Supporting local investment and export

Half-Year Financial Report

for the period from January 1 to June 30, 2018

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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, as well as 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 guaranteed 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 guaranteed by Bpifrance Assurance Export in the name and on behalf of the French State. Plans have been made to extend the arrangements to loans which will benefit from the guarantee of internationally strategic projects being developed by the French Ministry of Finances and Bpifrance Assurance Export.

In terms of governance, the composition of SFIL's Board of Directors has been modified by the replacement of certain members of the Board.

COMPOSITION OF THE BOARD OF DIRECTORS (JUNE 30, 2018)

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 **Schwan Badirou Gafari**	**Virginie Fernandes** Member of the Board of Directors representing Caisse des dépôts et consignations, shareholder
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
Pascal Cardineaud Member of the Board of Directors representing the employees	**Thomas Morisse** Member of the Board of Directors representing the employees
Sandrine Chemla Member of the Board of Directors representing the employees	**Françoise de Panafieu** Independent Member of the Board of Directors
Gabriel Cumenge Member of the Board of Directors proposed by the State	**Pierre Sorbets** Independent Member of the Board of Directors
Marion Domalain Member of the Board of Directors representing the employees	

Developments in the first half

1. Highlights in the first half

In the first half of 2018, SFIL fully carried out its basic missions, which involve the refinancing, through its subsidiary Caisse Française de Financement Local, of loans granted by La Banque Postale to local governments and public health facilities, specialized services for La Banque Postale and Caisse Française de Financement Local, and further progress in efforts to desensitize the portfolio of structured loans. SFIL, which in 2017 became the leading supplier of liquidity in the export credit sector covered by the State's guarantee, pursued its activity in the second field of activity.

Among the highlights of the last six months, the following events are to be noted.

Oxygène

SFIL undertook the switch of a large part of its IT system during the last weekend of March 2018, in order to implement a new IT system, which has been modernized and simplified, in particular with regard to market activities.

IFRS 9

The accounting standard IFRS 9, which has been applicable since January 1, 2018, was updated in the Oxygène project's parallel accounting system. There were three main impacts on the financial statements: the classification and evaluation of the financial instruments, the supply of loans and bonds, and hedge accounting methods, for which the SFIL Group chose to continue to apply IAS 39 until the future standard on macro-hedging takes effect.

Extension of the scope of export credit

On March 8, 2018, the government announced the project to extend the benefit of SFIL's export credit refinancing system to credits covered by the guarantee of strategic projects. This guarantee is designed to finance projects considered as strategic for France without being necessarily linked to an underlying export. The extension of SFIL's export credit activities to this new guarantee will enable France to offer a financing tool comparable to the best foreign competitors, in line with the practices observed in major exporting countries, particularly in Asia.

Positive recurrent net book income

Financial results remained very good. Recurrent income was positive over the first half of the year with marked improvement. Net book income was impacted by the effects of volatility as a result of the new accounting standards.

SFIL ratings

Since Moody's treated the rating of the French Republic in a positive perspective, and SFIL was correlated to this level, the latter's rating (Aa3) went from "stable" to "positive". In addition, SFIL's long-term S&P rating remained in line with France with no change at AA. SFIL's intrinsic rating set by S&P increased by two levels as the result of the success of its loan sensitivity reduction policy and the trend in its results.

Continuation of European legislative process to adopt banking rules

The measures taken to recognize the specificity of public development banks, integrated by the European Commission in its proposal to modify prudential rules in banking (Capital Requirement Regulation, which introduces in particular a ratio of minimum leverage and a long-term structural liquidity ratio), were confirmed and reinforced by the Council and the European Parliament. SFIL will therefore benefit from rules of calculation that are specific and appropriate to determine these ratios when these new requirements take effect (two years after the definitive adoption and publication of the text, expected in the first half of 2019).

Market volatility

The first half of 2018 was marked by the three following major international events:

- ongoing negotiations between the European Union and the United Kingdom within the framework of Brexit;
- the legislative elections in Italy leading to the creation of a coalition government;
- the tensions related to the increase in customs taxes on certain goods between the United States and China, first, then between the United States and the European Union in a second phase.

These three events had the effect of increasing volatility in the financial markets, but they did not affect to a significant point the covered bond market and the SFIL Group's issuance capability.

2. Operations in the first half

2.1. 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 2018, the latter acquired EUR 1.9 billion in loans from La Banque Postale in two transfers, which is less than the volume acquired from La Banque Postale during the first half of 2017 (EUR 2.4[1] billion). In June 2018, the total volume acquired increased to EUR 14.1 billion.

2.2. 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 its relations with three additional banks, bringing to 23 the total number of banks that have a cooperation agreement with SFIL for export credits.

In 2017, SFIL became the prime supplier of export credit liquidity. In the first half of 2018, SFIL maintained this position by signing two new agreements in the fields of defense and infrastructures. SFIL negotiated a total of eight refinancing operations, for EUR 5 billion, with 11 different banks, for five exporters and export operations on four continents.

2.3. 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 94% for the first half of 2018.

Furthermore, after 5 years of activity, SFIL and La Banque Postale have reviewed and adapted the contractual framework of the services rendered in compliance with the latest regulatory developments (IFRS 9, General Data Protection Regulation, legislation on critical outsourced services).

2.4. REDUCTION IN LOAN SENSITIVITY

After the closing of the French government's assistance fund for local authorities and public health facilities, SFIL continued its loan sensitivity reduction assignment during the first half of 2018, with the same perimeter and methodology.

Sensitive outstanding assets include those outside of the Gissler Charter (code of good conduct signed between banks and 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.

At the set up of SFIL, sensitive outstanding amounted to EUR 8.5 billion and concerned 879 clients.

As of June 30, 2018, 777 sensitivity reduction transactions have been signed with 659 clients for a total amount of EUR 5.4 billion. On the basis of the transactions concluded as of June 30, 2018, 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 1.1 billion at the end of 2018. This represents a reduction of EUR 7.4 billon (87%) since December 31, 2012, for 203 borrowers (i.e. decrease of 77% in the number of clients with sensitive structured loans). The completion of the desensitizing mission is thus confirmed.

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

There was a marked decrease in the number of litigation cases: as of June 30, 2018, 20 borrowers remained in litigation regarding one or several CAFFIL sensitive structured loans, which represents a decrease of 91% in the number of cases. Since the creation of SFIL, 203 borrowers have withdrawn or abandoned their legal proceedings.

2.5. SFIL GROUP FINANCING

SFIL refinancing

During the first half of the year, SFIL developed its bond issuer franchise as a French Public Agency, a regular player in the primary market in both euros and dollars in order to complete its reference curves. Thus, SFIL raised a total of EUR 2 billion via 2 new public transactions and one tap.

SFIL engaged in public benchmark transactions for EUR 1.8 billion issuing:

- in February EUR 1 billion on a 8-year maturity,
- in June for USD 1 billion on a 3-year maturity.

Over the period, SFIL contributed additional liquidity to its October 2022 benchmark transaction by an increase of EUR 200 million bringing the total nominal to EUR 1.2 billion.

CAFFIL refinancing (covered bonds or *obligations foncières*)

During the first half of 2018, CAFFIL was regular on euro benchmark primary market issuance setting up four new outstanding which completed its reference curve. In January, a dual tranche (8- and 15-year maturities) was priced for a total of EUR 1.5 billion, followed by a new ten-year jumbo transaction launched in April for EUR 1.5 billion. Then, in June, CAFFIL extended by three years its curve with a successful EUR 500 million 20-year benchmark transaction confirming its complete issuer profile.

In addition to public benchmark issuance, CAFFIL responded to investor demand for long term maturity to raise EUR 642 million in private placements and to increase two public outstanding maturing respectively in January 2031 and 2033.

The overall average life of liquidity rose in the first half to 12.1 per year.

SFIL Group other resources

Liquidity provided by SFIL's shareholder

The main SFIL Group's other resources come from liquidity provided by Caisse des dépôts et consignations and La Banque Postale under total credit facility agreements. As of the end of June 2018, the total outstanding raised amounted to EUR 2.0 billion decreasing by EUR 2.2 billion, since December 31, 2017.

Short term liquidity

In the first half, SFIL remained active in its money market issuance (NEU CP - Negotiable European Commercial Paper). As of June 30, 2018, the total outstanding reached EUR 705 million.

Changes in main balance sheet items

The main items on the SFIL Group's consolidated balance sheet (management data[1]) as of June 30, 2018, are presented in the table below.

EUR billions, value after currency swaps	
ASSETS	**LIABILITIES**
73.9	73.9
Of which main items of the notional balance sheet **61.3**	Of which main items of the notional balance sheet **61.3**
Cash assets *3.0* *(of which 2.7 for CAFFIL and 0.3 for SFIL)*	*SFIL bond issues* *4.9*
Loans *46.7*	*Refinancing by shareholders* *2.0*
Securities *9.4* *(of which 7.8 for CAFFIL and 1.6 for SFIL)*	*Covered bonds /* Obligations foncières *51.2*
	Commercial paper *0.7*
Cash collateral paid *2.2*	*Cash collateral received* *1.2* *(of which 0.5 for CAFFIL and 0.7 for SFIL)*
	Equity and other items *1.3*

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;
- EMTN issued by SFIL;
- commercial paper 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) *As regards the loans shown in the tables below, the notional balance sheet item concept corresponds to outstanding principal for euro transactions and for foreign currency transactions, to the euro equivalent value after swap hedging. Notional balance sheet items notably exclude hedging relationships and accrued interest not yet due.*

1. Main changes in assets in the first half of 2018

The net change in the SFIL Group's main assets during the first half of 2018 was EUR +1.8 billion.

This change can be analyzed as follows:

EUR billions, value after currency swaps	6/30/2018
BEGINNING OF YEAR	**59.5**
Purchase of loans from La Banque Postale	1.9
New loans paid out after reduction in sensitivity	0.1
New loans paid out from export credit activities	0.2
Change in cash collateral paid by SFIL	(0.2)
Amortization of loans and securities in the French public sector (excluding cash investment securities)	(1.9)
Amortization of loans and securities outside the French public sector (excluding cash investment securities)	(0.4)
Cash investment securities	1.6
Change in cash assets	0.5
Other	-
END OF PERIOD	**61.3**

- Through its subsidiary CAFFIL, SFIL acquired EUR 1.9 billion in loans marketed by La Banque Postale to the French local public sector.
- The transactions to reduce sensitivity resulted in EUR 0.1 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 0.2 billion in drawdowns.
- As an intermediary in the derivative transactions between CAFFIL and some of its counterparties, SFIL paid a total of EUR 2.2 billion as of June 30, 2018, down EUR 0.2 billion from the end of 2017.
- The other changes in assets pertained mainly to the natural amortization of the loans and securities portfolio (EUR 2.3 billion), to the EUR 1.6 billion change in the cash investment securities and to the EUR 0.5 billion change in the cash balance held with the French central bank (Banque de France).

It should be noted that SFIL held EUR 3.6 billion in cash management securities (banking securities and those of the European public sector) as of June 30, 2018.

2. Main changes in liabilities over the first half of 2018

The net change in the main liabilities of the SFIL Group during the first half of 2018 totaled EUR +1.8 billion.

This change can be analyzed as follows:

EUR billions, value after currency swaps	6/30/2018
BEGINNING OF YEAR	**59.5**
Covered bonds / *Obligations foncières*	2.2
of which issues	*4.4*
of which amortizations	*(2.2)*
of which buybacks	*(0.0)*
Change in cash collateral received	(0.1)
Senior unsecured refinancing	(2.2)
Issues by SFIL	2.0
Commercial paper	0.1
Equity and other items	(0.2)
END OF PERIOD	**61.3**

- Outstanding *obligations foncières* increased by EUR 2.2 billion, owing to the implementation of the new 2018 program to EUR 4.4 billion, and the amortization of the stock of covered bonds to EUR -2.2 billion.
- The cash collateral paid by the derivative counterparties of CAFFIL and SFIL decreased by EUR 0.1 billion.
- The EUR 2.2 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 2 billion.

Risk management

The SFIL Group has a low risk profile.

- CAFFIL principally includes public sector borrowers[1] on its balance sheet. The export credit loans on SFIL's balance sheet benefit systematically from a Bpifrance Assurance-Export policy covering 100% of the nominal debt;
- interest rate risk is also low given the Group's hedging policy, which systematically covers the balance sheet's fixed rate items;
- liquidity risk is, on the one hand, strictly controlled using various internal liquidity stress tests, and on the other hand, limited, with the Group refinancing itself mainly in the long term by the issue of covered bonds, liquid instruments that provide investors with a safe legal framework. In addition, the Group continues to diversify its sources of financing, since SFIL issues bonds in the market as a State Agency Lastly, the majority of its assets are eligible for refinancing by the Banque de France;
- foreign exchange risk is marginal, outstandings in foreign currencies being systematically hedged upon their entry on the balance sheet;
- operational risk is subject to protective procedures;
- the Group has no trading portfolio.

Subsequent to the Supervisory Review and Evaluation Process conducted by the European Central Bank in 2017, the capital requirement of phased Common Equity Tier 1 which SFIL should respect on a consolidated basis was set at 7.125% as of January 1, 2018. The Tier 1 capital requirement was set at 8.625% for 2018, and Total capital at 10.625%.

As of June 30, 2018, the SFIL Group's phased consolidated CET1 and Total capital ratios amounted to 22.30% and 23.05%, respectively, at a level representing more than twice the minimum requirement set by the European supervisory authority.

1. Credit risk

1.1. DEFINITION AND MANAGEMENT OF CREDIT RISK

Credit risk represents the potential loss that might affect the SFIL Group owing to a counterparty's downgraded position.

Risk management division defines the policies, directives and procedures related to credit risk. It develops decision-making processes (mainly the granting of loans) and the framework of delegations, and oversees processes involving analysis and internal rating. Final approval of credit risk policies is the responsibility of the risk committee.

1.2. BREAKDOWN OF EXPOSURES BASED ON BASEL III WEIGHTINGS

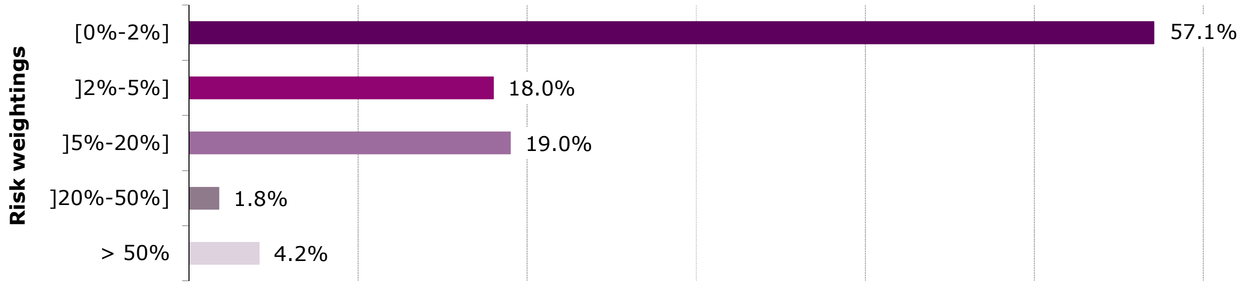
The quality of the SFIL and CAFFIL portfolio can also be seen in the weighting of risk-weighted assets (RWA) assigned to its assets in order to calculate the solvency ratio.

The Group has chosen the advanced method to calculate its solvency ratio and capital adequacy for most of its exposures.

As of June 30, 2018, the breakdown of exposures by risk weighting (the weightings are calculated on the basis of the probability of the counterparty's default and the loss incurred in the event of default) was as follows.

[1] *To a lesser degree, CAFFIL may also recognize on its balance sheet exposures on banks considered as replacement assets. The latter benefit from the first or second best quality ranking and the volume of the exposures as replacement assets cannot be greater than 15% of the* obligations foncières. *CAFFIL may also make use of derivatives with banks in the sole purpose of hedging interest rate and foreign exchange risks.*

Risk weightings (Basel III) of the SFIL Group's portfolio as of June 30, 2018



(Exposure At Default)

This analysis confirms the quality of the assets in SFIL's portfolio with average weighting of 7.5% and only 6% of the portfolio with a weighting of more than 20%.

The amount of weighted exposures totaled EUR 5,603 millions for the credit risk. Including the weighted assets linked to the risk of volatility of the Credit Valuation Adjustment (CVA) and the weighted assets to cover operational risks (the assets weighted for market risks are null, the total of weighted assets was EUR 6,354 millions. With a CET1 level of EUR 1,417 million, SFIL presents a CET1 ratio of 22.30% as of June 30, 2018.

With regard to the leverage ratio, the European Commission published a proposed amendment to this regulation in November 2016 with a view to introducing a minimum leverage ratio requirement of 3% as well as requirements specific to certain business models, including the possibility for public development banks to exclude certain assets from their leverage exposure. Subject to their adoption by European co-legislators, these measures are expected to be implemented in 2020 or 2021.

Based on the methodological principles currently in force, as of June 30, 2018, SFIL's leverage ratio was 1.98%.

In the event of deduction of public development bank assets in accordance with the proposed amendment to regulation 575/2013, SFIL's leverage ratio would be far higher than the minimum requirement of 3% provided for by the draft regulation.

1.3. UNPAIDS, DOUBTFUL LOANS AND PROVISIONS

Total unpaids amounted to EUR 63 million as of June 30, 2018. They were down by 7% compared with December 31, 2017 (EUR 67.5 million) and were focused on several counterparties.

As a reminder of the level of CAFFIL and in application of French accounting standards, doubtful and litigious loans totaled EUR 453 million as of June 30, 2018, representing less than 1% of CAFFIL's cover pool, a result that demonstrates the portfolio's high quality. These loans were down 19% compared with December 31, 2017 (EUR 558 million) and can be broken down as follows:

- EUR 421 million in loans qualified as doubtful[1], corresponding to loans to customers for an unpaid total of EUR 28 million;
- EUR 32 million in loans qualified as litigious, corresponding to unpaid interest subject to legal action.

In application of the IFRS standards and more specifically when IFRS 9 took effect on January 1, 2018, all financial assets accounted for at amortized cost and at fair value by equity as well as financing commitments should be classified in three stages of provisions and allocated on the basis of the expected credit loss.

- Stage 1: performing assets for which the credit risk has not significantly deteriorated since initial recognition;
- Stage 2: performing assets for which the credit risk has however significantly deteriorated since initial recognition;
- Stage 3: credit-impaired outstandings.

(1) A commitment is considered as doubtful when it presents one of the following characteristics :

• a probable or certain risk of non payment (unpaid for more than nine months for local governments and three months for the other counterparties);

• the existence of a observed risk on the counterparty (downgraded financial situation, alert procedure).

When a customer is classified in default in terms of credit risk, total outstandings are classified as doubtful loans by contagion in addition to unpaid due dates.

A commitment is considered as litigious when it presents an unpaid and is subject to legal action.

Outstanding assets classified in **Stage 3** mainly correspond to customers:

- those that have not paid in less than 90 days;
- those that were in a situation of real default (i.e. not technical) and for whom unpaids of more than 90 days have been settled. After settlement of all the unpaid sums, these outstandings are maintained in Stage 3 and in real default for a minimum of one year, referred to as a "probationary period";
- those for which the financial situation presents characteristics so that independently of the existence of any unpaid sum, it is possible to recognize that the customer is unlikely to pay.

Thus the definition of default (Stage 3) according to IFRS accounting standards covers a broader scope than the notion of doubtful and litigious loans according to French accounting standards, and is very close to the regulatory notion of non-performing exposure. In fact, the latter includes, in addition to Stage 3 assets, non-performing assets that are recorded at fair value through profit and loss (i.e. as non-performing assets classified non-SPPI).

Provisions are made on all these outstandings in the name of expected credit losses, including Stage 1 and Stage 2 outstandings. These amortizations are based on forward-looking scenarios and account for losses expected in the next 12 months (Stage 1) or over the life of the asset (Stages 2 and 3).

The value of the assets and the related provisions is presented in the following table.

	IFRS book value		Provisions	
EUR millions	**1/1/2018**	**6/30/2018**	**1/1/2018**	**6/30/2018**
Stage 1	*46,332*	*48,760*	*-7*	*-7*
Stage 2	*5,441*	*5,252*	*-39*	*-40*
Stage 3	*1,518*	*1,177*	*-11*	*-9*
TOTAL SPPI assets	**53,291**	**55,189**	**-57**	**-56**
Non-performing exposures	*1,601*	*1,575*		

At the end of June 2018, the stock of IFRS provisions for expected credit loss totaled EUR 56 million and was generally stable compared with the stock as of January 1, 2018, calculated within the framework of the initial application of IFRS 9.

In the first half of 2018, the positive effects of the policy to reduce the sensitivity of structured loans resulted in a significant decrease, at the same time, of unpaid commitments, outstanding doubtful and litigious loans according to French accounting standards, and of outstanding Stage 3 assets according to IFRS accounting standards.

1.4. RESERVE OF FINANCIAL ASSETS VALUED AT FAIR VALUE THROUGH EQUITY

Because of the effective application as of January 1, 2018, of IFRS 9, the AFS reserve was replaced by the reserve of financial assets valued at fair value through equity.

Before taxes, the total amount of this reserve at the level of the Group stood at EUR 0.9 million as of June 30, 2018, of which EUR 0.75 million for SFIL, versus EUR 125 million for the AFS reserve as of December 31, 2017.

This decrease is mainly explained by the transition of IAS 39 in the direction of IFRS 9, which gave rise as of January 1, 2018, to the reclassification at amortized cost of the majority of the assets contributing to the AFS reserve[1] and as an impact of the initial application of IFRS 9, to the reversal in equity at the beginning of 2018, of the AFS reserve based on these assets up until December 31, 2017. Certain assets, acquired in order to invest surplus cash, nonetheless continue to be valued at fair value through equity in the new reference and contribute to the reserve of financial assets valued at fair value.

(1) In fact, the majority of these assets belong to a business model designed to collect contractual flows and their contractual cash flows respect SPPI criteria (Solely Payments of Principal and Interest).

2. 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.

3. Balance sheet 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.

3.1. LIQUIDITY RISK

The liquidity risk can be defined as the risk that the institution may not be able to find the necessary liquidity on the right date and at a reasonable price 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 crédit foncier*.

The main liquidity risks reside, as far as CAFFIL is concerned and given the fact that the overcollateralization of the *société de crédit foncier* is mainly insured by SFIL[1], in the entity’s capacity to be able to settle certain privileged debt on time following too great an interval in the rhythm of reimbursements of its assets and its privileged liabilities.

Concerning SFIL, these risks reside in its capacity to find sufficient resources to meet the Group’s needs for liquidity, either by renewing its refinancing that comes due on the market and/or with shareholders, or by obtaining new refinancing from these sources.

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

- the financing of CAFFIL's balance sheet assets (EUR 47.4 billion in loans, EUR 7.8 billion in securities and 2.7 billion in cash on deposit with the Banque de France);
- the financing of SFIL's balance sheet assets (EUR 1.55 billion in securities and EUR 0.3 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 1.525 billion).

As of June 30, 2018, 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 51.2 billion) and cash collateral received by CAFFIL (EUR 0.5 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 1.97 billion;
- the short-term debt securities issued by SFIL totaling EUR 5.65 billion.

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 and SFIL can be made available through European Central Bank refinancing operations, via the Banque de France. In the first half of 2018, there were no operations of this type, except for operational tests required for regulatory purposes.

Since the first half of 2017, SFIL also ensures the refinancing of export credit operations. Liquidity is provided by CAFFIL through its issues of *obligations foncières.*

To control 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.

The Group’s liquidity risk is also managed by respect of liquidity regulation ratios and internal liquidity indicators.

It should be noted that CAFFIL, as a *société de crédit foncier (SCF),* is obligated to respect specific regulatory indicators.

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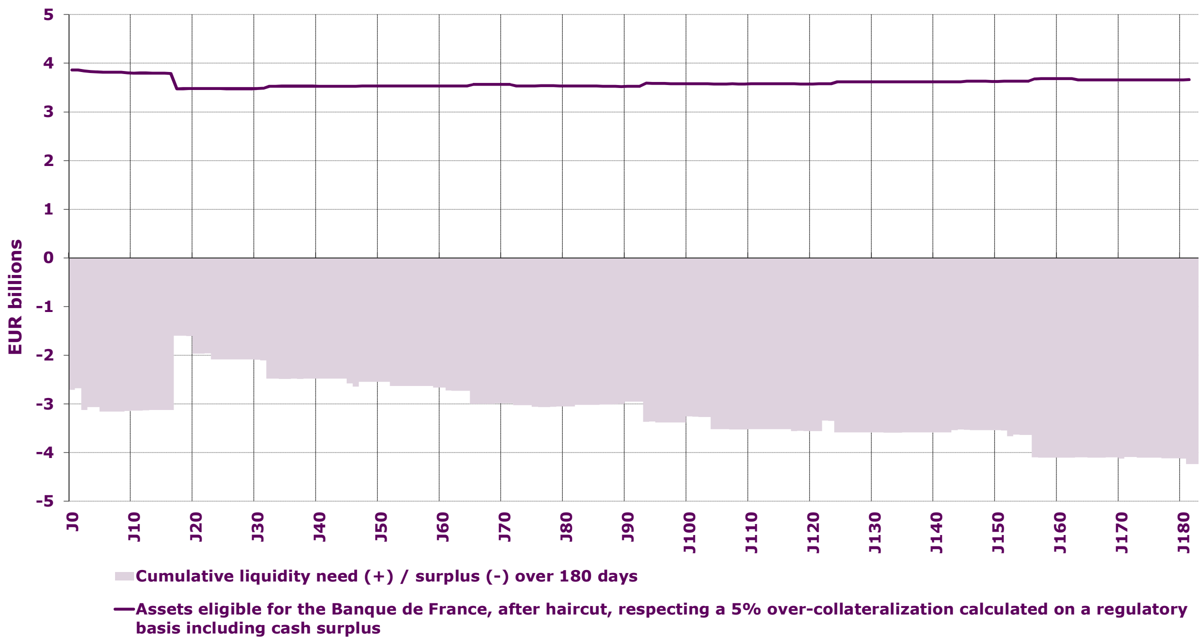
[1] A part of CAFFIL’s over-collateralization is refinanced by the entity’s equity.

As of June 30, 2018, the situation was as follows.

For CAFFIL:

LCR ratio: 406%

Coverage of liquidity needs over 180 days



Gap of the average life between assets and liabilities 0.05 per year.

For SFIL:

LCR ratio: 420%

3.2. INTEREST RATE RISK

Interest rate structural risk is defined as the risk of loss incurred in the event of a change in interest rates that would lead to a loss in value of balance sheet and off-balance sheet transactions, excluding any trading portfolio transactions. As SFIL and CAFFIL do not hold a trading portfolio they are not affected by this exception.

There are three different types of interest rate risk for SFIL:

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

These risks are generally covered by using derivatives.

To limit the impact of these risks, CAFFIL has implemented a two-staged hedging strategy:

- in the first stage, all the assets and liabilities benefiting from the legal privilege which did not have a floating rate are hedged against Euribor until maturity as soon as they are recorded on the balance sheet. In practice, acquisitions of loan portfolios (of which the unit value is generally small) are usually macro-hedged. Loans granted individually or bond issues may be micro- or macro-hedged. Hedging of assets and liabilities is more often obtained in using new interest rate swaps, but the same effect can also be obtained whenever possible by the cancelation of swaps of opposite direction.

- in the second stage, Euribor lending and borrowing flows (naturally or after hedging) are swapped against Eonia over a period of a maximum of two years in order to protect income from the risk generated by differences in the tenor (Euribor 1, 3, 6, or 12 months) and the fixing risk due to refixation dates to reference indices that differ for the assets and the liabilities. The residual risk is managed through macro-hedges with a management horizon of one week.

Concerning the parent company SFIL, the strategy involves a perfect micro-hedge of the interest rate risk, by swaps against Eonia, by matching asset and liability transactions on the same index or, as regards the export credit activity, by hedging transactions carried out under the stabilization mechanism. This process results in zero interest rate risk.

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

For CAFFIL, these interest rate risks are measured and limited through an indicator of the sensitivity of the net present value of balance sheet items for a shock of 100 times 1 bp:

	Level as of June 30, 2018 EUR millions	**Limit**
Directional interest rate risk	1.7	< EUR 25 million
Steepening risk		
Sensitivity by time bucket		
• Short bucket	(4.3)	< EUR 10 million
• Medium bucket	(1.0)	< EUR 10 million
• Long bucket	4.6	< EUR 10 million
• Very long bucket	2.4	< EUR 10 million
Sensitivity by time bucket in absolute value		
• Short bucket	8.8	< EUR 20 million
• Medium bucket	4.6	< EUR 20 million
• Long bucket	7.9	< EUR 20 million
• Very long bucket	10.5	< EUR 20 million

For the parent company SFIL, the limit is expressed on the fixed rate gap. It is 0 as a result of its micro-hedging management strategy.

These indicators are calculated in a static vision.

3.3. FOREIGN EXCHANGE RISK

The foreign exchange risk is defined as the risk of the volatility of income, observed or latent, linked to a change in the rate of exchange of a reference currency. The reference currency of the SFIL Group is the euro; the foreign exchange risk thus reflects the change in the value of the assets and the liabilities denominated in a currency other than the euro by reason of a fluctuation of the same currency against the euro.

Issues and assets denominated in foreign currencies give rise, at the latest when they are recognized on the balance sheet and until their final maturity, to a cross-currency swap against the euro. The floating rate exposures resulting from this management are incorporated into interest rate risk management. For operational reasons, SFIL continues to incur marginal foreign exchange risk affecting the share of margin of USD-denominated export credit transactions not paid on to CAFFIL.

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

4. Operational risk

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 notably includes the risk linked to the security of information systems, the legal risk, risks of internal and external fraud and the risks linked to the model, but excludes strategic risks. This definition is in line with the definition adopted by the Basel Committee. Management procedures for operational risks apply to all SFIL and CAFFIL processes and activities 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.

The first half of 2018 was marked by the introduction of a major IT program for SFIL. The potential operational risks involved in any project of this sort are monitored and reported within the framework of existing operational risks management.

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.

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.

The first half of 2018 was marked by ongoing efforts to ensure the compliance of measures taken within the framework of SFIL's activities, in particular with RGPD. The Compliance division also pursued its actions to develop a culture of compliance with a new training program.

6. Legal and tax risks

6.1. LEGAL RISKS

As of June 30, 2018, the number of borrowers in litigation for structured loans was 20, compared with 25 as of December 31, 2017. Since SFIL's creation 203 borrowers have dropped their claims against the Group.

Since the entry into force on July 30, 2014, of the law on the securing of structured loan contracts granted to public sector entities, 35 court decisions in favor of Dexia Crédit Local, SFIL and Caisse Française de Financement Local regarding structured loan contracts (25 rulings of the Nanterre Court of First Instance, 2 rulings of the Nanterre Commercial Court, 6 rulings of the Versailles Court of Appeal and 2 rulings of the French Supreme Court, the "Cour de cassation"). Only one unfavorable decision, concerning a single non-structured loan, has been handed down, being noted this is a first-instance ruling that has been appealed by Caisse Française de Financement Local, SFIL and Dexia Crédit Local.

As of June 30, 2018, there were no other significant lawsuits or disputes between SFIL or CAFFIL and their borrowers.

6.2. TAX RISKS

For the record, in 2015, the French tax authorities audited the income declared and tax paid by CAFFIL, SFIL's subsidiary, with regard to the fiscal years 2012 and 2013. Following this inspection, the auditors disputed the tax treatment of the two following points: the taxation in Ireland of the results of the former Dublin branch of Dexia Municipal Agency (CAFFIL's former name), which closed in 2013, and the deductibility of provisions for non-performing loans. In order to safeguard its rights over the disputed adjustment, in 2017 the tax authorities opened a verification procedure relating to the consequences of the previous inspections of taxable income for the 2014 to 2016 fiscal years. The two points of disagreement resulting from 2015 inspections have been confirmed. There were no other new developments.

In order to take into account the risk of a negative outcome, CAFFIL recorded an additional tax provision in 2015. However, as CAFFIL does not agree with the tax authorities' position, in 2016, it began to formulate a case for appealing the decision under currently applicable regulations. The discussions with the tax authorities and the new tax inspection did not call into question the assumptions used to calculate the amount provisioned in the accounts.

Operating results

1. Consolidated financial statements prepared in accordance with IFRS

The SFIL Group reported consolidated net income as of June 30, 2018, of EUR +43 million for a total balance sheet of EUR 73.9 billion at that date. The CET1 ratio (fully loaded) of the Group stood at 22.2%, confirming its financial stability.

Income as of June 30, 2018, also incorporated non-recurrent items[(*)] linked (i) to the volatility of the valuation of the derivative portfolio for EUR 9 million, (ii) to the impacts of the application of IFRS 9 as concerns the volatility in the valuation of non-SPPI loans on the balance sheet for EUR 9 million, and (iii) to taking account as of January 1 of each year of certain charges with regard to the application of IFRIC 21 for EUR -5 million.

Restated to account for these non-recurrent items, recurrent net income as of June 30, 2018, stood at EUR 29 million compared with net income restated for the same items as of June 30, 2017, of EUR 28 million.

EUR millions	6/30/2018					6/30/2017			
	Net book income				**Recurrent income**	**Net book income**			**Recurrent income**
		Volatility on value adjustments	*Linearisation over the year of charges due and accounted for in the first quarter*	*Credit risk to non-SSPI loans*			*Volatility on value adjustments*	*Linearisation over the year of charges due and accounted for in the first quarter*	
Net banking income	**117**	*13*		*12*	**92**	**101**	*2*		**99**
Operating expenses	**-59**		*-5*	*0*	**-54**	**-61**		*-5*	**-55**
Pre-tax income	**58**	***13***	***-5***	***12***	**38**	**40**	***2***	***-5***	**43**
Cost of risk	**1**		*0*		**1**	**1**			**1**
Pre-tax income	**59**	***13***	***-5***	***12***	**39**	**41**	***2***	***-5***	**44**
Corporate income tax	**-16**	*-3*	*1*	*-3*	**-10**	**-16**	*-1*	*1*	**-16**
Net income	**43**	***9***	***-5***	***9***	**29**	**25**	***1***	***-4***	**28**

An item-by-item analysis of this variation shows up the following points:

- Net banking income stood at EUR 92 million for the first half of 2018, as compared with EUR 99 in 2017, down EUR 7 million from the previous year. Nevertheless, since a reversal of EUR 19 million in specific provisions subsequent to the refinement of the method of valuation of recoverable flows of doubtful loans[(**)] were recorded as of June 30, 2017, restated for this reversal of provision, net banking income was up by EUR 12 million mainly as a result of the improvement in SFIL's conditions of financing;

[(*)] *Restated non-recurrent items are as follows.*

- *Fair value adjustments concerning hedges. As a reminder, since 2013, book value adjustments affect hedging operations set up by the SFIL Group to cover risks of rates and foreign exchange. These adjustments basically concern accounting for adjustments linked to the application of IFRS 13, which mainly introduced the recognition of valuation adjustments with reference to CVA (Credit Valuation Adjustment), DVA (Debit Valuation Adjustment) and, FVA (Funding Valuation Adjustment).*

These accounting valuation adjustments are recorded in the income statement as net gains or losses on financial instruments at fair value through profit or loss.

- *The variations in the valuation of a non-SPPI loan portfolio (valued on the basis of JVR in IFRS 9 although destined to be kept) linked to the variation of its credit spread.*
- *The linearisation of certain charges taken into account as of January 1 of each year in application of IFRIC 21.*

[(**)] *Note should be taken that the SFIL Group was able as of the first half of 2017 to refine in a reasonable and prudent manner its provisioning method according to the model of likely losses anticipated by IAS 39. This refinement led to the accounting recognition as of June 30, 2017, of a reversal of provisions of EUR 19 million, which resulted in an improvement in the interest margin.*

- Group operating expenses and amortization totaled EUR -54 million, and were down by EUR 1 million from 2017, since the rise in IT charges was amortized by the decrease in other operating expenses;
- the cost of risk was stable at EUR 1 million.

2. First-time application of IFRS 9

The new IFRS 9, which relates to financial instruments and replaces IAS 39, is applicable from January 1, 2018. It comprises three main components: classification and measurement, impairment and hedge accounting. Its application to SFIL Group's activity is presented below.

2.1. CLASSIFICATION AND MEASUREMENT

The new standard now provides for only three categories of financial assets: those recognized at amortized cost, those recognized at fair value through profit or loss and those recognized at fair value through other comprehensive income. This classification depends on both the business model in which the financial asset is used and the characteristics of its contractual cash flows.

A financial asset is at amortized cost if:

- the sole purpose of holding it is to collect the associated contractual cash flows;
- these contractual cash flows represent solely payments of principal and interest (SPPI).

Most of the loans and securities listed as assets of the SFIL Group meet these criteria (hold to collect model and SPPI characteristics) and continue to be recognized at amortized cost. However, some portfolios are now recognized at fair value: these are mainly securities held as cash surplus investments under a hold to collect and sell model (fair value recognized directly through other comprehensive income) and structured loans, which were previously recognized at amortized cost under IAS 39 and whose financial flows are not SPPI, resulting in recognition at fair value through profit or loss under IFRS 9. Furthermore, the sensitivity reduction transactions consisted in transforming non-SPPI loans into SPPI loans; these transactions are now systematically considered to be capable of derecognition, which leads to:

- for transactions of this type occurring prior to January 1, 2018: recognition of the early repayment penalty in the 2018 opening equity to reflect the first-time application of IFRS 9;
- for transactions of this type occurring after January 1, 2018: immediate recognition of the early repayment penalty in profit or loss.

2.2. IMPAIRMENT

In accordance with the new IFRS 9, loans and securities measured at amortized cost or at fair value through other comprehensive income, as well as financing commitments, are classified into one of three portfolios which are named “Stages”:

- Stage 1: performing outstandings with no significant credit risk deterioration since initial recognition;
- Stage 2: performing outstandings with significant credit risk deterioration since initial recognition;
- Stage 3: credit-impaired outstandings.

Provisions are set aside for all of these assets and financing commitments, including Stage 1 and Stage 2 performing outstandings. The related impairment is based on *forward looking* scenarios (defined by probability of occurrence), and takes into account expected losses over the next twelve months (Stage 1) or the outstanding's life (Stages 2 and 3).

In addition, changes in the credit risk of loans and securities recognized at fair value through profit or loss are included in their valuation.

Lastly, SFIL Group decided not to apply the option of spreading over time the impact on prudential capital associated with the standard's first-time application and relating to the provisioning component.

2.3. HEDGE ACCOUNTING

Until the future macro-hedging standard takes effect, the SFIL Group has chosen to continue applying IAS 39 in this area.

2.4. IMPACTS ASSOCIATED WITH THE FIRST-TIME APPLICATION OF IFRS 9 AND EXPECTED IMPACTS ON FUTURE RESULTS

The first-time application of IFRS 9 to the SFIL Group's transactions as of January 1, 2018 had a limited impact on equity as regards the new provisioning methods, but a more significant impact from the classification and measurement standpoint.

The following table shows the breakdown of financial assets by recognition method.

(EUR millions)	**1/1/2018**
Financial assets non SPPI recognized at fair value through net income	9,310
Financial assets SPPI recognized at fair value through equity	942
Financial assets SPPI recognized at amortized cost	52,293
TOTAL	**62,545**

The following table shows the impact on equity and the CET1 ratio, of the first-time application of IFRS 9, all other things being equal.

Impact linked to the first-time application of IFRS 9 on equity (EUR millions)	**1/1/2018**
Classification and measurement	86
Impairment	(10)
Hedge accounting	-
TOTAL before tax	**76**
TOTAL after tax	**50**

Impact linked to the first-time application of IFRS 9 on the CET 1 ratio (fully loaded) after prudential restatements (basis point)	**1/1/2018**
TOTAL	**119**

Lastly, IFRS 9 has an impact on future results due mainly to changes in the fair value of non-SPPI financial assets, a situation which leads to increased income volatility. This standard therefore increases net banking income volatility in a way unrelated to the SFIL Group’s activity, as its business model involves holding all loans until maturity. The SFIL Group therefore decided to isolate this impact within so-called non-recurring items in order to restate it in the analysis of the Group’s performance.

Outlook

In 2018, the SFIL Group targets the following objectives:

- to maintain its role as a major player in the market for loans to local governments and French public healthcare facilities within the framework of cooperation with La Banque Postale;
- to pursue its key role in the refinancing of banks that are partners of French exporters for their export credits.

The largest part of the sensitivity reduction operations has been dealt with, and outstanding assets involving the greatest risk (those indexed on EUR/CHF) have been brought down to a marginal level. As a result, this activity, which is generally accompanied by new loans granted to local governments, has settled into a moderate pace. The already significant reduction in the number of assignments observed is expected to continue in 2018.

With regard to the project to enlarge the scope of export credits to strategic projects, preliminary work to obtain the legislative authorizations at the national and European levels is underway, the goal being to treat the first file at the beginning of 2019.

In order to extend and diversify its issuance capacity, the SFIL Group decided to develop its themed bond franchise with social or environmental perspectives. Thus, during the second half of 2018, the SFIL Group plans to launch via CAFFIL a social covered bond in order to support its financing of French public healthcare facilities. The SFIL Group intends to enlarge its capacity to Green Bonds in 2019.

In the first half of 2018, SFIL and its subsidiary CAFFIL examined their situation in terms of credit rating and decided to mandate the international rating agency DBRS. Subsequent to its analysis, DBRS attributed a AA (high) rating, just a notch under the rating of France, SFIL's reference shareholder, and it gave CAFFIL's covered bond issues the best rating possible, i.e. triple A. In addition, SFIL and CAFFIL decided to discontinue to work with the Fitch rating agency after the end of 2018. Consequently, the financial rating agencies chosen by the SFIL Group for its issuance activities will be, as of January 2019, S&P, Moody's and DBRS.

From an operational point of view, subsequent to changes made in its IT system, SFIL will adapt its IT organization, aiming to reduce costs and apply active methods.

In light of the importance of digital transformation, SFIL has launched a project to build an internet platform for its borrowers, the main goal of which is to accompany local governments and public healthcare facilities in their efforts to dematerialize operations. The first tests will be conducted in September 2018 with a sample of borrowers.

Lastly, from a macro-economic point of view, as in 2017, two significant factors will be closely observed throughout the rest of the year. These issues concern changes in the regulatory environment and the degree of volatility of the markets within a framework influenced by the perspectives of the end of quantitative easing as announced by the European Central Bank, the provisions linked to Brexit and the geopolitical environment.

2. Condensed consolidated financial statements in accordance with IFRS

Assets as of June 30, 2018

EUR millions	Note	12/31/2017	1/1/2018[(1)]	6/30/2018
Central banks		2,560	2,560	3,047
Financial assets at fair value through profit or loss	*2.1*	-	9,310	8,542
Hedging derivatives		4,715	4,709	4,420
Financial assets available for sale		2,790	-	-
Financial assets at fair value through equity	*2.2*	-	942	2,540
Loans and advances due from banks at amortized cost	*2.3*	295	295	272
Loans and advances to customers at amortized cost	*2.4*	57,014	43,607	44,095
Bonds at amortized cost	*2.5*	-	8,391	8,227
Fair value revaluation of portfolio hedge		2,518	2,518	2,668
Financial assets held to maturity		-	-	-
Current tax assets		14	14	17
Deferred tax assets		64	38	20
Tangible assets		6	6	5
Intangible assets		29	29	32
Accruals and other assets		2,427	68	60
TOTAL ASSETS		**72,432**	**72,487**	**73,945**

Liabilities as of June 30, 2018

EUR millions	Note	12/31/2017	1/1/2018[(1)]	6/30/2018
Central banks		-	-	-
Financial liabilities at fair value through profit or loss	*3.1*	4	2,756	2,483
Hedging derivatives		8,063	6,587	6,387
Due to banks at amortized cost	*3.2*	4,215	4,215	1,970
Customer borrowings and deposits at amortized cost		-	(1)	-
Debt securities at amortized cost	*3.3*	56,315	56,315	60,974
Fair value revaluation of portfolio hedge		883	883	367
Current tax liabilities		1	1	3
Deferred tax liabilities		-	-	-
Accruals and other liabilities		1,434	158	146
Provisions		48	54	54
Subordinated debt		-	-	-
EQUITY		**1,469**	**1,519**	**1,561**
Share capital		1,445	1,445	1,445
Reserves and retained earnings		72	39	92
Net result through equity		(102)	(19)	(19)
Net income		54	54	43
TOTAL LIABILITIES		**72,432**	**72,487**	**73,945**

[(1)] *Presentation of the balance sheet after accounting for IFRS 9 applicable as of January 1, 2018 (cf. note 8).*

Income statement

EUR millions	Note	First half 2017	First half 2018
Interest income	*5.1*	1,389	1,338
Interest expense	*5.1*	(1,297)	(1,265)
Net gains or losses resulting from hedges of net position		-	-
Fee and commission income		5	2
Fee and commission expense		(2)	(2)
Net result of financial instruments at fair value through profit or loss	*5.2*	5	42
Net result of financial instruments at fair value through equity		-	-
Net result of financial instruments at amortized cost		-	2
Gains or losses resulting from reclassification of financial assets at amortized cost to fair value through profit or loss		-	-
Gains or losses resulting from reclassification of financial assets at fair value through equity to fair value through profit or loss		-	-
Net result of financial assets		1	-
Other profits		0	0
Other loss		(0)	(0)
NET BANKING INCOME		**101**	**117**
Operating expenses	*5.3*	(58)	(55)
Depreciation and amortization of property and equipment and intangible assets		(3)	(4)
GROS OPERATING INCOME		**40**	**58**
Cost of risk	*5.4*	1	1
OPERATING INCOME		**41**	**59**
Net gains (losses) on other assets		-	-
INCOME BEFORE TAX		**41**	**59**
Income tax		(16)	(16)
NET INCOME		**25**	**43**
EARNINGS PER SHARE (in EUR)			
- Basic		2.67	4.57
- Diluted		2.67	4.57

Net income and unrealized or deferred gains and losses through equity

EUR millions	First half 2017	First half 2018
NET INCOME	**25**	**43**
ITEM THAT MAY SUBSEQUENTLY BE RECLASSIFIED AS PROFIT OR LOSS	**11**	**83**
Unrealized or deferred gains and losses of financial assets available for sale	9	125
Unrealized or deferred gains and losses of financial assets at fair value through equity	-	1
Unrealized or deferred gains and losses of cash flow hedges	8	4
Tax	(6)	(47)
ITEM THAT MAY NOT BE RECLASSIFIED AS PROFIT OR LOSS	**-**	**-**
Actuarial gains and losses on defined-benefit plans	-	-
Tax	-	-
TOTAL UNREALIZED GAINS AND LOSSES RECOGNIZED DIRECTLY IN EQUITY	**11**	**83**
NET INCOME AND GAINS OR LOSSES THROUGH EQUITY	**36**	**126**

Consolidated statement of changes in equity

EUR millions	Share capital and reserves: Share capital	Share capital and reserves: Capital reserves	Consolidated retained earnings	Total of gains or losses through equity: Net change in fair value of available for sale financial assets and pension plans with defined benefits, net of taxes	Total of gains or losses through equity: Net change in fair value of equity financial assets, net of taxes	Total of gains or losses through equity: Net change in fair value of hedging derivatives, net of tax	Net income	Total consolidated equity
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***	-	***72***	**(104)**	**-**	**(24)**	**-**	***1,389***
Net income for the period	-	-	-	-	-	-	54	54
Changes in gains and losses through equity	-	-	-	21	-	5	-	26
EQUITY AS OF 12/31/2017	**1,445**	**-**	**72**	**(83)**	**-**	**(19)**	**54**	**1,469**
Capital increase	-	-	-	-	-	-	-	-
Issuance of preferred shares	-	-	-	-	-	-	-	-
Allocation of 2017 net income	-	-	54	-	-	-	(54)	-
Dividends paid on 2018 income	-	-	-	-	-	-	-	-
Subtotal of transactions with shareholders	***1,445***	**-**	***126***	**(83)**	**-**	**(19)**	**-**	***1,469***
Net income for the period	-	-	-	-	-	-	43	43
Changes in gains and losses through equity	-	-	-	82	1	-	-	84
Other changes		(34)	-	-	-	-	-	(34)
EQUITY AS OF 6/30/2018	**1,445**	**(34)**	**126**	**(1)**	**1**	**(19)**	**43**	**1,561**

Cash flow statement

EUR millions	12/31/2017	6/30/2018
NET INCOME BEFORE TAX	**93**	**59**
+/- Depreciation and write-downs	(56)	1
+/- Expense / income from investing activities	118	32
+/- Expense / income from financing activities	(95)	(139)
+/- Other non-cash items	42	60
Non-monetary items included in net income before tax and other adjustments	**9**	**(46)**
+/- Cash from interbank operations	(2,403)	(2,234)
+/- Cash from customer operations	452	(97)
+/- Cash from financing assets and liabilities	(127)	(1,472)
+/- Cash from not financing assets and liabilities	(712)	28
- Income tax paid	(36)	(27)
Decrease / (increase) in cash from operating activities	**(2,826)**	**(3,802)**
CASH FLOW FROM OPERATING ACTIVITIES (A)	**(2,724)**	**(3,789)**
CASH FLOW FROM INVESTING ACTIVITIES (B)	**-**	**-**
+/- Cash from or for shareholders	(0)	(50)
+/- Other cash from financing activities	410	4,298
CASH FLOW FROM FINANCING ACTIVITIES (C)	**410**	**4,248**
EFFECT OF CHANGES IN EXCHANGE RATES ON CASH (D)	**-**	**-**
INCREASE / (DECREASE) IN CASH EQUIVALENTS (A + B + C + D)	**(2,314)**	**459**
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD	**4,895**	**2,580**
Cash and balances with central banks (assets & liabilities)	4,878	2,559
Interbank accounts (assets & liabilities) and loans / sight deposits	17	21
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	**2,581**	**3,062**
Cash and balances with central banks (assets & liabilities)	2,560	3,047
Interbank accounts (assets & liabilities) and loans / sight deposits	21	15
CHANGE IN NET CASH	**(2,314)**	**482**

Notes to the condensed consolidated financial statements

1. Accounting policies and valuation methods

ACCOUNTING PRINCIPLES AND METHODS APPLIED

1.1. SCOPE OF CONSOLIDATION

The scope of consolidation for June 30, 2018, is the same as that of December 31, 2017.

1.2. ACCOUNTING POLICIES AND PRESENTATION RULES

1.2.1. Applicable accounting standards

SFIL's half year consolidated statements as of June 30, 2018, 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, 2017.

However, due to the entry into force of IFRS 9 for reporting periods beginning on or after January 1, 2018 and in accordance with point 3.2.3. of AMF's Recommendation "Closing of the Accounts 2017" (DOC-2017-09), SFIL has disclosed in its 2018 financial statements the information required under IFRS 7.42I and followings on the transition from IAS 39 to IFRS 9; IFRS 9 first time application impacts are detailed in note 8.

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

1.2.1.1. IASB and IFRIC texts endorsed by the European Union and effective as of January 1, 2018

- • IFRS 9 "Financial Instruments": This standard, which replaces IAS 39, was adopted by the European Union on November 22, 2016 (EU Regulation n°2016/2067), and has 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 is defined on the basis of the management model implemented, on the one hand, and the nature of the flows received, i.e. consisting exclusively of payments of principal and interest (SPPI[1]), or including other elements (non-SPPI), on the other hand;
  - impairment for credit risk: the standard introduces a single 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 has 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

The management model implemented by SFIL has been formalized for the different portfolios of financial assets:

- the management model implemented for all loans portfolios and most of securities portfolios is the Hold-To-Collect model: such assets are accounted for and measured at amortized cost except the ones which do not meet the cash flow criterion representing solely principal and interests;
- only securities held for cash investment purposes are classified within an Hold-To-Collect-and-Sale management model: this comes from the higher sales frequency and volume for these assets, objective of which is specifically to address day-to-day liquidity management needs of SFIL. These assets are accounted for and measured at fair value through the section "other comprehensive income" of equity.

Some loans, which do not meet the cash flow criterion representing solely principal and interests, are, from January 1, 2018, accounted for and measured at fair value through profit or loss. Such measurement is performed according to a mark-to-model-based methodology due to the absence of observable prices in an active market. They are composed of loans, contractual flows of which are not in line with those of a basic lending agreement as the latter is defined under the standard; this may be due in particular to the inclusion in the interest rate formula of a leverage effect or an indexation on foreign exchange rates.

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[1] *SPPI : Solely Payments of Principal and Interest*

Furthermore, the policy implemented by SFIL from its creation 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 complied 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) has been recorded as a counterpart to equity on the date of first application of the standard.

Moreover, on October 12, 2017, IASB issued an amendment to IFRS 9 entitled "Prepayment Features with Negative Compensation" which deals with instruments whose contractual terms may eventually result in a prepayment inferior to the sum of the outstanding principal and accrued interest. Under this amendment, such instruments do meet the SPPI criterion, provided that the prepayment essentially represents the outstanding principal and the related interest plus a reasonable compensation irrespective of its sign (payment by the borrower to the lender or by the lender to the borrower). Effective for reporting periods beginning on or after January 1, 2019, an earlier application of this amendment is permitted. SFIL opted for an earlier application of this amendment, given the endorsement by the European Union on March 22, 2018 (EU Regulation n° 2018/498).

Finally, as above mentioned, some securities which were or had been accounted for in a portfolio of assets available for sale under IAS 39, are now accounted for at amortized cost under IFRS 9: as for the first time application impact, this accounting change results in the direct reclassification in 2018 opening equity of the unrealized gain or losses accumulated in equity up to December 31, 2017.

Impairment of financial assets

As required under IFRS 9, the Group has defined the set of rules to break down its exposure into three levels ("Stages") depending on credit quality evolution since initial recognition. This set of rules relies on the existing risk monitoring framework of processes and committees (watchlist committee, default committee…).

The Standard also requires to define forward-looking scenarios in the objective of prospectively determining expected credit losses.

The Group has leveraged on its existing framework of calculation of the capital requirements involved by credit risk pursuant to Prudential Regulation (advanced models and prudential calculation rules) and, in the prospect of integrating a prospective dimension, forward-looking scenarios (projections of financial information impacting the portfolios) have been taken into consideration.

For Stage 1 and Stage 2 assets, the Expected Credit Losses calculation under IFRS 9 is inspired by the Expected Loss calculation under Basel committee rules (use of Exposure at Default, Probability of Default and Loss Given Default parameters and discounting at the effective interest rate). For Stage 3 assets, the Expected Credit Losses calculation is based mainly on individual recovery hypotheses made by the Credit Risk Department.

Finally, as regards the prudential requirements, SFIL does not apply the *phase-in* provisions embedded within EU Regulation n° 2017/2395 that enable a progressive recognition of the first time application impact of the standard.

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 in Europe 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 discloses 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 has been based on a steering committee involving SFIL executive management, the Finance division, the Risks division, the head of IS (information systems), as well as the President of the Executive Board of Caisse Française de Financement Local.

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 and 2018. All the components of the information system affected by the implementation of IFRS 9 have been subject to tests which have been integrated into the IT simplification and reinforcement program.

The governance of SFIL has been adapted so as to integrate the elements relating to the new standard into the existing procedures: asset-liability management committee will be in charge of determining and monitoring the management model pursued while new product committee will be in charge of assessing whether products meet the SPPI criterion.

Politics and procedures embedded within the existing risk management framework (watchlist and defaults) have been reviewed and updated through the inclusion of ad-doc documents, with the purpose of addressing the issue of impairment under IFRS 9.

Similarly, methodologies (models and parameters used), forward-looking scenarios and likelihood of occurrence related to impairment under IFRS 9 have been validated by the department credit validation and quality control. These scenarios have been embedded within the formal reporting sent to the Credit Validation Committee, the Risk Committee, the Internal Control and Risk Committee, the latter being a specialized committee of the Board of SFIL, and CAFFIL's executive board.

Moreover, backtesting procedures have been defined in order to monitor on an annual basis the efficiency of the framework of Expected Credit Loss calculation under IFRS 9; such procedures encompass the assessment of data quality, portfolio structure and forecast accuracy.

On each balance sheet date, the split in Stages as well as the impairment amounts are submitted for assessment and approbation to the impairment committee prior to their integration in the information systems. Impairment amounts are disclosed both internally – through a trimestral presentation to the internal control and risk committee and the risk quarterly review – and externally – through financial reports.

Finally, the accounts committee of the Group, which is an emanation of the executive board of SFIL, the executive board and the supervisory board of Caisse Française de Financement Local have been regularly informed on IFRS 9 project progress and on the financial impacts of the entry into force of this new standard.

Amendments of IFRS framework induced by IFRS 9

IFRS 9 amends some other IFRS, in particular:

- IAS 1 "Presentation of financial statements": the accounting headings belonging to net banking income and other comprehensive income are modified and adapted to IFRS 9;
- IFRS 7 "Financial Instruments: Disclosures": additional pieces of information in Annex are required, especially relating to hedge accounting and credit risk.

• ANC Recommendation n° 2017-02 "Regarding disclosure of consolidated financial statements for banking reporting entities under IFRS": This ANC recommendation issued on June 2, 2017, supersedes and replaces the one issued on November 7, 2013 (n° 2013-04) effective on the date of first time application of IFRS 9. It introduces a template of consolidated financial statements compliant with the new IFRS 9 standard.

2018 Half-year consolidated financial statements of SFIL are compliant to this Recommendation.

• IFRS 15 "Revenue from contracts with customers": endorsed by the European Union on September 22, 2016 (UE Regulation n° 2016/1905) and effective for reporting periods beginning on or after January 1, 2018, this standard deals with contracts with customers, excluding financial instruments, insurance contracts and leases.

The entry into force of this new standard has had no impact on consolidated financial statements of SFIL.

• Amendments to IAS 28 "Investments in Associates and Joint Ventures", IFRS 1 "First-time Adoption of International Financial Reporting Standards" and IFRS 12 "Disclosure of Interests in Other Entities": issued by IASB on December 8, 2016, in the framework of its Annual Improvements Projects – 2014-2016 cycle, endorsed by the European Union on February 7, 2018 (EU Regulation n° 2018/182) and effective for reporting periods beginning on or after January 1, 2018, for the amendments to IAS 28 and IFRS 1 and January 1, 2017 for the amendment to IFRS 12, this amendments deal with interests classified as held for sale or discontinued operations under IFRS 5 and consolidation rules applying to an associate or a joint venture being held by or through a mutual fund or a venture capital organization.

• Amendment to IFRS 4 "Insurance contracts: Application of IFRS 9 Financial instruments with IFRS 4"

• Amendment to IFRS 2 "Share-based payments"

• Amendment to IAS 40 "Investment property"

• IFRIC 22 "Foreign Currency Transactions and Advance Consideration"

These amendments have no impact on the consolidated financial statements of SFIL.

1.2.1.2. IASB and IFRIC texts endorsed by the European Union but not yet applicable

- IFRS 16 "Leases": endorsed by the European Union on October 31, 2017 (EU Regulation n° 2017/1986) and effective for reporting periods beginning on or after January 1, 2019, this standard, which will eventually replace IAS 17, states that at the commencement date a lessee shall recognize both a right-of-use asset and a lease liability.

The impacts of this standard on the consolidated financial statements of SFIL are being analyzed. The calculation of IFRS 16 first time application impact is being performed and, applying IFRS 16.C5.(b), SFIL moves towards the limited restatement method. SFIL has not opted for an earlier application of this standard.

- Amendments to IAS 12 "Income taxes" / IAS 23 "Borrowing costs" / IFRS 3/IFRS 11 "Business combinations": issued by IASB in December 2017 in the framework of its Annual Improvements Projects – 2015-2017 cycle.
- Amendment to IAS 19 "Employee benefits"
- Amendment to IAS 28 "Investments in associates"
- IFRIC 23 "Uncertainty over Income Tax Treatments"

The impacts of these amendments on the consolidated financial statements of SFIL are being analyzed.

1.2.2. 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. They are compliant with ANC (French accounting standards board) Recommendation 2017-02 issued on June 2, 2017. The consolidated financial statements were approved by the Board of Directors on September 6, 2018.

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 the occurrence of a significant increase of credit risk since initial recognition;
- 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.

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;
- assessment of the amount of expected credit losses;
- estimates of future taxable profits for the recognition and measurement of deferred tax assets.

1.2.3. Accounting principles applied to the financial statements

1.2.3.1. 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 all 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;
- 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, including unrealized gains or losses resulting from intra-group transactions, are eliminated on consolidation.

1.2.3.2. 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 expected future cash flows on a net basis or to simultaneously realize the asset and settle the liability.

1.2.3.3. Foreign currency transactions

Foreign currency transactions are accounted for using the exchange rate prevailing on the transaction date.

As a reminder, the main feature of a monetary item is the right to receive (or the obligation to deliver) a fixed or determinable number of units of currency. Under IAS 21, monetary assets and liabilities denominated in foreign currencies are recognized at closing rates and any resulting exchange differences are recognized in net income.

Financial assets denominated in a foreign currency and measured at fair value through the section “other comprehensive income” of equity are accounted for as monetary items under IFRS 9: the exchange difference resulting from the adjustment of the amortized cost of these assets is recognized in net income, while further adjustments of the carrying amount (except the loss allowance for expected credit losses: see below) are recognized in equity.

The Group holds no non-monetary assets or liabilities denominated in a foreign currency.

1.2.3.4. 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. Derivative instruments are recognized at fair value on the transaction date.

1.2.3.5. Financial assets

When the Group becomes party to the contractual provisions of a financial asset, the latter is classified under one of the three categories instituted by IFRS 9, depending on the business model it is held within on the one hand and the characteristics of its contractual cash flows on the other hand.

Business model

The inclusion of the Group’s financial assets within business models is assessed at a level that reflects how groups of financial assets are managed together to achieve Group’s business objectives, which are:

- refinancing local government entities and public hospitals through the acquisition of medium/long-run loans granted by La Banque Postale;
- reducing the sensitivity of structured loans;
- refinancing export credit contracts covered by BPI Assurance Export insurance policy.

This assessment implies most of the time the use of judgment and relies on facts, circumstances and, generally speaking, all relevant evidence that is available for the Group at the date of the assessment. These relevant evidences can be broken down into two groups:

- Qualitative evidences: how the performance of the business model and the financial assets held within that business model are evaluated and reported to the Group's key management personnel, the risks that affect the performance of the business model and the financial assets held within that business model and, in particular, the way in which those risks are managed, how managers of the business are compensated (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flows collected);
- Quantitative evidences: the frequency, value and timing of sales in prior periods, the reasons for those sales and expectations about future sales activity.

It can be inferred from this assessment that the Group only uses the Hold-To-Collect (HTC) model and the Holt-To-Collect-and-Sell (HTCS) model. The Group holds no financial assets for trading purposes, i.e. the Group does not acquire, incur or hold financial assets for the purpose of realizing a net gain through selling or repurchasing them it in the near term.

Characteristics of contractual cash flows (SPPI criterion)

The SPPI (Solely Purchase of Principal and Interests) criterion test is intended to assess whether the contractual cash flows of a financial asset are consistent with the ones of a basic lending agreement, i.e. payment of principal and interest on that outstanding principal. Irrespective of the legal form of the asset and the form of its rate (fixed or variable), this is the case when the contractual cash flows embed only a compensation for the time value of money, a compensation for the credit risk, if applicable a compensation for other basic lending risks (e.g. liquidity risk) and costs (e.g. administrative costs) associated with holding the asset for a particular period of time, plus if applicable a margin.

Most of the time a qualitative analysis is sufficient to determine whether the asset is SPPI compliant or not. Sometimes, an additional quantitative analysis is necessary: it intends to compare the contractual cash flows of the financial asset considered with those of a benchmark asset. If the gap assessed through this comparison is not material, the asset is assimilated to a basic lending agreement.

Financial assets measured at amortized cost

A financial asset is classified and subsequently measured at amortized cost if it is compliant with the two following conditions:

- This financial asset is held within a business model, the objective of which is to hold financial assets in the purpose of collecting contractual cash flows (HTC model);
- Contractual provisions of this asset result, at specified dates, in cash flows which embed only the repayment of principal and interest on the outstanding principal (SPPI criterion).

At initial recognition, the Group records a financial asset belonging to this category at fair value, including if applicable any premium / discount and transaction costs. Subsequently, the financial asset is measured at amortized cost, which corresponds to its carrying amount at initial recognition minus repaid principal, plus or minus as appropriate the amortization of the premium / discount calculated using the effective interest rate method and taking into account any loss allowance for expected credit losses. The latter reduces the carrying amount of the financial asset with an offsetting entry to the cost of risk section of the net income.

Due and accrued interest on loans and fixed income securities as well as the amortization of premium / discount, calculated using the effective interest rate method, are recognized in the net interest margin.

The effective interest rate is the rate that accurately discounts the expected future cash flows over the expected life of the financial instrument or, where more appropriate, a shorter period, so as to obtain the gross carrying amount of the financial asset or, if the underlying asset is a purchased or originated credit-impaired financial asset or has been subsequently impaired (see below), its net carrying amount (which takes into account the loss allowance for expected credit losses). The calculation of this rate takes into account the commissions received or paid by the parties which, because of their nature, form an integral part of the effective rate of the contract, possible premiums and discounts and transaction costs. Transaction costs are incremental costs that are directly attributable to the acquisition of a financial instrument and are used for the calculation of the effective interest rate. An incremental cost is one that would not have been incurred if the entity had not acquired the financial instrument.

Financial assets measured at fair value through the section "other comprehensive income" of equity

A financial asset is classified and subsequently measured at fair value through the section "other comprehensive income" of equity if it is compliant with the two following conditions:

- This financial asset is held within a business model, objective of which is both to collect the contractual cash flows and to sell financial assets (HTCS model);
- Contractual provisions of this asset result, at specified dates, in cash flows which embed only the repayment of principal and interest on the outstanding principal (SPPI criterion).

At initial recognition, the Group records a financial asset belonging to this category at fair value, including if applicable any premium / discount and transaction costs. Subsequently, the unrealized gains or losses stemming from the variation of the fair value of this asset are recognized in the section "other comprehensive income" of equity, except an amount corresponding to the loss allowance for expected credit losses, which is recognized in the section "cost of risk" of the net income.

Due and accrued interest on loans and fixed income securities as well as the amortization of premium / discount, calculated using the effective interest rate method (see above), are recognized in the net interest margin.

Financial assets measured at fair value through net income

A financial asset which does not belong to either of the two categories described above (amortized cost and fair value through the section "other comprehensive income" of equity) falls under this category and is classified and subsequently measured at fair value through net income: this category is mainly composed of financial assets that are not SPPI compliant.

At initial recognition, the Group records a financial asset belonging to this category at fair value, including if applicable any premium / discount and excluding transaction costs. Subsequently, the unrealized gains or losses stemming from the variation of the fair value of this asset are recognized in the section "net banking income" of the net income.

In accordance with the principles stated under ANC Recommendation 2017-02 issued on June 2, 2017, the Group decided to record separately:

- The fair value variations excluding accrued interest; they are recorded on the line *Net gains or losses on financial instruments at fair value through net income* of the net banking income;
- Due and accrued interest; they are recorded in the net interest margin.

Designation options

The Group does not use the following options:

- Option to designate a financial asset as measured at fair value through net income: this option can be exercised only if it eliminates or significantly reduces a recognition inconsistency for assets or liabilities (accounting mismatch);
- Option to present in other comprehensive income subsequent changes in fair value of particular investments in equity instruments; the Group does not hold such instruments.

Impairment of financial assets

Defining the impairment base

A loss allowance for expected credit losses is calculated for all financial assets measured at amortized cost or at fair value through the section "other comprehensive income" of equity. At each closing date, they are broken down into three Stages:

- Stage 1: credit risk on the financial asset has not increased significantly since its initial recognition;
- Stage 2: credit risk on the financial asset has increased significantly since its initial recognition;
- Stage 3: the asset has defaulted.

At each closing date, the loss allowance for expected credit losses is measured as:

- The amount corresponding to the expected credit losses during the next 12 months for Stage 1 assets;
- The amount corresponding to the expected credit losses during the residual lifetime for Stage 2 and Stage 3 assets.

No loss allowance is recognized at initial recognition for purchased or originated credit-impaired financial assets. Interest incomes generated by these assets are determined using an effective interest rate that embeds expected credit losses. Subsequently, the loss allowance recognized on these assets corresponds to the accumulated variations of lifetime expected credit losses from initial recognition. The Group does not primarily intend to purchase or originate purchased or originated credit-impaired financial assets.

Assessing whether credit risk has significantly increased

The assessment of credit risk increase is performed on an individual basis: the Group does not use the collective basis approach. The objective of the assessment is to compare the default risk on the contract at closing date with its default risk at the date of initial recognition. This assessment takes into consideration all reasonable and supportable information that is relevant and that is available for the Group without incurring undue cost or making undue effort, in particular qualitative and quantitative information on past events (use of historic metrics), on current economic environment and on expectations on future economic environment (forward looking information). In practice, the assessment of credit risk increase is realized at counterparty level:

- Either through the comparison of the probability of default (PD) at maturity (weighted average PD of the forward looking scenarios) to the PD at initial recognition;
- Or through the characterization of risk levels (ratings coming from internal notation systems) year-to-year migrations towards risk levels regarded as risky (higher historic default rates).

The contract is classified in Stage 3 when the exposures to that counterparty are regarded as Non performing under Basel framework (NPE – Non performing exposures), i.e.:

- When the counterparty is unlikely to pay, which is evidenced by a credit risk rating characterizing a real default situation: it is probable that the counterparty will not repay all or part of its debt, without recourse to realizing securities if applicable; and / or
- When it presents material arrears in payment on the principal and / or on interest past due of more than 90 days.

The contract is classified in Stage 2 when the exposures to that counterparty are regarded as Performing under Basel framework but it is in one of the following situations:

- It is followed by the Watchlist Committee, due to an increase in its credit risk, or it is in Forbearance, which means that the Group has refrained the enforcement of its rights toward counterparty facing financial difficulties;
- It presents arrears in payment on the principal and / or on interest past due of more than 30 days (and less than 90 days) for Public Sector and Corporate / projects entities or more than 1 day for Sovereigns and Credit institutions;
- Its rating presents one of the following characteristics: it is non Investment grade (internal rating inferior or equal to BB+), it has no rating, it has experimented or is to experiment a rating migration regarded as risky in the forward looking scenarios. The rating migrations regarded as risky have been assessed to be as such based on a quantitative modeling realized on the basis of a statistical analysis using historical data and completed by the use of expert judgment.

If none of the situations detailed above has occurred, the significant increase in credit risk is not characterized and the contract is classified in Stage 1.

The principle of "contagion" used in Basel framework to define NPE, has been transposed to accounting: the assessment of credit risk significant increase is performed at counterparty level.

Stage transitions must be compliant with the following rules:

- The contracts that present an internal credit rating characterizing a real default situation can get out of Stage 3 and go back to Stage 2 or Stage 1 only after a cure period of one year during which they are considered as non performing and stay classified in Stage 3. Exit from Stage 3 must in addition be formally decided in Default Committee and is conditional to the full repayment of arrears if any;
- The contracts in Forebearance can get out of Stage 2 or as appropriate Stage 3 and go back to Stage 1 only after a cure period of 2 years after the date when the forbearance has been granted if the contract is in Stage 2, or after the date when the contract exited Stage 3.

<u>Calculating the impairment amount</u>

The loss allowance recognized on the contract is equal to the average of expected credit losses of each of the scenarios weighted by their probability of occurrence. For all material portfolios, the definition of scenarios integrate a forward looking dimension, which consists in projecting macroeconomic and financial variables and assessing their impacts on loss allowances. These scenarios are built upon either projections realized by the credit risk direction, or on quantitative research developed from data issue from advanced models. In the case of French local communities, the main pieces of information taken into account are the expectations and objectives in term of local public expenditures and tax revenues developed in particular in the draft budget bills and the programs for stability of the State, as well as the hypothesis regarding recourse to taxation.

For the contracts of counterparties classified in Stage 1 or Stage 2, the expected credit losses equals the present value of the product of three parameters discounted at the original effective interest rate of the contract: the probability of default (PD), the exposure at default (EAD) and the loss given default (LGD). These parameters depend on the scenario and the year considered. The Group has capitalized on the framework of calculation of these parameters under Basel regulation and has introduced adjustments so as to comply with specific provisions of IFRS 9: point in time analysis with the integration of a forward looking perspective under IFRS 9 (vs. through the cycle analysis for the probability of default and downturn analysis for the loss given default under Prudential regulation). This approach has resulted in the definition of IFRS 9 specific models for each material portfolio.

For the contracts of counterparties classified in Stage 3, the expected credit losses equals the loss at maturity, i.e. the difference between the sequence of cash flows contractually due to the Group and the sequence of cash flows that the Group expects to recover, both discounted at the original effective interest rate. Depending on the materiality of the contract, the cash flows that the Group expects to recover are calculated either through individual simulations performed by the credit risk direction, or through standard recovery scenarios using predefined management rules. These flows are, if applicable, net of any flows derived from realizing securities which form an integral part of contractual provisions. The expected credit losses accounted for are floored to the amount of expected credit losses calculated by applying the methodology used for a Stage 2 contract and integrating a stress factor with the use of the probability of default corresponding to the worst rating of the scale that the underlying asset belongs to.

At each closing date, the classification in Stages and the loss allowances for expected credit losses are subject to analysis and are validated by the impairment committee prior to their accounting. Besides, back testing procedures have been set up so as to annually monitor the efficiency of the framework of expected credit losses calculation under IFRS 9; they encompass data quality, portfolio structure and expectations quality.

Recognizing the impairment

Positive and negative variations of the amount of the loss allowance for expected credit losses are recognized in the section “cost of risk” of the net income.

When an asset is determined by management as being irrecoverable, it is derecognized (see below) and the loss allowance for expected credit losses is reversed in the section “cost of risk” of the net income; the net loss is recognized in the same section. Subsequent recoveries, if any, are also recognized in cost of risk.

Derecognition of financial assets

A financial asset is derecognized when and only when the contractual rights to the cash flows from this asset expire or if this asset is transferred and the transfer meets one of the following conditions:

- Substantially all the risks and rewards of ownership of this asset have been transferred; or
- Substantially all the risks and rewards of ownership of this asset have been neither transferred nor retained and the control on this asset has not been retained. If the control on this asset has been retained, the underlying asset continues to be recognized to the extent of Group’s continuing involvement in it.

The gain or loss realized when derecognizing a financial asset equals the difference between on the one hand the consideration received (net of transaction costs and including any new asset obtained less any new liability assumed) and on the other hand the carrying amount of this asset measured at the date of derecognition. It is recognized in the section “net banking income” of the net income of the period considered.

Case of disposals

Financial assets are derecognized on disposal. The gain or loss realized on disposal takes into account the followings:

- For financial assets measured at amortized cost, the carrying amount of the disposed asset is systematically determined based on the “first in, first out” approach (FIFO method) on a portfolio basis;
- For financial assets measured at fair value through the section “other comprehensive income” of equity, cumulative gains and losses previously recognized in equity are, applying FIFO method, reversed in net income on disposal, within the line of the net banking income recording the net gains and losses of this category.

Case of repos and reverse repos operations

Sold securities that are subject to a commitment to repurchase them at a predetermined price (repos) are not derecognized and remain on the balance sheet in their original category. The corresponding liability is included in the section of financial liabilities at amortized cost. The asset is reported as pledged in the notes.

Securities purchased under commitment to sell at a predetermined price (reverse repos) are recorded as off-balance sheet items and the corresponding loans are recorded on the balance sheet in the section of financial assets at amortized cost.

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

Case of prepayments

The prepayment of a loan results in general in the payment of a penalty which is included within the gain or the loss realized on derecognition.

- In the case of a prepayment without refinancing, the loan does not exist any longer and is derecognized.
- In the case of a prepayment with refinancing, the accounting treatment differs depending on whether the restructured terms are substantially different from the original terms; it is the in particular the case in one of the following situations:
- The restructured loan is not classified in the same accounting category as the original loan, either because its contractual cash flows are from now compliant with the SPPI criterion (while they were not originally) or because they are not any longer (while they were originally);
- 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 net present value of the cash flows remaining from the original loan, both of these present values being discounted at the original effective interest rate.

If restructured terms are not substantially different from original terms, the original loan is not derecognized. Its gross carrying amount is adjusted so as to reflect the post-restructuring terms, including costs and fees incurred; it corresponds to the present value of the restructured cash flows discounted at the original effective interest rate (or, in the case of purchased or originated credit-impaired assets, at this rate adjusted so as to reflect credit quality). Such an adjustment, called "catch-up" effect, constitutes the excess of the restructured margin of the loan over its original margin: it is immediately recognized in net income of the period, within the net interest margin. Furthermore, for financial assets measured at amortized cost or at fair value through the section "other comprehensive income" of equity, the Group assesses whether, due to the modifications in the terms, a significant increase in credit risk since initial recognition has occurred: if so, an adjustment of the loss allowance for expected credit losses is recognized (see above).

If restructured terms are substantially different from original terms, the original loan is derecognized and the loan under restructured terms is recognized as a new financial asset. Its gross carrying amount is adjusted so as to reflect the market conditions; it corresponds to the present value of the restructured cash flows discounted at the effective interest rate of a loan granted under normal market conditions at the date when the loan is restructured. Such an adjustment constitutes the excess of the restructured margin of the loan over normal market conditions at the date when the loan is restructured: it is immediately recognized in net income of the period, within the line of the net banking income that records the net gains and losses of the category of the derecognized financial asset.

1.2.3.6. Financial liabilities

Financial liabilities held for trading

The Group does not hold financial liabilities belonging to this category.

Financial liabilities designated at fair value through net income

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 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 net income 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 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 net income within the net interest margin. In the case of bonds issued above par, the amortization of issue premiums is deducted from related interest income and expense, within the net interest margin.

Interest paid related to *obligations foncières* is accounted for in the net interest margin for accrued amounts, due and not yet due, calculated *prorata temporis* on the basis of contractual rates.

Fees and commissions on bond issues are amortized according to a quasi-actuarial method over the life of the bond to which they are attached and are accounted for in the net interest margin.

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

Registered covered bonds are private placements recorded at nominal value. Related issue premiums, fees and commissions and interest are treated the same way as *obligations foncières* (see above).

Derecognition of financial liabilities

A financial liability is derecognized when and only when it is extinguished, i.e. when the obligation specified in the contract is discharged, cancelled or expires.

The restructuring of a financial liability results in the derecognition of this financial liability when the restructured terms are substantially different from the original terms.

1.2.3.7. Derivatives

Applying the provisions of IFRS 9, the Group 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 discloses the financial information on hedge accounting that is required under IFRS 7 as amended by IFRS 9.

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

The Group enters into derivative contracts for the unique purpose of hedging its exposures to interest rate or foreign exchange risks. However, some derivatives must be measured at fair value through net income on balance sheet date; they are:

- The ones which failed hedge effectiveness tests on balance sheet date and
- The ones which hedge financial assets that are measured at fair value through net income. In this case, the revaluation of the derivative hedges natively the revaluation of the hedged risk of the financial asset, making pointless the documentation of a hedging relationship.

Both realized and unrealized gains and losses on these derivatives, measured at fair value through net income on balance sheet date, are recognized in net income within the net banking income.

Hedging derivatives

Hedging derivatives can be classified as either:

- hedges of the fair value of a recognized asset or liability or a firm commitment (fair value hedge); or
- hedges of a future cash flow that might eventually impact the future net income and that is attributable to a recognized asset or liability or a forecast and highly probable future transaction (cash flow hedge).

Hedge accounting may be used for such derivatives, provided certain criteria are met:

- precise and 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 of the hedged item attributable to the hedged risk throughout the reporting periods;
- the hedge, effectiveness of which has been reliably measured, shall be effective at inception and on an ongoing basis;
- for hedges of a future cash flow, the future transaction that constitutes if applicable the hedged item must be highly probable and must involved an exposure to variations in cash flows that could ultimately affect the net income.

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 net income, along with the corresponding change in fair value of the hedged items 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.

The efficient portion of the changes in the fair value of derivatives that are designated and documented in a cash flow hedging relationship and that respect the criteria set out above, is recognized in equity. The non-efficient portion of the changes in the fair value of the derivatives is recognized in the net income. Amounts deferred in equity are recycled to the net income and classified as income or expense in the periods during which the hedged firm commitment or forecast transaction affects the net income.

If at any time the hedge no longer meets the criteria for hedge accounting, one of the following accounting treatments shall be applied:

- In the case of a fair value hedge, 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;
- In the case of a cash flow hedge, the amounts deferred in equity during the previous reporting periods (i.e. the efficient portion of the changes in the fair value of derivatives) are maintained in equity until the derecognition or the extinguishment of the hedged item. They are recycled to the net income when or as the item formerly hedged impacts the net income.

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 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.

Most of macro-hedging instruments used by the Group are plain-vanilla interest rate swaps designated at inception within a fair value hedge of fixed-rate resources or expenses. Hedge effectiveness is assessed through the use of target schedules. Prospective (realized at inception) and retrospective (realized at each half-year and annual closing) efficiency tests are intended to ensure there is no "over" hedging: they are successful if, for each time-bucket of the target schedule, the nominal amount of hedged items is superior to the notional amount of hedging derivatives.

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 fair value adjustments recorded in the net income.

Revaluation related to the hedged risk is recognized on the balance sheet (respectively in asset or liability depending on whether the groups of hedged items are assets or liabilities) as Fair value revaluation of portfolio hedge.

1.2.3.8. 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 market, or in its absence, the most advantageous market the Group has access to on that date. The fair value of a liability reflects its non-performance risk, which includes in particular 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 a financial instrument is not listed on an active market, valuation techniques are used. Valuation techniques include the use of market data from recent arm's length 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; for example modifications in the credit risk quality of the underlying financial instruments and market liquidity. 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 financial instruments measured at amortized cost 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 prepayment options are included in determining the fair value these instruments.

Financial instruments measured at fair value

Non derivative financial assets measured at fair value, either through the section "other comprehensive income" of equity or through net income, and derivative instruments 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 as much as possible observable, and if necessary non-observable, market data.

For non derivative financial assets measured at fair value and for derivative instruments, 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 using an Euribor-based curve. This differential treatment reflects the different financing costs associated with the derivatives used (FVA - Funding Valuation Adjustment).

As a reminder, 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's 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. without considering credit risk, into a fair value including this risk. Its calculation is based on the risk exposures combined with loss rates including market parameters.

1.2.3.9. Interest income and expense

For all interest-bearing instruments, interest income and expense are recognized in the net income using the effective interest rate method: see above section 1.2.3.5. Financial assets.

Accrued interest is recognized on the balance sheet in the same item as the related financial asset or liability.

1.2.3.10. Commission income and expense

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

Loan commitment commissions are recognized as an adjustment to the effective interest rate and recorded in net interest margin if the loan is granted.

1.2.3.11. 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 cannot 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 financial assets measured at fair value through the section "other comprehensive income" of equity and cash flow hedges, and other operations which are charged or credited directly to other comprehensive income, are also credited or charged to other comprehensive income.

1.2.3.12. Provisions

Provisions mainly include provisions for litigations, restructuring, and loan commitments.

Under IAS 37, a provision is recognized when and only 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.

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.

Regarding loan commitments, the followings must be distinguished (see above section 1.2.3.5. Financial assets):

- Loan commitments measured at fair value through net income: they are in the scope of IFRS 9. Therefore, they are not impaired but valued and their valuation is recognized in the asset side of the balance sheet;

- Other loan commitments: they are in the scope of the provisions of IFRS 9 related to derecognition and impairment only. Therefore, loss allowances for expected credit losses related to these commitments are measured and recognized the same way as the ones related to financial assets measured at amortized cost or fair value through the section “other comprehensive income” of equity. The assessment of whether credit risk has significantly increased since initial recognition is performed from the date on which the Group is irrevocably and legally committed, i.e. from the issuing of a letter of loan offer. Besides, related loss allowances are recognized on the liability side of the balance sheet against net income, within the cost of risk.

1.2.3.13. 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 net income 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 softwares depends on whether they are strategic for the company. Those which are considered strategic, are depreciated over 5 years; those which are not are amortized over 3 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 net income in Depreciation, amortization and impairment of tangible and intangible assets.

Gains or losses on disposal of assets are charged to Net gains (losses) on other assets.

1.2.3.14. Leases

SFIL contracts leases as lessee. Under IAS 17 given that they are 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.

1.2.3.15. Employee benefits

Employee benefits are classified in four categories:

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; they are not discounted and are recognized as an expense of the reporting period. Annual leave is recognized when the benefits are granted to the employee. To this purpose, a provision is recorded based on rights vested by employees at the end of the reporting period.

Long-term benefits

These benefits, generally related to seniority, are paid to current employees. Their payment is deferred for more than twelve months after the end of the annual period during which the employees rendered the related service. They represent, specially, long service awards. The actuarial gains and losses related to these benefits and all service costs are recognized immediately in net income.

Termination benefits

Employee termination benefits result either from the decision by SFIL to terminate an employment contract before the legal retirement age or by a decision of voluntary redundancy in exchange for termination benefits. A charge for termination benefits at the end of the employment contract is recorded only when SFIL is no longer able to withdraw its offer. Termination benefits payable at more than twelve months after the end of the reporting period are discounted to their present value.

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 a formal or constructive 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 is valued by independent actuaries and 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 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 at closing.

The net charge to net income comprises the current service cost, the past service arising from plan amendments or curtailments and the net interest costs on the benefit net liability (or asset).

1.2.3.16. Dividends on shares

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

1.2.3.17. 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 at closing.

1.2.3.18. 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-party transactions are those with companies owned directly or indirectly by the same final shareholder and with directors.

1.2.3.19. 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 France. It has no direct activity in other countries and is unable to present a relevant geographic breakdown of its results.

1.2.3.20. Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalents include balances at central banks and interbank deposits and demand deposits on credit institutions.

2. Notes to the assets (EUR millions)

2.1. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

2.1.1. Analysis by nature

	12/31/2017	6/30/2018
Cash collateral paid [1]	-	2,182
Loans and advances to customers	-	6,350
Non hedging derivatives	-	10
TOTAL	**-**	**8,542**

(1) Subsequent to the application of IFRS 9 as of January 1, 2018, cash collateral paid is classified in Financial assets at fair value through profit and loss in 2.1.

2.1.2 Loans and advances to customers analysis by counterparty

	12/31/2017	6/30/2018
Public sector	-	5,842
Other - guaranteed by a State or local government	-	508
TOTAL	**-**	**6,350**
of which eligible for central bank refinancing	-	*5,508*
of which assets assigned in guarantee to the central bank	-	-

2.2. FINANCIAL ASSETS AT FAIR VALUE THROUGH EQUITY

2.2.1. Analysis by nature

	12/31/2017	6/30/2018
Equity	-	0
Bonds	-	2,540
TOTAL	**-**	**2,540**

2.2.2. Analysis by counterparty

	12/31/2017	6/30/2018
Public sector	-	736
Credit institutions	-	1,804
Other financial institutions	-	-
Non financial institutions	-	0
TOTAL	**-**	**2,540**
of which eligible for central bank refinancing	-	-

2.3. LOANS AND ADVANCES DUE FROM BANKS AT AMORTIZED COST

2.3.1. Analysis by nature

	12/31/2017	6/30/2018
Sight accounts	17	10
Other loans and advances due from banks	278	262
Performing assets	**295**	**272**
Impaired loans and advances	-	N/A
Impaired assets (1)	**-**	**N/A**
Total assets before impairment	**295**	**272**
Specific impairment	-	N/A
Collective impairment	-	N/A
TOTAL	**295**	**272**

(1) Subsequent to the application of IFRS 9 as of January 1, 2018, assets depreciated in the first half in table 2.3.3.

2.3.2. Analysis by counterparty

	12/31/2017	6/30/2018
Credit institutions	17	10
Swiss cantonal banks benefiting from their cantons' legal guarantee	30	30
Banks guaranteed by a local government, *crédits municipaux*	22	9
Other credit institutions: loans benefiting from the assignment in guarantee of refinanced public debt	226	223
TOTAL	**295**	**272**
of which eligible for central bank refinancing	*-*	*-*

2.3.3. Impairment

	6/30/2018								
	Gross amount			Impairment			Net	Accumulated partial write-offs	Accumulated total write-offs
	Stage 1	Stage 2	Stage 3 (depreciated assets)	Stage 1	Stage 2	Stage 3			
Credit institutions	**272**	**-**	**-**	**(0)**	**-**	**-**	**272**	**-**	**-**
TOTAL	**272**	**-**	**-**	**(0)**	**-**	**-**	**272**	**-**	**-**

2.4. LOANS AND ADVANCES TO CUSTOMERS AT AMORTIZED COST

2.4.1. Analysis by counterparty

	12/31/2017	6/30/2018
Loans to public sector	54,284	42,344
Other - guaranteed by a State or local government	2,219	1,746
Other - loans to SFIL's employees	6	5
Performing assets	**56,509**	**44,095**
Impaired loans and advances	558	N/A
Impaired assets (1)	**558**	**N/A**
Total assets before impairment	**57,067**	**44,095**
Specific impairment	(23)	N/A
Collective impairment	(30)	N/A
TOTAL	**57,014**	**44,095**
of which eligible for central bank refinancing	*39,575*	*36,606*

(1) Subsequent to the application of IFRS 9 as of January 1, 2018, assets depreciated in the first half in table 2.4.2.

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 193 forborne contracts as of June 30, 2018, with 96 borrowers, for a total of EUR 1,160 million.

2.4.2. Impairment

	6/30/2018								
	Gross amount			Impairment			Net	Accumulated partial write-offs	Accumulated total write-offs
	Stage 1	Stage 2	Stage 3	Stage 1	Stage 2	Stage 3			
Public sector	37,832	3,368	1,177	(2)	(22)	(9)	42,344	-	-
Non-financial institutions	1,542	205	-	-	(1)	-	1,746	-	-
Loans to SFIL's employees	5	-	-	-	-	-	5	-	-
TOTAL	**39,379**	**3,573**	**1,177**	**(2)**	**(23)**	**(9)**	**44,095**	**-**	**-**

2.5. BONDS AT AMORTIZED COST

2.5.1. Analysis by counterparty

	12/31/2017	6/30/2018
Public sector bonds	N/A	7,298
Replacement assets	N/A	694
Credit institutions bonds	N/A	-
Other bonds - guaranteed by a State or local government	N/A	235
TOTAL	**N/A**	**8,227**
of which eligible for central bank refinancing	*N/A*	*4,271*

(1) Subsequent to the application of IFRS 9 as of January 1, 2018, assets depreciated in the first half in table 2.5.2.

2.5.2. Impairment

	6/30/2018								
	Gross amount			Impairment			Net	Accumulated partial write-offs	Accumulated total write-offs
	Stage 1	Stage 2	Stage 3	Stage 1	Stage 2	Stage 3			
Public sector	5,713	1,606	-	(4)	(16)	-	7,299	-	-
Credit institutions	162	73	-	(0)	(1)	-	234	-	-
Non-financial institutions	694	-	-	(0)	-	-	694	-	-
TOTAL	**6,569**	**1,679**	**-**	**(4)**	**(17)**	**-**	**8,227**	**-**	**-**

3. Notes to the liabilities (EUR millions)

3.1. FINANCIAL LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

3.1.1. Analysis by nature

	12/31/2017	6/30/2018
Cash collateral received [1]	-	1,161
Non hedging derivatives	4	1,322
TOTAL	**4**	**2,483**

(1) Subsequent to the application of IFRS 9 as of January 1, 2018, cash collateral received is classified in Financial liabilities at fair value through profit or loss in 3.1.

3.2. DUE TO BANKS AT AMORTIZED COST

3.2.1. Analysis by nature

	12/31/2017	6/30/2018
Sight accounts	-	2
Term deposits	4,213	1,967
Accrued interest	2	1
TOTAL	**4,215**	**1,970**

3.3. DEBT SECURITIES AT AMORTIZED COST

3.3.1. Analysis by nature

	12/31/2017	6/30/2018
Commercial paper	625	706
Euro medium term notes [1]	2,793	4,901
Obligations foncières	45,156	47,756
Registered covered bonds	7,741	7,611
TOTAL	**56,315**	**60,974**

[1] *Contrary to* obligations foncières*, these bonds 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]	
	12/31/2017	6/30/2018	12/31/2017	6/30/2018
ASSET				
Financial assets at fair value through equity	-	-	-	89
Loans and advances due from banks at amortized cost	-	-	-	-
Bonds at amortized cost	-	-	57	108
LIABILITIES				
Due to banks at amortized cost	-	-	4,215	1,968
INCOME STATEMENT				
Financial assets at fair value through profit or loss	-	-	-	0
Financial assets at fair value through equity	-	-	N/A	0
Credit institutions interest income on loans at amortized cost	-	-	(12)	(5)
Interest income on bonds at amortized cost	-	-	(0)	(0)
Credit institutions interest expenses on borrowing at amortized cost	-	-	(20)	(5)
Fees and commissions	-	-	4	2
Cost of risk	-	-	-	(0)
OFF BALANCE SHEET				
Foreign exchange derivatives	-	-	-	-
Interest rate derivatives	-	-	554	405
Commitments and guarantees received	-	-	7,031	9,279
Commitments and guarantees issued	-	-	4,821	5,153

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

[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.

	12/31/2017					
	Spain	**Ireland**	**Italy**	**Portugal**	**Greece**	**Total**
Financial assets available for sale	203	-	451	-	-	654
Financial assets at fair value through profit or loss	-	-	-	-	-	**-**
Financial assets at amortized cost	-	-	-	-	-	**-**
Loans and advances to customers	-	-	112	-	-	112
TOTAL	**203**	**-**	**563**	**-**	**-**	**766**
UNREALIZED GAINS AND LOSSES ON AVAILABLE FOR SALE SECURITIES	**1**	**-**	**(48)**	**-**	**-**	**(47)**
UNREALIZED GAINS AND LOSSES ON LOANS AND RECEIVABLE SECURITIES	**-**	**-**	**-**	**-**	**-**	**-**

	6/30/2018					
	Spain	**Ireland**	**Italy**	**Portugal**	**Greece**	**Total**
Financial assets at fair value through profit or loss	-	-	-	-	-	-
Financial assets at fair value through equity	-	-	-	-	-	-
Financial assets at amortized cost	-	-	-	-	-	-
Loans and advances to customers	254	-	567	10	-	831
TOTAL	**254**	**-**	**567**	**10**	**-**	**831**

5. Notes to the income statement (EUR millions)

5.1. INTEREST INCOME - INTEREST EXPENSE

The SFIL Group presents under the headings « Interest income – interest expense » the remuneration, determined according to the effective interest rate method, from financial instruments valued at amortized cost or at market value through equity.

These items also include interest income and expense on financial instruments recognized at fair value through profit or loss since they were not considered to respect the SPPI criterion, with the flows received not involving solely payments of principal and interest. On the other hand, the variation in value calculated excluding interest accrued on financial instruments at fair value through gain or loss is recognized in the section net result of financial instruments at fair value through profit or loss (cf. part 5.2).

Interest income and interest expense on hedging derivatives are presented with the revenues of the items for which they contribute risk coverage. In addition, certain derivatives are not documented in a relationship of hedge accounting, but ownership ensures the economic coverage of financial instruments recognized at fair value through gain or loss: the interest income and interest expense in these economic hedging derivatives are attached to the items that record interest on these financial instruments.

	First half 2017	First half 2018
INTEREST INCOME	**1,389**	**1,338**
Central banks	-	-
Financial assets at fair value through profit or loss	-	90
Financial assets at fair value through equity	-	6
Loans and advances due from banks at amortized cost	1	8
Loans and advances to customers at amortized cost	684	434
Bonds at amortized cost	-	71
Financial assets available for sale	18	-
Financial assets held to maturity	-	-
Derivatives used for hedging	685	729
Impaired assets	-	-
Other	1	-
INTEREST EXPENSE	**(1,297)**	**(1,265)**
Accounts with central banks	(8)	(5)
Financial liabilities at fair value through profit or loss	-	(91)
Due to banks at amortized cost	(6)	(5)
Due to customers at amortized cost	-	-
Debt securities at amortized cost	(687)	(604)
Subordinated debt	-	-
Derivatives used for hedging	(595)	(560)
Other	(1)	-
INTEREST MARGIN	**92**	**73**

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

	First half 2017	First half 2018
Net result on non hedging derivatives	8	8
Net result on financial assets or liabilities at fair value through profit or loss	-	(97)
Net result of hedge accounting	(3)	132
Net result of foreign exchange transactions	0	(1)
TOTAL	**5**	**42**

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 net income from hedge accounting

	First half 2017	First half 2018
Fair value hedges	**1**	**118**
Fair value changes in the hedged item attributable to the hedged risk	8	(4)
Fair value changes in the hedging derivatives	(7)	122
Cash flow hedges	**-**	**-**
Fair value changes in the hedging derivatives – ineffective portion	-	-
Discontinuation of cash flow hedge accounting (Cash flows no longer expected to occur)	-	-
Portfolio hedge	**(0)**	**(0)**
Fair value changes in the hedged item	(170)	7
Fair value changes in the hedging derivatives	170	(7)
CVA / DVA Impact [1]	**(4)**	**14**
TOTAL	**(3)**	**132**

[1] The effect of the application of IFRS Standard 13 brought to light a net income as of June 30, 2018 of EUR 14 million; this amount was derived using the DVA income for EUR 16 million and the CVA for EUR -2 million.

5.3. OPERATING EXPENSES

	First half 2017	First half 2018
Payroll costs	(25)	(24)
Other general and administrative expenses	(21)	(21)
Taxes	(12)	(10)
TOTAL	**(58)**	**(55)**

5.4. COST OF RISK

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

	First half 2018				
	Gross amount	Impairments	Reversals	Losses	Net amount
Financial assets at fair value through equity, Stage 1	-	(0)	-	-	**-**
Financial assets at fair value through equity, Stage 2	-	-	-	-	**-**
Financial assets at fair value through equity, Stage 3	-	-	-	-	**-**
Loans and advances due from banks at amortized cost, Stage 1	(0)	(0)	0	-	**(0)**
Loans and advances due from banks at amortized cost, Stage 2	-	-	-	-	**-**
Loans and advances due from banks at amortized cost, Stage 3	-	-	-	-	**-**
Loans and advances to customers at amortized cost, Stage 1	(2)	(1)	1	-	**(2)**
Loans and advances to customers at amortized cost, Stage 2	(21)	(4)	2	-	**(23)**
Loans and advances to customers at amortized cost, Stage 3	(11)	(6)	8	-	**(9)**
Bonds at amortized cost, Stage 1	(5)	(2)	3	-	**(4)**
Bonds at amortized cost, Stage 2	(18)	(3)	4	-	**(17)**
Bonds at amortized cost, Stage 3	(0)	-	-	-	**(0)**
Off-balance sheet commitments at amortized cost, Stage 1	(0)	(0)	0	-	**(0)**
Off-balance sheet commitments at amortized cost, Stage 2	(0)	(1)	0	-	**(1)**
Off-balance sheet commitments at amortized cost, Stage 3	**-**	**-**	**-**	**-**	**-**
TOTAL	**(57)**	**(17)**	**18**	**-**	**(56)**

6. Off-balance sheet notes (EUR millions)

6.1. GUARANTEES

	12/31/2017	6/30/2018
Guarantees received from credit institutions	22	8
Enhanced guarantees received (1)	3,247	4,563
Loan guarantee commitments received	3,248	4,563
Guarantees received from customers (2)	2,549	2,363

(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

	12/31/2017	6/30/2018
Loan commitments granted to credit institutions	-	-
Loan commitments granted to customers (1)	3,318	4,611
Loan commitments received from credit institutions (2)	7,031	9,279
Loan commitments received from customers	-	-

(1) The commitments of financing on loans and credit lines corresponding to contracts issued but not paid out as of June 30, 2018. The amount as of June 30, 2018, mainly corresponded to commitments of EUR 4,563 million on files within the framework of the new export credit business.

(2) At the end of June 2018, commitments corresponded to financing commitments received from the Caisse des dépôts et consignations and La Banque Postale toward SFIL for respectively EUR 8,888 million and EUR 391 million.

SFIL recognized the total of commitments solely related to existing tranches, which is limited to EUR 8,888 million. This amount does not allow for the possibility planned in the convention of financing with the Caisse des dépôts et consignations to negotiate additional funds in good faith. In light of an amount of loan principal limited to EUR 12.5 billion, such financing would be at the most EUR 2,500 million as of June 30, 2018.

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 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.

7.1.1. Composition of the fair value of the assets

	12/31/2017		
	Book value	**Fair value**	**Unrecognized fair value adjustment**
Central banks	2,560	2,560	-
Loans and advances due from banks	295	307	12
Loans and advances to customers	57,014	54,000	(3,014)
Financial assets available for sale	2,790	2,790	-
Derivatives	4,715	4,715	-
TOTAL	**67,374**	**64,372**	**(3,002)**

	6/30/2018		
	Book value	**Fair value**	**Unrecognized fair value adjustment**
Central banks	3,047	3,047	-
Financial assets at fair value through profit or loss	8,542	8,542	-
Financial assets at fair value through profit equity	2,540	2,540	-
Loans and advances due from banks at amortized cost	272	280	9
Loans and advances to customers at amortized cost	44,095	40,949	(3,146)
Bonds at amortized cost	8,227	7,306	(921)
Hedging derivatives	4,420	4,420	-
TOTAL	**71,143**	**67,089**	**(4,058)**

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

	12/31/2017		
	Book value	Fair value	Unrecognized fair value adjustment
Due to banks	4,215	4,259	44
Derivatives	8,067	8,067	-
Debt securities	56,315	57,603	1,288
TOTAL	**68,597**	**69,929**	**1,332**

	6/30/2018		
	Book value	Fair value	Unrecognized fair value adjustment
Financial liabilities at fair value through profit or loss	2,483	2,483	-
Due to banks	1,970	1,982	12
Debt securities	60,974	60,298	(676)
Hedging derivatives	6,387	6,387	-
TOTAL	**71,814**	**71,150**	**(664)**

7.1.3. 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.

	12/31/2017			
Fair value of financial assets	**Level 1 [1]**	**Level 2 [2]**	**Level 3 [3]**	**Total**
Financial assets available for sale	1,863	927	-	2,790
Derivatives	-	4,155	560	4,715
TOTAL	**1,863**	**5,082**	**560**	**7,505**

	6/30/2018			
Fair value of financial assets	**Level 1 [1]**	**Level 2 [2]**	**Level 3 [3]**	**Total**
Financial assets at fair value through profit or loss	2,182	8	6,352	8,542
Financial assets at fair value through equity	563	1,967	10	2,540
Hedging derivatives	-	3,727	693	4,420
TOTAL	**2,745**	**5,702**	**7,055**	**15,502**

	12/31/2017			
Fair value of financial assets	**Level 1 [1]**	**Level 2 [2]**	**Level 3 [3]**	**Total**
Derivatives	-	7,166	901	8,067
TOTAL	**-**	**7,166**	**901**	**8,067**

	6/30/2018			
Fair value of financial assets	**Level 1 [1]**	**Level 2 [2]**	**Level 3 [3]**	**Total**
Financial liabilities at fair value through profit or loss	1,160	753	570	2,483
Hedging derivatives	-	5,997	390	6,387
TOTAL	**1,160**	**6,750**	**960**	**8,870**

[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.

7.1.4. Transfer between levels 1 and 2

	12/31/2017	6/30/2018
Level 1 to level 2	-	-
TOTAL	**-**	**-**

7.2. OFFSETTING FINANCIAL ASSETS AND LIABILITIES

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

	12/31/2017					
	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 and 13
				Effect of master netting arrangements	Financial instruments received as collateral	
Derivatives (including hedging instruments)	4,715	-	4,715	(3,493)	(1,039)	183
Loans and advances due from banks	295	-	295	-	-	295
Loans and advances to customers	57,014	-	57,014	-	-	57,014
TOTAL	**62,024**	**-**	**62,024**	**(3,493)**	**(1,039)**	**57,492**

	6/30/2018					
	Gross amounts before offsetting	Gross amounts offset according to IAS 32	Gross amounts offset according to IAS 32	Other amounts in the application scope but not offset		Net amounts according to IFRS 7 and 13
				Effect of master netting arrangements	Financial instruments received as collateral	
Derivatives (including hedging instruments)	4,430	-	4,430	(3,120)	(979)	331
Loans and advances at fair value through profit or loss	6,350	-	6,350	-	-	6,350
Loans and advances due from banks	272	-	272	-	-	272
Loans and advances to customers	44,095	-	44,095	-	-	44,095
TOTAL	**55,147**	**-**	**55,147**	**(3,120)**	**(979)**	**51,048**

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

	12/31/2017					
	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 and 13
				Effect of master netting arrangements	Financial instruments received as collateral	
Derivatives (including hedging instruments)	8,067	-	8,067	(3,493)	(2,189)	2,385
Due to banks	4,215	-	4,215	-	-	4,215
Customer borrowing and deposits	-	-	-	-	-	-
TOTAL	**12,282**	-	**12,282**	**(3,493)**	**(2,189)**	**6,600**

	6/30/2018					
	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 and 13
				Effect of master netting arrangements	Financial instruments received as collateral	
Derivatives (including hedging instruments)	8,176	-	8,176	(3,120)	(2,072)	2,984
Due to banks	1,970	-	1,970	-	-	1,970
Customer borrowing and deposits	-	-	-	-	-	-
TOTAL	**10,146**	-	**10,146**	**(3,120)**	**(2,072)**	**4,954**

8. First time application impact of IFRS 9 as of January 1, 2018 (EUR millions)

Restatements

	IAS 39 12/31/2017	Financial assets available for sale (a)	Debt securities assimilated to loans and advances in IAS 39 (b)	Loans and advances non SPPI (c)	Hedging derivatives of loans and advances non SPPI (d)	Restatement of deposit and collateral	**Net amount after restatement phase 1**
ASSET							
Central banks	2,560			-	-		**2,560**
Deposit and collateral at fair value through profit or loss	-			-	-	2,359	**2,359**
Loans and advances due from banks at fair value through profit or loss	-			-	-		**-**
Loans and advances to customers at fair value through profit or loss	-			7,168	-		**7,168**
Derivatives at fair value through profit or loss	-			-	6		**6**
Hedging derivatives	4,715			-	(6)		**4,709**
Financial assets available for sale	2,790	(2,790)		-	-		**-**
Financial assets at fair value through equity	-	942		-	-		**942**
Loans and advances due from banks at amortized cost	295			-	-		**295**
Loans and advances to customers at amortized cost	57,014		(6,422)	(7,168)	-		**43,425**
Bonds at amortized cost	-	1,848	6,422	-	-		**8,270**
Fair value revaluation of portfolio hedge	2,518			-	-		**2,518**
Financial assets held to maturity	-			-	-		**-**
Current tax assets	14			-	-		**14**
Deferred tax assets	64			-	-		**64**
Tangible assets	6			-	-		**6**
Intangible assets	29			-	-		**29**
Other assets	2,427			-	-	(2,359)	**68**
TOTAL	**72,432**	**-**	**-**	**-**	**-**		**72,432**
LIABILITIES							
Central banks	-	-	-	-	-		**-**
Financial liabilities at fair value through profit or loss	4	-	-	-	1,476	1,276	**2,756**
Hedging derivatives	8,063	-	-	-	(1,476)		**6,587**
Due to banks at amortized cost	4,215	-	-	-	-		**4,215**
Customer borrowing and deposits at amortized cost	-	-	-	-	-		**-**
Debt securities at amortized cost	56,315	-	-	-	-		**56,315**
Fair value revaluation of portfolio hedge	883	-	-	-	-		**883**
Current tax liabilities	1	-	-	-	-		**1**
Deferred tax liabilities	-	-	-	-	-		**-**
Other liabilities	1,434	-	-	-	-	(1,276)	**158**
Provisions	48	-	-	-	-		**48**

Subordinated debt	-	-	-	-	-	**-**
EQUITY	**1,469**	**-**	**-**	**-**	**-**	**1,469**
Capital	1,445	-	-	-	-	**1,445**
Reserves and retained earnings	72	-	-	-	-	**72**
Gains and losses recognised in equity	(102)	-	-	-	-	**(102)**
Net income for the period	54	-	-	-	-	**54**
TOTAL	**72,432**	**-**		**-**	**-**	**72,432**

(a) Instruments classified as Available for sale financial assets under IAS 39 are debt securities, cash-flows of which are composed only by the repayment of principal and interest. They have been reclassified depending on the business model they are held within: debt securities acquired for cash investment purposes and held within an hold-to-collect-and-sell model have been reclassified as Financial assets at fair value through the other comprehensive income section of equity, while those held within an hold-to-collect model have been reclassified as Loans and advances to customers measured at amortized cost.

(b) Debt securities classified as Loans and advances to customers at amortized cost under IAS 39 have been reclassified as Debt securities at amortized cost.

(c) Loans and advances, contractual cash-flows of which are not compliant with the SPPI criterion defined under IFRS 9, have been reclassified from the Loans and advances to customers at amortized cost category to the Loans and advances to customers at fair value through net income category: they are composed of loans, contractual flows of which are not in line with those of a basic lending agreement as the latter is defined under IFRS 9; this may be due in particular to the inclusion in the interest rate formula of a leverage effect or an indexation on foreign exchange rates.

(d) Hedging derivative instruments for which the hedged financial asset has been reclassified as Financial assets at fair value through net income have been disqualified and reclassified, on the asset side or the liability side of the balance sheet, as Derivatives at fair value through net income.

Value adjustments

	Amount after restatement phase 1	**Adjustment value phase 1**				**Adjustment phase 2**	**IFRS 9 1/1/2018**
		Restatement of financial assets available for sale (a)	Restatement of bonds assimilated to loans and advances in IAS 39 (b)	Restatement of loans and advances non SPPI (c)	Other restatement (d)	Provisions for credit risk (e)	
ASSET							
Central banks	2,560	-	-	-	-	-	**2,560**
Deposit and collateral at fair value through profit or loss	2,359	-	-	-	-	-	**2,359**
Loans and advances due from banks at fair value through profit or loss	-	-	-	-	-	-	**-**
Loans and advances to customers at fair value through profit or loss	7,168	-	-	(241)	-	18	**6,945**
Derivatives at fair value through profit or loss	6	-	-	-	-	-	**6**
Hedging derivatives	4,709	-	-	-	-	-	**4,709**
Financial assets available for sale	-	-	-	-	-	-	**-**
Financial assets at fair value through equity	942	-	-	-	-	-	**942**
Loans and advances due from banks at amortized cost	295	-	-	-	-	0	**295**

Loans and advances to customers at amortized cost	43,425	-	-	-	199	(16)	**43,608**
Bonds at amortized cost	8,270	49	78	-	-	(5)	**8,391**
Fair value revaluation of portfolio hedge	2,518	-	-	-	-	-	**2,518**
Financial assets held to maturity	-	-	-	-	-	-	**-**
Current tax assets	14	-	-	-	-	-	**14**
Deferred tax assets	64	(17)	(27)	83	(68)	3	**38**
Tangible assets	6	-	-	-	-	-	**6**
Intangible assets	29	-	-	-	-	-	**29**
Other assets	68	-	-	-	-	-	**68**
TOTAL	**72,432**	**32**	**51**	**(158)**	**130**	**(0)**	**72,487**

LIABILITIES							
Central banks	-	-	-	-	-	-	**-**
Financial liabilities at fair value through profit or loss	2,756	-	-	-	-	-	**2,756**
Hedging derivatives	6,587	-	-	-	-	-	**6,587**
Due to banks at amortized cost	4,215	-	-	-	-	-	**4,215**
Customer borrowing and deposits at amortized cost	-	-	-	-	(1)	-	**(1)**
Debt securities at amortized cost	56,315	-	-	-	-	-	**56,315**
Fair value revaluation of portfolio hedge	883	-	-	-	-	-	**883**
Current tax liabilities	1	-	-	-	-	-	**1**
Deferred tax liabilities	-	-	-	-	-	-	**-**
Other liabilities	158	-	-	-	-	-	**164**
Provisions	48	-	-	-	-	6	**48**
Subordinated debt	-	-	-	-	-	-	**-**
EQUITY	**1,469**	**32**	**51**	**(158)**	**131**	**(6)**	**1,519**
Capital	1,445	-	-	-	-	-	**1,445**
Reserves and retained earnings	72	-	-	(158)	131	(6)	**39**
Gains and losses recognised in equity	(102)	32	51	-	-	-	**(19)**
Net income for the period	54	-	-	-	-	-	**54**
TOTAL	**72,432**	**32**	**51**	**(158)**	**130**	**(0)**	**72,487**

(a) The reserve composed of the fair value adjustments accumulated in equity until December 31, 2017 on the debt securities reclassified from the Available for sale financial assets category under IAS 39 standard to the Loans and advances at amortized cost under IFRS 9 has been reversed.

(b) Most of the debt securities which were classified as Loans and advances to customers at amortized cost under IAS 39 standard had been classified as Available for sale financial assets at initial recognition and had been subsequently reclassified in this category on October 1, 2008, in accordance with the limited amendment to IAS 39 endorsed by the European Union on October 15, 2008. This reclassification has resulted into the freezing of the reserve composed of the fair value adjustments accumulated in equity on these assets; this reserve has subsequently been amortized until December 31, 2017. On January 1, 2018, the retrospective application of IFRS 9 results in the reversal of the fraction yet not amortized of this reserve.

(c) The measurement at fair value through net income under IFRS 9 of loans previously measured at amortized cost under IAS 39 has impacted the value of the underlying loans.

(d) The policy implemented by SFIL from its creation 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 complied 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, an adjustment of the value of the underlying loans has been recorded as a counterpart to equity on the date of first application of the standard; this adjustment corresponds to the impacts (adjusted for the time-related amortization) that would have resulted from the derecognition of the loans on the date of their transformation.

In addition, on the Liability side of the balance sheet, the value of the debt securities issued has been adjusted as a counterpart to equity: this adjustment concerns issued securities which have been transformed prior to December 31, 2017, and for which the application of IFRS 9 would have resulted in their derecognition and the recognition of a result. Time-related amortization of this result is taken into account.

(e) The entry into effect of the new impairment model for credit risk has resulted on January 1, 2018, in a EUR 10 million increase of impairments (without considering tax effects), which can be broken down into the following effects:

- Recognition of loss allowances on Stage 1 contracts: EUR -7 million;
- Recognition of loss allowances on Stage 2 contracts: EUR -39 million;
- Complete reversal of the stock of collective impairments previously recognized: EUR +24 million;
- Variations of specific impairment on Stage 3 contracts (base changing): EUR +12 million, the main effect of this impact is the reversal of the impairment on assets measured at amortized cost until December 31, 2017, under IAS 39 and that are measured at fair value through net income from January 1, 2018, under IFRS 9.

Classification of financial assets by level of risk

	1/1/2018							
	Gross amount				Impairment			Net
	Stage 1	Stage 2	Stage 3	**TOTAL**	Stage 1	Stage 2	Stage 3	
Financial assets at fair value through equity	942	-	-	942	-	-	-	**942**
Loans and advances due from banks at amortized cost	295	-	-	295	(0)	-	-	**295**
Loans and advances to customers at amortized cost	38,620	3,610	1,432	43,662	(5)	(39)	(11)	**43,607**
Bonds at amortized cost	6,475	1,831	86	8,392	(1)	(0)	-	**8,391**
TOTAL FINANCIAL ASSETS	**46,332**	**5,441**	**1,518**	**53,291**	**(6)**	**(39)**	**(11)**	**53,235**

Gap analysis between provisions under IAS 39 and expected losses under IFRS 9

	IAS 39	Restatements	Adjustment value	IFRS 9
	12/31/2017	Asset impacts of restatements	Impact of evaluation method changes	1/1/2018
Asset provisions				
Financial assets at fair value through profit or loss	-	-	-	**-**
Financial assets available for sale	-	-	-	**-**
Financial assets at fair value through equity	-	-	-	**-**
Financial assets at amortized cost	-	-	-	**-**
Loans and advances due from banks at amortized cost	-	-	-	**-**
Loans and advances to customers at amortized cost - specific provisions	23	(35)	47	**35**
Loans and advances to customers at amortized cost - collective provisions	30	(6)	(24)	**-**
Bonds at amortized cost - collective provisions	-	-	-	**-**
Bonds at amortized cost - specific provisions	-	17	4	**21**
TOTAL ASSETS	**53**	**(24)**	**27**	**56**

9. Post-closing events

No significant event that influences the Company's financial situation has occurred since the closing on June 30, 2018.

3. Statutory Auditors’ report on the 2018 first half-year financial information

Statutory Auditors' review report on the 2018 first half-year financial information

For the period from January 1 to June 30, 2018

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 the 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, 2018;
- 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, 2018, and of the results of its operations for the period then ended, in accordance with IFRS as adopted by the European Union.

Without qualifying the above conclusion, we draw your attention to the changes in accounting method regarding the application of new standards IFRS 9 "Financial Instruments" and IFRS 15 "Revenue from contracts with customers" set out in Note 1 "Accounting policies and valuation methods" and in the other notes presenting figures relating to the first-time adoption of IFRS 9.

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, September 7, 2018

The Statutory Auditors
French original signed by

DELOITTE & ASSOCIES — ERNST & YOUNG et Autres

Sylvie Bourguignon — Vincent Roty

4. Statement by the person responsible

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, 2018

Philippe Mills

Chief Executive Officer

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