
If the eligibility test is passed (i.e. the difference in net present value is less than 10%), any prepayment penalties are amortized over the term of the new loan, as there is continuity between the two operations. If not (i.e. the difference exceeds 10%), prepayment penalties are recognized immediately in the income statement.

Prepayment without refinancing
When a loan has been extinguished, the Group recognizes prepayment penalties and any gains or losses of unamortized premium or discount, as income for the period.

Impairment of financial assets

The Group records impairment charges when there is objective evidence that a financial asset or group of financial assets is impaired, as a result of one or more events occurring since initial recognition and when that loss event has an impact on the estimated future cash flows that can be reliably estimated. Impairment represents management's best estimate of losses in the value of assets at each balance-sheet date.

Financial assets measured at amortized cost

The Group first assesses whether objective evidence of impairment exists for a financial asset when taken individually. If no such evidence exists, the financial asset is included in a group of financial assets with similar credit risk characteristics and collectively assessed for impairment.

- Determination of the impairment
  - Individually assessed financial assets: if there is objective evidence that loans or other receivables, or held-to-maturity assets are impaired, the impairment charge is calculated as the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, net of any guarantees and collateral, discounted at the financial instrument's original effective interest rate (except for reclassified assets, see below). When an asset is individually impaired, it will be excluded from the portfolio on which a collective impairment is calculated. As from the impairment of the asset, the Interest and similar income section of the income statement records the theoretical remuneration of the asset calculated by applying the original effective interest rate to the net book value of impairment.
  - Collective impairment: this covers the risk of loss in value not covered by specific impairment where there is objective evidence that probable losses are present in certain segments of the portfolio or other lending commitments at the balance-sheet date. These losses are estimated on the basis of past performance and historical loss experience in each segment and the current economic environment in which borrowers operate. For this purpose, the Group uses a credit risk model based on an approach that combines default probabilities and losses in the event of default. These models are subject to regular back-testing and are based on Basel III data and risk models, consistent with the incurred loss model.

- Accounting treatment of the impairment
  Impairment charges are recognized in the income statement in Cost of risk. If the amount of impairment subsequently decreases due to an event occurring after its recognition, the excess is written back by reducing the impairment allowance account accordingly. The write-back is credited to the Cost of risk.
  When an asset is determined by management as being irrecoverable, the outstanding specific impairment is reversed via the income statement, in Cost of risk, and the net loss is recorded under the same heading. Subsequent recoveries are also accounted for in this heading.

Reclassified financial assets

Regarding impairment, reclassified financial assets follow the same rules as financial assets initially valued at amortized cost for calculation of the impairment. If there is objective evidence that reclassified financial assets are impaired, the amount of the impairment on reclassified assets is calculated as the difference between the net carrying amount of the asset and the net present value of the expected cash flows discounted at the effective interest rate at the date of reclassification. Any existing unamortized available-for-sale reserve will be taken to the profit or loss account in Cost of risk.
In the event of a positive update to expected cash flows, the impairment amount is reversed through net interest income over the new schedule of expected cash flows, not by a reversal of impairment.

Available-for-sale assets

Impairment of available-for-sale financial assets is recognized on an individual basis if there is objective evidence of impairment as a result of one or more events occurring since their initial recognition. Available-for-sale assets are only subject to specific impairment.

- Determination of the impairment
  The Group only holds available-for-sale debt securities. Their impairment is triggered by the same criteria as those applied to financial assets valued at amortized cost (see above).

- Accounting treatment of the impairment
  When available-for-sale assets are impaired, the total AFS reserve is recycled into profit or loss and the Group reports these impairment losses in the income statement in Cost of risk (for debt instruments) or Net result of financial assets available for sale (for equity instruments). Any subsequent decline in fair value constitutes an additional impairment loss, recognized in the income statement. In the event of an increase in the fair value of an interest bearing financial instrument that relates objectively to an event occurring after the last impairment was recognized, the Group recognizes a reversal of the impairment loss in the income statement in Cost of risk when the available-for-sale asset is a fixed income financial asset.

<u>Off-balance sheet commitments</u>

Off-balance sheet commitments such as credit substitutes (e.g. guarantees and standby letters of credit) and loan commitments are converted into on-balance sheet items when called. However, under specified circumstances such as uncertainty about the counterparty's creditworthiness, the off-balance sheet commitment should be classified as impaired if the creditworthiness has deteriorated to an extent that makes repayment of any loan and associated interest payments doubtful.

Sale and repurchase agreements (including securities lending)

Sold securities that are subject to a commitment to repurchase them at a predetermined price (repos) are not de-recognized and remain on the balance sheet in their original category. The corresponding liability is included in Customer borrowings and deposits or Due to banks as appropriate. The asset is reported as pledged in the notes.

Securities purchased under commitment to sell (reverse repos) are recorded as off-balance sheet items and the corresponding loans are recorded in Loans and advances to customers or Loans and advances to banks as appropriate.

The difference between the sale and repurchase price is recognized as interest income or expense and is amortized over the maturity of the agreement using the effective interest rate method.

Securities lent to third parties are retained in the financial statements. Securities borrowed are not recognized in the financial statements. If these borrowed securities are sold on to third parties, an obligation to return them is recorded at fair value in Financial liabilities at fair value through profit or loss, and any gains or losses are included in Net gains (losses) on financial instruments at fair value through profit or loss.

Financial liabilities

Liabilities designated at fair value through profit or loss

The Group does not use this option.

Financial liabilities at amortized cost

Financial liabilities at amortized cost are recognized initially at fair value, being their issue proceeds net of directly attributable transaction costs incurred. They are subsequently measured at amortized cost and any difference between their initial carrying amount and the redemption value is recognized in the income statement over the expected life of the instruments using the effective interest rate method.

Financial liabilities at amortized cost include *obligations foncières* and other resources that benefit from the privilege on assets defined in article L.513-11 of the Monetary and Financial Code.

Obligations foncières are recorded at nominal value. Reimbursement and issue premiums are amortized according to a quasi-actuarial method over the expected life of the securities concerned, as of the first year, *prorata temporis*. They are recorded on the balance sheet in items corresponding to the type of debt concerned. The amortization of these premiums is recorded in the income statement as interest income and expense on debt securities.

In the case of bonds issued above par, the amortization of issue premiums is deducted from related interest income on debt securities.

Interest paid on *obligations foncières* is accounted for as interest expense on debt securities for accrued amounts, due and not yet due, calculated *prorata temporis* on the basis of contractual rates.
Fees paid on bond issues are amortized according to a quasi-actuarial method over the life of the related financial liabilities.

Bonds denominated in other currencies are treated in the same way as foreign exchange transactions (see above - Foreign currency transactions).

Registered covered bonds are private placements recorded at nominal value. Issue premiums and interest expense are treated the same way as for *obligations foncières* (see above).

Pursuant to article L.513-12 and article R.513-8 of the Monetary and Financial Code, total assets must at all times be greater than 105% of total liabilities benefiting from the privilege mentioned in article L.513-11 of the above-mentioned Monetary and Financial Code.

Derivatives

All derivatives are initially recognized on the balance sheet at fair value and then are revalued at their fair value. The fair value of derivatives is calculated either on the basis of prices observed in listed markets or by using internal valuation models.

The amount registered on the balance sheet includes the premium paid or received after amortization, the amount of changes in fair value and accrued interest, which altogether make up the fair value of the derivative. Derivative instruments are recorded as assets if their fair value is positive and as liabilities if it is negative.

Derivatives not documented in a hedging relationship

Derivatives that do not qualify for hedge accounting are considered to be trading instruments. Gains and losses from changes in their fair value are reported in Net result of financial instruments at fair value though profit or loss.

As of June 30, 2017, trading derivatives resulted from operations in which hedge ineffectiveness arose after the hedged items were impaired. Gains and losses (realized and unrealized) were recognized as Net result of financial instruments at fair value through profit and loss.

Hedging derivatives

Hedging derivatives can be categorized as either:
- hedges of the fair value of a recognized asset or liability or a firm commitment (fair value hedge);
- hedges of a future cash flow attributable to a recognized asset or liability or forecast transaction (cash flow hedge).

Hedge accounting may be used for derivatives designated in this way, provided certain criteria are met:
- formal documentation of the hedging instrument, hedged item, hedging objective, strategy and relationship between the hedging instrument and the hedged item must be prepared before hedge accounting is applied;
- the hedge is documented showing that it is expected to be effective both prospectively and retrospectively in offsetting changes in fair value or cash flows attributable to the hedged risk on the hedged item throughout the reporting period;
- the hedge shall be effective at inception and on a going concern basis.

Changes in the fair value of derivatives that are designated and documented in a fair value hedging relationship, and that respect the criteria set out above, are recorded in the income statement, along with the corresponding change in fair value of the hedged assets or liabilities that are attributable to that specific hedged risk.

Regarding notably structured financial instruments, the existence of a perfect hedge with a derivative, and the documentation of the associated hedging relationship, have the effect of re-evaluating the hedged risk of the financial instrument, in parallel with the revaluation of the hedging derivative. This results in the same accounting effects as if the derivative embedded in the financial instrument has been separated.

If at any time the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged interest-bearing financial instrument is amortized to profit or loss over the residual maturity of the hedged item by adjusting the yield on the hedged item.

The efficient portion of the changes in the fair value of derivatives that are designated in a cash flow hedging relationship, that respect the criteria set out above, and that prove to be efficient in relation to the hedged risk, is recognized in equity as Unrealized or deferred gains and losses of cash flow hedges. The non-efficient portion of the changes in the fair value of the derivatives is recognized in the income statement.

Amounts deferred in equity are transferred to the income statement and classified as income or expense in the periods during which the hedged firm commitment or forecast transaction affect the income statement.

Hedging of the interest rate risk of a portfolio

The Group uses the provisions of IAS 39 as adopted by the European Union (IAS 39 carve-out) because it better reflects the way the Group manages its financial instruments.

The objective of hedging relationships is to reduce the interest rate risk exposure stemming from certain categories of assets or liabilities designated as the qualifying hedged items.

The Group performs a comprehensive analysis of its interest rate risk exposure. It consists in assessing fixed-rate exposure generated by all fixed-rate balance sheet items. It selects financial assets and liabilities to be included in the hedge of the portfolio's interest rate risk exposure. The same methodology is constantly applied to select financial assets and liabilities that are included in the portfolio. Financial assets and liabilities are classified by time-buckets. Hence, when they are removed from the portfolio, they must be removed from all time-buckets on which they have an impact.

The Group chose to put together homogeneous portfolios of loans and portfolios of bonds. Based on this gap analysis, which is realized on a net basis, the Group defines at inception the risk exposure to be hedged, the length of time-buckets and the testing method and frequency.

Hedging instruments are made up of a portfolio of derivatives, in which positions may be offset. Hedging items are recognized at fair value (including accrued interest expense or income) with adjustments recorded in the income statement.

Revaluation related to the hedged risk is recognized on the balance sheet (in asset or liability depending on positive or negative revaluation) as Fair value revaluation of portfolio hedge.

Fair value of financial instruments

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal, or in its absence, the most advantageous market to the Group has access to that date. The fair value of a liability reflects its non-performance risk, which includes the Group's own credit risk.

Market prices are used to determine fair value where an active market exists. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on a going concern basis. Active market prices are not, however, available for a significant number of the financial assets and liabilities held or issued by the Group.

If the financial instrument is not listed on an active market, valuation techniques are used. Valuation techniques include the use of data from recent arm's length market transactions between knowledgeable, willing parties, if available, reference to the current fair value of another instrument that is substantially the same, and valuation models.

A valuation model reflects what the transaction price would have been on the measurement date in current market conditions. The valuation model incorporates all the factors that market participants would consider when pricing a transaction. Within this framework, the Group uses its own valuation models and market assumptions, i.e. present value of cash flows or any other techniques based on market conditions existing at the balance-sheet date.

Fair value of financial instruments measured at amortized cost

The following comments are applicable to the fair value of loans and advances presented in the notes.
- The fair value of fixed-rate loans is estimated by comparing market interest rates when the loans were granted with current market interest rates offered on similar loans.
- Caps, floors and early repayment options are included in determining the fair value of loans and advances.

Financial instruments measured at fair value

Available-for-sale financial assets and derivatives are measured at fair value by reference to listed market prices when available. When listed market prices are not available, fair values are estimated on the basis of pricing models or discounted cash flows, using observable or non-observable market data.

For available-for-sale investments, when listed prices are not available, the pricing models attempt to reflect as accurately as possible the market conditions on the valuation date as well as any changes in the credit quality of these financial instruments and the market liquidity.

To determine the fair value of its derivatives, the Group uses different discount curves depending on whether collateral was actually exchanged. Collateralized derivatives are discounted using an OIS-based curve. Uncollateralized transactions are discounted with a Euribor-based curve.

This differential treatment reflects the different financing cost associated with the derivatives used (FVA - Funding Valuation Adjustment).

As a reminder, the entity Caisse Française de Financement Local does not pay any collateral to its derivative counterparties, which benefit from the legal privilege on assets, as well as the legal holders of covered bonds.

In addition, a value adjustment is included in the fair value of derivatives to reflect the impact of counterparty credit risk (CVA - Credit Valuation Adjustment) or the Group's own credit quality (DVA - Debit Valuation Adjustment). Value adjustment allows switching from a fair value based on cash flows discounted at risk-free rate, i.e. into a fair value including credit risk. Its calculation is based on the risk exposures combined with loss rates including market parameters.

Interest income and expense

For all interest-bearing instruments at amortized cost, interest income and expense are recognized in the income statement using the effective interest rate method (including transaction costs).

The effective interest rate is the rate that exactly discounts expected future cash flows through the life of the financial instrument, or when appropriate, a shorter period to determine the net carrying amount of the financial asset.

The calculation of this rate includes commissions received or paid that are an integral part of the effective interest rate due to their nature, transaction costs and any premiums and discounts.

Transaction costs are incremental costs that are directly attributable to the acquisition of a financial asset or liability and are used for the calculation of the effective interest rate.

Accrued interest is recognized on the balance sheet in the same item as the related financial asset or liability.
Once an interest-bearing financial asset has been written down to its estimated recoverable amount, interest income is thereafter recognized based on the interest rate used to discount the future cash flows in order to measure the impairment loss.

Fee income and expense

Most of fees arising from the Group's activities are recognized on an accrual basis over the life of the underlying transaction.

Loan commitment fees are recognized as an adjustment to the effective interest rate and recorded in Interest income if the loan is granted. They are recorded as fee income on the expiry date of the commitment if no loan has been granted.

Deferred taxes

Deferred taxes are recognized using the liability method to account for temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. The tax rates enacted or substantively enacted at the balance-sheet date are used to determine deferred taxes.

Deferred tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

Deferred tax liabilities are recognized to account for temporary differences arising from investments in subsidiaries, jointly controlled companies and associates, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the difference will not reverse in the foreseeable future.

Deferred taxes relating to fair value re-measurements of available-for-sale investments and cash flow hedging instruments, and other operations which are charged or credited directly to other comprehensive income, are also credited or charged to other comprehensive income.

Provisions

Provisions mainly include provisions for litigations, restructuring, and off-balance sheet loan commitments.

A provision is measured at the present value of the expenditures expected to be required to settle the obligation. The discount rate used is the pre-tax rate that reflects current market assessments of the time value of money.
Provisions are recognized when:

- the Group has a present legal or constructive obligation as a result of past events;
- it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- a reliable estimate of the amount of the obligation can be made.

Provisions on loan commitments are accounted for according to the same method used for financial assets valued at amortized cost.

Tangible and intangible assets

Fixed assets consist exclusively of operating tangible and intangible assets. These assets are held for production or administrative purposes. Fixed assets are recognized as assets if:

- it is probable that the associated future economic benefits will flow to the entity, and
- their cost can be measured reliably.

Fixed assets are recorded at acquisition cost plus any directly attributable expenses.

Software developed internally, when it meets the criteria for recognition, is recorded at its development cost, which includes external expenditures on hardware and services and staff expenses that can be directly attributed to its production and preparation for use.

After initial recognition, assets are carried at cost less accumulated depreciation and impairment. When they are ready to be used, assets are depreciated linearly over their expected useful life. Depreciation is recognized in Depreciation, amortization and impairment of tangible and intangible assets.

The Group applies the component approach to all of its assets. The depreciation periods are as follows:

Components	**Depreciation period**
Technical Installations	10 - 20 years
Fixtures and fittings	10 - 20 years
IT equipment	3 years
Software developed or acquired*	3 or 5 years
Office equipment	2 - 12 years

** Purchased licenses and equipment are depreciated over 3 years. The depreciation period of internally developed software depends on whether it is strategic for the company. If considered strategic, it is depreciated over five years; if not, it is amortized over three years.*

Fixed assets are tested for impairment when impairment indicators are identified. When the carrying amount of an asset is greater than its estimated recoverable amount, an impairment charge is recognized and the carrying amount of the asset is written down to the estimated recoverable amount. Impairment charges are recognized in Depreciation, amortization and impairment of tangible and intangible assets.

Gains or losses on disposal of assets are charged to Gains or losses on assets.

Leases

SFIL contracts leases as lessee. Agreements that transfer to counterparties substantially all the risks and rewards incidental to the ownership of assets, but not necessarily legal title, are classified as finance leases. All other leases are classified as operating leases.

Under finance leases, leased assets are reported in Property, plant and equipment at their fair value or, if lower, the present value of the minimum lease payments. Subsequently, they are recognized in accordance with accounting rules applicable to Property, plant and equipment. Corresponding liabilities are recorded as Accruals and other liabilities and finance charges payable are recognized in the income statement using the effective interest method.

Under operating leases, leased assets are not recognized on the balance sheet. Rentals payable under operating leases are accounted for on a straight-line basis over the periods of the leases. When leases are terminated early, all penalties payable to the lessor are reported as expenses in the period in which the termination has occurred.

Employee benefits

Employee benefits are classified in four categories, as follows.

Short-term benefits

Short-term benefits are those expected to be settled wholly in twelve months after the end of the annual reporting period during which employee services are rendered.
The undiscounted amount of the benefits expected to be paid in respect of service rendered by employees in an accounting period is recognized in that period.

Post-employment benefits

Post-employment benefits are only made of defined contribution plans.

The assets of these plans are generally held by insurance companies or pension funds. The pension plans are generally funded by payments from both SFIL and its employees.
Under defined benefit plans, SFIL has the obligation to provide the agreed benefits to current and former employees. Actuarial and investment risks fall on SFIL; as a result, this obligation is measured and recognized as a liability.

Post-employment benefit obligations under defined benefit plans are measured using an actuarial valuation technique that includes demographic and financial assumptions and the Projected Unit Credit Method, under which each period of service gives rise to an additional unit of benefit entitlement and each unit is measured separately to build up the final obligation.

The defined benefit net liability recognized in the balance sheet represents the present value of defined benefit obligations reduced by the fair value of plan assets (if any).
When the fair value of assets exceeds the amount of the obligation, an asset is recognized if it represents a future economic benefit for SFIL in form of a reduction in future contributions to the plan or a future partial refund.

The net charge to the income statement comprises the current service cost, the past service arising from plan amendments or curtailments and the net interest costs. The measurement of defined benefit net liability (or asset) and the fair value of assets is subject to adjustments as a result in changes in actuarial assumptions. Actuarial gains and losses resulting from these adjustments are recognized in other comprehensive income.

Other long-term benefits

These benefits are generally related to length of service, such as long-service awards. Their payment is deferred for more than twelve months after the end of the annual period during which the employees rendered the related service.

Employee entitlement to annual leave or long-service leave is recognized when it is granted to the employee. A provision is recorded to estimate the liability for annual leave and long-service leave arising from services rendered by employees up to the balance-sheet date.

Actuarial gains and losses relating to these benefits are immediately recognized in the profit and loss account.

Termination benefits

Termination benefits are employee benefits payable as a result of either SFIL's decision to terminate an employee's employment before the normal retirement date, or an employee's decision to accept voluntary redundancy in exchange for those benefits.

Termination benefits are recorded as expenses only when SFIL no longer has the option to withdraw its compensation offer. Termination benefits due more than twelve months after the balance sheet date are discounted.

Dividends on shares

Dividends on shares are recognized in liabilities in the period in which they are declared (they must be authorized). Dividends for the year that are declared after the balance sheet date are disclosed in the note on post-closing events.

Earnings per share

Basic earnings per share before dilution are calculated by dividing net income available for shareholders by the weighted average number of shares outstanding.

Related-party transactions

Two parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party when making financial or operational decisions. SFIL is owned by the French State and by two companies registered in France, Caisse des dépôts et consignations and La Banque Postale. Within this framework, related parties include shareholders and members of the Board of Directors.

Segment reporting

The Group's activity involves the financing or refinancing of loans to public sector entities and exporters.
The Group conducts its business solely from Paris. It has no direct activity in other countries and is unable to present a relevant geographic breakdown of its results.

Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalents include balances at central banks and interbank deposits at sight.

2. Notes to the assets (EUR millions)

2.1 - LOANS AND ADVANCES DUE FROM BANKS

Analysis by nature	12/31/2016	6/30/2017
Sight accounts	12	13
Other loans and advances due from banks	378	362
Performing assets	**390**	**375**
Impaired loans and advances	-	-
Impaired assets	-	-
Total assets before impairment	**390**	**375**
Specific impairment	-	-
Collective impairment	-	-
TOTAL	**390**	**375**

2.2 - LOANS AND ADVANCES TO CUSTOMERS

Analysis by counterparty	12/31/2016	6/30/2017
Public sector	56,469	55,777
Other - guaranteed by a State or local government	2,751	2,670
Other - loans to SFIL's employees	11	8
Performing assets	**59,231**	**58,455**
Impaired loans and advances	557	549
Impaired assets	**557**	**549**
Total assets before impairment	**59,788**	**59,004**
Specific impairment[(1)]	(60)	(41)
Collective impairment	(46)	(45)
TOTAL	**59,682**	**58,918**
of which eligible for central bank refinancing	*39,122*	*39,090*
of which assets assigned in guarantee to the central bank	-	-

The loans depreciated concern customers that represent an identified credit risk (non-performing loans: EUR 523 million) and customers with unpaid loans corresponding to disagreement on the amount due (compromised non-performing loans: EUR 26 million).

SFIL, through its subsidiary Caisse Française de Financement Local, reduced its level of collective provisions in light of the success of its policy to reduce the sensitivity of the concerned structured loans.

Assets considered as "forborne" by SFIL concern exposures to loan contracts for which concessions have been granted in light of the borrower’s financial difficulties (recognized or forthcoming) that would not have been granted under other circumstances. These concessions may be either a waiver of a part of the debt, a rescheduling of the loan repayment, restructuring measures through an amendment to the loan contract, or a partial or full refinancing of the loan with a new contract, including for transactions aimed at reducing the sensitivity of the loan.

There were 207 forborne contracts as of June 30, 2017, with 106 borrowers, for a total of EUR 1,445 million.

[(1)] Within a context of the success of the policy to reduce sensitivity in 2016 and of confirmations of legal decisions favorable to the bank, SFIL was able to define in a reasonable and prudent manner the best method to estimate the recoverability of flows of doubtful loans on its balance sheet to take into account especially of the impact of the extension of payments over time. The application of this approach coherent with IFRS means that it is no longer systematically necessary to provision all the interest commitments in order to account for hypotheses of long-term recoveries. In this way, the net interest charge is improved by a recovery of provisions in the amount of EUR 19 million in the accounts as of June 30, 2017.

3. Notes to the liabilities (EUR millions)

3.1. DUE TO BANKS

Analysis by nature	12/31/2016	6/30/2017
Demand deposits	-	-
Term deposits	6,720	6,266
TOTAL	**6,720**	**6,266**

Analysis by nature	12/31/2016	6/30/2017
Current account	-	-
Interest accrued not yet due	-	-
Long-term borrowing	6,713	6,261
Interest accrued not yet due	7	5
Sight accounts	-	-
TOTAL	**6,720**	**6,266**

3.2. DEBT SECURITIES

Analysis by nature	12/31/2016	6/30/2017
Certificats de dépôt	595	582
Euro medium term notes[1]	976	1,838
Obligations foncières	48,289	48,399
Registered covered bonds	7,821	7,833
TOTAL	**57,681**	**58,652**

[1] Contrary to CAFFIL's *obligations foncières* and registered covered bonds, the bonds issued by SFIL do not benefit from the legal privilege.

4. Other notes on the balance sheet (EUR millions)

4.1. TRANSACTIONS WITH RELATED PARTIES

Analysis by nature	Parent company [1]		Other related parties [2]	
	12/31/2016	6/30/2017	12/31/2016	6/30/2017
ASSETS				
Loans and advances	-	-	-	-
Bonds	-	-	100	157
LIABILITIES				
Due to banks - sight accounts	-	-	-	-
Due to banks - term loans	-	-	6,720	6,266
INCOME STATEMENT				
Interest income on loans and advances	-	-	(4)	(2)
Interest income on bonds	-	-	37	10
Interest expense on borrowing	-	-	(13)	(6)
Fees and commissions	-	-	0	0
OFF-BALANCE SHEET				
Foreign exchange derivatives	-	-	-	-
Interest rate derivatives	-	-	863	694
Commitments and guarantees received	-	-	5,023	5,474
Commitments and guarantees issued	-	-	5,220	5,130

[1] This item exclusively includes Caisse Française de Financement Local, which is fully consolidated.

[2] This item includes transactions with Caisse des dépôts et consignations and La Banque Postale, shareholders of SFIL.

4.2. BREAKDOWN OF GOVERNMENT BONDS IN A SELECTION OF EUROPEAN COUNTRIES

Breakdown of government bonds in a selection of European countries

The credit risk exposure reported represents the accounting net carrying amount of exposures, i.e. the notional amounts after deduction of specific impairment and taking into account accrued interest.

	12/31/2016					
	Spain	**Ireland**	**Italy**	**Portugal**	**Greece**	**Total**
Financial assets available for sale	302	-	458	-	-	760
Financial assets held for trading	-	-	-	-	-	-
Held to maturity investments	-	-	-	-	-	-
Loans and advances to customers	-	-	113	-	-	113
TOTAL	**302**	**-**	**571**	**-**	**-**	**873**
Unrealized gains and losses on available-for-sale securities	**0**	**-**	**(64)**	**-**	**-**	**(64)**
Unrealized gains and losses on loans and receivable securities	**-**	**-**	**-**	**-**	**-**	**-**

	6/30/2017					
	Spain	**Ireland**	**Italy**	**Portugal**	**Greece**	**Total**
Financial assets available for sale	304	-	454	-	-	758
Financial assets held for trading	-	-	-	-	-	-
Held to maturity investments	-	-	-	-	-	-
Loans and advances to customers	-	-	115	-	-	115
TOTAL	**304**	**-**	**569**	**-**	**-**	**873**
Unrealized gains and losses on available-for-sale securities	**1**	**-**	**(60)**	**-**	**-**	**(59)**
Unrealized gains and losses on loans and receivable securities	**-**	**-**	**-**	**-**	**-**	**-**

5. Notes to the income statement (EUR millions)

5.1. INTEREST INCOME - INTEREST EXPENSE

	First half 2016	First half 2017
INTEREST INCOME	**1,806**	**1,389**
Central banks	0	-
Loans and advances due from banks	6	1
Loans and advances to customers	756	684
Financial assets available for sale	19	18
Financial assets held to maturity	-	-
Derivatives used for hedging	1,014	685
Impaired assets	-	-
Other	11	1
INTEREST EXPENSE	**(1,715)**	**(1,297)**
Accounts with central banks	(6)	(8)
Due to banks	(16)	(6)
Customer borrowing and deposits	-	-
Debt securities	(827)	(687)
Subordinated debt	-	-
Derivatives used for hedging	(866)	(595)
Other	(0)	(1)
INTEREST MARGIN	**91**	**92**

5.2. NET RESULT OF FINANCIAL INSTRUMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS

	First half 2016	First half 2017
Transaction net income	(8)	8
Net income from hedge accounting	(27)	(3)
Net income on foreign exchange transactions	(0)	0
TOTAL	**(35)**	**5**

All interest received and paid on the assets, liabilities and derivatives is recognized as net interest income, as required under IFRS.

Consequently, the net gains or losses on hedging operations merely include the change in the clean value of the derivatives and the re-valuation of the assets and liabilities registered in relation to the hedge.

Analysis of the net income from hedge accounting

	First half 2016	First half 2017
Fair value hedges	**(8)**	**1**
Fair value changes related to the hedged risk	603	8
Fair value changes of hedging derivatives	(611)	(7)
Cash flow hedges	**-**	**-**
Fair value changes of hedging derivatives - ineffective	-	-
Interruption in the hedging relationship of cash flow (cash flow for which a strong probability is not ensured)	-	-
Covering of portfolio hedge	**(0)**	**(0)**
Fair value changes related to the hedged risk	421	(170)
Fair value changes of hedging derivatives	(421)	170
CVA/DVA impact[1]	**(19)**	**(4)**
TOTAL	**(27)**	**(3)**

(1) The effect of the application of IFRS 13 brought to light a net charge as of June 30, 2017, of EUR 4 million for the year; this amount was derived using the DVA income for EUR 7.4 million and the CVA for EUR 3.4 million.

5.3. OPERATING EXPENSES

	First half 2016	First half 2017
Payroll costs	(24)	(25)
Other general and administrative expenses	(21)	(21)
Taxes	(10)	(12)
TOTAL	**(55)**	**(58)**

5.4. COST OF RISK

	First half 2016			First half 2017		
	Collective impairment	Specific impairment and losses	Total	Collective impairment	Specific impairment and losses	Total
Credit (loans, commitments and securities held to maturity)	6	1	7	1	0	1
Fixed income securities available for sale	-	-	-	-	-	-
TOTAL	**6**	**1**	**7**	**1**	**0**	**1**

6. Off-balance sheet notes (EUR millions)

6.1. GUARANTEES

	12/31/2016	6/30/2017
Guarantees received from credit institutions	84	73
Enhanced guarantees received [(1)]	2,597	3,168
Loan guarantee commitments received	3,722	3,168
Guarantees received from customers [(2)]	2,863	2,759

[(1)] Irrevocable, unconditional guarantees issued by the French State and received by SFIL for funding major export credits.

[(2)] Guarantees received from customers are generally given by local governments.

6.2. FINANCING COMMITMENTS

	12/31/2016	6/30/2017
Loan commitments granted to credit institutions	-	-
Loan commitments granted to customers [(1)]	2,722	3,311
Loan commitments received from credit institutions [(2)]	4,972	5,423
Loan commitments received from customers	-	-

[(1)] The financing commitments on loans and lines of credit corresponded to contracts issued but not paid out as of June 30, 2017. The amount mainly included commitments on operations in the new business line of export credit.

[(2)] At of June 30, 2017, this item concerned a firm and irrevocable commitment by the Caisse des dépôts et consignations and La Banque Postale to make available to SFIL the funds required.

7. Notes on risk exposure (EUR millions)

7.1. FAIR VALUE

This note presents the fair value adjustments that are not recognized, in income or in equity, because they correspond to assets or liabilities valued at amortized cost in the IFRS accounts.

These fair value adjustments take into account the features of the relevant assets and liabilities (maturity, hedging of interest rate risk, amortization profile, and, for assets, their rating); they also take into account current market conditions in terms of price or spread of these same operations, or operations to which they could be equated. The breakdown of assets and liabilities as a function of the method used to determine their fair value is shown in Note c. below; it can be seen that most assets are valued according to a technique that takes into account the fact that significant parameters are not observable for the assets since the exposure primarily consists of loans, a form of debt that is not listed on liquid markets. For the valuation of liabilities, certain observable parameters have been used.

These fair values provide interesting information but are not relevant for drawing conclusions on the value of the company or on the income generated in the future. The assets and liabilities stand out for being consistent in rates and maturity and moreover are intended to be maintained on the balance sheet until their maturity, given the specialized activity of the company.

a. Composition of the fair value of the assets

	12/31/2016		
	Book value	Fair value	Unrecognized fair value adjustment
Central banks	4,878	4,878	-
Loans and advances due from banks	390	384	(6)
Loans and advances to customers	59,682	58,288	(1,394)
Financial assets available for sale	2,037	2,037	-
Derivatives	6,441	6,441	-
TOTAL	**73,428**	**72,028**	**(1,400)**

	6/30/2017		
	Book value	Fair value	Unrecognized fair value adjustment
Central banks	5,156	5,156	-
Loans and advances due from banks	375	393	18
Loans and advances to customers	58,918	56,442	(2,476)
Financial assets available for sale	2,748	2,748	-
Derivatives	5,191	5,191	-
TOTAL	**72,388**	**69,930**	**(2,458)**

b. Composition of the fair value of the liabilities, excluding equity

	12/31/2016		
	Book value	Fair value	Unrecognized fair value adjustment
Due to banks	6,720	6,742	22
Derivatives	9,865	9,865	-
Debt securities	57,681	58,765	1,084
TOTAL	**74,226**	**75,372**	**1,106**

	6/30/2017		
	Book value	Fair value	Unrecognized fair value adjustment
Due to banks	6,266	6,362	96
Derivatives	8,695	8,695	-
Debt securities	58,652	60,168	1,516
TOTAL	**73,613**	**72,225**	**1,612**

c. Methods used to determine the fair value for financial instruments

The fair value of a financial instrument is assessed based on observable market prices for this instrument or for a comparable instrument, or using an assessment technique that relies on observable market data. A hierarchy of methods used to assess fair value has been established; it features the following 3 levels:

- Level 1: instruments that are considered liquid, i.e. their value is derived from an observed price on a liquid market, for which SFIL is assured to have a large number of contributors. Level 1 securities include some State bonds.
- Level 2: instruments for which SFIL cannot directly observe the market price, but has observed it for similar listed instruments of the same issuer or guarantor. In this case, the prices and other observable market data are used, and an adjustment is performed to take the degree of liquidity of the security into account.
- Level 3: instruments for which there is no active market or observable market data; they are therefore valued by using a valuation spread that stems from an internal model. Level 3 derivative instruments are valued using various internally developed assessment models.

The measurement of derivatives is based on an analysis combining the observability of the market data used in the assessment and the robustness of the valuation models measured in terms of efficiency to provide a valuation in market consensus. The result of this application is that the derivatives used by the Group SFIL in hedging its activities are primarily of level 2.

For the derivatives in level 3, this classification mainly involves hybrid, structured products (interest rate – foreign exchange), spread (correlation) products and options on interest rates.

This classification is mainly due to the fact that these products present complex payoffs which require an advanced statistical model with variable parameters which are sometimes unable to be seen in the market.

Fair value of financial assets	12/31/2016 Level 1 [1]	Level 2 [2]	Level 3 [3]	Total
Financial assets available for sale	1,035	1,002	-	2,037
Derivatives	-	5,847	594	6,441
TOTAL	**1,035**	**6,849**	**594**	**8,478**

Fair value of financial assets	6/30/2017 Level 1 [1]	Level 2 [2]	Level 3 [3]	Total
Financial assets available for sale	1,813	935	0	2,748
Derivatives	-	4,407	784	5,191
TOTAL	**1,813**	**5,342**	**784**	**7,939**

Fair value of financial liabilities	12/31/2016 Level 1 [1]	Level 2 [2]	Level 3 [3]	Total
Derivatives	-	8,577	1,288	9,865
TOTAL	**-**	**8,577**	**1,288**	**9,865**

Fair value of financial liabilities	6/30/2017 Level 1 [1]	Level 2 [2]	Level 3 [3]	Total
Derivatives	-	7,506	1,189	8,695
TOTAL	**-**	**7,506**	**1,189**	**8,695**

[1] Price listed on an active market for the same type of instrument.

[2] Price listed on an active market for an instrument that is similar (but not exactly the same) or use of a valuation technique in which all significant inputs are observable.

[3] Use of a valuation technique in which all the significant parameters are not observable.

Sensitivity of the market value of level 3 financial instruments to changes in reasonably possible hypotheses

The following table gives a synthetic view of financial instruments in level 3 for which changes in hypotheses concerning one or more non-observable parameters would cause a significant change in market value. These amounts illustrate the interval of uncertainty inherent in the recourse to judgment in estimating parameters of level 3 or in the choice of valuation techniques and models. They reflect the uncertainty of valuation which is effective at the date of valuation. Although this uncertainty essentially results from the sensitivity of the portfolio at the date of valuation, it does not make it possible to foresee or to deduct future variations in the market value any more than they represent the effect of extreme market conditions on the value of the portfolio. To estimate sensitivity, SFIL either values financial instruments using reasonably possible parameters or applies hypotheses based on its policy of additional valuation adjustments.

	12/31/2016	6/30/2017
Uncertainty inherent in level 3 market parameters	20	12
Uncertainty inherent in level 3 derivatives valuation models	32	31
Sensitivity of the market value of level 3 financial instruments	**52**	**43**

d. Transfer between level 1 and 2

	12/31/2016	6/30/2017
Level 1 to level 2	-	-
TOTAL	**-**	**-**

e. Level 3: Flow analyses

Fair value of financial assets	Financial assets available for sale	Derivatives	TOTAL FINANCIAL ASSETS	Derivatives	TOTAL FINANCIAL LIABILITIES
12/31/2016	**-**	**594**	**594**	**1,288**	**1,288**
Total gains and losses through profit and loss	-	1	1	(32)	(32)
Total unrealized or deferred gains and losses	-	104	104	(201)	(201)
Total OCI unrealized or deferred gains and losses	-	-	-	-	-
Purchases	-	16	16	127	127
Sales	-	-	-	-	-
Direct origination	-	-	-	-	-
Settlement	-	2	2	-	-
Transfer in activities destined to be transferred	-	-	-	-	-
Transfer to level 3	-	67	67	12	12
Transfer out of level 3	-	-	-	(5)	(5)
Other variations	-	-	-	-	-
6/30/2017	-	**784**	**784**	**1,189**	**1,189**

7.2. OFFSETTING FINANCIAL ASSETS AND LIABILITIES

a. Financial assets subject to offsetting, enforceable master netting arrangements and similar agreements

	12/31/2016					
	Gross amounts before offsetting	Gross amounts offset according to IAS 32	Net amounts presented in the balance sheet	Other amounts in the application scope but not offset		Net amounts according to IFRS 7 § 13
				Effect of master netting arrangements	Financial instruments received as collateral	
Derivatives (including hedging instruments)	6,441	-	6,441	(4,563)	(1,615)	263
Loans and advances due from banks	390	-	390	-	-	390
Loans and advances to customers	59,682	-	59,682	-	-	59,682
TOTAL	**66,513**	**-**	**66,513**	**(4,563)**	**(1,615)**	**60,335**

	6/30/2017					
	Gross amounts before offsetting	Gross amounts offset according to IAS 32	Net amounts presented in the balance sheet	Other amounts in the application scope but not offset		Net amounts according to IFRS 7 § 13
				Effect of master netting arrangements	Financial instruments received as collateral	
Derivatives (including hedging instruments)	5,191	-	5,191	(3,830)	(1,152)	209
Loans and advances due from banks	375	-	375	-	-	375
Loans and advances to customers	58,918	-	58,918	-	-	58,918
TOTAL	**64,484**	**-**	**64,484**	**(3,830)**	**(1,152)**	**59,502**

b. Financial liabilities subject to offsetting, enforceable master netting arrangements and similar agreements

	12/31/2016					
	Gross amounts before offsetting	Gross amounts offset according to IAS 32	Net amounts presented in the balance sheet	Other amounts in the application scope but not offset		Net amounts according to IFRS 7 § 13
				Effect of master netting arrangements	Financial instruments received as collateral	
Derivatives (including hedging instruments)	9,865	-	9,865	(4,563)	(2,275)	3,027
Due to banks	6,720	-	6,720	-	-	6,720
Customer borrowing and deposits	-	-	-	-	-	-
TOTAL	**16,585**	**-**	**16,585**	**(4,563)**	**(2,275)**	**9,747**

	6/30/2017					
	Gross amounts before offsetting	Gross amounts offset according to IAS 32	Net amounts presented in the balance sheet	Other amounts in the application scope but not offset		Net amounts according to IFRS 7 § 13
				Effect of master netting arrangements	Financial instruments received as collateral	
Derivatives (including hedging instruments)	8,695	-	8,695	(3,830)	(2,047)	2,818
Due to banks	6,266	-	6,266	-	-	6,266
Customer borrowing and deposits	-	-	-	-	-	-
TOTAL	**14,961**	-	**14,961**	**(3,830)**	**(2,047)**	**9,084**

8. Post-closing events

No significant event that influences the Company's financial situation has occurred since the closing on June 30, 2017.

3. Statutory Auditors' report on the first half-yearly financial information

Statutory Auditors’ review report on the first half-yearly financial information

For the period from January 1 to June 30, 2017

This is a free translation into English of the Statutory Auditors’ review report issued in French and is provided solely for the convenience of English-speaking readers. This report includes information relating to the specific verification of information presented in the interim management report. This report should be read in conjunction with, and construed in accordance with, French law and professional standards applicable in France.

To Shareholders,

In compliance with the assignment entrusted to us by your Annual General Meeting and in accordance with the requirements of Article L.451-1-2 III of the French Monetary and Financial Code ("Code monétaire et financier"), we hereby report to you on:

- the review of the accompanying condensed first half-year consolidated financial statements SFIL, for the period from January 1 to June 30, 2017;
- the verification of the information presented in the first half-year management report.

These condensed first half-year consolidated financial statements are the responsibility of the Board of Directors. Our role is to express our conclusion on these financial statements, based on our review.

Conclusion on the financial statements

We conducted our review in accordance with professional standards applicable in France. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with professional standards applicable in France and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Based on our review, nothing has come to our attention that causes us to believe that the condensed first half-year consolidated financial statements do not give a true and a fair view of the assets and liabilities and of the financial position of the Company as at June 30, 2017 and of the results of its operations for the period then ended, in accordance with IFRS as adopted by the European Union.

Specific verification

We have also verified the information presented in the first half-year management report on the condensed first half-year consolidated financial statements subject to our review.

We have no matters to report as to its fair presentation and its consistency with the condensed first half-year consolidated financial statements.

Paris-La Défense and Neuilly-sur-Seine, September 7, 2017

The Statutory Auditors
French original signed by

DELOITTE & ASSOCIES	ERNST & YOUNG et Autres
Sylvie Bourguignon	Vincent Roty

4. Statement by the person responsible

I, the undersigned, **Philippe Mills**, **Chief Executive Officer of SFIL**,

hereby affirm that, to the best of my knowledge, these half-year financial statements have been prepared in conformity with applicable accounting standards and provide an accurate and fair view of the assets and liabilities, financial position and earnings of SFIL, and that the half year management report presents a fair image of significant events that have taken place during the first six months of the year and their impact on the half year financial statements, and a description of all the major risks and uncertainties concerning the remaining six months of the fiscal year.

Signed in Issy-les-Moulineaux, September 7, 2017

Philippe Mills

Chief Executive Officer