Caisse Française de Financement Local

CAFFIL

Public sector assets – *Obligations foncières* to support the French economy.

ANNUAL FINANCIAL REPORT 2018

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CAFFIL

Contents

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

Profile

Caisse Française de Financement Local (also known by its acronym CAFFIL) is an issuer of covered bonds with a portfolio of assets solely comprised of exposures to public sector entities. It is fully owned by the French State-owned development bank SFIL.

Caisse Française de Financement Local is a French specialized credit institution (*société de crédit foncier*). Its sole business is the refinancing of loans to public sector entities through the issue of covered bonds, called *obligations foncières*.
Caisse Française de Financement Local and its parent company have been tasked by the French State:
- to finance loans to French local governments and public hospitals granted by La Banque Postale;
- to refinance large export credits with the unconditional and irrevocable guarantee of the French State.

Caisse Française de Financement Local is a wholly-owned subsidiary of SFIL, which also manages the Company in accordance with article L.513-15 of the Monetary and Financial Code. SFIL is a credit institution approved by the Autorité de contrôle prudentiel et de résolution (ACPR), 75% of which is held by the French State, its reference shareholder, 20% by Caisse des Dépôts et Consignations (CDC) and 5% by La Banque Postale (LBP). The shareholding structure of Caisse Française de Financement Local is thus firmly anchored in the public sphere, reflecting the missions entrusted to it by the French State.

CAFFIL is the leading European issuer of covered bonds, which are secured by a portfolio of public sector loans. The Company issues *obligations foncières* (covered bonds) regularly. Their primary characteristics are that:
- they are regulated by specific legal provisions;
- they are rated Aaa/AA+/AAA by Moody's, Standard & Poor's and DBRS;
- they comply with the EU's UCITS and CRD directives, and with article 129 of the CRR standard;
- they benefit from the Covered Bond Label created by the European Covered Bond Council (ECBC).

The *obligations foncières* issued by CAFFIL are thus eligible for refinancing by the European Central Bank (ECB) and thus enable investors to benefit from the best prudential treatment.

CAFFIL regularly wins recognition from specialized financial publications for the quality of its issues. CMD Portal named it best issuer of the year for its euro-denominated covered bonds in 2016, 2017 and 2018, as did, in 2016, The Covered Bond Report and The Cover.

Key figures
as of December 31, 2018

Portfolio of assets
(cover pool)

EUR 56.9 billion

Obligations foncières
(covered bonds)

EUR 50.3 billion

Regulatory
over-collateralization

111.5%

Covered bonds
issued in 2018

EUR 4.9 billion

Doubtful and litigious loans –
French Gaap
(% cover pool)

0.7%

Assets eligible for the central
bank refinancing
(% cover pool)

66.5%

Common Equity Tier 1 Ratio
(Basel III – fully loaded)

25.0%

Liquidity Coverage Ratio
(LCR)

603%

External ratings
as of January 1, 2019

Moody's	Standard & Poor's	DBRS
Aaa	AA+	AAA

Management Report
Caisse Française de Financement Local 2018

1. General presentation of Caisse Française de Financement Local

1.1 – NATURE AND ACTIVITIES OF THE COMPANY

Caisse Française de Financement Local (also known by its acronym CAFFIL) is a credit institution active in the refinancing of loans to public sector entities through the issue of covered bonds, which are called *obligations foncières*.

It is a specialized credit institution authorized to operate as a *société de crédit foncier*. As a credit institution, the Company is subject to all legal and regulatory provisions that apply to credit institutions. It conducts banking transactions in its ordinary course of business. As a *société de crédit foncier*, it engages in transactions that are specialized and have an exclusive purpose, as defined in articles L.513-2 and following of the Monetary and Financial Code.

In the case of Caisse Française de Financement Local, this specialization is exclusively limited to transactions with public sector entities or entities they guarantee as specified in its October 1, 1999, authorization and its own by-laws:
- The authorization mentions that the Company "is approved as a *société de crédit foncier,* the activities of which exclusively concern the granting or acquisition of loans to public sector entities or those they guarantee, as well as the holding of securitization units or shares of similar entities when the assets in these securitizations are for at least 90% composed of assets of the same nature as the above-mentioned loans, in accordance with article 94-II and III of law 99-532".
- The purpose of the Company (article 2 of the by-laws) specifies that the exclusive purpose of the Company is:
  - to grant or to acquire exposures on public sector entities as defined in article L.513-4 of the Monetary and Financial Code as well as securitization units or shares of similar entities considered as exposures on public sector entities as defined in article L.513-5 of the Monetary and Financial Code;
  - to hold securities and other assets under the conditions set by decree to be considered as replacement assets.

Sociétés de crédit foncier, which were created by the law of June 1999, are now well-known in the world of bond issuers and investors. They issue covered bonds called *obligations foncières* and contract other covered debt negotiable or not in regulated markets. All these instruments are characterized by the legal privilege that primarily affects cash flows from the Company's assets to pay the interest and reimbursement of the *obligations foncières*. *Sociétés de crédit foncier* may also issue or contract non-covered debt. *Obligations foncières* constitute a significant element in the international covered bond market.

1.2 – LEGAL AND SHAREHOLDING STRUCTURE OF THE COMPANY

1.2.1. Legal structure and name of the Company

The Company was created on December 29, 1998, for a period of 99 years. It was authorized to operate as a *société de crédit foncier* by the Comité des établissements de crédit et des entreprises d'investissement (now a part of ACPR) at its meeting on July 23, 1999. The authorization became definitive as of October 1, 1999.

On January 31, 2013, the Company took the name Caisse Française de Financement Local to replace that of Dexia Municipal Agency, upon the sale of its sole shareholder, Société de Financement Local (renamed SFIL in June 2015), to the French State, Caisse des dépôts et consignations and La Banque Postale.

The Company's registered office is located at 1-3, rue du Passeur de Boulogne in Issy-les-Moulineaux (92130), France.

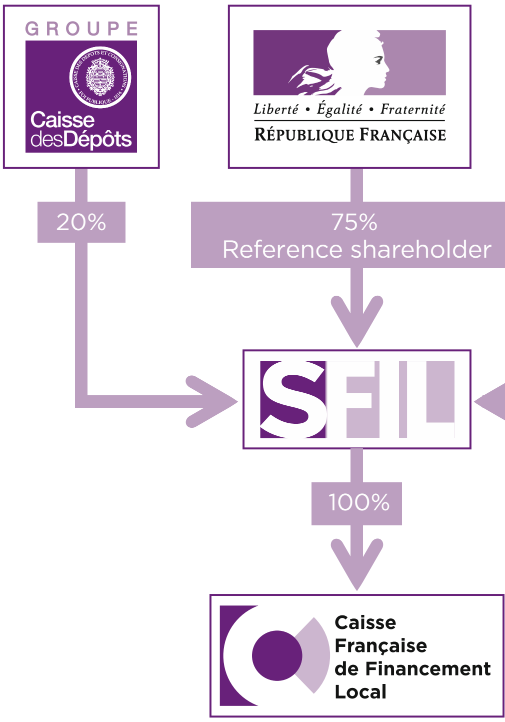
Caisse Française de Financement Local is a *société anonyme à directoire et conseil de surveillance*, a joint-stock corporation with an Executive Board and a Supervisory Board, under the provisions of articles L.210-1 and following of the Code of Commerce. Its operation is regulated by articles L.511-1 and following (credit institutions) and L.513-2 and following (*sociétés de crédit foncier*) of the Monetary and Financial Code.

1.2.2. Shareholding structure of the Company

Caisse Française de Financement Local and its parent company SFIL are key elements in the financing of local governments and public hospitals in France. The organization, introduced by the French State in 2013, is based on a commercial activity developed by La Banque Postale with refinancing provided by Caisse Française de Financement Local (see 1.3.1.).
Since 2015, the French State has entrusted SFIL and Caisse Française de Financement Local with a second mission that is the responsibility to refinance large export credits with the guarantee of the State (see 1.3.2.). The objective is to enable

large export credits, as well as French local governments and public hospitals to benefit from optimal financing conditions through a high rating and irreproachable risk management.

The capital of Caisse Française de Financement Local is 100% held by SFIL, which also manages the Company in accordance with article L.513-15 of the Monetary and Financial Code. SFIL is a credit institution approved by the Autorité de contrôle prudentiel et de résolution (ACPR). Its shareholders are the French State (75%), Caisse des dépôts et consignations (20%) and La Banque Postale (5%). SFIL's shareholders are thus firmly anchored in the public sphere, reflecting the missions the French State assigned it.



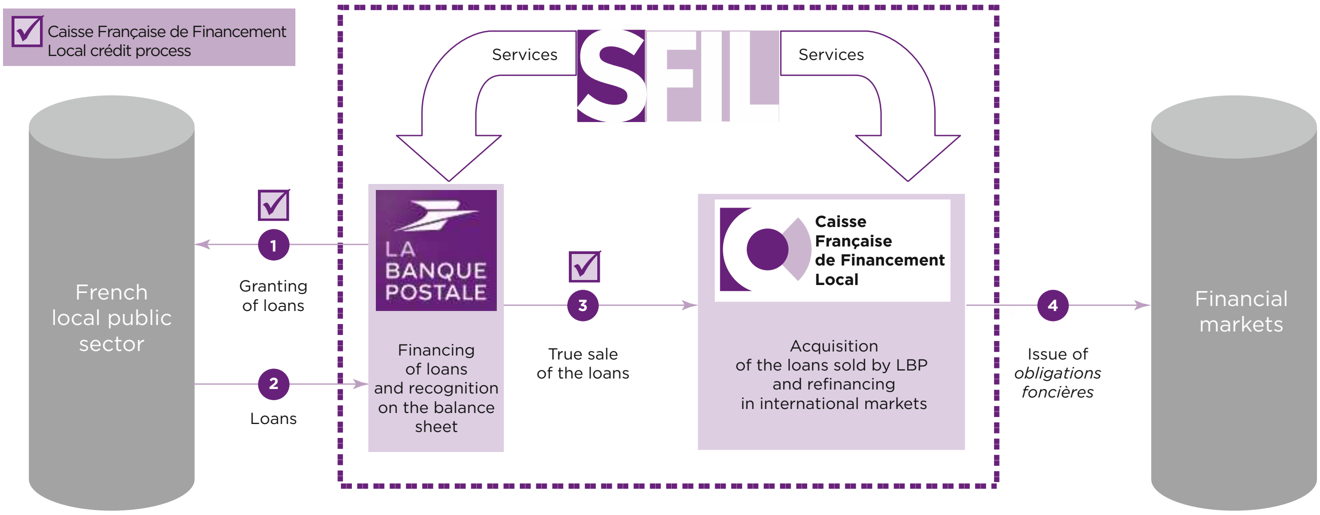
The French State is the "reference shareholder" of SFIL and Caisse Française de Financement Local for ACPR, underlining its commitment to ensure oversight and to influence strategic decisions, as well as its determination to ensure Caisse Française de Financement Local's and SFIL's ongoing financial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

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

1.3 – ECONOMIC MODEL OF CAISSE FRANÇAISE DE FINANCEMENT LOCAL

1.3.1. Financing of loans to the French local public sector and public hospitals in partnership with La Banque Postale

In early 2013, Caisse Française de Financement Local and La Banque Postale signed an exclusive sale agreement to fund the needs of the French local public sector and public hospitals. The arrangement, set up under the aegis of the French State, works as follows: La Banque Postale markets loans to the French local public sector and public hospitals, then sells them to Caisse Française de Financement Local, which refinances them by issuing *obligations foncières* (covered bonds). The loans originated are exclusively in euros with a vanilla interest rate. La Banque Postale committed to propose to Caisse Française de Financement Local all the loans that would be eligible for its cover pool.



This partnership enables Caisse Française de Financement Local to maintain its control of the credit risk through a two-stage analysis.

- Before a loan is originated, an initial analysis of the counterparty is carried out at the two entities. The loans that do not meet the credit and eligibility criteria of Caisse Française de Financement Local cannot be transferred to its balance sheet. Caisse Française de Financement Local's eligibility criteria are strictly monitored by internal management policies and limit eligible counterparties to French local public sector entities and public hospitals.
- Before loans originated by La Banque Postale are sold to Caisse Française de Financement Local, a new analysis of the assets is conducted, and Caisse Française de Financement Local may refuse a loan prior to the sale if the asset no longer meets the criteria.

As required by law, the sale of loans to Caisse Française de Financement Local is carried out by using a transfer form (*bordereau de cession*) that is specific to *sociétés de crédit foncier*.

1.3.2. Refinancing of large export credits

In addition to their mission of refinancing French local governments and public hospitals, SFIL and Caisse Française de Financement Local have been entrusted with a second mission by the French State: to refinance large French export contracts, with the objective to support French exports in terms of financial competitiveness, in accordance with a public refinancing plan comparable to that of other OECD countries. In this context, SFIL signed a protocol agreement governing relations with 25 commercial banks, thereby confirming relations with almost all the banks active in the French export credit market. SFIL may acquire all or a part of the participation of each of these banks in an export credit.

In this context, Caisse Française de Financement Local grants loans to SFIL in order to refinance its export credits. Such loans benefit from an irrevocable and unconditional 100% guarantee by the French State (enhanced guarantee[(1)]). This business brings Caisse Française de Financement Local closer to the French State, without modifying the risk profile of its cover pool.

These export refinancing loans, like the new French public sector loans marketed by La Banque Postale, are added to the portfolio of Caisse Française de Financement Local, which is financed by the issue of *obligations foncières*. Given the current size of the cover pool and the growth of its traditional line of business, the percentage share of this refinancing activity will increase gradually and will only become significant in several years. This share may reach 15% within four to five years.

1.3.2.1. Organization

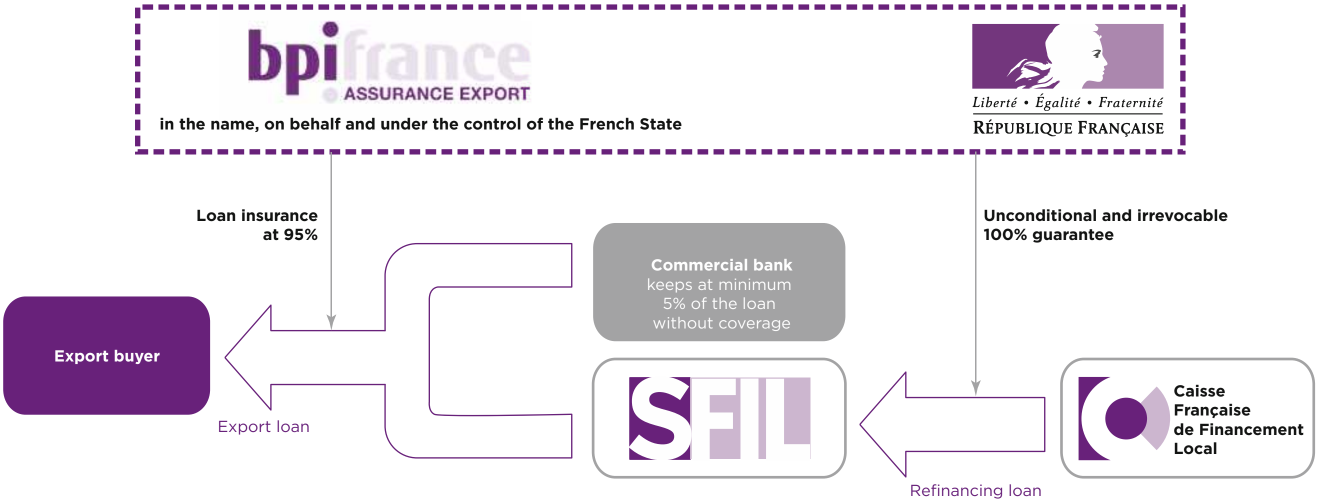
The system functions as follows:

- SFIL contributes to the financial proposal made by one or more banks in the banking syndicate granting the buyer credit covered by the export credit insurance guaranteed by the French State.
- After the export contract finalization, these banks sell a part of the loans (and the attached rights) to SFIL and keep at least the share of the export credit not covered by the insurance (usually 5%).
- Caisse Française de Financement Local grants a loan to SFIL to enable it to refinance the acquired export credit. This refinancing loan benefits from an irrevocable and unconditional 100% guarantee by the French State, referred to as an enhanced guarantee.

Loans granted by Caisse Française de Financement Local to SFIL to refinance the purchased export credits thus constitute exposures that are totally guaranteed by the French State and eligible for the cover pool of a *société de crédit foncier*. These loans also comply with the European CRR regulation (article 129, which specifies the assets authorized for inclusion in a cover pool to ensure that the covered bonds will benefit from the best prudential treatment).

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

Usual opérational diagram of export credit refinancing by SFIL-CAFFIL



1.3.2.2. French State export guarantees

Previously granted by Coface, since late 2016, these guarantees have been managed by Bpifrance Assurance Export, in the name, on behalf, and under the control of the French State, pursuant to article L.432.2 of the Insurance Code. They are therefore granted directly by the State, demonstrating its support for exporters, and are intended to promote, support and secure French exports financed over the medium and long term as well as French overseas investment:

- Guarantee-granting decisions are made by the Minister in charge of the Economy and Finances after instruction by Bpifrance Assurance Export and the opinion of the French Export Credit and Guarantee Commission (*Commission des garanties et du crédit au commerce extérieur)*; Bpifrance Assurance Export manages the State guarantees in strict compliance with the international rules of the WTO, the European Union and the OECD.
- Bpifrance Assurance Export issues insurance policies, as well as enhanced guarantees, in accordance with the decision made. In this context, Bpifrance Assurance Export is also tasked with collecting insurance and guarantee premiums, managing risks, payments, and collections on behalf of the French State.
- The risks related to these guarantees are borne by the French State and all financial flows (premiums, payments, repayments) are recorded in separate accounting entries by Bpifrance Assurance Export. Premiums and collections are received directly on the account of the French State, and payments are made directly from the same account, without passing through the accounts of Bpifrance Assurance Export.

1.3.3. Servicing and financing provided by SFIL

The role of SFIL primarily involves the following:

- to ensure the complete operational management of the Company, as defined by the regulations applicable to *sociétés de crédit foncier*, in particular article L.513-15 of the Monetary and Financial Code;
- to provide Caisse Française de Financement Local with some of the derivatives and non-privileged funding it needs to carry out its activities.

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

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

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

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

In addition to commitments of the French State as the reference shareholder, on January 31, 2013, SFIL signed a declaration of support of Caisse Française de Financement Local, which is reproduced in this annual financial report – General information.

It should be noted that SFIL also supplies services for the business of lending to French public sector entities engaged by La Banque Postale (LBP) and its joint venture LBP/CDC, La Banque Postale Collectivités Locales. These services concern activities involving commercial support, financial oversight, the supply of data for risk analysis and back office operations.

1.3.4. Other management agreements

Specific individual agreements have been established with entities that, in the past, have transferred assets to the *société de crédit foncier*, and continue to ensure management for their national clientele. These assets are now managed in a run-off mode. At the end of 2018, there were agreements with the following entities: Kommunalkredit Austria (Austria), Belfius Banque et Assurances (Belgium), and Dexia Crediop (Italy). These agreements already existed in previous years.

Starting in 2015, management of new registered covered bonds (RCB) is entrusted to Landesbank Baden-Württemberg (LBBW). Dexia Kommunalbank Deutschland continues to manage registered covered bonds issued prior to 2015.

1.4 – LEGAL FRAMEWORK

1.4.1. European framework

The *obligations foncières* issued by Caisse Française de Financement Local are covered bonds. Many countries have passed specific legal provisions for covered bonds in recent years, and the number of issuers has risen significantly.
Two directives govern and define covered bonds:
- The first directive is Undertakings for Collective Investment in Transferable Securities (UCITS) on the legislative, regulatory, and administrative aspects of certain vehicles for collective investment in securities, article 52-4.
- The second is the Capital Requirements Directive (CRD), on the minimum regulatory capital requirement, which is complemented by the related Capital Requirements Regulation (CRR), article 129.

These two directives in particular specify the assets that may be incorporated into the portfolio financed by the covered bonds, the privilege that protects investors, as well as the required level of public oversight and transparency in terms of communication. Investors in bonds that satisfy the requirements of these two directives and the associated regulation benefit from financial and regulatory advantages.

The *obligations foncières* issued by Caisse Française de Financement Local satisfy the requirements of these two European directives and the associated regulation. In this regard, they benefit from a 10% preferential risk weighting in the calculation of the solvency ratio with the standard method (given their current rating). Current and future *obligations foncières* issued by Caisse Française de Financement Local respect the conditions of eligibility for refinancing by the European Central Bank.

In addition, all the *obligations foncières* backed by the cover pool of Caisse Française de Financement Local benefit from the Covered Bond Label, which was created in 2012 by the European Covered Bond Council (ECBC) to improve the quality of financial information and the transparency of the European covered bond market.
To meet Label requirements, Caisse Française de Financement Local committed to respect the above-mentioned directives and to ensure a high level of transparency in its communication to investors. All detailed information on the issues and cover pool of Caisse Française de Financement Local is now posted on the Covered Bond Label site (https://www.coveredbondlabel.com/issuer/47/). It includes the harmonized transparency template (HTT) reporting used by all beneficiaries of the label.

The European Commission, the European Parliament and the European Council are currently working on a project of regulation to harmonize the legal framework for European covered bonds (see section 2.4.).

1.4.2. French legislative framework and regulations

Sociétés de crédit foncier are governed by the contents of articles L.513-2 to L.513-27 and R.513-1 to R.513-18 of the Monetary and Financial Code.

These articles of the law are complemented by the following regulatory texts:
- regulation 99-10 of the Comité de la réglementation bancaire et financière of July 9, 1999, as amended, relating to *sociétés de crédit foncier* and *sociétés de financement de l'habitat*;
- ACPR instructions 2011-I-06, 2011-I-07, 2014-I-16 and 2014-I-17.

In addition to these regulations and the law on *sociétés de crédit foncier*, which is described below, Caisse Française de Financement Local is subject to the same obligations as credit institutions in terms of reporting vis-à-vis the regulator and respect for liquidity ratios. The solvency ratio, large exposures and the leverage ratio are reported to the regulator on a consolidated basis, at the level of the parent company SFIL.

1.4.2.1. General framework

Article L.513-2 describes the general framework of the activities of *sociétés de crédit foncier*, in particular:
- their exclusive purpose which is to finance guaranteed home loans or loans to the public sector, or replacement assets, and the issue of *obligations foncières* and other resources benefiting or not from the legal privilege;
- the possibility to obtain financing by assigning in guarantee certain assets (which no longer contribute to the calculation of over-collateralization);
- the impossibility of owning subsidiaries or affiliates.

Application to Caisse Française de Financement Local

The assets are comprised of commitments on public sector entities. These assets are financed through the issue of debt that is covered by a legal privilege that guarantees them a priority right on the cash flows generated by the assets. The portion of assets that is not financed by covered debt – over-collateralization – is funded by the Company's equity and debt that does not benefit from the privilege, which is subordinated to the covered debt. Non-privileged debt is provided by SFIL, the sole shareholder of Caisse Française de Financement Local.

Since Caisse Française de Financement Local is not allowed to have any subsidiaries or affiliates, it does not publish consolidated financial statements and has no obligation to produce IFRS financial statements. Nonetheless, for reasons of comparability and transparency, Caisse Française de Financement Local publishes annual and half year financial statements according to IFRS.

1.4.2.2. Assets

Articles L.513-3 (home loans), L.513-4 (commitments on public sector entities), L.513-5 (securitization units) and L.513-6 (replacement assets) define the exposures that may be included in the assets of *sociétés de crédit foncier*.

Application to Caisse Française de Financement Local

The assets held by Caisse Française de Financement Local are solely comprised of commitments on public sector entities that are eligible by the terms of article L.513-4 of the Monetary and Financial Code, i.e. States, local governments or groups of such, public sector entities in the European Economic Area, Switzerland, the United States of America, Canada and Japan. These commitments are comprised of loans and bond issues representing a commitment on, or totally guaranteed by, these public bodies. Exposures to foreign public sector entities were marketed by the company's former shareholder and are now managed in a run-off mode. Since 2013, all of Caisse Française de Financement Local's new assets relate to French borrowers.

Other assets, which current legislation calls replacement assets, may be acquired if they correspond to exposures on credit institutions benefiting from at least a Step 1 rating (level triple A or double A) or, when their maturity does not exceed 100 days, from a Step 2 rating (level simple A), their total amount is limited to 15% of the total of outstanding *obligations foncières* and other debt benefiting from the legal privilege (registered covered bonds in the case of Caisse Française de Financement Local). This asset category is used for cash investments by the Caisse Française de Financement Local.

1.4.2.3. Liabilities and the privilege

Article L.513-2 specifies that to finance their assets, *sociétés de crédit foncier* may issue debt that benefits (*obligations foncières* or other covered resources) or does not benefit from the privilege. Article L.513-10 makes it possible to hedge the assets and the privileged liabilities by derivative instruments that thus benefit from the privilege.

Article L.513-15 requires that a *société de crédit foncier* entrust the management of its operations to another credit institution with which it has signed an agreement. To maintain the privilege that benefits investors in *obligations foncières* and other covered resources, a *société de crédit foncier* should not have any employee (who would benefit in French law from a first-rank privilege). This management agreement itself benefits from the privilege of article L.513-11, *pari passu* with holders of privileged debt.

Article L.513-11 describes this privilege, in particular:

- that when a *société de crédit foncier* is subject to bankruptcy or liquidation procedures, cash flows generated by the assets, after any financial instrument hedges if such be the case, are allocated in priority to serve the *obligations foncières* and other resources benefiting from the privilege, also after any financial instrument hedges if such be the case;
- that the liquidation of a *société de crédit foncier* does not accelerate the reimbursement of *obligations foncières* and other debt benefiting from the privilege, which continue to be paid at their contractual due dates with priority over all other commitments. These other commitments can only be settled after all debt benefiting from the privilege has been discharged.

Article L.513-20 stipulates that the bankruptcy or liquidation of the shareholder of a *société de crédit foncier* cannot be extended to the *société de crédit foncier.*

Lastly, article L.613-55-1.I of the Monetary and Financial Code, transposing the BRRD, stipulates that *obligations foncières* cannot be used to absorb losses in the event of the resolution of a *société de crédit foncier* (bail-in).

Application to Caisse Française de Financement Local

The contracts of Caisse Française de Financement Local that benefit from the legal privilege are the *obligations foncières* and registered covered bonds that it issues, the hedging derivative contracts and the servicing agreement signed with SFIL.

In addition to its equity, Caisse Française de Financement Local uses two categories of debt to finance its assets:

- debt that benefits from the legal privilege, defined by law as *obligations foncières* or other resources benefiting from the legal privilege by reason of their contract. Caisse Française de Financement Local thus issues registered covered bonds benefiting from the legal privilege by reason of their contract in the same way as *obligations foncières;* intended for German institutional investors, these private placements governed by German law also benefit from the French legal privilege attached to issues of *sociétés de crédit foncier*;
- debt that does not benefit from the legal privilege includes debt that is not covered by the assets and which, for this reason, is subordinated vis-à-vis debt benefiting from the privilege (see 5. Debt benefiting from the legal privilege). With equity, it finances over-collateralization. It may be of three types:
  - debt negotiated according to the terms of a financing agreement signed with the parent company;
  - refinancing in its own name from the Banque de France. Caisse Française de Financement Local implemented the organizational and IT procedures required to participate in the refinancing operations of the Banque de France, and tests them

regularly. The financing obtained does not benefit from the privilege specified by the legislation on *sociétés de crédit foncier*, but is guaranteed by assets assigned to the central bank. These pledged assets are temporarily excluded from the cover pool and the calculation of the over-collateralization ratio;
– financing obtained from credit institutions within the framework of repurchase agreements (repo).

In addition, on January 31, 2013, SFIL, the parent company of Caisse Française de Financement Local, signed a declaration of support ensuring that "Société de Financement Local and the French State, its reference shareholder, will ensure that Caisse Française de Financement Local will always be able to pursue its activity in an ongoing manner and to honor its financial commitments in compliance with the obligations imposed by banking regulations in effect". This declaration of support is reproduced in issuance documents and the annual financial report of Caisse Française de Financement Local.

1.4.2.4. Other provisions

The other articles of the Monetary and Financial Code define management and control procedures for *sociétés de crédit foncier*. They can be consulted on the Company's Website (http://www.caffil.fr) or on the official Legifrance Website (http://www.legifrance.gouv.fr/).

It can be noted that article L.513-12 and article R.513-8 of the Monetary and Financial Code require that the over-collateralization ratio, i.e. the ratio between the assets covering the privileged debt and the debt benefiting from the privilege at all times be greater than 105%.
The items concerning this ratio, as well as the management of the interest rate, foreign exchange and liquidity risks are discussed below in the chapters dedicated to these subjects.

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

As of December 31, 2018, Caisse Française de Financement Local's issuance program was rated by four international rating agencies: Moody's, Standard & Poor's (S&P), DBRS and Fitch.

However, SFIL and Caisse Française de Financement Local decided to no longer apply for a rating from Fitch as from end-2018. As a result, since the beginning of 2019, the financial rating agencies selected by Caisse Française de Financement Local for its issuance activity are Moody's, S&P and DBRS.

The ratings of the bonds issued by Caisse Française de Financement Local are at the highest level of credit quality (Step 1). This requires that the quality of the cover pool and strict management rules be consistent with the criteria and approaches of the agencies.
The principle by which each agency rates obligations foncières (and covered bonds in general) involves taking as a starting point the issuer's rating or that of the parent company if the issuer is not rated, and enhancing this rating by one or more notches in function of the current safeguards (legal framework, quality of assets, asset/liability management, over-collateralization, etc.).

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

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

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

2. Highlights of 2018

2.1 – PLANNED CHANGES TO THE SHAREHOLDING STRUCTURE OF SFIL, CAISSE FRANÇAISE DE FINANCEMENT LOCAL'S PARENT COMPANY

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

2.2 – THE COVERED BOND MARKET

The primary market for benchmark euro-denominated public covered bond issues saw intense activity in 2018, with some EUR 138 billion of supply (compared with EUR 115 billion in 2017 and EUR 127 billion in 2016). This high level of activity was partly attributable to the refinancing of bonds that matured during the year (EUR 90 billion). Peripheral issuers, particularly from Canada, also took advantage of this market to access financing conditions more favorable to them in euros than in dollars. French players also continued to issue actively in this market, providing 19% of supply, while Canadian, Australian and Norwegian issuers combined accounted for some 25%.

As expected, one of the highlights of 2018 was the gradual reduction of the European Central Bank's intervention through its covered bond purchase program. Outstandings under this program as of December 31, 2018 stood at EUR 263 billion, up by around EUR 22 billion over the year, compared with an increase of EUR 37 billion in 2017. This gradual reduction in the European Central Bank's purchases combined with abundant primary supply led to a widening of covered bond spreads over the year.

In this context, Caisse Française de Financement Local completed its annual *obligations foncières* financing program with good volumes, spreads and average maturities. This allowed it to provide the long-term liquidity needed to develop its French public sector and large export credit refinancing activity.

Covered bonds continue to benefit from a particularly favorable regulatory treatment, which should encourage investors to prioritize them in their 2019 asset allocation. Demand is expected to remain strong due to both the maturing of significant volumes (around EUR 102 billion) and traditional investors' growing interest in this asset class. We expect such investors to be attracted by the better absolute spread levels on offer compared with those observed before the European Central Bank implemented its purchase program in 2014.

2.3 – INTERNATIONAL EVENTS LEADING TO INCREASED MARKET VOLATILITY

2018 was marked by the following three major international events:
- continued Brexit negotiations between the European Union and the United Kingdom;
- general elections in Italy leading to the formation of an unprecedented coalition government;
- tensions relating to the increase in customs duties on certain goods between the United States and China initially, and then between the United States and the European Union.

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

2.4 – HARMONIZATION OF THE EUROPEAN LEGAL FRAMEWORK FOR COVERED BONDS

As part of the work to harmonize the European legal framework for covered bonds, on March 12, 2018 the European Commission published a draft text (directive and amendment of article 129 of the Capital Requirements Regulation - CRR):
- The main aims of the draft directive are to define covered bonds, list the instrument's specific structural characteristics and detail the regulator's related supervisory principles.
- The draft amendment to CRR article 129 defines the types of assets eligible for the cover pool as well as a minimum level of overcollateralization. These two elements combined thus enable covered bond investors to benefit from a preferential weighting for solvency calculations using the standard method.

The European Commission's proposal was a subject of frequent exchange among all covered bond market players throughout 2018. In particular, the European Parliament and the European Council reviewed both texts once they were published. Following that review:
- on November 26, 2018, the European Parliament's Committee on Economic and Monetary Affairs (ECON) voted to adopt the covered bond directive and the amendments to CRR article 129;
- the European Council's Committee of Permanent Representatives also approved a compromise text (directive and amendments to CRR article 129) on November 28, 2018.

An agreement between the three parties (European Commission, European Parliament and European Council) is expected in early 2019. The objective will be to implement this new regulation within a maximum of two years.

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

2.5 – FIRST-TIME APPLICATION OF IFRS 9

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

The first-time application of IFRS 9 increased the amount of equity by EUR 50 million and led to a 126-basis-point increase in Caisse Française de Financement Local's fully loaded CET1 ratio (see section 15.1.1).

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

2.6 – COMPLETION OF THE IT STREAMLINING PROGRAM

SFIL, as servicer of the Caisse Française de Financement Local (see 1.3.3.), finalized its modernization and simplification program, when it migrated at the end of March 2018 a large part of its IT system to a new, catering in particular for its markets activities. It also inaugurated an overall data warehouse. Since that, SFIL group has an IT system tailored to its roles that enables it to meet more effectively its management needs and risk control.

2.7 – RATING OF *OBLIGATIONS FONCIÈRES*

There was no change in 2018 in the rating of Caisse Française de Financement Local's *obligations foncières* by the three historical agencies (Moody's, S&P and Fitch).

In 2018, SFIL and Caisse Française de Financement Local reviewed their credit rating situation and decided to appoint the international rating agency DBRS. On September 10, 2018, DBRS assigned a AAA rating to the covered bonds issued by Caisse Française de Financement Local.

SFIL and Caisse Française de Financement Local also decided to no longer apply for a rating from Fitch as from end-2018. As a result, since the beginning of 2019, the financial rating agencies that the SFIL Group has selected for its issuance activity are Moody's, S&P and DBRS.

The corresponding ratings as of January 1, 2019, were as follows: Aaa (Moody's), AA+ (S&P) and AAA (DBRS). The outlook for each of these ratings is stable.

2.8 – REFINANCING OF PUBLIC SECTOR LOANS GRANTED BY LA BANQUE POSTALE

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

In this context, in 2018, Caisse Française de Financement Local acquired a total of EUR 3.4 billion in loans (EUR 3.3 billion in 2017). Since the beginning of the partnership in 2013, loans acquired through LBP have accounted for EUR 15.6 billion.

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

2.9 – LARGE EXPORT CREDITS REFINANCING

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

In 2018, SFIL strengthened its position as the leading liquidity provider in the French large export credit market, while Caisse Française de Financement Local granted new refinancing loans to SFIL for a total amount of EUR 3.8 billion (EUR 2.6 billion in 2017).

Since the launch of this role in mid-2015, Caisse Française de Financement Local has granted refinancing loans to SFIL for a total volume of EUR 7.1 billion. As of December 31, 2018, the outstanding amount of these loans recorded in Caisse Française de Financement Local's balance sheet was EUR 1.1 billion. As a reminder, the disbursement of refinancing loans for large export credits is staggered over several years.

On March 8, 2019, the French government announced its plan to create a new guarantee analogous to export credit insurance, which will cover the financing of large projects deemed strategic for France's economy. The financing of these projects will benefit from a French State guarantee with no precondition of underlying exports. After obtaining the necessary authorizations, SFIL will be able to participate in the scheme and be refinanced by Caisse Française de Financement Local using the enhanced guarantee mechanism. The regulations were amended accordingly at the end of 2018. The extension of the SFIL Group's export credit activity to this new guarantee should enable France to offer a financing tool comparable to the best foreign equivalents, in line with the practices observed in major exporting countries, particularly in Asia.

3. Change in cover pool and debts

EUR billions value after currency swaps	12/31/2016	12/31/2017	12/31/2018	Change 2018 / 2017
Cover pool	**58.2**	**55.8**	**56.9**	**2.0%**
Loans	47.0	46.9	47.5	1.3%
Securities	7.5	7.2	8.1	13.2%
Cash deposit in central bank	3.7	1.7	1.3	(25.5)%
Assets removed from the cover pool	**-**	**-**	**0.0**	**ns**
Privileged debt	**51.7**	**49.7**	**50.8**	**2.2%**
Obligations foncières(1)	50.4	49.0	50.3	2.5%
Cash collateral received	1.3	0.7	0.5	(25.1)%
Non-privileged debt	**5.2**	**4.8**	**4.9**	**2.5%**
SFIL	5.2	4.8	4.9	2.5%
Equity IFRS (excluding unrealized gains and losses)	**1.4**	**1.5**	**1.5**	**(1.5)%**

(1) Including registered covered bonds

Caisse Française de Financement Local's cover pool grew by approximately 2.0% in 2018. As of December 31, 2018, the cover pool excluding accrued interest not yet due amounted to EUR 56.9 billion.

Caisse Française de Financement Local's cover pool is composed of loans and debt securities and also includes the temporary cash surplus put aside to anticipate the forthcoming repayment of *obligations foncières* or the refinancing of new export loans. This cash is deposited at the Banque de France, or invested in bank or European public sector securities. The cash surplus, placed with the Banque de France, represents EUR 1.3 billion at the end of December 2018, versus EUR 1.7 billion at the end of December 2017. The cash surplus invested in securities or lent to SFIL represents a total of EUR 3.3 billion as of December 31, 2018 versus EUR 1.6 billion at the end of December 2017.

As of December 31, 2018, no assets were excluded from the cover pool in order to be sold to a bank in a repurchase agreement or assigned in guarantee to the Banque de France.

As of this date, outstanding debt benefiting from the legal privilege, including cash collateral received, was EUR 50.8 billion, which increased by 2.2% in comparison with December 2017.

As of December 31, 2018, the debt contracted with the parent company totaled EUR 4.9 billion and does not benefit from the legal privilege. It mainly corresponds to the financing of the over-collateralization of the cover pool which is at a significantly higher level than the amount required by regulators and the rating agencies.

4. Cover pool

4.1 – CHANGE IN ASSETS IN 2018

The net change in the cover pool in 2018 corresponded to an increase in assets in the amount of EUR 1.1 billion. This change is explained by the following items.

EUR billions	2018	
1- Acquisition of loans from La Banque Postale		**3.4**
Loans to the French public sector (vanilla loans in euros)	3.4	
2- Export credits drawings		**0.9**
Loans to SFIL to refinance export credit guaranteed by the French State	0.9	
3- Reduction of loan sensitivity		**0.2**
Sensitive structured loans eliminated	(0.3)	
Refinancing loans (vanilla loans in euros)	0.3	
New loans (vanilla loans in euros)	0.2	
4- Amortization of portfolio of loans and securities		**(4.6)**
5- Early reimbursments		**(0.1)**
6- Changes in treasury		**1.3**
Net change in securities investments	1.7	
Net change in Banque de France cash deposit	(0.4)	
Net change in the cover pool		**1.1**

In 2018, Caisse Française de Financement Local acquired a total of EUR 3.4 billion in loans to the French local public sector and public hospitals originated by La Banque Postale.

Drawings on refinancing loans of large export credits granted to SFIL became effective during 2018 in the amount of EUR 0.9 billion. These loans benefit from an irrevocable and unconditional 100% guarantee by the French State.

In application of the policy of reduction of loan sensitivity in effect since the beginning of 2013, the operations conducted by SFIL in 2018 made it possible to decrease outstanding loans considered as sensitive by EUR 0.3 billion through their replacement with fixed rate loans. They were accompanied by new fixed rate loans in the amount of EUR 0.2 billion.

The natural amortization of the portfolio of loans and securities represented EUR 4.6 billion in 2018, and early reimbursements represented EUR 0.1 billion.

Available cash increased by EUR 1.3 billion. It is deposited at the Banque de France, invested in bank bonds classified as replacement assets, in European public sector bonds or lent to SFIL.

There were no divestments, except for treasury investments, in 2018.

4.2 – OUTSTANDING ASSETS AS OF DECEMBER 31, 2018

Caisse Française de Financement Local's pool of assets is exclusively composed of exposures on public sector entities, or guaranteed by the same, and replacement assets (within the limits specified by current legislation).

EUR billions	12/31/2017	12/31/2018
Loans and bonds to the public sector	53.2	52.8
of which local public sector business line	52.2	51.2
of which large export credits refinancing business line[(1)]	0.2	1.1
of which treasury investment in public sector bonds[(3)]	0.7	0.5
Banque de France cash deposit[(3)]	1.7	1.3
Replacement assets[(3)]	0.9	2.8
COVER POOL	**55.8**	**56.9**
Financing commitments granted to refinance large export credits[(1)(2)]	3.0	6.0
Financing commitments granted to other public sector loans	0.1	0.0
FINANCING COMMITMENTS GRANTED	**3.1**	**6.0**

(1) For the record, loans refinancing large export credits concluded with SFIL benefit from an irrevocable and unconditional 100% guarantee granted by the French State (enhanced guarantee).
(2) In 2017 and 2018, commitments granted represented concluded contracts in drawing phase.
(3) The total amount of excess treasury (cash or cash investments) increased from EUR 3.3 billion to EUR 4.6 billion in 2018

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

The amount of financing commitments given came to EUR 6.0 billion as of December 31, 2018, It concerns loans to SFIL signed but not yet drawn, in connection with the refinancing of large export credits. As a reminder, these loans benefit from an irrevocable and unconditional 100% guarantee by the French State.

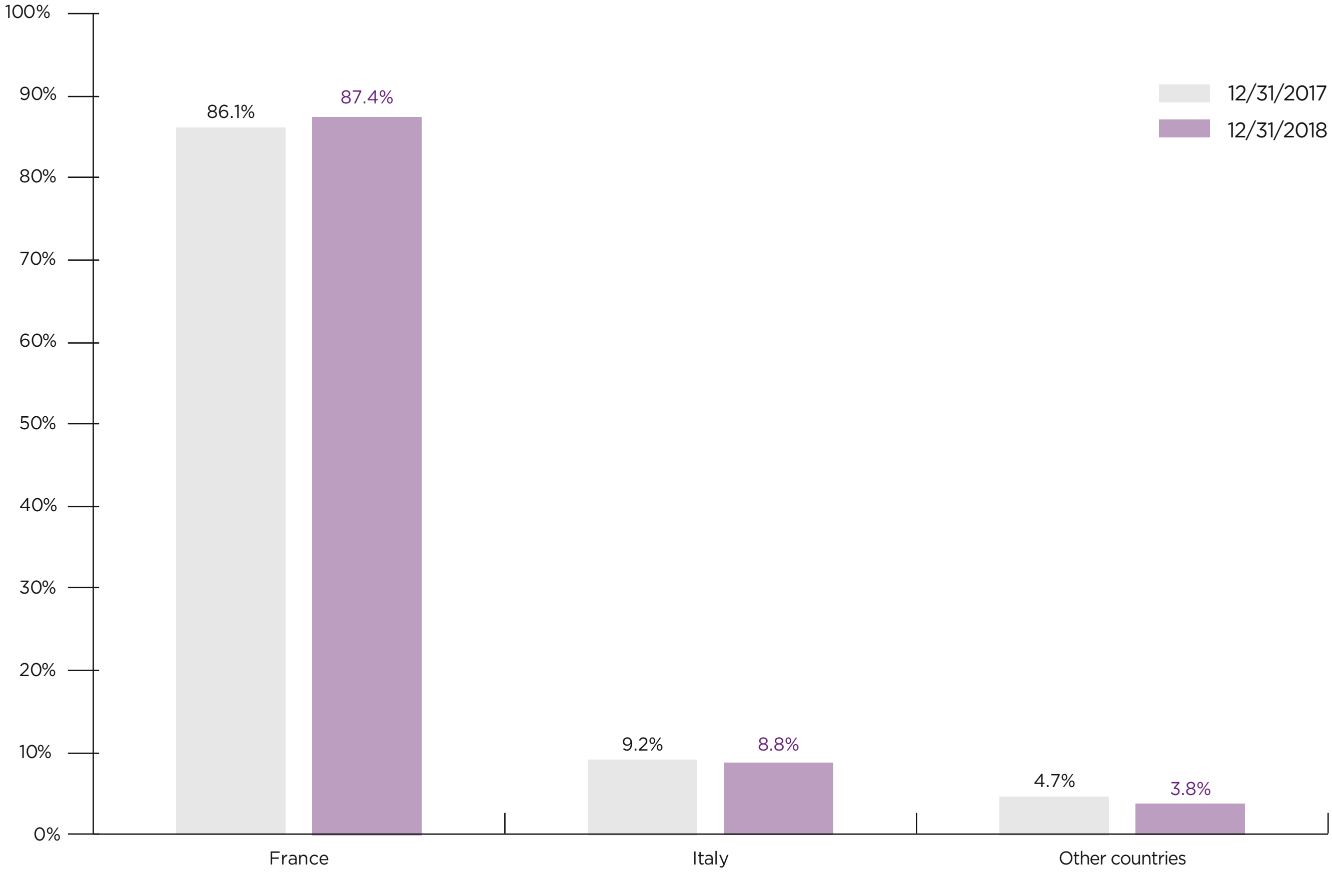
4.2.1. Public sector loans and bonds (excluding replacement assets and treasury placed with the Banque de France)

4.2.1.1. Geographic breakdown

As of December 31, 2018, French public sector loans made up the majority (87.4%) of the cover pool, a share due to increase in the future. They include loans amounting to EUR 13.1 billion acquired from La Banque Postale since 2013, which account for nearly 25% of public sector loans and bonds and 30% of its loans to the French local public sector. The State-guaranteed loans granted to SFIL for the refinancing of large export credits (EUR 1.1 billion on balance sheet) represent approximately 2% of its public sector loans and bonds.

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

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



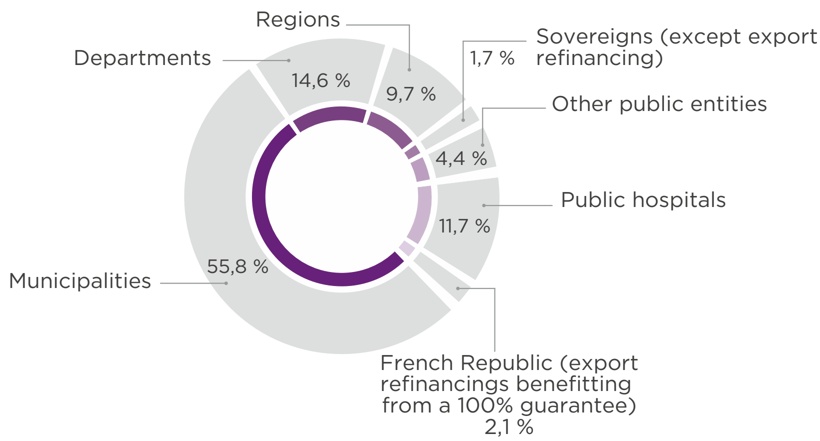
As of December 31, 2018, Italian assets represented the largest share of non-French assets in run-off, with a total volume of EUR 4.7 billion, or 8.8% of the cover pool (excluding replacement assets and Banque de France cash deposits). These assets are granular exposures (more than 200 counterparties consisting mainly of regional and municipal authorities) distributed throughout Italy.

Exposures to Other countries as of December 31, 2018, are broken down by country in the section Breakdown of cover pool, which is presented at the end of this management report.

4.2.1.2. Breakdown by type of counterparty

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

- for 80%: exposures on municipalities, departments or regions;
- for 6%: sovereign exposures or commitments on other public sector entities;
- for 12%: exposures on public hospitals;
- for 2%: exposures 100% guaranteed by the French State in respect of loans granted to SFIL for the refinancing of large export credits;



4.2.1.3. Securitizations

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

4.2.2. Replacement assets

Assets considered by law as replacement assets correspond to exposures on credit institutions benefiting from at least a Step 1 rating, or a Step 2 rating when their remaining maturity does not exceed 100 days, and their total amount is limited to 15% of *obligations foncières* and registered covered bonds.

As of December 31, 2018, replacement assets represented 5.6% of *obligations foncières* and registered covered bonds.

The Caisse Française de Financement Local's cash surplus can be invested in banking sector securities (in addition to deposits at the Banque de France and investments in European public sector securities) or lent to SFIL. In this case, bank exposures are classified as replacement assets, broken down below based on the rating of the issuers. In addition, Caisse Française de Financement Local granted loans to SFIL to invest its surplus cash. These loans are also included in the replacement assets.

Replacement assets EUR millions	**Country**	**12/31/2017**	**12/31/2018**
Step 1 credit rating			
Covered bonds			
	France	176	278
	Other countries	127	677
Other bank bonds			
	France	148	417
	Other countries	100	219
Loans to parent company, SFIL	France	360	800
Step 2 credit rating			
Bank bonds (maturity < 100 days)			
	France	-	285
	Other countries	-	122
Bank accounts balances	France and other countries	10	3
TOTAL		**921**	**2,801**

4.2.3. Assets removed from the cover pool

Thanks to its status as a credit institution, Caisse Française de Financement Local has access to refinancing operations offered to banks by the Banque de France within the Eurosystem. In steering its cover pool and its over-collateralization or in order to meet the need for temporary liquidity, Caisse Française de Financement Local may thus convert a portion of its assets into cash. The loans or securities assigned in guarantee with the central bank in order to obtain financing on the occasion of tenders organized by the Banque de France are then taken out of the cover pool and replaced by the cash thus obtained.
The same treatment would be applied to the assets in the cover pool if they were mobilized in interbank repurchase agreements in the event of a need for liquidity.
During the last three fiscal years, in the context of the regular tests of its operational procedures for accessing refinancing from the Banque de France or bank counterparties, Caisse Française de Financement Local has mobilized assets of very small unit amounts.

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

4.2.4. Structured loans

4.2.4.1. Definition

Certain loans to French counterparties in Caisse Française de Financement Local's cover pool may be classified as structured loans. The Gissler charter, the code of conduct adopted by banking institutions and local government entities, which is available on the French Ministry of the Interior's website, defines structured loans as:
- all loans with structures classified in categories B to E;
- all "not in the charter" loans, i.e. that the charter prohibits from being marketed because of their structure (leverage > 5, etc.), their underlying index(es) (foreign exchange, etc.) or their currency (denominated in CHF, JPY, etc.).

4.2.4.2. Part of structured loans in the cover pool

	Outstanding				Number of customers[1]		
EUR billions	12/31/2017	12/31/2018	Change	% cover pool	12/31/2017	12/31/2018	Change
French public sector loans	**44.7**	**44.3**	**(0.4)**	**77.8%**	**15,363**	**14,615**	**(748)**
Of which vanilla loans	**39.3**	**39.9**	**0.6**	**70.1%**	**13,717**	**13,168**	**(549)**
Of which structured loans	**5.4**	**4.4**	**(1.0)**	**7.7%**	**1,646**	**1,447**	**(199)**
Sensitive loans not in the charter	0.6	0.4	(0.2)	0.7%	64	51	(13)
Sensitive loans (3E/4E/5E)	0.8	0.6	(0.2)	1.1%	162	145	(17)
Subtotal sensitive loans:	**1.4**	**1.0**	**(0.4)**	**1.8%**	**226**	**196**	**(30)**
Structured loans benefiting from the derogatory mechanism of the support fund	0.5	0.4	(0.1)	0.7%	71	62	(9)
Other structured loans	3.5	3.0	(0.5)	5.2%	1,349	1,189	(160)

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

In 2018, outstanding loans to the French local public sector decreased by EUR 0.4 billion. Structured loans on Caisse Française de Financement Local's balance sheet amounted to EUR 4.4 billion, representing 7.7% of the cover pool.

4.2.4.3. Sensitive loans and reduction in loan sensitivity

The most structured loans according to the Gissler classification (categories 3E, 4E and 5E as well as "not in the charter" loans) may be classified as "sensitive". As of December 31, 2018, they now represent only EUR 1.0 billion (1.8% of the cover pool) compared with EUR 8.5 billion on SFIL's inception at the end of 2012, i.e. a fall of more than 83%. The number of customers holding sensitive loans fell over the same period from 879 to 196. Of these loans, those considered to be the most sensitive ("not in the charter") represented only EUR 0.4 billion, or 0.7% of the cover pool and 51 customers as of December 31, 2018. Those 51 customers are mostly municipalities with more than 10,000 residents, groups of municipalities and, to a lesser extent, public hospitals.

Given the transactions of reduction in loan sensitivity already signed as of end-2019, sensitive loans with a rate exceeding 5% will amount to less than EUR 0.2 billion and concern 29 customers, i.e. 0.4% of the cover pool and 0.2% of French local public sector customers. The scope of sensitive structured loans is therefore extremely limited and the associated risk is no longer material for Caisse Française de Financement Local.

5. Debt benefiting from the legal privilege

As of December 31, 2018, debt benefiting from the legal privilege is composed of *obligations foncières* and registered covered bonds issued by Caisse Française de Financement Local as well as of cash collateral received from counterparties in derivative transactions.

EUR billions	12/31/2017	12/31/2018
Cash collateral received	0.7	0.5
Obligations foncières and registered covered bonds	49.0	50.3
TOTAL	**49.7**	**50.8**

5.1 – CHANGE IN CASH COLLATERAL

Cash collateral received by Caisse Française de Financement Local decreased compared with the situation at the end of December 2017. Its level stood at EUR 0.5 billion at the end of December 2018.

5.2 – CHANGE IN ISSUES

Within the recurrent annual program of EUR 4 to 6 billion, the issuance policy of Caisse Française de Financement Local primarily aimed to construct a coherent yield curve in the euro market while keeping an eye on the good performance of its benchmarks in the secondary market. The diversification of its sources of financing is necessary to achieve long maturities coherent with its needs. This implies an active presence in the market of private placements within the framework of the EMTN program or the issue of registered covered bonds. Meanwhile, as part of the implementation of the SFIL Group's social and environmental policy and in order to diversify its sources of financing, CAFFIL has announced a "social covered bond" public issue project, which was implemented in February 2019. This issue is the first step in the SFIL Group's strategy to use of "social" and "green" bond issues.

5.2.1. New issues in 2018

In 2018, Caisse Française de Financement Local raised EUR 4.9 billion through benchmark public issues enabling it to extend its reference curve, as well as tap issues, while at the same continuing to work on the private placements segment.

Caisse Française de Financement Local raised money in the public primary market three times, for a total amount of EUR 3.5 billion:
- a dual tranche issue (8 and 15 years) in January for a total amount of EUR 1.5 billion;
- a 10-year issue in April for an amount of EUR 1.5 billion;
- a 20-year issue in June for an amount of EUR 0.5 billion; this particularly long-dated public issue extended Caisse Française de Financement Local's reference curve by three years.

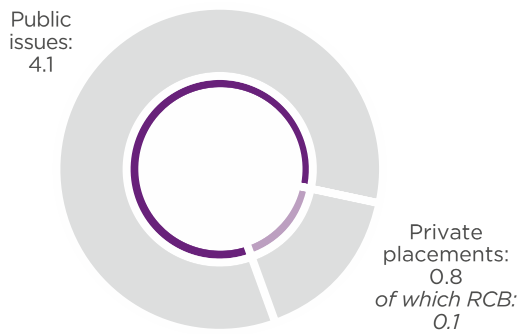
At the same time, Caisse Française de Financement Local provided additional liquidity on four of its reference issues via taps for a cumulative amount of EUR 0.6 billion.

In addition to these public transactions, Caisse Française de Financement Local remained active in the private placement segment and especially with the registered covered bond (RCB) format, thus making it possible to respond to investors' demand for long and very long maturities. Altogether, it raised EUR 0.8 billion in this market segment.

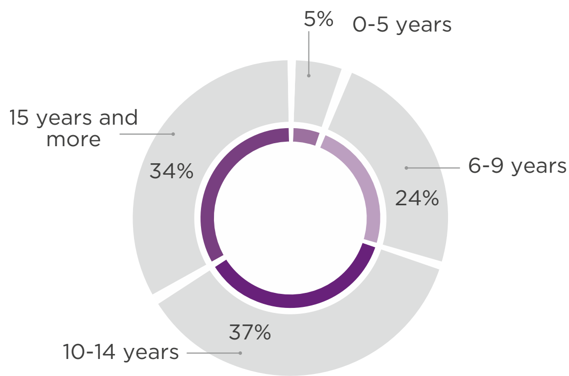
The weighted average life of 12.2 years for 2018 issues made for an excellent match between assets and liabilities.

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

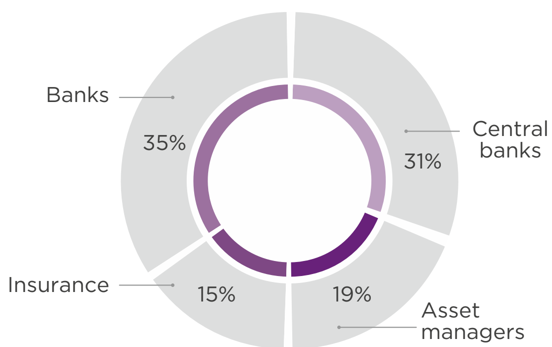
Breakdown of 2018 issues by format
EUR billions



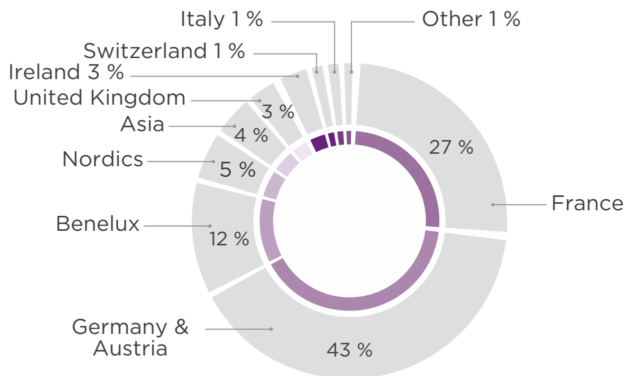
Breakdown of 2018 issues by maturity
(%)



Breakdown of 2018 public issues by investor category
(%)



Breakdown of 2018 public issues by geographic zone
(%)

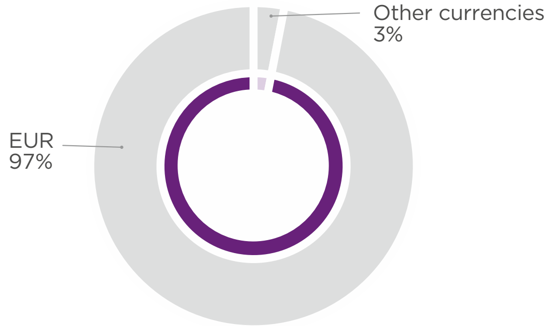


5.2.2. Outstanding debt as of December 2018

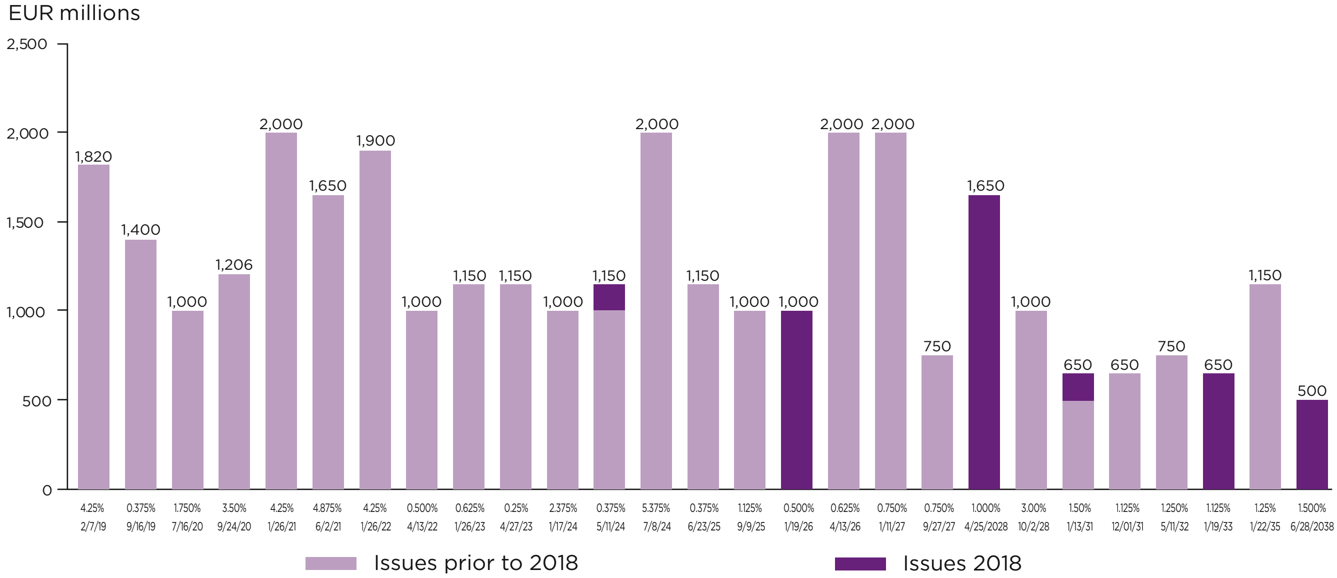
Outstanding *obligations foncières* and registered covered bonds totaled EUR 50.3 billion in swapped value at the end of December 2018. This includes new issues of *obligations foncières* for EUR 4.9 billion and amortization of issues maturing in 2018 for EUR 3.6 billion.

EUR billions, value after currency swaps	2017	2018
BEGINNING OF THE PERIOD	**50.4**	**49.0**
Issues	6.0	4.9
Amortizations	(7.2)	(3.6)
Buyback	(0.2)	-
END OF THE PERIOD	**49.0**	**50.3**

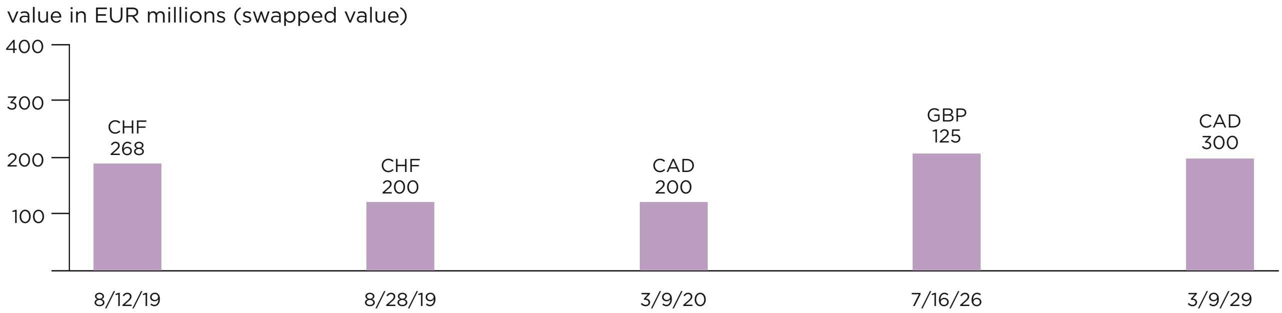
As of December 31, 2018, issues can be broken down by currency as follows:



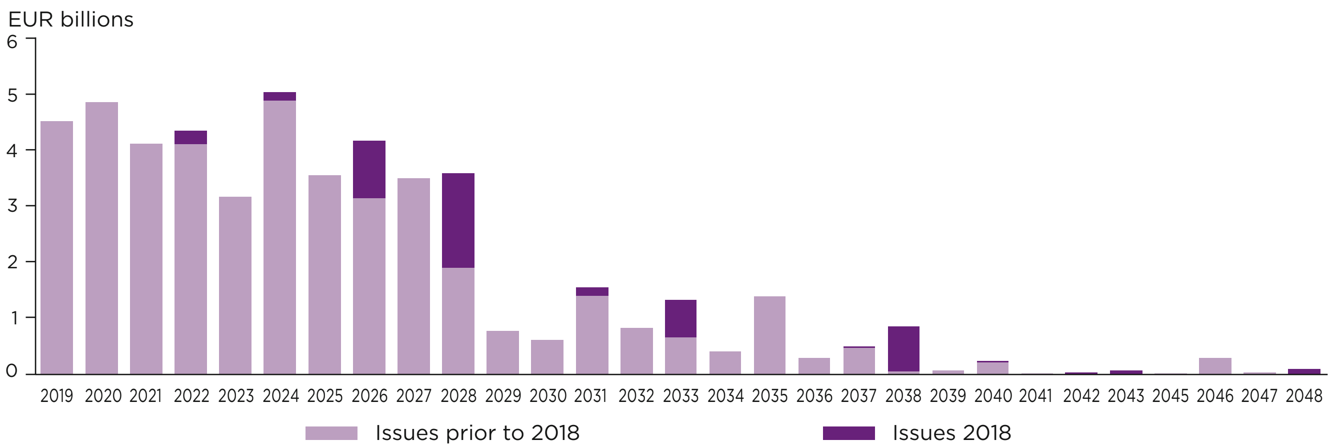
Breakdown of benchmark *tranches* in EUR



Main *tranches* in other currencies



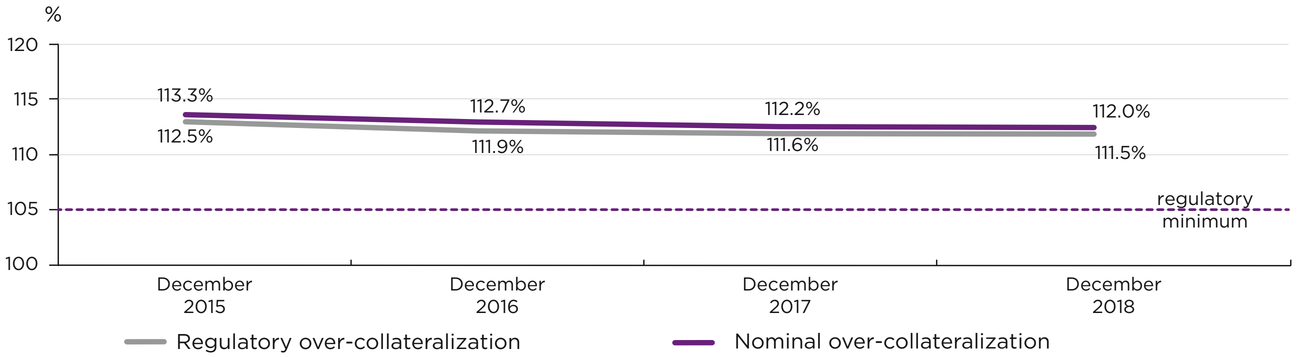
Amortization of *obligations foncières* and registered covered bonds



6. Changes in the over-collateralization ratio

The over-collateralization ratio, which is calculated on the basis of regulatory standards governing *sociétés de crédit foncier*, is the ratio between the assets and the resources benefiting from the legal privilege. The legal minimum threshold is set at 105% and corresponds to the minimum level that Caisse Française de Financement Local had committed to maintain since its creation.

In practice, the over-collateralization ratio is regularly higher than 105%. To maintain an adequate level of credit rating, a level of over-collateralization of more than 5% may be required. This requirement depends on the method applied by each of the rating agencies and on the new assets and liabilities on Caisse Française de Financement Local's balance sheet and it may vary over time. Caisse Française de Financement Local takes these particular requirements into account in the management of its activity in order to make sure they are constantly met and strives to maintain its over-collateralization at a relatively stable level, as can be seen in the following graph.

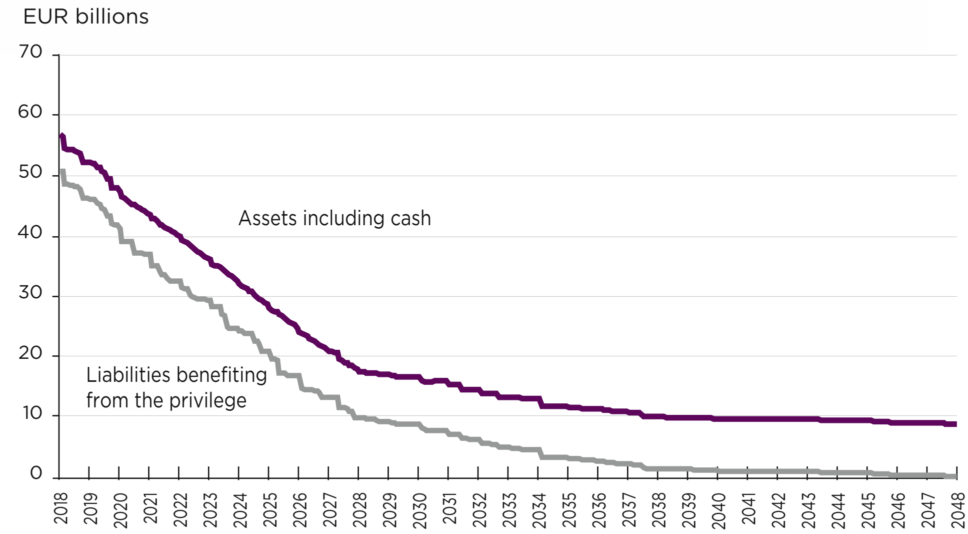


Regulatory over-collateralization may differ from nominal over-collateralization. In fact, it is calculated on the basis of the rules determined by the Autorité de contrôle prudentiel et de résolution (ACPR). In particular, these rules require different weighting levels according to the assets. The assets in Caisse Française de Financement Local's cover pool are weighted at 100%. The small difference between the two ratios can be explained by the accrued interest not yet due taken into account in the regulatory over-collateralization ratio.

Any assets that Caisse Française de Financement Local may have assigned in guarantee to borrow funds from the Banque de France or any other banking institution would be excluded from the calculation of over-collateralization.

Over–collateralization may also be illustrated by the gap between the amortization curves of the assets and liabilities benefiting from the privilege. The following graph presents the curves as of December 31, 2018.

Amortization of assets and liabilities as of December 31, 2018



In this graph, the assumption is made that excess cash generated over time is included in the cover pool.

7. Change in debt that does not benefit from the legal privilege

The asset surplus (assets exceeding *obligations foncières* and registered covered bonds) and miscellaneous needs are financed by equity and debt that does not benefit from the privilege of the law on *sociétés de crédit foncier*.

Such financing is obtained through the parent company. At the end of December 2018, the funds borrowed from SFIL within the framework of the financing agreement were made up of different loans with maturities that could initially run from one day to ten years with an Euribor or Eonia index.

Temporary financing may also be obtained from the Banque de France. These funds do not benefit from the privilege stipulated in the law on *sociétés de crédit foncier*, but they are guaranteed by loans and securities assigned for this purpose in the account of Caisse Française de Financement Local at Banque de France. Since the creation of SFIL, excep when it used small sums to test the access procedure for such funding, Caisse Française de Financement Local has not contracted any loans from the Banque de France or from credit institutions other than its parent company.

The change in financing that does not benefit from the legal privilege, excluding accrued interest not yet due, can be presented as follows.

EUR billions	12/31/2017	12/31/2018
SFIL	4.8	4.9
Banque de France	-	-
TOTAL	**4.8**	**4.9**

8. Internal Control and Preparation of accounting and financial information

8.1 – GENERAL DESCRIPTION OF THE INTERNAL CONTROL PROCEDURES

8.1.1. Responsibilities of internal control and the general architecture of internal control

SFIL, with its subsidiary Caisse Française de Financement Local, is one of the large banks that has been under the direct supervision of the European Central Bank (ECB) since November 2014 in the framework of the Single Supervisory Mechanism (SSM). In addition, as a *société de crédit foncier*, Caisse Française de Financement Local is subject to special and additional oversight by the Autorité de contrôle prudentiel et de résolution (ACPR).

Since it manages Caisse Française de Financement Local, SFIL has been delegated to exercise the functions of internal control for Caisse Française de Financement Local pursuant to its management agreement. Consequently, internal control at SFIL also meets the regulatory obligations of Caisse Française de Financement Local in this regard.

The objectives and organization of SFIL's internal control system comply with the provisions of the French Monetary and Financial Code and the *arrêté* of November 3, 2014. According to these articles, the internal control system requires that different control procedures are applied to provide:
- a control system for operations and internal procedures;
- an organization of financial and accounting data;
- systems to measure risks and results;
- systems to monitor and control risks;
- a system for documentation and information;
- surveillance of flows of cash and securities.

This internal control system is a process put into practice by Executive Management and all the employees of SFIL, at the initiative of its Board of Directors. The organization is designed to provide reasonable but not absolute assurance with regard to the achievement of the objectives that SFIL set in terms of performance, profitability and protection of its financial assets.

The internal control objectives in effect at SFIL on behalf of Caisse Française de Financement Local aim to:
- verify the effectiveness of the risk control system to ensure that risks are in line with the risk appetite that its governance bodies have defined;
- ensure that the financial and accounting data produced is reliable and relevant. The main objective of the financial information is to give a true and fair view of the position of Caisse Française de Financement Local in a regular, complete and transparent manner;
- monitor compliance with internal and external rules and practices of business ethics. The diligent operation of Caisse Française de Financement Local implies strict respect of legislative and regulatory obligations, in particular with regard to corporate governance and compliance;
- monitor the effectiveness and operational efficiency of processes, in order to ensure that operations are carried out properly while guaranteeing efficient management of available resources.

In order to allow the accomplishment of the objectives set, and in compliance with the *arrêté* of November 3, 2014, the general architecture of the internal control system of SFIL is based on three levels of control:
- the first control level takes place in the operating teams;
- the second level corresponds to the permanent control activities carried out under the responsibility of the Operational Risks and Permanent Control division or, for non-compliance risks, the Compliance division ;
- the third control level concerns periodic control conducted by an independent team, the Internal Audit and Inspection division, which reports to the Chief Executive Officer of SFIL and which exercises periodic oversight of the efficient and effective application of the two above-mentioned levels of control.

The different functions in charge of internal control (Operational Risks and Permanent Control division, Compliance division and Internal Audit and Inspection division) meet regularly in an Internal Control Committee in order to share information about the risks each division has identified in its field of competence, to coordinate internal control initiatives so as to remedy risk situations and analyze the conclusions in their respective control plans.

A computer system enables the Operational Risks and Permanent Control division and the Internal Audit and Inspection division to monitor their risks, controls, recommendations and action plans. A project is currently underway to provide SFIL with a new system in 2019.

The heads of internal control functions report on the performance of their duties to General Management and the relevant committee of the Board of Directors, the Risks and Internal Control Committee. They can refer matters to this committee and the Board of Directors on their own initiative, and can submit proposals directly to the Board of Directors or the relevant committee if they feel that an event could have a significant impact and needs bringing to its attention. If these duties or events concern Caisse Française de Financement Local, these managers accordingly inform the Executive Board and, if necessary, the Supervisory Board.

These different levels of control are deployed under the aegis of the supervisory and management bodies of SFIL and Caisse Française de Financement Local.

8.1.2. Executive Board of Caisse Française de Financement Local

The Executive Board of Caisse Française de Financement Local is the front-ranking guarantor of the efficient operation of the Company's internal control procedures. In light of the structure of Caisse Française de Financement Local and of the management agreement which binds it to its parent company, the Executive Board relies on the governance and organization of internal control in effect at SFIL.

- The Risks and Internal Control Committee, which is composed of the members of the Board of Directors of SFIL, is responsible, in keeping with the Code of Commerce and the *arrêté* of November 3, 2014, for ensuring the efficiency of internal control and risk management systems, giving an appreciation of the quality of internal control, in particular the coherence of measurement, surveillance and risk control systems, and suggesting, if need be, any additional action. This committee is also responsible for monitoring permanent control, compliance and periodic control at SFIL. It likewise examines, with the Company's auditors, any risks weighting on their independence.
- As accountable officers under current banking regulations, SFIL's Chief Executive Officer and Deputy Chief Executive Officer guarantee the efficient operation of SFIL's internal control system. They allocate the resources that the various divisions in charge of control need to carry out their responsibilities, and verify that the objectives are met and that the internal control system is adapted to the regulations and SFIL's and Caisse Française de Financement Local's activities. To this end, they regularly receive activity reports and the results of the controls carried out in terms of permanent control, compliance and periodic control. These reports are also presented and discussed at meetings of Operational Risks and Permanent Control committee and SFIL's Executive Committee, and the issues raised engender action and decisions in order to ensure continuous improvement in internal control.

8.1.3. The first level of control: control carried out at the operational level

As the first level of the internal control system, employees and managers of SFIL's operating divisions are in charge of analyzing the risks involved in all the transactions they have initiated, organizing and conducting first-level controls for such operations, verifying that internal control procedures in their division are adapted to such risks and contributing to their development. To this end, they rely on the policies, procedures, limits and indicators with a clear separation between the launch of operations and their validation, control or settlement. These policies, procedures, limits and indicators are defined by several internal committees. They are composed of operating, support, and control staff, and chaired by a member of the Executive Committee of SFIL.

8.1.4. Second level of control: permanent control excluding compliance

8.1.4.1. Organization and governance

The purpose of SFIL's permanent control function, excluding compliance, is to ensure the reliability of the risk control system, the efficiency of the transaction and internal procedure control system, the quality of accounting and financial information and the quality of IT systems.

The permanent control system, excluding compliance, applies to all of the Company's divisions, activities and processes. It is managed by the Operational Risks and Permanent Control division in such a way as to maintain synergies with the operational risk management, IT security and business continuity systems. This system relies both on a network of correspondents within the operating divisions, which are responsible for carrying out and monitoring certain controls, and on the Operational Risks and Permanent Control division, which steers the system and carries out a number of second-level controls.

The Operational Risks and Permanent Control Committee is chaired by SFIL's Deputy Chief Executive Officer and composed of all members of its Executive Committee. The Chairman of Caisse Française de Financement Local's Executive Board also takes part. This committee meets quarterly to review the monitoring, completion and adaptation of the permanent control plan: control evaluation results, monitoring of action plans, additions, deletions or changes in controls and review of these controls' frequency. It gives an opinion on the main issues related to the permanent control system and on ways to improve it.

8.1.4.2. Activities

The management principles governing permanent control, excluding compliance, are described in the management policy for operational risks and permanent control. Permanent control is based on a control plan covering SFIL's and Caisse Française de Financement Local's various divisions, activities and processes. These controls are determined in liaison with the operating divisions and are reviewed every year to adapt them to the SFIL Group's situation, by integrating:

- the results of controls carried out during the year (their adequacy in terms of the risks to be covered, their effectiveness, formalization and the relevance of the associated control points);
- the review of incidents raised;
- the results of the operational risk mapping by process;
- the recommendations of the Internal Audit division, the external auditors and the regulator;
- SFIL's new activities and processes.

As such, this continuous improvement approach makes it possible to develop the control plan by adapting existing controls, if necessary adding new controls and/or removing those that are no longer relevant to the Group's activities, processes or risks.

The Operational Risks and Permanent Control division and its correspondents carry out or evaluate controls within their scope as often as required based on the criticality of the underlying risks. This evaluation is documented by a commentary and supporting documentation. The results of the controls that the correspondents carry out or evaluate are reviewed by the Operational Risks and Permanent Control division, which has the option of validating the control or not, on a case-by-case basis, particularly if the control documentation is deemed insufficient. In the event the control results are unsatisfactory, action plans are systematically put in place to improve the result for subsequent periods.

Permanent controls are carried out at a frequency defined based on the criticality of the underlying risks.

8.1.4.3. Reporting

The accountable officers, the members of the Executive Committee and of the Board of Directors are kept regularly informed of permanent control activities through the Risk and Internal Control Committee. The same is true for the Executive and Supervisory Boards of Caisse Française de Financement Local.
The main points raised concerning permanent control system issues and areas for improvement are presented quarterly to the Risks and Internal Control Committee through the quarterly risks review.

The Risks and Internal Control Committee meeting of January 24, 2019 and the Executive Board meeting of February 21, 2019 were informed of the control results, focus points, corrective actions to be implemented and permanent control improvements achieved in 2018.

8.1.5. Second level of control: compliance control

8.1.5.1. Organization and governance of the compliance control

The SFIL's Compliance division is responsible for managing compliance risk, as defined in article 10 of the *arrêté* of November 3, 2014, for all of SFIL's and Caisse Française de Financement Local's activities. The aim of compliance risk management is to ensure compliance with:

- laws, regulations, professional conduct rules and directives;
- measures to protect the reputation of the Group, its investors and its customers;
- ethical rules relating to business practices, and measures to prevent conflicts of interest, protect customers' interests and maintain markets integrity;
- measures to combat money laundering, terrorism financing and corruption, as well as compliance with sanctions and asset freezing measures.

Pursuant to article 29 of the *arrêté*, SFIL's Compliance division is autonomous, independent of all operational units and particularly of any commercial activity. It reports to SFIL's General Secretary, Executive Committee member and designated compliance manager for relations with the ACPR. Reporting directly to SFIL's Chief Executive Officer, the General Secretary has direct and independent access to the company's Risks and Internal Control Committee and Board of Directors. The General Secretary also acts as the TRACFIN correspondent in connection with the bank's anti-money laundering and financing of terrorism obligations.

8.1.5.2. Compliance control system

To ensure that the system for managing SFIL's and Caisse Française de Financement Local's activity-related compliance risks is effective, the Compliance division implements a control plan aimed at containing compliance risks.
The Compliance division implements and documents compliance controls in accordance with the control plan approved by SFIL's Executive Committee, Risks and Internal Control Committee and Caisse Française de Financement Local's Executive Board. At the beginning of the year, any dysfunctions or non-compliance identified as a result of the control plan are systematically the subject of specific action plans assigned to the divisions in charge of implementing remediation actions. The Compliance division monitors overall progress on these action plans.

At least once a year, the Compliance division sets about changing the compliance risk mapping and the resulting control plan to take into account changes in SFIL's activity and those arising from the entry into force of new regulations. The methodology for rating "gross" and "net" compliance risks is identical to the internal audit methodology. The updated compliance risk mapping and control plan are submitted every January for approval by the Risks and Internal Control

Committee. The 2019 compliance risk mapping and control plan were presented to and approved by the Risks and Internal Control Committee on January 24, 2019. Caisse Française de Financement Local's Executive Board was also informed of the updated control plan and compliance risk mapping on February 21, 2019.
Compliance controls are carried out at a frequency defined based on their criticality.

The compliance control scope does not extend to the control of compliance with rules outside the banking and financial sphere (labor and social security law, regulations regarding personal and property security, etc.), which other divisions are responsible for monitoring.

Lastly, the Compliance division uses various internal tools to report shortcomings, breaches and malfunctions: a network of compliance correspondents, a professional and ethical alert procedure and an incident reporting system.

8.1.5.3. Reporting

SFIL's and Caisse Française de Financement Local's accountable officers, the members of SFIL's Executive Committee and Board of Directors and of Caisse Française de Financement Local's Supervisory Board are regularly kept up to date with the compliance system. The Compliance division submits a semi-annual report to the Executive Committee, Caisse Française de Financement Local's Executive Board and the Risks and Internal Control Committee presenting the results of its activities and controls, including compliance control results, action plan monitoring, and the compliance risk mapping and annual control plan. The Executive Committee issues an opinion on the compliance system's main issues and broad areas for improvement.

Lastly, every year the Compliance division makes a presentation and submits an annual activity report to a special Risks and Internal Control Committee meeting excluding general management, to which the risk, compliance and periodic control officers contribute. In respect of the 2018 fiscal year, this presentation was made at the Risks and Internal Control Committee meeting of January 24, 2019, and the Executive Board was informed of the compliance control results and improvements achieved in 2018 at its meeting of February 21, 2019.

8.1.6. Third level of control: periodic control

The periodic control of Caisse Française de Financement Local, which is ensured by SFIL, involves internal audit and inspection.

8.1.6.1. Organization and governance of the periodic control

Periodic control, in the sense of the *arrêté of* November 3, 2014, is exercised by the Internal Audit and Inspection division. This division's scope of intervention covers all of SFIL's activities, operational processes and systems without reservation or exception and including outsourced essential activities and anti-fraud procedures.
The independence and efficiency of the internal audit and inspection function are guaranteed by several factors:
- the General Auditor's direct reporting to SFIL's Chief Executive Officer;
- the absence of involvement in the operating management of SFIL's activities;
- unconditional, immediate access to all information, documents, premises, systems or persons its activities require;
- the resources made available by Executive Management to carry out these missions;
- the respect of the principles of integrity, objectivity, confidentiality and competence (through a permanent training plan to inculcate audit techniques and regulatory developments) on the part of the staff of the internal audit division.

These principles are reflected in the internal audit charter and the inspection charter, approved by the SFIL Risks and Internal Control Committee meeting of January 26, 2018, and distributed to all SFIL employees to remind them of the rights and duties of the auditors and the auditees.

The General Auditor of SFIL exercises a particular function concerning Caisse Française de Financement Local, as spelled out in article 5.8 of the management agreement between Caisse Française de Financement Local and SFIL. SFIL's Internal Audit division audits all of the transactions and procedures of Caisse Française de Financement Local. It also provides periodic control in Caisse Française de Financement Local's internal control.
It ensures that all the risks incurred by Caisse Française de Financement Local are covered by:
- the identification of these risks and the periodic evaluation of the internal control environment;
- the planning and accomplishment of internal audit missions;
- the coordination of regulatory authorities' audits;
- the follow-up on recommendations;
- investigations (preventive measures, awareness and detection of fraud).

The General Auditor has direct access to the Chairman of the Supervisory Board of Caisse Française de Financement Local.

As of January 1, 2019, the Internal Audit and Inspection division had nine staff (plus two alternates), including six auditors and audit managers. The General Auditor supervises all the division's audit activities and reports. She is assisted by a supervisor, who shares responsibility for the team of auditors and oversees the audit assignments that they carry out under the auspices of the audit managers. Meanwhile, every auditor and audit manager is responsible for a specific field, with duties covering permanent documentation, risk monitoring and the following up of recommendations for implementation by SFIL's operating divisions.

8.1.6.2. Internal Audit and Inspection division activities

Activities in this area are described in an internal audit brochure that is regularly updated and based on the reference framework of the professional internal audit practices of IFACI (Institut Français de l'Audit et du Contrôle Interne). The last update of this manual dates from June 2017. In addition, periodic control-related activities have been mapped in a dedicated major risk management process as part of the SFIL Group's structural, cross-cutting project to map all of its activities. As an extension of this mapping, indicators have been redesigned to regularly monitor the effectiveness and performance of the Internal Audit and Inspection division's activities. Optimization paths have also been identified and will be implemented in 2019.

Internal Audit and Inspection has adopted a top-down approach for the annual evaluation of risks, in line with the recommendations of the Institute of Internal Auditors. It is based on the identification of SFIL's objectives, then on a study of risks that are critical to the success of such goals.
In 2018, an annual assessment of risks was carried out in the second half and it gave rise to an update of the mapping of the major risks of SFIL and Caisse Française de Financement Local. This map was compared to the similar information culled in 2017. The results of this update and the objective of covering all of the SFIL Group's activities over a three-year cycle were used as the basis for the Internal Audit and Inspection division's proposed 2019 and multi-year audit and inspection plan. The Risks and Internal Control Committee approved this plan on January 24, 2019, followed by the Executive Board on February 21, 2019. The Supervisory Board also receives a yearly presentation on major risk mapping.

SFIL's multi-year audit plan, which is reviewed every year, is broken down into audit missions that are conducted throughout the year on the basis of a pre-established schedule and budget, depending on audit resources. These different missions include four main stages (preparation, accomplishment, conclusion and finalization). The audit methodology, which is based on IFACI methodology, was reviewed in terms of operating efficiency and in particular to focus on the significant risks identified within the audited scope. Audit missions are carried out using the methods described in a Company brochure on internal audits that is regularly updated. The latest update of this manual was in June 2018. A report on each audit assignment is submitted to SFIL's Executive Committee containing a general assessment of the audited theme and of residual risks, enabling the committee to validate their appropriateness to SFIL's risk profile. It also contains recommendations to improve the effectiveness of processes and internal controls. Caisse Française de Financement Local's Executive Board, meanwhile, receives a summary of audit assignments every six months.

In 2018, internal audit assignments focused on the following topics:
- the SFIL Group's core business (export credit transaction management);
- key operational processes (SFIL's and CAFFIL's bond issuance and management of critical activities after the simplification program);
- support processes (regulatory reporting, recruitment and mobility, internal and external communication, archiving practices and supervision of the outsourced essential service of physical and digital archiving);
- risk and internal model monitoring (annual and ongoing evaluation of internal models for credit risks and management of local government entity credit risks, including calculation of limits and consumption levels, the internal liquidity adequacy assessment process and the internal validation function for market risks).

The annual audit plan runs from February 1 of the reference year to January 31 of the following year. The 2018 audit plan was 91% completed as of its end-date, exceeding the initial objective of 80%. All audit assignments not completed by January 31, 2019, were completed in February 2019. These assignments' findings and recommendations were presented to the Executive Committee for discussion and decision, as well as to the Risks and Internal Control Committee and Caisse Française de Financement Local's Executive Board.

The follow-up on recommendations made after the missions organized by Internal Audit and Inspection, oversight bodies or the Company auditors, as is the case, is carried out in a continuous and automated process to monitor the deployment of action plans resulting from these recommendations. Responsibility for the appropriate implementation of the recommendations is incumbent on identified managers. The follow-up of this implementation is under the responsibility of the auditors and audit managers in function of their field of competence. The validation of the stage of progress or accomplishment of these action plans is the responsibility of the Supervisor and the General Auditor. All of these recommendations prompted continuous monitoring in 2018 and official reports based on the situations as of May 31 and October 31, 2018, as well as presentation to the Executive Committee (in July 2018 and January 2019), the Risks and Internal Control Committee on September 4, 2018, and January 24, 2019, and the Executive Board of Caisse Française de Financement Local on August 30, 2018 and February 21, 2019.

Internal Audit and Inspection is also in charge of the preparation, organization, and follow-up of the missions regulatory authorities carried out at SFIL. It also coordinates the preparation of responses to reports and the monitoring of action plans subsequent to the recommendations made.

In addition, under the aegis of the Chairman of the Financial Statements Committee and the Risks and Internal Control Committee, Internal Audit and Inspection ensured the organization of all the meetings of these committees. It oversees the respect of deadlines in the transmission and communication of information and files required for decision-making. It monitors the annual program of works set out by the Chairman of these committees. It also provides the minutes that are drawn up at each of the meetings in close cooperation with the Chairman of the committee. Lastly, it has responsibility for the safe storage of the minutes. In 2018, Internal Audit and Inspection organized five meetings for the Risks and Internal Control Committee and four for the Financial Statements Committee.

Finally, Internal Audit and Inspection is also in charge of inspection at SFIL. The purpose of this function is to play a role in the prevention, detection and investigation of fraud and to propose corrective measures in the event of dysfunctions. This unit may also respond to particular requests from the Company's legal division to provide information that may serve corporate interests. SFIL's Executive Management may also solicit the function of inspection to carry out missions and address certain specific issues. In 2018, the inspection function's controls focused on compliance with the rules governing SFIL's staff's use of its resources, access to sensitive computer directories and control of compliance with expense claims policies.

8.1.6.3. Internal Audit and Inspection division activity reporting

SFIL's Executive Committee is kept regularly informed of internal audit and inspection activities. In particular, the audit plan is presented every year for information after discussion with SFIL's Executive Management. Every audit mission is discussed (scope, objectives, planning, etc.) for information and commentary before it effectively takes place, and its conclusions are presented for discussion and decision via a report which comprises:
- a general assessment regarding the subject of audit;
- an evaluation of residual risks to enable the Executive Committee to validate their match with SFIL's risks profile;
- recommendations to improve the efficiency of processes and internal controls.

A report on the follow-up of the recommendations of internal audit, inspection, oversight bodies and statutory auditors as well as the implementation of related action plans is likewise presented every six months.

Moreover, the internal audit charter and the charter of inspection activities are submitted for validation to the Risks and Internal Control Committee. The audit and inspection plan is also submitted annually to this committee for validation. In addition, this committee is regularly informed of the results of the follow-up of recommendations by the internal audit and inspection functions, regulatory bodies and Statutory Auditors, and of the progress made in related action plans. Regular reports of activity are also presented for study. In addition, the annual report on internal control at SFIL and Caisse Française de Financement Local (articles 258 and following of the *arrêté* of November 3, 2014) is presented every year for review. A synthesis of these different reports is presented to SFIL's Board of Directors by the Chairman of the Risks and Internal Control Committee and to the Executive Board and the Supervisory Board of Caisse Française de Financement Local.

8.1.7. Specific Controller

The Specific Controller of Caisse Française de Financement Local is a French professionally certified auditor named by the Company's Supervisory Board. The Specific Controller carries out controls pursuant to articles L.513-23 and L.513-24 and articles R.513-15 and R.513-16 of the Monetary and Financial Code as well as CRBF standard 99-10. He is responsible for ensuring that the Company respects its exclusive corporate purpose and prudential standards. He conducts appropriate audits in cooperation with the statutory auditors and is completely independent vis-à-vis the Company's officers. He is also liable for the negative consequences of any error or negligence committed in the exercise of his functions. The Specific Controller has access to all information from management, internal control units and internal audit. In addition, operating services and internal control units have been instructed to provide specified information in order to allow the Specific Controller to monitor the over-collateralization ratio, the nature of assets, interest rate risk management, the gap in the average life of assets and privileged liabilities, coverage of cash needs over 180 days, and the coverage plan of privileged liabilities by the assets. For every Caisse Française de Financement Local issue contract or on the basis of a quarterly issuance program, he affirms compliance with legal and regulatory standards concerning the over-collateralization ratio of the privileged liabilities by the assets, once the issue has been settled. The Specific Controller certifies that the documents the Company sends to the ACPR meet legal and regulatory requirements for *sociétés de crédit foncier*. At the request of the Banque de France, the Specific Controller annually issues a certificate in support of the statement submitted by Caisse Française de Financement Local concerning the composition of the cover pool. He submits an annual report on his activity to the Supervisory Board of Caisse Française de Financement Local, and a copy is addressed to the Autorité de contrôle prudentiel et de résolution (ACPR).

8.2. PREPARATION OF ACCOUNTING AND FINANCIAL INFORMATION

8.2.1. Financial statements

A company's annual financial statements, in addition to all the financial data produced by the Accounting department should give a true and fair view of its assets, financial position and results. For credit institutions, the *arrêté* of November 3, 2014, on internal control highlights in its accounting chapter that the organization adopted should guarantee the existence of procedures called audit tracks. They make it possible to establish a link between accounting data and the original justification, and vice-versa. All these items should make it possible to reconstitute, justify and explain any and all financial items produced for accounting or regulatory purposes. This principle grounds the organization of accounting practices in the SFIL Group and also applies to both SFIL and Caisse Française de Financement Local.

2018 was marked by two major changes that impacted SFIL and Caisse Française de Financement Local:
- the overhaul of a large part of SFIL's information system with the implementation of a new market transaction management tool, as well as the provision of an overall data warehouse for all of the institution's activities;
- the effective implementation of the new IFRS 9 accounting standard for the publication of Caisse Française de Financement Local's financial statements under IFRS.

8.2.1.1. Role and organization of Accounting

Accounting data is produced at Caisse Française de Financement Local by the Accounting division of SFIL, within the framework of the management agreement between the two companies. Accounting division at SFIL reports to the Chief Financial Officer (CFO), who also oversees the Back-Office and Financial Performance Management divisions, including the oversight of balance sheets, management control and purchasing. Accounting division plays a central role in the piloting of SFIL and in financial management, thereby making it possible to benefit from this central viewpoint.

Accounting produces basic accounting data for the financial statements of Caisse Française de Financement Local. It is also responsible for producing the consolidated financial statements of the SFIL Group and, with the Risks division, ensuring all regulatory and prudential standards are respected.

The Accounting division is tasked with analyzing and verifying accounting data. It relies notably on the reconciliation of this data with that of the other Finance division units, in particular as regards the formation of results. This approach is also used to confirm the information on the Company's balance sheet, in particular risk database input data used to calculate prudential indicators.

To carry out its mission, the Accounting division sits on the main committees with a potential impact on its activity and has access to an extensive range of information, either directly or through the Chief Financial Officer. It participates actively in managing the technical development of IT systems, and relies on a cross-divisional team within the Technology and Organization division to improve, secure and ensure the sustainability of its IT system. The Technology and Organization division is notably in charge of accounting and regulatory as well as ALM and management control tools. Its role is to participate actively in the development and improvement of the systems used by SFIL's operating divisions. This system makes it possible to ensure continuous improvement in terms of process quality and efficiency and reliability of financial information.

8.2.1.2. Preparation of the financial statements

In the preparation of the financial statements, the accounting system of Caisse Française de Financement Local is in large measure automatically supplied by upstream management systems that manage transactions with customers and market counterparties as well as operating expenses. When data is entered into one of the management systems, it is automatically recorded in accounting according to a pre-defined plan, and complemented by manual entries for certain types of operations. Caisse Française de Financement Local can record operations in a single accounting system based on a double set of accounting standards (French GAAP and IFRS standards as endorsed by the European Union). The synthesis of this data is thus obtained automatically using parameterized publication tools.

The internal control system in the operating divisions guarantees the completeness and accuracy of accounting entries. The team in charge of accounting standards ensures compliance with standards, validates automated accounting procedures and examines complex or unusual operations. When certain operations can not be completely incorporated into the management tools available, they are processed using specific internal control procedures.

A first level of control is conducted by Accounting teams that are specialized by products, in particular by analyzing accounting/management data reconciliation, bank reconciliation and technical suspense accounts. Monthly comparisons with management data and reconciliations of micro-hedges make it possible to ensure the correct transcription of financial operations. In order to verify the coherence of interest expense and income from one period to another, this data is compared with average outstandings in order to produce average rates that are easier to compare from one period to the next. Finally, these teams also prepare a synthetic memorandum on the work done which points out areas that need attention and improvement for the processes to be used in future financial statements.

Complementary controls are carried out by other teams from Accounting at the monthly, quarterly and annual closings. Through specific reviews, the teams in charge of preparing the financial statements check the quality of the work done by the teams responsible for first-level control. These teams also reconcile the accounting data from Net banking income with management data produced by separate teams. This cross referencing is done at least once a quarter and consistency from one period to the next is verified using analytical controls. The main changes deserve an explanation. These analyses are synthesized in a quarterly report that is submitted to the Chairman of the Executive Board of Caisse Française de Financement Local. The efforts and resources deployed during the year made it possible to stabilize the management data collected both for the validation of the current period's results and for the estimates required within the framework of the forecasts prepared by the Finance division.

To ensure thorough implementation of its control plan, Accounting has a monitoring tool at its disposal with which it can verify the deployment of key controls and their validation. This information and any comments on discrepancies are subject to review by the head of Accounting with the main team members.

The preparation of the financial statements is carried out by the aggregation of the accounts thus produced according to an automated and standardized process. This function requires parameters administered by a dedicated and independent team. Stability in reporting, which represents a key point in terms of communication, is thereby verified. Notes to the consolidated and financial statements are generally produced based on accounting data that may be enhanced by management information. Qualitative analyses are then carried out through cross-referenced controls of synthetic data in accounting as well as with the contribution of the teams in charge of monitoring the Group's balance sheet. Cross-referenced controls are also conducted between the financial statements and the notes to the financial statements. Throughout this process, reviews and controls are carried out according to the hierarchical delegations that exist.

8.2.1.3. Approval of the financial statements

The financial statements, balance sheet, income statement and notes are subject to particular scrutiny during the preparatory phase and in their final form by a delegated member of Caisse Française de Financement Local's Executive Board. The Executive Board of Caisse Française de Financement Local approves the yearly and half-yearly financial statements at a

meeting attended by the two statutory auditors and the accounting department. The principal issues in the period's management report are also examined on this occasion. These annual and half-year financial statements are subject to an audit and a review (respectively) by the statutory auditors.
The annual financial report is prepared by Caisse Française de Financement Local's Executive Board in liaison with units of SFIL, in particular the CAFFIL Coordination division, Accounting, Risks and the General Secretary. The Company's statutory auditors verify the information it contains. This document is presented to Caisse Française de Financement Local's Supervisory Board, and then to the annual shareholders' meeting.
The calling of shareholders' meetings and the right to attend such meetings are described in articles 27 and 28 of the Company's by-laws.

8.2.1.4. Publication of the financial statements of Caisse Française de Financement Local

This accounting and financial information is made public in several ways. In addition to the regulatory publication in the BALO, the half-year and annual financial statements, together with the corresponding management reports, are posted on the Internet site www.caffil.fr. Half-year and annual financial reports are posted on the Autorité des Marchés Financiers (AMF) through the NASDAQ regulatory information wire. Moreover, unaudited activity reports are drawn up to describe the situation as of March 31 and September 30. They are available to the public on the Company's Website.
Some of this information is also available, with differences in presentation, in the report on the quality of the assets that is submitted to regulatory authorities and posted on the Internet site of Caisse Française de Financement Local, in compliance with CRBF instruction 2011-I-07. Other information is also posted on the Website of the Company, as required by the Covered Bond Label.

8.2.1.5. Role of statutory auditors

Both SFIL and Caisse Française de Financement Local are audited by two auditing firms working together.

The statutory auditors review the financial statements only on a yearly and half-yearly basis. They are consulted throughout the process of preparation of the financial statements in order to ensure efficiency and transparency. In due diligence, they analyze accounting procedures and evaluate current internal control systems to determine the nature, period and extent of their controls of the principal areas of risk. They may make recommendations on internal control procedures and systems that could improve the quality of financial and accounting information produced. They have access to all memoranda and notes produced by staff that is in charge of accounting principles and standards, and they also review the accounting manuals, as well as the analyses conducted by the Accounting teams. They consult internal audit and inspection reports. They verify the consistency of the data in the management report with the accounting information, as well as the conformity of the management report and the financial statements with all the items they have reviewed and audited. Their contribution includes a review of all the agreements that are regulated. They provide an exhaustive and accurate summary of regulated agreements in the specific report they submit at the end of their annual mission. They employ due diligence to obtain reasonable assurance that the financial statements are free of any material misstatement.

8.2.2. Management reporting

The financial statements (balance sheet, off-balance sheet, income statement, cash flow statement and notes) that Caisse Française de Financement Local communicates to its shareholder and to the general public are completed by quarterly activity reports.
This management information also includes items related to loans originated by La Banque Postale and acquired by Caisse Française de Financement Local, as well as to the refinancing of large export credits and updates on the reduction of the sensitivity of structured loans. This data is accompanied by forecasts and evaluations of risks, which is directly supplied by the operating divisions or the Risks division before it is incorporated into the annual financial report. Their accuracy is therefore guaranteed by the internal control system of the divisions concerned.
New loans are granted solely in France as concerns LBP's marketing activity, as well as the business of refinancing large export credits and the efforts to reduce the sensitivity of structured loans. A geographic breakdown of borrowers who are French residents and those who are domiciled in another country is presented in the Management Report. Since SFIL both manages Caisse Française de Financement Local's activities and acts as a service provider for La Banque Postale, it has adopted analytical cost accounting to ensure proper billing of the financial services it renders.

9. Risks management

9.1 – OVERALL RISK MANAGEMENT SYSTEM

Because the Company is an issuer of covered bonds, the risks authorized for Caisse Française de Financement Local are strictly selected and limited. When the Company was created, a distinction was made between risks that are compatible and risks that are not compatible with the legal and regulatory framework of *sociétés de crédit foncier* and with the specific nature of Caisse Française de Financement Local's by-laws and its license granted by the Comité des établissements de crédit et des entreprises d'investissement (CECEI), now merged into the Autorité de contrôle prudentiel et de résolution (ACPR).
The criteria of the rating agencies define restrictions or limits for risks compatible with the Company's activity.
The general approach decided by the Executive Board of Caisse Française de Financement Local and applied in every unit of SFIL in charge of the operations concerned involves monitoring that:

- risks not compatible with the activity of Caisse Française de Financement Local are not taken by the Company or are eliminated from the start;

- risks compatible with the activity are maintained exactly within authorized limits;
- controls are defined by the Risks division and carried out by the front and middle offices of SFIL. The results of the controls are reported to the Executive Board of Caisse Française de Financement Local and any anomalies discovered during such controls are reported to the Supervisory Board. Finally, these results are transmitted to the Specific Controller and the data is made available for his review.

SFIL and Caisse Française de Financement Local have implemented a complete risk management system:
- to identify, monitor, manage and measure risks using specific methods;
- to decide on limits to be implemented;
- to decide on delegations to assign to the front office teams;
- to decide on the amount of provisions that are required;
- to inform the competent committees regarding changes in these risks, proactively warning them that a limit or threshold has been exceeded.

The level of risk that is acceptable for SFIL and Caisse Française de Financement Local is defined by Executive Management and the Risks Committee at SFIL, in line with the risk appetite of the two companies. It is then approved by the SFIL Risks and Internal Control Committee and finally by the SFIL Board of Directors. It is also approved by the Executive and Supervisory Boards of Caisse Française de Financement Local. Within this framework, policies have been defined for the entire scope as well as limits and rules for delegating decisions. The Risk Management division monitors these limits and, where appropriate, proposes measures to Executive Management to ensure compliance therewith.

A quarterly risks review is presented to the Risks and Internal Control Committee every quarter by the head of risks of SFIL. This review provides a synthetic view of the main risks at SFIL and Caisse Française de Financement Local and their development during the quarter (credit risks, market and balance sheet risks, operational risks) as well as changes in regulations over the period. Items concerning Caisse Française de Financement Local are also presented by the Executive Board to the Supervisory Board of Caisse Française de Financement Local.
All operations conducted by Caisse Française de Financement Local are subject to the control by different committees set up by SFIL. This oversight takes into account the particular rules and limits applicable to Caisse Française de Financement Local.

The Risks division relies on several committees, the missions and composition of which have been approved by the Risks and Internal Control Committee of SFIL. These committees may be cross-divisional – Risks Committee, Committee on the Validation of Methods and Models, New Products Committee – or specialized on credit risks, market risks and operational risks describe below.

The Risks Committee defines the risk profile of SFIL and Caisse Française de Financement Local, validates risk control dispositions and ensures their respect. In particular, it is in charge of defining delegations in the granting of credit and approving the risk policies of SFIL concerning all types of risks and the limits defined by the Risks division.

The Market Validation Committee is responsible for validating and implementing the Group's market risk and derivatives valuation models. The Credit Validation and Quality Control Committees are responsible for validating the internal rating systems used to calculate regulatory capital and the IFRS 9 impairment and economic capital models as well as their implementation.

The New Products Committee, chaired by the SFIL's Chief Risks Officer, examines all new products, management processes and transformation of a pre-existing product or process. It makes decisions in this respect. This committee also studies new products intended for financing, refinancing or hedging risks, as well as the development of any existing product or service to the extent that it substantially modifies the risk profile or the internal processes of the Company. It also determines and evaluates the risks of non-compliance connected to the creation or modifications of products or services based on the compliance opinion submitted to it.

9.2 – CAISSE FRANCAISE DE FINANCEMENT LOCAL'S MAIN RISKS

9.2.1. Credit Risk

9.2.1.1. Definition

Credit risk represents the potential loss that Caisse Française de Financement Local may incur as the result of the decline in a counterparty's solvency.

9.2.1.2. Organization and governance

The Risks division defines the policies, guidelines and procedures relating to credit risk. It is responsible for developing the decision-making process (principally the granting of loans) and the framework of delegations and for supervising the analysis and rating process. SFIL's Risks Committee and Caisse Française de Financement Local's Executive Board are responsible for final approval of the credit risk policies.

Within the framework of its surveillance of credit risk, the Risks division provides for:
- the definition of credit risk policies in conformity with the risk appetite of SFIL and Caisse Française de Financement Local;

- the definition of limits by type of counterparty setting the maximum exposure considered to be acceptable for o a specific counterparty ;
- the proactive monitoring of limits, which the Risks division may change at any time in function of trends in related risks;
- the definition of delegations by type of counterparty and the monitoring of respect for the rules governing the lending process;
- the management of the lending process both for new commitments and rescheduled loans through credit analyses and internal ratings (by using either the internal rating systems or expert advice);
- the monitoring of credit risk in all the portfolios of SFIL and Caisse Française de Financement Local (local public sector in France, international, bank counterparty, export credit, etc.) by generating credit analyses and reviewing ratings annually;
- the identification of assets with downgraded risks susceptible to be put on the watchlist;
- the proposal of specific collective impairment for the portfolio and the expected credit losses pursuant to the IFRS.

The Risks division is also in charge of maintaining and developing:
- internal rating systems for the French and Italian local public sector, for banks and sovereign;
- Pillar 2 models (economic capital).

The Risks division finally deals with statistical models linked to the different stress scenarios.

The Risks division relies on several specialized committees, as described below.
- The Credit Committee approves new commitments[1] by SFIL and Caisse Française de Financement Local (loans and market transactions) and the rescheduled loan agreements on the balance sheet of Caisse Française de Financement Local. Each file presented to the Credit Committee contains an independent analysis conducted by the Risks division. At each meeting, the Credit Committee is also informed of commitments made within the framework of delegations granted to the Risks division, to the Debt Portfolio Management division, the Treasury and Financial Markets division or the commercial teams of La Banque Postale. This committee meets on a weekly basis.
- The Watchlist Committee is in charge of monitoring assets kept under particular scrutiny because of the downgrade of risk. This committee meets quarterly.
- The Non-Performing Exposures and Forbearance Committee decides whether a loan should enter or exit default status, and classes arrears as either non-performing or technical. It also approves the list of counterparties with non-performing exposures and that of counterparties experiencing financial difficulties and subject to related forbearance. This Committee meets quarterly;
- Every quarter, the Impairment Committee sets the amount of excepted credit losses (ECL) for each of the three stages based on recovery scenarios that the Watchlist Committee determines for stage 3. It identifies as well potential losses and determines the cost of risk pursuant French GAAP standards;
- The Rating Committee ensures the proper application of the internal rating systems and the appropriateness of the rating processes. This committee meets quarterly. Although it is an integral part of the credit risk management process, the committee is organized by the head of the Validation Credit and Quality Control team, which reports directly to the head of Risks in order to guarantee the independence of the control process.

Moreover, within the framework of the purchase of assets by Caisse Française de Financement Local, the control of eligibility is organized at two successive levels.
- The CAFFIL Coordination division within SFIL pilots the process of asset acquisition and associated controls of eligibility prepared by the different divisions of SFIL; the definitive portfolio is validated by the Executive Board after solliciting the opinion of the SFIL's Credit Committee.
- The customer back-office division carries out permanent controls daily on outstanding assets.

These controls are standardized by procedures.

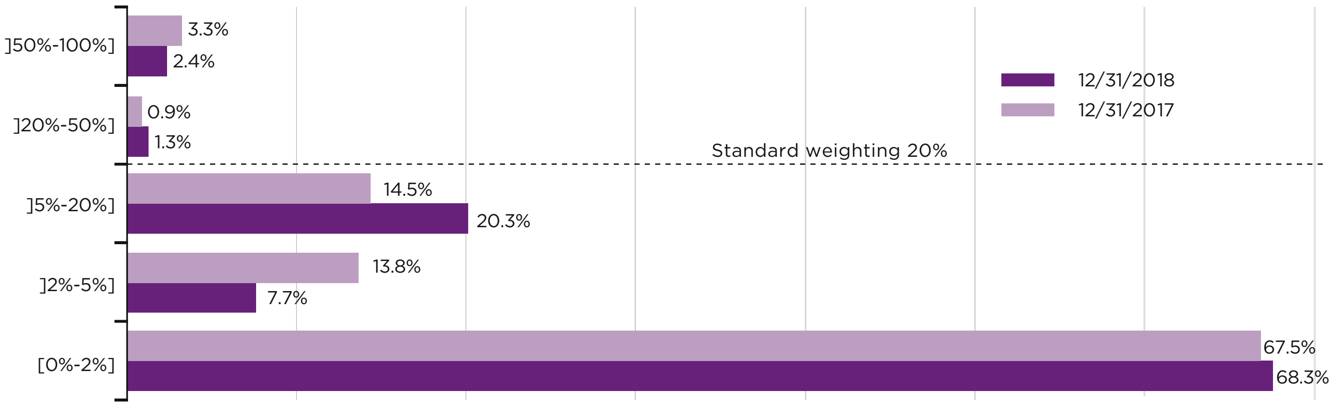
The Specific Controller also carries out regular, detailed ex-post checks on asset eligibility.

9.2.1.3. Breakdown of exposures according to risk weighting

The quality of Caisse Française de Financement Local's portfolio is illustrated by the risk weighting assigned to its assets (Risk Weighted Assets) for the calculation of the bank's solvency ratio. This reflects the fact that for most of its assets SFIL has opted for the advanced method of calculating regulatory capital requirements. Banking regulators authorized the Company to use the advanced internal models developed for the consolidated calculation and reporting of capital requirements for credit risk. The calculation of such weighting in particular combines the probability of default (PD) and loss given default (LGD) of the counterparty.
This enables Caisse Française de Financement Local to present an analysis of its exposure as of December 31, 2018, broken down by risk weighting, such as used for the calculation of capital requirements for credit risk.

(1) Except for commitments delegated to the Risks division, to the Debt Portfolio Management division, and the sales teams of La Banque Postale.

Risk weighting of Caisse Française de Financement Local's portfolio as of December 31, 2018



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

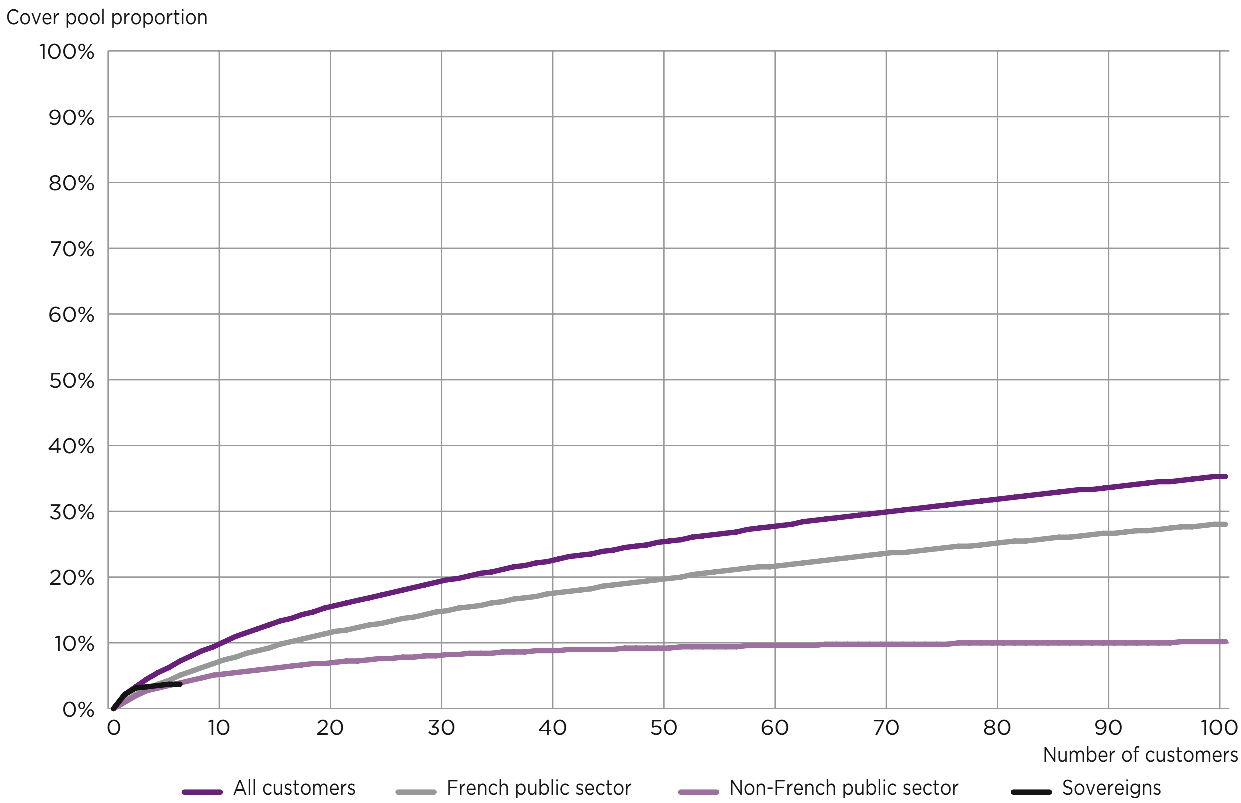
- 76% of the portfolio has a weighting of 5% or less;
- the average risk weighting of the cover pool assets is 6.1%, versus 20% for European local governments according to the Basel II/III standard method;
- less than 4% of the portfolio has a weighting of more than 20%.

The change in weightings since December 31, 2017 relates mainly to methodological changes within Caisse Française de Financement Local's internal rating systems and to the increase in the relative proportion of replacement assets.

Weighted exposure with respect to credit risk amounted to EUR 4,404 million. Including weighted assets associated with the credit valuation adjustment (CVA) volatility risk and with operational risk (there being no risk weighted assets associated with market risk), total risk weighted assets came to EUR 5,084 million. Combined with its high level of regulatory equity, the credit quality of Caisse Française de Financement Local's assets enabled the Company to post a phased-in Basel III solvency ratio of 25.6% as of December 31, 2018. The fully loaded Common Equity Tier 1 Ratio in Basel III was 25.0% as of December 31, 2018.

9.2.1.4. Concentration by customer

The risk of concentration refers to exposure to a limited number of counterparties. Diversification can make it possible to avoid this problem, and it is a risk management tool to protect from any loss in capital.
The chart below presents the concentration of cover pool by type of counterparty. It confirms the great diversity of Caisse Française de Financement Local's portfolio of assets.



As of December 31, 2018 the 20 largest exposures (excluding replacement assets and cash deposits in Central Bank), all categories combined, represented 16% of the cover pool (slightly higher than as of December 31, 2017 due in particular to the increase in refinancing loans for export credits fully guaranteed by the French State). The biggest exposure represented 2.1% of the cover pool and the 20th 0.4%.

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

Change in arrears

At the end of December 2018, arrears amounted to EUR 66 million, representing a decrease of nearly 3% from December 31, 2017 (EUR 68 million) and nearly 20% from December 31, 2016 (EUR 82 million).

	12/31/2016		12/31/2017		12/31/2018	
	Amounts EUR millions	**number of customers**[1]	**Amounts** EUR millions	**number of customers**[1]	**Amounts** EUR millions	**number of customers**[1]
Total arrears	**82**	**94**	**68**	**116**	**66**	**73**
Technical arrears	1	38	3	64	4	33
Default related arrears	81	56	65	52	62	40
of which less than 90 days	*0*	*4*	*0*	*-*	*0*	*5*
of which 90 days or more	*81*	*52*	*65*	*52*	*62*	*35*
of which doubtful loans (French Gaap)	*54*	*42*	*33*	*45*	*25*	*32*
of which litigious loans	*27*	*14*	*32*	*7*	*37*	*8*
of which vanilla loans	*8*	*24*	*5*	*27*	*3*	*24*
of which structured loans	*73*	*32*	*60*	*25*	*59*	*16*

(1) depending on each row, considering the customer in the category with its most long arrear, considering the customer as litigious if one of its loans is under litigation, considering the customer in the category with its most highly structured loan.

Unpaid outstandings are concentrated on a very limited number of counterparties, representing only 0.3% of Caisse Française de Financement Local's total number of customers. These counterparties are all located in France. Since the end of 2016, the number of customers with a dispute-related unpaid outstanding has decreased significantly due in particular to the success of the policy for reducing the sensitivity of sensitive structured loans.

Change in doubtful loans, litigious loans and provisions under French GAAP

As of December 31, 2018, doubtful and litigious loans (French GAAP) represented less than 0.7% of Caisse Française de Financement Local's cover pool (EUR 384 million), illustrating the portfolio's excellent quality. They were down 31% compared with December 31, 2017 (EUR 558 million). Non-performing loans and litigious loans correspond only to French customers.

Doubtful and litigious[1] loans comprise:

- EUR 347 million of receivables classified as doubtful, corresponding to loans granted to customers whose total unpaid outstanding amounted to EUR 25 million (including EUR 22 million on structured loans). When a customer is classified in default in terms of credit risk, the outstanding amount of all its loans is automatically classified as non-performing, by contagion, in addition to its existing past dues;
- EUR 37 million of receivables classified as litigious, corresponding to unpaid interest on loans subject to ongoing legal proceedings.

The table below shows the breakdown of non-performing and litigious loans by type of borrowers.

EUR millions	12/31/2017		12/31/2018	
	Doubtful loans	**Litigious loans**	**Doubtful loans**	**Litigious loans**
FRANCE				
State	-	-	-	-
Regions	52	-	51	29
Departments	-	23	-	-
Groups of municipalities	118	-	29	-
Municipalities	238	8	215	8
Public sector entities	118	1	52	-
TOTAL DOUBTFUL AND LITIGIOUS	**526**	**32**	**347**	**37**
of which arrears on structured loans	*28*	*32*	*22*	*37*
of which arrears on other loans	*5*	*-*	*3*	*0*

(1) A loan is considered as non-performing when it presents one of the following characteristics:
• a probable or certain risk that it will not be repaid (unpaid for more than nine months for local government borrowers, and for more than three months for other counterparties);
• the existence of a known counterparty risk (deterioration of the financial situation, alert procedure);
A loan is considered as litigious when it presents an unpaid claim and it is subject to legal proceedings.

The table below shows the total amount of provisions pursuant to French GAAP.

EUR millions	12/31/2017	12/31/2018
Specific provisions	36	27
Collective provisions	30	47
TOTAL	**66**	**74**

As of December 31, 2018, specific provisions under French standards amounted to EUR 27 million. The change in the amount of these provisions compared with December 31, 2017, is mainly due to the gradual positive impact of Caisse Française de Financement Local's structured loan sensitivity reduction policy.
In addition, collective provisions are calculated on the various asset portfolios. These provisions amounted to EUR 47 million as of December 31, 2018, compared with EUR 30 million as of December 31, 2017. This increase relates to:
- Caisse Française de Financement Local's decision to extend its collective provision calculation scope to include exposures similar to those used in IFRS 9 (this calculation change is estimated at EUR 7 million and was recorded under the Cost of risk);
- entries/exits from the watchlist scope decided in 2018.

Change in receivables and provisions under IFRS

Effective January 1, 2018, IFRS 9 introduced changes to the classification of Caisse Française de Financement Local's financial assets. As a reminder, this standard now only provides for three categories of financial instruments: 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 the instrument's contractual cash flows (see section 15.1.1. of the management report and section 1.1.2. of the financial statements under IFRS).

In accordance with the new IFRS 9, all loans and securities recognized at amortized cost or at fair value through other comprehensive income, as well as financing commitments, are provisioned for expected credit losses. They are classified into three 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.

Furthermore, loans whose contractual cash flow characteristics preclude them from classification at amortized cost are recognized at fair value through profit or loss. These loans are not impaired, however change in their fair value, recognized directly in profit or loss, includes a component linked to changes in credit risk.

Stage 3 outstandings correspond mainly to customers:
- with an outstanding unpaid for more than 90 days;
- whose financial situation has characteristics which could lead to conclude that, independently from the existence of unpaid amounts, to the existence of a probable credit risk (unlikely to pay);
- that were in a situation of real (i.e. non-technical) default and for which outstandings unpaid for more than 90 days were settled. After all unpaid outstandings have been settled and the default committee has formally decided to remove them from default status, they are kept at Stage 3 for a minimum period of one year, known as the "probation period";

The definition of default (Stage 3) under IFRS thus covers a wider scope than the concept of non-performing loans and litigious loans under French GAAP, and is very close to the regulatory concept of non-performing exposures (NPE), which, in addition to Stage 3 assets, includes non-performing assets that are recognized at fair value through profit or loss (i.e. non-performing assets classified as non-SPPI).

Provisions for expected credit losses are set aside for all of these outstandings, including Stage 1 and Stage 2 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).

The following table shows Caisse Française de Financement Local's financial assets and financing commitments broken down by Stage, IFRS provisions for associated expected credit losses, as well as regulatory non-performing exposures.

Breakdown of assets by stages and IFRS impairments	**Net carrying amount before impairments** EUR millions		**Impairments** EUR millions	
	1/1/2018	**12/31/2018**	**1/1/2018**	**12/31/2018**
Stage 1 : no significant deterioration	46,040	48,160	(6)	(5)
Stage 2 : credit risk deteriotation	5,441	6,225	(39)	(45)
Stage 3 : credit impaired	1,518	1,096	(11)	(10)
TOTAL SPPI ASSETS	**52,999**	**55,481**	**(56)**	**(60)**

	IFRS Net carrying amount EUR millions	
	1/1/2018	**12/31/2018**
Non-Performing Exposures	1,601	1,454

In 2018, both outstandings classified as non-performing exposures and Stage 3 outstandings decreased, reflecting the positive impact of Caisse Française de Financement Local's structured loan sensitivity reduction policy.

As of December 31, 2018, IFRS provisions for expected credit losses amounted to EUR 60 million and were relatively unchanged from January 1, 2018, as calculated under the first-time application of IFRS 9.

9.2.1.6. Bank counterparty risk

Counterparty risk refers to the risk of loss on an exposure linked to the default of a counterparty. It is naturally in function of the amount of the exposure, the probability of default on the part of the counterparty, and the portion of the loan that cannot be recovered in the event of default.

Caisse Française de Financement Local holds two types of exposure to banks:

- replacement assets in the amount of EUR 2.8 billion (see 4.2.2.);
- its derivative contracts, entered into within the framework of its management of interest rate and foreign exchange risks.

All of Caisse Française de Financement Local's derivative operations are conducted within the framework of standard ISDA or FBF (Fédération bancaire française) contracts with major international banks. These contracts have particular characteristics, since they must meet the standards set by rating agencies for *sociétés de crédit foncier* (and other issuers of covered bonds). In 2017, Caisse Française de Financement Local amended these contracts to take into account recent regulatory changes (signing of variation margin amendments). These interest rate and currency swaps all benefit from the same legal privilege as *obligations foncières*. For this reason, Caisse Française de Financement Local does not pay its derivative counterparties any collateral (or variation margin), whereas they have to pay Caisse Française de Financement Local except for some which benefit from the agencies' highest short-term rating.

At the end of December 2018, Caisse Française de Financement Local was exposed (positive fair value of the swaps) on eight bank counterparties, all of these paid cash collateral of EUR 0.5 billion, offsetting total exposure.

All derivative exposures as of December 31, 2018, are listed below.

EUR billions	Short-term notional amounts	Long-term notional amounts	% of long-term notional amounts	*Mark to Market*		Collateral received	Number of counterparties
				-	+		
SFIL	-	15.4	19%	(1.4)	-	-	1
Other counterparties	31.3	65.0	81%	(2.2)	0.5	0.5	26
TOTAL	**31.3**	**80.4**	**100%**	**(3.6)**	**0.5**	**0.5**	**27**

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

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

9.2.2. Market risk

9.2.2.1. Definition and scope of market risks

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

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

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

9.2.2.2. Market risk governance and monitoring

The governance of market risks revolves around the Market Risks Committee, which conducts a quarterly review of defined risk indicators (sensitivity, mark to market changes in structured swaps hedging the assets of customers in default, monitoring of the valuation of assets recognized at fair value through profit or loss or through other comprehensive income and of provisions for placement securities under French GAAP, monitoring of limits, monitoring of cash collateral received and monitoring of credit export activity indicators). This committee is also in charge of approving the policies, guidelines and procedures relating to non-regulatory market risks for submission to the Risks Committee.

The continuous monitoring of non-regulatory market risks is carried out by SFIL's Market and Balance Sheet Risks division, which is mainly responsible for:
- defining policies, guidelines and procedures related to the monitoring of market risks;
- defining limits;
- defining calculation and assessment methods for these risks;
- validating the valuation of derivatives for accounting purposes;
- carrying out daily controls of margin calls on derivatives (cash collateral);
- valuing balance sheet items (assets and liabilities);
- monitoring the valuation of currency swaps entered into to hedge refinancing loans for large export credits in USD not yet recognized under hedge accounting;
- monitoring the valuation of swaps that can no longer be classified under hedge accounting following the default of certain customers.

Control of non-regulatory market risks is carried out by monitoring sensitivity to market variables (the « Greeks »), which reflects instruments' fair value change in response to a standardized movement (or shock) in market variables.

Securities not offering an variable rate at outset that are recognized at fair value through other comprehensive income under IFRS or as placement securities under French GAAP are generally hedged by swaps. The securities portfolio's residual risk is therefore limited to credit spread risk, with the Market and Balance Sheet Risks division calculating the impact recognized as a result of changes in the issuers' credit spreads.

It also monitors accounting valuation adjustments on derivatives (CVA and DVA) every quarter.

9.2.3. ALM risk

9.2.3.1. Governance

Balance sheet risk management is structured around three committees:
- the Asset-Liability Management (ALM) Committee, on which sit representatives of the Finance division's ALM unit, the Market and Balance Sheet Risks division and the other bank business lines concerned by this management, determines the strategy for managing balance sheet risks and ensures that it is correctly applied by monitoring management indicators;
- the Interest Rate ALM and Liquidity ALM committees prepare information for the ALM Committee and are responsible for implementing its decisions operationally.

The Finance division's ALM unit is responsible for implementing the ALM policies defined for SFIL and Caisse Française de Financement Local in compliance with the relevant management limits and regulatory framework.
The Market and Balance Sheet Risks division is in charge of defining the balance sheet risk management policy, calibrating and monitoring the limits on ALM indicators and performing second-level controls on most of these indicators.

9.2.3.2. Liquidity risk

Definition

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

Liquidity risk management

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

Caisse Française de Financement Local has two main types of liquidity need:
- financing of the assets that cover the *obligations foncières* it issues;
- financing of the liquidity requirements related to compliance with regulatory ratios, specific *sociétés de crédit foncier* ratios and the rating agency methodologies used to meet a rating target.

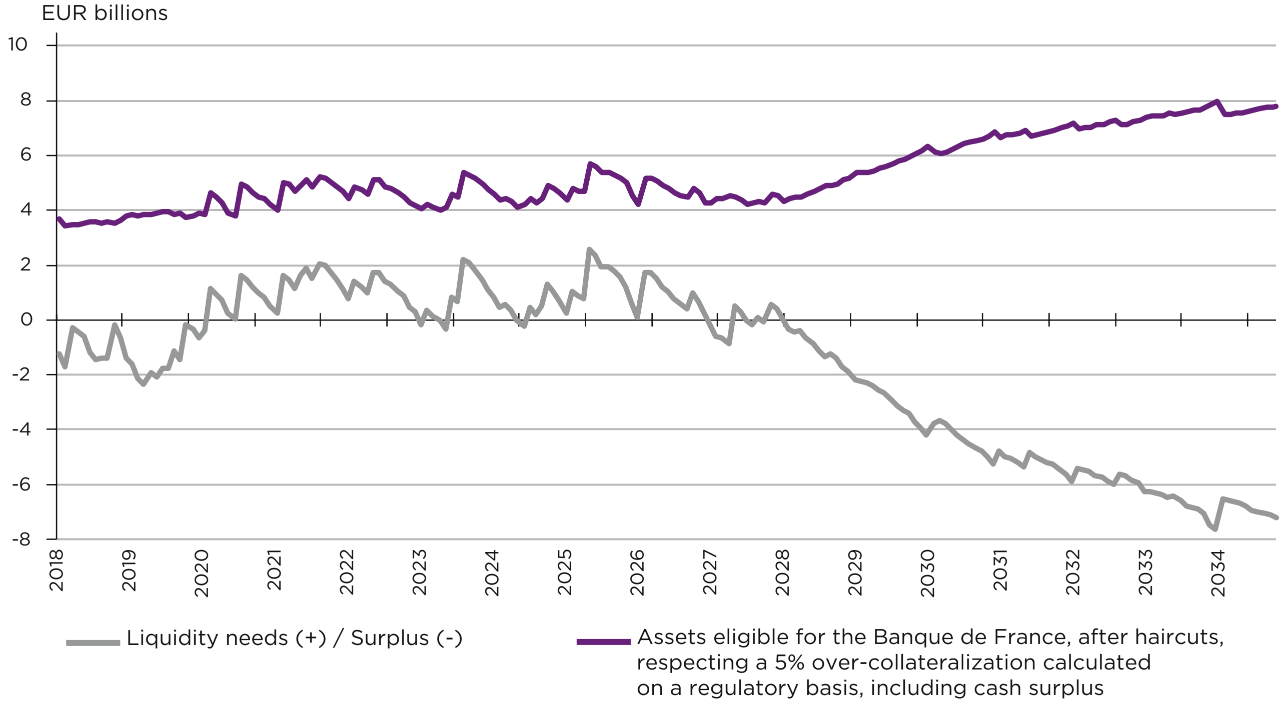
The sources of financing used to meet these requirements, other than the entity's equity, are:
- debt benefiting from the legal privilege, i.e. *obligations foncières* and registered covered bonds and the cash collateral received by Caisse Française de Financement Local ;
- refinancing arising from the loan agreement entered into with SFIL to cover the financing requirements related to Caisse Française de Financement Local's over-collateralization.

Furthermore, Caisse Française de Financement Local has a large stock of assets eligible for European Central Bank refinancing via the Banque de France. In addition to access to the central bank in its own name, Caisse Française de Financement Local can also mobilize certain of its assets by using interbank financing in the form of repurchase agreements. If necessary, these transactions would easily cover its cash flow requirements. There were no transactions of this type in 2018.

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

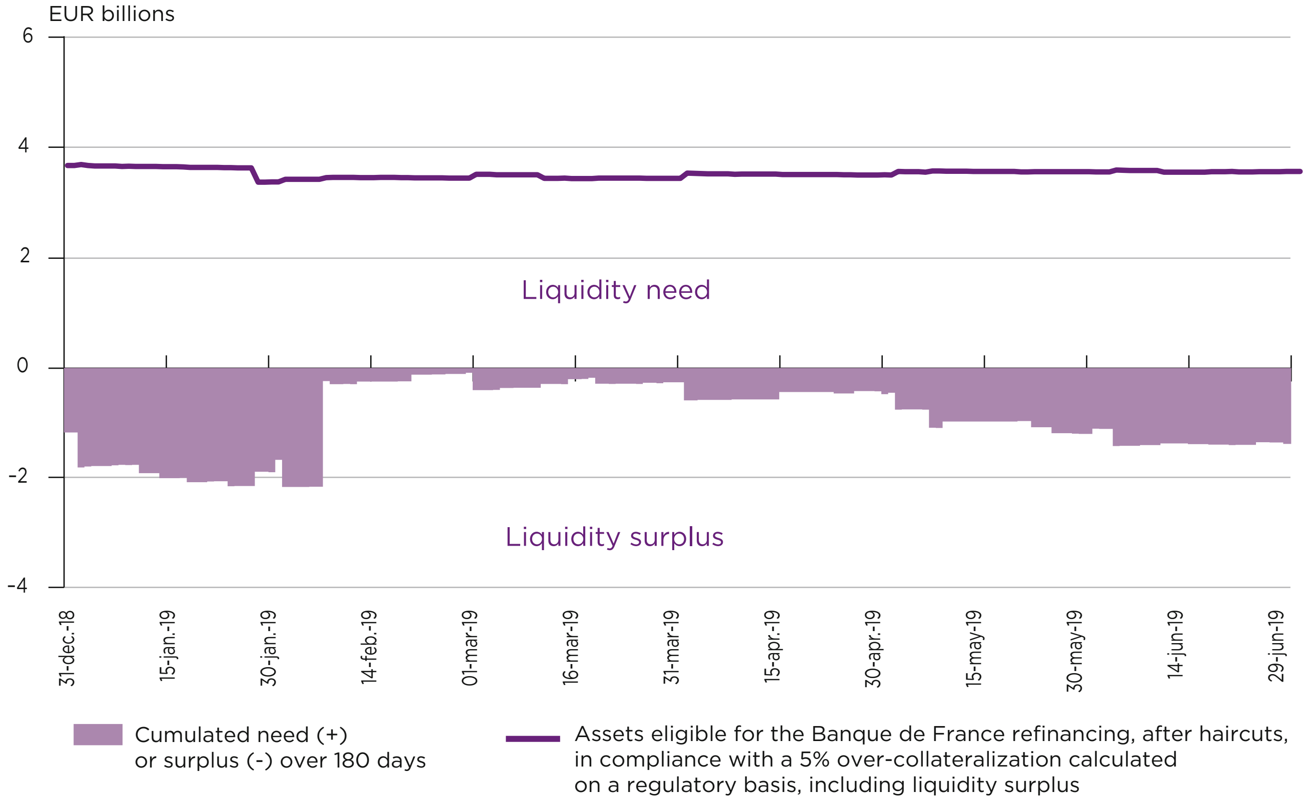
The aggregate maximum liquidity requirement that Caisse Française de Financement Local could face in the future in a run-off situation in which it was unable to issue new *obligations foncières* is lower than the maximum funding already occasionnely obtained on a one-off basis from the central bank in the past. It is also lower than the Caisse Française de Financement Local's refinancing potential with the Banque de France, measured by the amount of eligible assets after haircut that would be available while complying with the minimum over-collateralization required by the regulations.

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



Caisse Française de Financement Local has its own autonomous resources that enable it to cover its temporary liquidity needs, even in the event of the default of its parent company, since any legal proceedings engaged for the bankruptcy or liquidation of its parent company cannot be extended to Caisse Française de Financement Local (article L.513-20 of the Monetary and Financial Code).

Meanwhile, Caisse Française de Financement Local manages its liquidity risk using the following indicators:
- Regulatory indicators specific to *sociétés de crédit foncier (SCF)*:
  - the regulatory coverage ratio (or over-collateralization ratio): this represents the ratio between assets and debts benefiting from the legal privilege, and must be at least 105% (see section 6.);
  - the maximum gap of 1.5 years between the average maturity of debt benefiting from the legal privilege and that of assets eligible to make up the minimum amount necessary to meet the regulatory coverage ratio (see the specific section on transformation risk below).
  - forecast cash needs at 180 days: Caisse Française de Financement Local ensures that, at any times, its cash needs over a period of 180 days are covered by replacement assets and assets eligible for Banque de France's credit operations. Cash needs include repayments of *obligations foncières* and registered covered bonds, debt not benefiting from the legal privilege and forecast repayments of cash collateral received, after deduction of cash flows from amortization of assets. This forecast is published quarterly in the Asset Quality Report, and is shown below. At the end of December 2018, there was a liquidity surplus for the whole period.



- The regulatory liquidity indicators applicable to credit institutions, in particular the liquidity coverage ratio (LCR). As of 31 December, 2018, Caisse Française de Financement Local's LCR was 603%.

- Internal liquidity indicators:
  - the management coverage ratio (or over-collateralization ratio), which targets an over-collateralization level consistent with the Caisse Française de Financement Local's target rating (see section 6.);
  - the difference in duration between assets and debts benefiting from the legal privilege (limited to three years): this is published every quarter and came to 0.26 year as of December 31, 2018 (see the specific section on transformation risk below);
  - the one-year survival horizon in stressed conditions;
  - the sensitivity of the net present value of the static liquidity gap adjusted for regulatory constraints (compliance with the LCR and the over-collateralization ratio);
  - the consumption of the spread and EUR/USD basis risk appetite by the various maturities of refinancing loans for large export credits.

Lastly, dynamic liquidity forecasts (taking into account new assets and refinancing assumptions) are carried out regularly in normal and stressed conditions, aimed at:
- defining the amounts and maturities of the various sources of financing that could be raised;
- assessing the capacity of Caisse Française de Financement Local and the SFIL Group to withstand a liquidity shock.

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

Transformation risk is part of liquidity risk. It corresponds to the differences in maturity between assets and the resources used to refinance them.
Caisse Française de Financement Local manages this risk using the following two indicators:
- Duration gap
- Weighted average life gap

Duration gap

The difference in maturity between assets and liabilities can lead to liquidity risk. As interest rate risk is controlled (see section 9.2.3.3.), Caisse Française de Financement Local ensures that asset and liability maturities match by keeping the difference in duration between assets and debts benefiting from the legal privilege to three years or less.
Given the method used to hedge interest rate risk (see section 9.2.3.3.), assets and debts benefiting from the legal privilege are all recognized at floating rates after swaps. Caisse Française de Financement Local's balance sheet thus appears to have a single loan opposite a single borrowing. Durations are calculated as follows: "sum of the periods, weighted by the cash flows and discounted at the zero coupon curve rate for the period (t), over the sum of cash flows discounted at the interest rate of the zero coupon curve for the period (t)":

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

The duration gap between the assets and the liabilities is closely monitored since it is sensitive to fluctuations in interest rates used to calculate the net present value and to significant changes in assets and liabilities.
The duration gap observed in practice remains under the three-year limit, as shown in the table below.

Duration in years	**12/31/2017**	**3/31/2018**	**6/30/2018**	**9/30/2018**	**12/31/2018**
Cover pool	7.44	7.64	6.71	6.82	6.78
Privileged liabilities	6.49	6.67	6.73	6.72	6.52
Gap in asset-liability duration	**0.95**	**0.97**	**-0.02**	**0.10**	**0.26**
Duration gap limit	3	3	3	3	3

Weighted average life gap

Changes in the gap in weighted average life can differ from the changes in the gap in duration over the same period, for the evolution in the duration gap is partly attributable to movements in the interest rate curve. The gap in the weighted average life of the cover pool and the liabilities benefiting from the legal privilege is presented below.

Weighted average life (in years)	**12/31/2017**	**3/31/2018**	**6/30/2018**	**9/30/2018**	**12/31/2018**
Cover pool	7.99	8.17	7.24	7.35	7.27
Privileged liabilities	6.93	7.12	7.19	7.19	6.96
Gap in asset-liability weighted average life	**1.06**	**1.05**	**0.05**	**0.16**	**0.31**

Regulatory limit

Current regulations impose a limit of one and a half years on the weighted average life gap between the cover pool, considered on the basis of the minimum amount required to satisfy the legal over-collateralization ratio of 105% and the resources benefiting from the privilege. Caisse Française de Financement Local respects this limit.

9.2.3.3. Interest rate risk

Definition

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

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

These risks are generally hedged using derivatives.

Hedging strategy

To limit its impact, interest rate risk is hedged in two stages by Caisse Française de Financement Local:
- In the first stage, all the assets and the liabilities benefiting from the privilege which do not naturally have a floating rate are hedged against Euribor until maturity as soon as they are recorded on the balance sheet. In practice, acquisitions of loan portfolios (in which the unit amount is generally small) are usually macro-hedged. Loans granted individually or bond issues can be micro- or macro-hedged. Hedging of assets and liabilities is more often obtained in using new interest rate swaps, but the same effect can also be obtained whenever possible by the cancelation of swaps of opposite direction.
- In the second stage, Euribor lending and borrowing flows (naturally or after hedges) are swapped against Eonia in order to eliminate the basis risk generated by differences in the tenor (Euribor 1, 3, 6 or 12 months) and the fixing risk due to refixing dates of reference indices that differ for the assets and the liabilities. The residual risk is managed using macro-hedges with a management horizon of one week.

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

Non-privileged debt is not concerned by these hedging operations. In fact, debt contracted by Caisse Française de Financement Local with its shareholder to finance over-collateralization is borrowed either directly with a Eonia index and does not need to be swapped, or with a Euribor index and thus finances assets also indexed on Euribor. Short-term debt owed the Banque de France with a fixed rate (if any) is not hedged, but finances fixed rate assets.
These different types of interest rate risk are monitored, analyzed and managed through the production of gaps (fixed rate, basis and fixing), and/or net present value (NPV) sensitivity indicators.

More specifically, the following indicators are produced in a static view:
- the fixed rate gap, which corresponds to the difference between balance sheet and off-balance sheet assets and liabilities for fixed rate transactions or transactions for which the rate has been fixed. This gap is calculated every month until balance sheet extinction;

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

Limits governing interest rate risk

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

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

Limiting directional risk

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

Directional risk
Total sensitivity

EUR millions	Limit	12/31/2017	3/31/2018	6/30/2018	9/30/2018	12/31/2018
SENSITIVITY	**(25)/25**	**1.5**	**(1.5)**	**1.7**	**(2.0)**	**0.9**

Measurement of the slope/rotation risk

The quarter-end sensitivity measurements are presented below.

Risk of slope between two distant points on the rate curve
Sum of sensitivities

EUR millions	Limit	12/31/2017	3/31/2018	6/30/2018	9/30/2018	12/31/2018
Short term	**(10)/10**	0.2	(7.1)	(4.3)	(5.5)	(5.8)
Medium term	**(10)/10**	(4.6)	(2.1)	(1.0)	(4.9)	0.0
Long term	**(10)/10**	3.1	5.6	4.6	4.6	2.5
Very long term	**(10)/10**	2.7	2.0	2.4	3.8	4.3

Risk of slope between two close points on the rate curve
Sum of sensitivities in absolute value

EUR millions	Limit	12/31/2017	3/31/2018	6/30/2018	9/30/2018	12/31/2018
Short term	**20**	11.6	11.5	8.8	10.3	9.2
Medium term	**20**	14.8	4.6	14.4	9.9	10.0
Long term	**20**	3.6	7.9	8.7	13.0	12.9
Very long term	**20**	6.9	10.5	10.8	14.1	13.3

The main risks identified and associated with a low interest rate environment are:
- exposure to a rapid normalization of rates;
- an increase in early repayments not offset by early repayment penalties;
- margin reduction.

Caisse Française de Financement Local has little exposure to interest rate changes and therefore to a rapid normalization of rates: it uses interest rate risk management indicators to manage and monitor exposure to the risks of both parallel and non-parallel shifts in the yield curve, including exposure to the risk associated with the sudden normalization of interest rates.

Caisse Française de Financement Local has little exposure to early repayment risk as almost all of its loan agreements contain early repayment penalty clauses.

Lastly, Caisse Française de Financement Local's business model, based on the refinancing of the local public sector and large export credits, is relatively insensitive to the low interest rate environment. In particular, because Caisse Française de

Financement Local does not take sight deposits, it is unaffected by the issue of transformation margin reduction in a low interest rate environment.

Outstanding derivatives

The strategies employed to hedge interest rate risk and foreign exchange risk are illustrated by notional outstanding swaps analyzed in the following table, broken down between external counterparties and an internal counterparty (SFIL), as of December 31, 2018.

Breakdown of outstanding swaps EUR billions	**Notional** Absolute value
Euribor against Eonia	
Macro-hedges	31.3
TOTAL SHORT-TERM SWAPS	**31.3**
Fixed rate swaps against Euribor	
Micro-hedges on covered bonds	41.0
Micro-hedges on loans and debt securities	20.8
Macro-hedges on loans	14.2
Subtotal	**76.0**
Currency swaps	
Micro-hedges on covered bonds	1.3
Micro-hedges on loans	2.6
Micro-hedges on debt securities	0.5
Subtotal	**4.4**
TOTAL LONG-TERM SWAPS	**80.4**

9.2.3.4. Foreign exchange risk

Definition

The foreign exchange risk is defined as the risk of a loss, linked to a change in the exchange rate of currencies vis-à-vis a reference currency. The reference currency of Caisse Française de Financement Local is the euro. The foreign exchange risk reflects a change in the value of assets and liabilities denominated in a currency other than the euro by reason of fluctuations of this same currency vis-à-vis the euro.

Hedging Strategy

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

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

9.2.4. Operational risk

9.2.4.1. Definition

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

Management procedures for operational risks apply to all of SFIL's divisions responsible for Caisse Française de Financement Local's management, activities and processes.

9.2.4.2. Organization and governance

SFIL has implemented an organization, procedures and a management system for monitoring and controlling its operational risks. The Operational Risks and Permanent Control division within the Risks division draws up the management policy to be used for operational risks, as well as the methods employed to identify and control them. It implements the operational risk management system, relying on a network of correspondents designated within each operating division. The correspondents' role is to collect operational incident data, assess risks and key risk indicators with the help of the relevant process managers and the staff of the Operational Risks and Permanent Control division. The involvement of the process managers and operating divisions strengthens the effectiveness of the operational risk management system, of which they are the primary guarantors.

The Operational Risks and Permanent Control Committee is chaired by SFIL's Deputy CEO and made up of the entire Executive Committee, including the Chairman of Caisse Française de Financement Local's Executive Board. It meets quarterly to examine operational incidents that have occurred in the past quarter and monitor risk prevention and system improvement proposals (permanent control excluding compliance control, operational risk management excluding compliance risk, IT security and business continuity). It reviews the major operational risks (excluding compliance risks) so identified and key risk indicators that have exceeded their alert threshold. It decides whether they are acceptable and what corrective measures should be taken, if any.

A quarterly presentation summarizing operational risk highlights, the quarterly risks review, is made to SFIL's Risks and Internal Control Committee and Caisse Française de Financement Local's Supervisory Board. Moreover, a detailed presentation of action plans, areas for improvement and corrective measures proposed or already implemented to limit operational risk excluding compliance risk is also made every year to this committee and Caisse Française de Financement Local's Executive Board. The most recent committee presentation was made on January 24, 2019, and that to the Executive Board on February 21, 2019.

9.2.4.3. SFIL's policy of operational risk

SFIL has opted for the standard method for calculating equity in respect of operational risk.

SFIL's policy for measuring and managing operational risks consists of regularly identifying and assessing its risk exposure and the existing mitigation and control systems to establish whether or not the level of residual risk is acceptable. The policy applied involves three main processes: the collection and reporting of operational incidents, the mapping of operational risks and the monitoring of key operational risk indicators. This system is complemented by an IT security management policy, a Recovery and Business Continuity Plan (RBCP) and, where necessary, insurance policies to cover specific risks.

9.2.4.4. Operational risk measurement and management

Collection of operational incidents

SFIL has defined an operational incident and loss collection process governed by guidelines and procedures. The systematic collection and analysis of operational incidents provides the information needed to assess SFIL's exposure to operational risk. This operational incident and loss collection process allows SFIL not only to comply with regulatory requirements but also to gather key data to improve the quality of its internal control system.

Various collection thresholds have been defined and communicated to SFIL's operating divisions. The threshold of the mandatory declaration for financial impacts is EUR 2,500. The identification and the analysis of the incidents are the responsibility of the operational risks correspondents with the support of the Operational Risks and Permanent Control division. To this end, SFIL uses a dedicated operational risk management tool and in particular a module for incident collection. In function of the results of this analysis, corrective or preventive measures are taken in order to reduce SFIL's exposure to operational risk.

Operational risk identification and assessment

Based on the incidents and losses collected, operational risks are mapped and the resulting mapping is regularly updated. This mapping is made for each SFIL operating division. The SFIL Group is also currently mapping its operational risks by process under a three-year plan to formalize its processes and activities, which launched in late 2016 and continued throughout 2018. It has defined four main types of activity (steering, asset acquisition, term-based asset-liability management, and resource provision) and 39 major bank processes within these broad categories, 36 of which are subject to formalization. As part of this plan, the Operational Risks and Permanent Control division is continuing to roll out its methodology for identifying and assessing operational risks, excluding compliance risk, as the processes are formalized. This is implemented in collaboration with the process managers and the operational risk correspondents of the divisions involved. As of end-2018, operational risk mapping had been completed for 19 processes. This methodology makes it possible to identify and assess the various process associated risks and their existing mitigation factors (systems or controls in place), to determine those risks' residual criticality to decide whether to accept them. If the identified operational risks' residual criticality is deemed material, corrective or improvement actions must be implemented (strengthening of systems, procedures and the permanent control plan, implementation of systems for monitoring and controlling risks, etc.). This new mapping of operational risks is being rolled out as SFIL's processes are formalized, and is gradually replacing the mapping of operational risks by division.

Monitoring of key operational risk indicators

The Operational Risks division has implemented key operational risk indicators and related warning thresholds. These indicators are used to continuously and dynamically monitor changes in operational risks. They signal any increase in the level of operational risk, decline in process performance or malfunctioning of the internal control system.

Definition and monitoring of action plans

The process managers define the actions to correct significant incidents, deficient controls or notable operational risks identified. The Operational Risks and Permanent Control division regularly monitors these action plans. This process makes it possible to continuously improve the internal control system and reduce risks over time.

IT security management

The Operational Risks and Permanent Control division set up a system with a policy and guidelines based on ISO standard 27000, which is applicable to all of SFIL's operating divisions. It is designed to protect information data from any attack on confidentiality, integrity or availability. This policy and these guidelines define the principles applicable by category of security as well as the roles and responsibilities of the different security players. It comprises operational rules, procedures, processes and operating tools, determined with the Technology and organization division, especially those involving the management of authorizations to access SFIL's IT applications and systems and regarding the respect of IT security rules.

Meanwhile, to improve existing systems a three-year information system security plan has been defined and is regularly monitored.

The systems implemented and changes therein are monitored quarterly by the IT Security and Business Continuity Plan Committee and validated by the Operational Risks and Permanent Control Committee.

Business continuity and crisis management

SFIL has developed a Recovery and Business Continuity Plan (RBCP). It comprises a set of measures and procedures designed to ensure, in various operational crisis scenarios including extreme shocks, that the services or other essential operational tasks that SFIL performs continue, if necessary temporarily or in degraded mode. It also provides for the pro-gramed recovery of these activities so as to limit the losses caused by operation in degraded mode. This plan is based on a business impact assessment that formalizes the needs of SFIL's operating divisions to enable them to restart and resume business based on their criticality.

The RBCP is based on the following three features.

- The operational business continuity plan, which is managed by the Operational Risks and Permanent Control division and documented in guidelines and operational procedures. This plan, these guidelines and procedures are regularly updated and tested. Disaster recovery sites have been selected for the Issy-les-Moulineaux and Lyon offices to enable the resumption and operational continuation of SFIL's activities. Tests on the functioning of these sites were carried out in April, in May and in June 2018.
- The IT disaster recovery plan, which is managed by the Technology and organization division and documented in guidelines and operational procedures. This plan is also regularly tested. Tests were carried out within this framework in 2018 on the new market transactions management tool, the new data warehouse and the Oracle technology.
- The crisis management system, which is managed by the Operational Risks and Permanent Control division. This system is governed by a crisis management operational procedure. A crisis unit has been identified and crisis scenarios based on identified extreme risks have been defined and are regularly tested. In particular, a transportation unavailability scenario associated with potential terrorist risk is tested three times a year. A crisis unit exercise, based on a specific scenario, was carried out in November 2018.

New developments in security and business continuity are monitored quarterly by the Information Systems Security and Business Continuity Plan Committee and validated by the Operating Risks and Permanent Control Committee.

Operational risks insurance

To reduce the potential financial impact of operational risks, SFIL has subscribed to several insurance policies. Targeted policies cover the liability of members of the Company's management bodies, professional liability and fraud, as well as multi-risks premises, IT equipment. It also has a policy to protect it from cybercrime. These policies cover SFIL and Caisse Française de Financement Local.

Security of means of payment

Caisse Française de Financement Local does not provide its customers with any means of payment and is not exposed to operational risks in this area.

9.2.5. Legal and tax risks

9.2.5.1. Definition

Legal risk is the risk of any litigation with a counterparty resulting from any misunderstanding, lack or insufficiency that may be attributed to the Company in the exercise of its activities.

9.2.5.2. Organization and monitoring

Caisse Française de Financement Local's monitoring of legal risks focuses on the prevention of litigation, the anticipation of legal developments and the respect of governance principles. The legal risk control is in particular under the responsibility of the SFIL's Legal division, which is part of the General Secretariat. In its capacity, the Legal division has a dual role:

- to advise other SFIL divisions so as to allow them to measure the legal risks inherent in their activities;
- to defend the interests of SFIL and Caisse Française de Financement Local.

Furthermore, the Legal division contributes to the work of various committees:

- Within the framework of its Regulatory Watch Commitee, it provides information on the principles underlying legal and regulatory provisions that affect the operations of SFIL and Caisse Française de Financement Local;
- Within the New Products Committee, it advises, as necessary, on the cases presented to it;
- It analyses legal risks associated with the cases presented for the Credit Committee;
- It reviews the cases under litigation and the progress of the procedures at the Loan Sensitivity Reduction Committee meeting. It also expresses its opinion when a loan sensitivity reduction operation involves a legal risk.

The Legal division may also participate in formulating the comments made as part of the audit and internal control operations.

The Board of Directors, Executive Management and Executive Committee of SFIL, as well as the Executive Board and Supervisory Board of Caisse Française de Financement Local receive regular updates on the progress of litigation. A management report regarding the lawsuits is presented at each supervisory board.

SFIL's Finance division is responsible for tax declarations and may consult the SFIL's General Secretariat for tax advice. SFIL relies notably on tax advisory firms of excellent repute for managing its tax risk.

Legal risk

As regards litigation, there were 18 borrowers with disputed structured loans as of December 31, 2018, compared with 25 as of December 31, 2017, 39 as of December 31, 2016 and 131 as of December 31, 2015.

Since SFIL's creation, 205 borrowers have dropped their claims against the Group. A highlight of 2018 was a Court of Cassation ruling on March 28 confirming the validity of the structured loans recorded on Caisse Française de Financement Local's balance sheet. Thus, since the entry into force on July 30, 2014 of the law on securing of structured loan contracts concluded by public sector entities, 39 court decisions have confirmed the validity of such contracts (27 Court of First Instance, 10 Appeal Court and 2 Court of Cassation judgments).

However, two court decisions were unsatisfactory for Caisse Française de Financement Local, being noted that these decisions relate to proceedings that are still ongoing.

As of December 31, 2018, to the best of Caisse Française de Financement Local's knowledge, there were no other governmental, legal or arbitration proceedings against it that could have a material impact on its financial position.

Tax risk

For the record, in 2015, French tax authorities undertook a tax audit about the corporate income tax paid for 2012 and 2013. Following the tax assessment, the tax authorities expressed their disagreement with the tax treatment of the following two points: the taxation in Ireland of the income from the Dublin branch of Dexia Municipal Agency, which was closed in 2013, and the deductibility of provisions for non-performing loans. In order to safeguard its rights to the disputed adjustment, in 2017 the tax authority initiated a tax audit relating to the consequences of its previous assessment of taxable income for the 2014 to 2016 fiscal years. The two points of disagreement resulting from the former tax audit (FY 2012 and 2013) still held. Caisse Française de Financement Local had set aside a tax provision to cover the eventuality of an unfavorable outcome. However, since 2016 Caisse Française de Financement Local has contested the tax authority's position on the results of the former branch in Ireland, presenting its case within the legal recourse framework provided for under current laws and regulations.

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

9.2.6. Risks of non-compliance

9.2.6.1. Definition

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

9.2.6.2. Organization and governance

The compliance system deployed within SFIL aims to reduce the risk of non-compliance with laws, regulations and internal procedures relating to:
- employee ethics and the prevention of conflicts of interest;
- the compensation policy, maintenance of the confidentiality of information and protection of personal data;
- protection of the integrity and transparency of financial markets;
- protection of customers' interests;
- financial security, in particular compliance with financial sanctions and asset freezing measures, and the fight against money laundering, terrorism financing and corruption.

The system is based on a shared responsibility between the operating divisions and the Compliance division: the operating divisions must integrate into their day-to-day actions compliance with laws and regulations, rules of good professional conduct and the SFIL Group's internal rules. The Compliance division is tasked with two main roles:
- advising and assisting the business lines so that they can perform their tasks in accordance with their professional and regulatory obligations and the SFIL Group's commitments;
- monitoring and assessing the adequacy and effectiveness of the compliance risk control and management system.

The Compliance division is placed under the authority of the General Secretary, who, in her capacity as Head of Compliance and member of the Executive Committee, is in turn placed under the direct authority of SFIL's Chief Executive Officer. The Legal division, the Governance and General Administration division and the Communications division also report to the General Secretariat, and provide active support to the Compliance division within the scope of their respective responsibilities. The General Secretary is responsible for relations with the supervisory authorities regarding compliance-related matters. SFIL's Compliance division is independent of all of its operational units and, in particular, any commercial activity.

More specifically, the Compliance division's work involves the following main tasks:
- defining and implementing the standards framework, i.e. policies and procedures falling within its scope of competence, and adapting and operationally implementing them in areas under its functional responsibility;
- drawing up procedures aimed at ensuring compliance with the laws and regulations applicable to banking activities, for compliance-related matters;
- drawing up and implementing a compliance training plan;
- analyzing projects to create or modify products or services and issuing compliance opinions, and, more generally, working on cross-functional projects with compliance implications and advising the other divisions;
- anticipating and helping to apply regulatory changes;
- carrying out divisional transformation and efficiency projects, particularly the transformation of tools in cooperation with the Technology and Organization division;
- monitoring compliance risks by producing half-yearly reports presenting highlights, points for attention and control results;
- mapping compliance risks and drawing up and implementing a compliance control plan;
- proposing action plans and/or remediating identified non-conformities;
- reporting to General Management, in collaboration with the Risks division and the General Secretariat, and monitoring relations with banking supervisors for compliance-related matters.

The compliance system's effectiveness is controlled at the highest level of the SFIL Group:
- SFIL's Board of Directors carries out a semi-annual review of the mechanisms for preventing and controlling compliance risks and the General Secretary reports twice a year to the Risks and Internal Control Committee, while Caisse Française de Financement Local's Executive Board and Supervisory Board are also kept regularly informed;
- in his capacity as member of the Executive Committee, the General Secretary is informed of projects that are subject to an Executive Committee decision and, on such occasions, may express the compliance function's opinion and report any dysfunctions observed.

9.2.6.3. Implementation of the compliance system

In 2018, the Compliance division continued its actions to improve its organization, systems and processes, with the aim of increasing its efficiency in order to comply with regulatory changes and the supervisory authorities' expectations and, in general, to establish a compliance culture in all the Bank's business processes. It accordingly contributed to the project to formalize the Bank's activities and processes. It also carried out certain tasks and initiatives aimed at strengthening the system's governance and non-compliance risk control in accordance with regulatory changes. The projects it pursued in this area were:
- adapting the general AML/CFT procedure to the latest regulatory developments, particularly those arising from the implementing decree of April 18, 2018, on the fourth directive's transposition ordinance designed to strengthen the French anti-money laundering and combating the financing of terrorism system;
- compliance with the GDPR with regard to personal data protection.

The division also continued its compliance system awareness-raising and training initiatives for all Bank employees, with the aim of strengthening its compliance culture.

Lastly, the Compliance division continued to provide support and advice to the Bank's General Management and business lines in order to manage as early as possible any compliance issues or obligations.

10. Commitments granted – commitments received

Financing commitments given as of December 31, 2018, are related to financing the SFIL's export credit activity, for EUR 6.3 billion. They correspond to contracts signed in the process of being drawn, for EUR 6.0 billion, and contracts in the process of being finalized and due to be signed in the coming months, for EUR 0.3 billion.

Commitments received consisted mainly of:
- the authorized overdraft in the current account as stipulated in the financing agreement signed with SFIL, for EUR 50 million;
- unconditional and irrevocable enhanced guarantees from the French State received in connection with the export credit refinancing activity, for EUR 7.4 billion;
- guarantees received on loans to customers, for EUR 2.4 billion.

11. Payment deadlines

In application of articles L.441-6-1 and D.441-4 of the Code of Commerce, Caisse Française de Financement Local must publish every year a breakdown of the balance of the monies it owes to suppliers by due date.
Caisse Française de Financement Local has a very limited number of direct suppliers, since its management is contractually entrusted to its parent company, in conformity with article L.513-15 of the Monetary and Financial Code. Caisse Française de Financement Local usually settles its bills as soon as they are recorded, and the balance of monies owed to suppliers is theoretically always zero. As of December 31, 2018, all supplier accounts were settled. The only supplier debt recorded corresponded to invoices not yet received.

(A) Classes of late payments	Arrears on invoices received by the closing date					
	0 day (for information)	1 to 30 days	31 to 60 days	61 to 90 days	91 days and more	TOTAL
Number of invoices concerned	-	-	-	-	-	-
Total amount of invoices concerned excluding VAT (EUR thousands)	-	-	-	-	-	-
Proportion of total amount of invoices received in the year	-	-	-	-	-	-

(B) Invoices excluded from (A) concerning litigious debt or debt not yet accounted for:	
Number of invoices concerned	-
Total amount of invoices concerned	-

Reference payment period: legal or contractual, generally 45 days.
Bank and related transactions are not included in the information on payment terms.

12. Research and development

Since the Company exercises no activity in research and development, no data related to this activity is mentioned in the financial statements.

13. Non-tax-deductible charges and expenses

In accordance with article 223 (4) of the French General Tax Code, no non-deductible expense or charge referred to in article 39–4 of the General Tax Code was made by the Company during the year.
General operating expenses considered as non-deductible following a definitive tax assessment (article 223 (5), article 39–5 and 54 (4) of the General Tax Code) are therefore zero.

14. Social, environmental and societal information

In application of article L.225-102-1 of the Code of Commerce modified by article 225 of law 2010-788 of July 12, 2010 (Grenelle 2 law) and decree 2012-557 of April 24, 2012, Caisse Française de Financement Local must communicate information on social, environmental and societal issues in the Management Report. Since Caisse Française de Financement Local has no salaried employees nor actual premises, social, environmental and societal issues do not apply to this entity.
Social, environmental and societal information concerning SFIL, which manages the activities of Caisse Française de Financement Local, is presented in its annual financial report and on its website.
Meanwhile, as part of the implementation of the SFIL Group's social and environmental policy and in order to diversify its sources of financing, CAFFIL has announced a "social covered bond" public issue project, which was implemented in February 2019. This issue is the first step in the SFIL Group's strategy to use "social" and "green" bond issues.

15. Income for the year

15.1 – INCOME ACCORDING TO IFRS

Caisse Française de Financement Local publishes its financial statements according to IFRS, as adopted by the European Union in order to allow for a better understanding and a better comparability of its financial statements by international investors.

15.1.1. 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 Caisse Française de Financement Local's activity is presented below.

15.1.1.1. 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[1]).

Most of the loans and securities listed as assets of Caisse Française de Financement Local 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, which results 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.

15.1.1.2. 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, Caisse Française de Financement Local 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.

15.1.1.3. Hedge accounting

Pending the entry into force of the future macro-hedging standard, Caisse Française de Financement Local has chosen to continue applying IAS 39 in this area.

15.1.1.4. Impacts associated with the first-time application of IFRS 9 and expected impacts on future results

The first-time application of IFRS 9 to Caisse Française de Financement Local'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	6,951
Financial assets SPPI recognized at fair value through equity	200
Financial assets SPPI recognized at amortized cost	52,743
TOTAL	**59,894**

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.

Impacts linked to the first time application of IFRS 9 on equity EUR millions	**1/1/2018**
Classification and measurement	86
Impairment	(9)
Hedge accounting	-
TOTAL BEFORE TAX	**77**
TOTAL AFTER TAX	**50**

Impact linked to the first time application of IFRS 9 on the CET 1 ratio (fully loaded) after prudential restatement basis point	**1/1/2018**
TOTAL	**126**

Lastly, IFRS 9 has an impact on future results due mainly to changes in the fair value of non-SPPI financial assets, which leads to increased income volatility. This standard therefore increases net banking income volatility in a way unrelated to Caisse Française de Financement Local's activity, as its business model involves holding all loans until maturity. Caisse

(1) *SPPI: Solely payments of principal and interest*

Française de Financement Local therefore decided to isolate this impact within so-called non-recurring items in order to restate it in the analysis of the Company's performance.

15.1.2. Net income for 2018

The income statement for 2018 is presented in a synthetic form as follows.

IFRS EUR millions	2017	2018	Change 2018/2017
Interest margin	185	128	
Net commissions	(12)	(7)	
Net result on financial instruments at fair value through profit or loss	(33)	36	
Net result on financial instruments at fair value through equity	-	0	
Net result due to derecognition of financial instruments at amortized cost	-	14	
Net result resulting from reclassification of financial assets at amortized cost to fair value through profit or loss	-	-	
Net result resulting from reclassification of financial assets at fair value through equity to fair value through profit or loss	-	-	
Net results on financial assets	16	-	
Other income and expense	0	0	
NET BANKING INCOME	**156**	**171**	**10%**
General operating expenses	(98)	(94)	
Taxes	(7)	(7)	
GROSS OPERATING INCOME	**51**	**70**	**37%**
Cost of risk	22	(4)	
INCOME BEFORE TAX	**73**	**66**	**(9)%**
Income tax	(32)	(4)	
NET INCOME	**41**	**62**	**51%**

As of December 31, 2018, net income was positive at EUR +62 million, compared with EUR +41 million as of December 31, 2017.

15.1.3. Income restated excluding non-recurring items

Income was strongly influenced by the following factors that should be mentioned in the analysis:

- the change in the fair value of financial assets classified as non-SPPI under IFRS 9 (see section 15.1.1.4.). This impact is recognized in the income statement under Net result on financial assets at fair value through net income and is restated under non-recurring items.

EUR millions	2017	2018
Fair value adjustment of non SPPI financial assets	-	(5)

- adjustments in fair value concerning hedges. The application of certain accounting standards or methods (see below) is a source of volatility in Net banking income as shown in the table below.

EUR millions	2017	2018
Fair value adjustments on hedging	(37)	0

For the record, since 2013, fair value adjustments have an effect on existing hedging transactions the Company uses to cover its interest rate and foreign exchange risks. These adjustments impacted asymmetrically the hedged item and its hedging derivative, although the Company applies strict financial hedging rules, and this factor was therefore the cause of major changes in Net banking income. It concerns mainly:
- fair value adjustments introduced by the standard IFRS 13: Credit Valuation Adjustment / Debit Valuation Adjustment (CVA / DVA);
- adjustment of fair value of derivatives that hedge the foreign exchange risk related to export credit refinancing loans denominated in USD, which in 2018, could not be formally documented as hedging derivatives before the foreign currency loans are recorded on the Company's balance sheet.

These adjustments in the accounting value are recorded in the income statement mainly in the item Net result of assets at fair value.

- the effect of changes in the income tax rate. It is reminded to the reader that Caisse Française de Financement Local has taken note of the reduction in corporate income tax to 25% as of 2022. To this end in 2017, it reduced its deferred tax assets and recorded a non-recurring expense of EUR -2 million in its accounts.

EUR millions	2017	2018
Ajustments of Defered tax assets	(2)	-

- the tax adjustment's positive impact (see section 9.2.5.2.). As of December 31, 2018, Caisse Française de Financement Local had settled the amounts owed relating to the adjustment, reversed the provisions in question and recalculated the associated deferred taxes, while keeping in its accounts the amount of the provision set aside in respect of sums not yet paid. These factors had a positive impact of EUR 14 million in 2018.

EUR millions	2017	2018
Tax adjusment effects	-	14

The recurring income statement for 2017 and 2018 is as follows.

EUR millions	2017			2018		
	Accounting income statement	Non-reccuring items	Recurring income statement	Accounting income statement	Non-reccuring items	Recurring income statement
NET BANKING INCOME	**156**	(37)	**193**	**171**	(5)	**176**
Opertating Expenses	(105)	-	(105)	(101)	-	(101)
OPERATING INCOME	**51**	(37)	**88**	**70**	(5)	**75**
Cost of risk	22	-	22	(4)	-	(4)
PRE-TAX INCOME	**73**	(37)	**110**	**66**	(5)	**71**
Income tax	(32)	11	(43)	(4)	15	(19)
NET INCOME	**41**	**(26)**	**67**	**62**	**10**	**52**

Restated for the non-recurring items mentioned above, Net banking income for the year fell from EUR 193 million in 2017 to EUR 176 million in 2018, a decrease of EUR 17 million. Net income for the year fell by EUR 15 million, from EUR 67 million in 2017 to EUR 52 million in 2018.

15.1.4. Analysis of recurring net income

The EUR 17 million decrease in Net banking income was due to an unusual event in 2017: a reversal of EUR 31 million of specific provisions following the refinement of the method for estimating recoverable flows from non-performing loans[1] had been recognized during the 2017 fiscal year; adjusted for this provision reversal, net banking income increased by EUR +14 million, mainly due to the improvement in Caisse Française de Financement Local's over-collateralization financing conditions.

The decrease in operating expenses between 2017 and 2018 was mainly driven by the decrease in taxes and duties as well as in expenses billed by SFIL. As a reminder, Caisse Française de Financement Local's operating expenses consist mainly of amounts that its parent company invoices for its operational management.

As of December 31, 2017, a significant provision reversal related to the success of Caisse Française de Financement Local's loan sensitivity reduction policy was also recognized in the Cost of risk.

There was a tax charge for the fiscal year of EUR 19 million; it notably reflects the non-deductibility of the contribution to the Single Resolution Fund.

15.2. INCOME ACCORDING TO FRENCH GAAP

Net income for the year 2018 is presented below in a synthetic manner.

French GAAP EUR millions	2017	2018	Var 2018/2017
Interest margin	127	150	
Net commissions	(12)	(7)	
Provisions and income on trading portfolio	0	-	
Provisions and income on securities	3	(9)	
Other income and expense	-	-	
NET BANKING INCOME	**118**	**134**	**14%**
General operating expenses	(98)	(96)	
Taxes	(7)	(5)	
GROSS OPERATING INCOME	**13**	**33**	**154%**
Cost of risk	22	(16)	
OPERATING INCOME	**35**	**17**	**(51)%**
Income (loss) on fixed assets	-	-	
Income tax	(5)	27	
NET INCOME	**30**	**44**	**47%**

(1) Within the framework of the successful policy to reduce the interest rate sensitivity in 2016 and the confirmation of legal decisions favorable to the bank, Caisse Française de Financement Local was able to hone, in a reasonable and prudent manner, the methods it uses to estimate the recoverability of flows of non-performing loans on its balance sheet. In particular, in order to account for the impact of the spread of payments, the implementation of this approach, which is in compliance with IFRS, makes it no longer systematically necessary to estimate the total amount of interest to account for hypotheses of future recovery. Thus, the net interest rate expense is improved through a recovery of provisions in the amount of EUR 31 million, recorded as of December 31, 2017.

The Company's business is piloted according to IFRS (as adopted by the European Union). The French GAAP financial statements are published in accordance with legal requirements and serve as a base to calculate income subject to corporate income tax.

Readers are reminded that following the transition from IAS 39 to IFRS 9, the accounting treatment under IFRS of early repayment penalties on loans and of associated hedging swap termination fees has converged with these items' accounting treatment under French GAAP. In accordance with IFRS 9, early repayments of Caisse Française de Financement Local's loans in connection with its sensitivity reduction measures result in derecognition of the original loan and recognition of a new loan, which results in recognition in net banking income of the surplus margin on the restructured loan (taking into account hedging impact) with reference to the market conditions observed when it was restructured. As a reminder, most of these transactions did not result in derecognition of the original loan under the previous standards as they complied with the 10% test provided for in IAS 39 AG 62. Under French GAAP, the early repayment penalty net of the associated hedging swap termination fees is also recognized in net banking income. However, there may still be a difference between, on the one hand, the surplus margin recognized under IFRS, which is calculated based on market conditions when the loan is restructured, and, on the other hand, the early repayment penalty recognized under French GAAP, which is generally calculated in accordance with the original loan's contractual provisions.
Furthermore, the accounting treatment of termination fees on hedging swaps designed to directly match assets with liabilities differs from the treatment applied in the financial statements prepared under IFRS. These swap termination fees are usually amortized in the IFRS financial statements, while under French GAAP they are generally recognized immediately in net banking income. This accounting treatment may lead to recognition of the results earlier than would a systematic amortization approach.
The methods used under French GAAP, which have not changed in the last two years, are described in the financial statements presentation and measurement rules in the notes to the annual financial statements, in the sections entitled Customer loans, Micro-hedging transactions and Macro-hedging transactions.

Net banking income increased year-on-year by 14%, or EUR 16 million, from EUR 118 million to EUR 134 million.
This increase reflected notably the growth in the interest margin, which increased by EUR 23 million, from EUR 127 million to EUR 150 million. This improvement was mainly due to Caisse Française de Financement Local's over-collateralization better financing conditions. As a reminder, the interest margin corresponds to the difference between income from assets and the cost of liabilities (hedged against interest rate and foreign exchange risks). It varies differently depending on whether it is presented in accordance with IFRS (economic presentation) or French GAAP (see above).
At the same time, net fee and commission income represented a charge of EUR 7 million, lower than the EUR 12 million charge reported in the year ended December 31, 2017.
Lastly, there was a EUR 9 million charge for provisions and income on placement securities, corresponding to an increase in provisions on these securities related to changes in their market value.

Operating expenses consisted mainly of amounts billed by the parent company for Caisse Française de Financement Local's operational management. The fall in operating expenses between 2017 and 2018 was mainly driven by the decrease in taxes and duties as well as in expenses billed by SFIL.

The cost of risk represented a charge of EUR 16 million in 2018, related to:
- a change in 2018 in the estimated collective provision calculation scope, for a charge of EUR 7 million, as a consequence of Caisse Française de Financement Local's decision to extend the collective provision calculation scope to include exposures similar to those used to calculate provisions under IFRS.
- entries/exits from the collective provision scope decided in 2018 representing a charge of approximately EUR 9 million.

Income of EUR 27 million was recorded in respect of income tax, corresponding to the tax expense related to the Company's results and the positive effects resulting from the tax dispute, given that as of December 31, 2018, Caisse Française de Financement Local had settled the related tax adjustment and recalculated the amount of the associated provision for sums not yet paid. These factors had a positive effect of EUR 39 million in 2018.

Net income accordingly increased from EUR 30 million in 2017 to EUR 44 million in 2018.

15.3. YIELD OF THE ASSETS

Article R.511-16-1 of the Monetary and Financial Code, introduced by the decree 2014-1315 of November 3, 2014, requires that in their annual financial report, credit institutions publish the yield of their assets, defined as the ratio between the net result and the total of the balance sheet. In 2018, this ratio equals +0.09% in IFRS and +0.07% in French GAAP.

16. Proposed allocation of net income

In previous years, Caisse Française de Financement Local has made the following distributions:

Year of distribution	Distributed from the year's income	Amount distributed EUR	Amount per share EUR	Number of shares
2000	1999	3,600,000	1.20	3,000,000
2001	2000	-	-	4,000,000
2002	2001	-	-	4,500,000
2003	2002	-	-	4,500,000
2004	2003	120,000,000	24.00	5,000,000
2005	2004	62,000,000	10.00	6,200,000
2006	2005	84,320,000	12.40	6,800,000
2007	2006	116,280,000	15.30	7,600,000
2008	2007	70,080,000	8.00	8,760,000
2009	2008	113,520,000	12.00	9,460,000
2010	2009	133,560,000	12.60	10,600,000
2011	2010	110,075,000	9.25	11,900,000
2012	2011	15,080,000	1.16	13,000,000
2013	2012	-	-	13,150,000
2014	2013	-	-	13,150,000
2015	2014	-	-	13,150,000
2016	2015	-	-	13,150,000
2017	2016	35,110,500	2.67	13,150,000
2018	2017	49,950,000	3.70	13,500,000

The Ordinary Shareholders' Meeting will be asked to distribute a dividend in the amount of EUR 40.5 million and to vote a resolution to allocate net income as follows (in euros).

ALLOCATION OF NET INCOME	EUROS
Net income for the year	**43,608,129.09**
Legal reserve (5%)	(2,180,406.45)
Income available	**41,427,722.64**
Retained earnings	1,909,851.11
Income available for distribution	**43,337,573.75**
Proposed dividends	(40,500,000.00)
Retained earnings after allocation	**2,837,573.75**

17. Additional information

First of all, as the terms of office of Fidus, Caisse Française de Financement Local's Specific Controller, and Eric Lebègue, its alternate Specific Controller, were due to expire, the Executive Board renewed their appointments for four years at its meeting of March 18, 2019.

Then, no significant event that influences the Company's financial situation has occurred between the closing date and the management report date.

18. Outlook for 2019

In 2019, Caisse Française de Financement Local and its parent company SFIL will aim to maintain their position as the recognized leader for their two activities entrusted by the French State:
- financing loans to French local government entities and public hospitals, within the framework of the system established with La Banque Postale;
- supporting French exporters by refinancing large export credits guaranteed by the State.

The operational implementation of the extension of the large export credit refinancing activity to projects of strategic interest for France is expected to come on stream in 2019. This new type of project will enable the SFIL Group to broaden its scope of intervention by financing international projects in which a French company operates not as an exporter but as a supplier, investor, operator, service provider or subcontractor. These projects will benefit from a new guarantee from the French State and may be refinanced by Caisse Française de Financement Local using the enhanced guarantee mechanism.

To cover its financing requirements, in 2019 Caisse Française de Financement Local plans to issue between EUR 4 billion and EUR 6 billion of *obligations foncières* with a long-dated average maturity, adapted to the profile of the assets financed. It will carry out this program mainly through a number of benchmark issues in euros and private placements adapted to the needs of its broad investor base. Meanwhile, as part of the implementation of the SFIL Group's social and environmental policy and in order to diversify its sources of financing, CAFFIL has announced a "social covered bond" public issue project, which was implemented in February 2019. This issue is the first step in the SFIL Group's strategy to use “social” and “green” bond issues.

Meanwhile, from a macroeconomic point of view, as in 2018, the Group will closely monitor two important contextual elements in 2019:
- developments in the regulatory environment and, in particular, the project to harmonize the national covered bond framework at European level;
- the degree of market volatility in an environment influenced by the winding down of quantitative easing initiated by the European Central Bank, Brexit-related measures and the geopolitical environment.

Lastly, the assessment of the project transfer to CDC of the control of SFIL, Caisse Française de Financement Local's parent company, announced by the State and CDC on November 15, 2018, will continue in 2019 and is expected to be completed at the same time as the changes to the shareholding structure of La Poste and CNP Assurances.
SFIL's shareholder base will remain - as today - fully public. Its shareholders will ensure that SFIL's financial solidity is preserved and its economic base protected, and will continue to provide it with the necessary support, in accordance with the applicable regulations.

Breakdown of cover pool as of December 31, 2018

EUR millions	12/31/2018					12/31/2017
	Direct exposure		Indirect exposure		Total	Total
COUNTRY	**Loans**	**Bonds**	**Loans**	**Bonds**		
France						
State:						
- export refinancing	-	-	1,101	-	1,101	218
- others	7	-	113	-	120	118
Banque de France	1,271	-	-	-	1,271	1,707
Regions	1,915	239	256	-	2,410	2,399
Departments	6,783	20	177	-	6,980	7,018
Municipalities	15,122	17	374	-	15,513	16,165
Groups of municipalities	11,434	77	136	-	11,647	11,172
Public sector entities:						
- health	6,104	58	-	-	6,162	6,219
- social housing	1,164	-	-	-	1,164	1,291
- others	851	154	1	-	1,006	1,119
Credit institutions	803	980	-	-	1,783	694
Subtotal	**45,454**	**1,545**	**2,158**		**49,157**	**48,120**
Germany						
Länder	-	275	-	-	275	275
Subtotal	**-**	**275**	**-**	**-**	**275**	**275**
Austria						
Länder	-	-	183	-	183	187
Subtotal	**-**	**-**	**183**	**-**	**183**	**187**
Belgium						
Regions	4	-	15	-	19	30
Public sector entities	49	-	-	-	49	54
Credit institutions	-	176	-	-	176	57
Subtotal	**53**	**176**	**15**	**-**	**244**	**141**
Canada						
Communities	100	-	-	-	100	161
Public sector entities	35	-	-	-	35	35
Credit institutions	-	96	-	-	96	-
Subtotal	**135**	**96**	**-**	**-**	**231**	**196**
Denmark						
Credit institutions	-	91	-	-	91	-
Subtotal	**-**	**91**	**-**	**-**	**91**	**-**
Spain						
State	-	125	-	-	125	200
Regions	-	50	-	-	50	65
Municipalities	73	-	-	-	73	80
Credit institutions	-	-	-	-	-	-
Subtotal	**73**	**175**	**-**	**-**	**248**	**345**

EUR millions	12/31/2018					12/31/2017
	Direct exposure		Indirect exposure		Total	Total
COUNTRY	**Loans**	**Bonds**	**Loans**	**Bonds**		
United States						
Federated States	-	253	-	-	253	253
Subtotal	**-**	**253**	**-**	**-**	**253**	**253**
Italy						
State	-	535	-	-	535	543
Regions	-	1,912	-	-	1,912	1,975
Provinces	-	479	-	-	479	522
Municipalities	7	1,726	-	-	1,733	1,851
Subtotal	**7**	**4,652**	**-**	**-**	**4,659**	**4,891**
Japan						
Municipalities	-	25	-	-	25	25
Subtotal	**-**	**25**	**-**	**-**	**25**	**25**
Norway						
Credit institutions	-	222	-	-	222	70
Subtotal	**-**	**222**	**-**	**-**	**222**	**70**
Netherlands						
Credit institutions	-	95	-	-	95	-
Subtotal	**-**	**95**	**-**	**-**	**95**	**-**
Portugal						
State		10		-	10	-
Municipalities	14	-	-	-	14	17
Public sector entities	4	-	-	-	4	5
Subtotal	**18**	**10**	**-**	**-**	**28**	**22**
United Kingdom						
State		-		138	138	232
Credit institutions	-	216	-	-	216	-
Subtotal	**-**	**216**	**-**	**138**	**354**	**232**
Sweden						
Municipalities	18	-	-	-	18	18
Credit institutions	-	122	-	-	122	100
Subtotal	**18**	**122**	**-**	**-**	**140**	**118**
Switzerland						
Cantons	257	-	6	-	263	303
Municipalities	335	-	-	-	335	493
Public sector entities	60	-	-	-	60	90
Subtotal	**652**	**-**	**6**	**-**	**658**	**886**
Supranational						
International organizations	24	-	-	-	24	28
Subtotal	**24**	**-**	**-**	**-**	**24**	**28**
TOTAL COVER POOL	**46,434**	**7,953**	**2,362**	**138**	**56,887**	**55,789**

Loans and securities are off premium / discount. Loans and securities denominated in foreign currencies are recorded at their euro swapped value. Loans and bonds are presented after specific impairments. In addition to these impairments, Caisse Française de Financement Local makes collective and sectorial impairments.

Income for the last five years

	2014	2015	2016	2017	2018
FINANCIAL POSITION					
Share capital (EUR millions)	1,315	1,315	1,315	1,350	1,350
Number of shares	13,150,000	13,150,000	13,150,000	13,500,000	13,500,000
RESULTS OF OPERATIONS (EUR MILLIONS)					
Revenues(1)	1,177	2,172	2,476	575	542
Income before income tax, amortization, depreciation and contingencies net of reversals	63	71	86	14	18
Income tax	(9)	(96)	(16)	(5)	(27)
Income after income tax, amortization, depreciation and contingencies net of reversals	8	(30)	67	30	44
Exceptional distribution	-	-	-	-	-
Dividend(2)	-	-	35	50	41
PER SHARE DATA (EUR)					
Revenues	89.54	165.16	188.28	43.72	40.15
Income before income tax, amortization, depreciation and contingencies net of reversals	4.12	(1.92)	5.37	0.64	3.30
Income tax	(0.69)	(7.34)	(1.19)	(0.40)	(2.00)
Income after income tax, amortization, depreciation and contingencies net of reversals	0.59	(2.30)	5.08	2.26	3.23
Exceptional distribution	-	-	-	-	-
Dividend per share(2)	-	-	2.67	3.70	3.00

(1) Revenues are comprised of the macro-hedging items:
- *interest and related income, netted of macro-hedging expense;*
- *commision income;*
- *net income on foreign exchange transactions;*
- *other comprehensive income.*

(2) Dividends paid in respect of the 2016 and 2017 fiscal years and proposed dividend distribution for the 2018 fiscal year.

Report on corporate governance

prepared in accordance with article L.225-68 of the Code of Commerce

This report presents Caisse Française de Financement Local's governance, detailing notably the role and composition of its Supervisory Board and Executive Board, and the compensation of members of management and supervisory bodies.

To prepare this report, Caisse Française de Financement Local refers to:
- the Code of Commerce, as a commercial company;
- the Monetary and Financial Code, as a credit institution;
- relevant European regulations for credit institutions;
- the provisions of the ordinance of August 20, 2014, on the governance and operations on the equity of companies with public sector shareholders.
- the governance provisions adopted by its parent company SFIL, which opted to refer to the AFEP/MEDEF code of corporate governance as a reference for the SFIL Group.

This report was drawn up by Caisse Française de Financement Local's Supervisory Board which gathered the appropriate information from the Company's Executive Board and its parent company's General Secretariat.

Caisse Française de Financement Local has two main missions, as follows:
- to refinance public sector loans within the framework of funding French local governments and public hospitals;
- to grant loans to SFIL in order to fund large export credits within the framework set up by the French State. Such refinancing benefits from an irrevocable and unconditional 100% guarantee by the French State.

These two activities are based on the issue of *obligations foncières* and use of other financial resources benefiting from the same privilege. The objective is to provide optimal financing conditions for large export credits as well as French local governments and public hospitals through a high rating and irreproachable risk management.

For the record, Caisse Française de Financement Local is a legally independent company with its own Supervisory Board and Executive Board. However, in order to preserve the privilege enjoyed by holders of *obligations foncières* and other privileged debt securities, the law stipulates that a *société de crédit foncier* is not allowed to employ staff directly and must entrust the management of all its operations to a credit institution with which it signs an agreement (article L.513-15 of the Monetary and Financial Code). This is because employees would have a priority that would supersede any other claim in the event of bankruptcy or liquidation, whereas the management agreement, which benefits from the privilege granted by the law on *sociétés de crédit foncier*, is *pari passu* with the holders of *obligations foncières* and other privileged debt securities. Caisse Française de Financement Local has entrusted the management of its operations to SFIL, since 2013. There are divisions or departments at SFIL that handle transactions conducted in the name of Caisse Française de Financement Local.

1. Caisse Française de Financement Local's Governance

Caisse Française de Financement Local is a *société anonyme à directoire et conseil de surveillance*, a joint-stock corporation with an Executive Board and a Supervisory Board, governed by the provisions of articles L.210-1 *et seq* of the Code of Commerce. Its activity is governed by articles L.511-1 *et seq* (credit institutions) and L.513-2 *et seq* (*sociétés de crédit foncier*) of the Monetary and Financial Code.

In terms of governance, Caisse Française de Financement Local implements, for the areas relating to it, the provisions of its parent company that refer to the AFEP/MEDEF code. Since 2017, the Supervisory Board has maintained an even gender balance while ensuring that its members have training and professional experience that complements the development of the Company's activities. The Board's members are qualified experts in the Company's main areas of activity as a *société de crédit foncier*. In addition, in 2018 the Supervisory Board implemented a succession plan for corporate officers in accordance with the recommendations of the AFEP-MEDEF Code.
However, some deviations from good governance practices remain.

Thus, the absence of independent members on its Supervisory Board reflects a choice related to the status and role conferred on Caisse Française de Financement Local under arrangements for the SFIL Group's refinancing of the French public sector and exports, as well as to the Company's shareholder structure. In addition, Caisse Française de Financement Local is wholly owned by SFIL, a public development bank that complies with the rules relating to the independence of members of its Board of Directors. Also, as a result of this organization and the company's shareholder structure, it does not implement the recommendations relating to the number of shares held by members of the Board of Directors and to the convening at least once a year of a Supervisory Board's meeting without the presence of members of the Executive Board.

Meanwhile, as the Monetary and Financial Code authorizes an entity to refer to its parent company's Governance and Appointments Committee and Compensation Committee for the definition of its appointments and compensation policy, Caisse Française de Financement Local's Supervisory Board has decided not to create a specific committee at its level but to rely on those of SFIL. Similarly, both SFIL's Financial Statements Committee and its Risks and Internal Control Committee handle issues concerning Caisse Française de Financement Local. The documents presenting these issues are included in the files presented to the Supervisory Board, which is also briefed on these committees' discussions when they are related to the Company.

1.1 – THE SUPERVISORY BOARD

1.1.1. The role of the Supervisory Board

The Supervisory Board exercises permanent control over the Executive Board's management of the Company. The Shareholders' Meeting appoints the Supervisory Board's members for four-year terms, on the basis of their qualifications and potential contribution to the Company. Prior to their appointment, SFIL's Governance and Appointments Committee reviews their respective skills and qualifications using the Fit and Proper test process.

The Supervisory Board meets at least once a quarter, with both statutory auditors and the Company's Specific Controller in attendance. The Board met four times in fiscal year 2018, with an average attendance rate of 79% (individual rates are specified in section 1.1.2.). Having been unable to attend the Board's various meetings for professional reasons and because of unforeseen constraints, one member tendered his resignation, which will take effect in 2019.

The Chairman of the Supervisory Board or of the Executive Board informs the Board's members of meeting agendas, allowing enough time before the meetings take place for them to review the items for discussion, and provides a file containing the memos or documents relating to said items. The files containing the information and documents sent to the Board enable it to form a clear, reliable and comprehensive view of the Company's situation, profitability and development. At the Supervisory Board meetings, the Executive Board reviews and comments on the agenda items, using summary presentations where appropriate. The Supervisory Board issues opinions on strategic choices, makes recommendations and, where appropriate, commissions ad hoc studies, which are reviewed at subsequent meetings. The agenda follows a standard format: minutes of the previous meeting, activity report for the past and current quarters, including the monitoring of issuance conditions, presentation of the financial statements, asset acquisitions from La Banque Postale and refinancing of large export credits. Specific topics are included on the agenda depending on the time of year, such as the report on internal control and the report on risk measurement and monitoring, pursuant to articles 258 *et seq* of the *arrêté* of November 3, 2014, and the information to be published on asset quality and the level and sensitivity of interest rate risk, pursuant to article 13 of CRBF regulation 99-10. The Supervisory Board pays particular attention to Caisse Française de Financement Local's acquisition of public sector assets from La Banque Postale and to the loans it makes to refinance large export credits. It closely monitors execution of Caisse Française de Financement Local's issuance program and the performance of its *obligations foncières* on the primary and secondary markets. The Supervisory Board believes that the optimization of Caisse Française de Financement Local's financial conditions – irrespective of market conditions and the ratings assigned by Moody's, Standard & Poor's, DBRS and Fitch(1) – depends on the extent to which investors recognize the excellent quality of the Company's assets and its minimal level of customer counterparty, market counterparty, interest rate and liquidity risk. The Supervisory Board pays particular attention to the reports that the Executive Board submits to it on these issues and to the transparency of the related disclosures to investors. The Supervisory Board is also briefed on requests from the Company's supervisors and the information that its management provides in response.

In 2018, in addition to the questions related to the management of the Company that are under its responsibility, the Supervisory Board paid particular attention in its governance to its issuance strategy, issue ratings, purchasing of public sector loans from La Banque Postale, refinancing of large export credits, monitoring of litigation, assistance rendered by its servicer, SFIL, and risks especially with the review for approval of the ICAAP and ILAAP reports, recovery plan and Recovery and Business Continuity Plan. In 2018, the Supervisory Board also reviewed in detail the implementation of IFRS 9, which came into force on January 1, 2018. It also examined the plans to expand the export activity, make themed issues and change SFIL's shareholding structure.

The Supervisory Board called an Ordinary and Extraordinary Shareholders' Meeting on May 28, 2018. The Ordinary Shareholders' Meeting was called notably to:
- approve the financial statements and the appropriation of income;
- approve the Company's regulated agreements and commitments;

The purpose of the Ordinary and Extraordinary Shareholders' Meeting was also, as part of the Extraordinary Shareholders' Meeting, to amend article 4 of the by-laws concerning the Supervisory Board's entitlement, pursuant to article L.225-65 of the Code of Commerce, to transfer the Company's registered office to any location in France.

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(1) As a reminder, Caisse Française de Financement Local decided to no longer apply for a rating for its obligations foncières from the Fitch rating agency as of January 1, 2019.

1.1.2. Composition of Supervisory Board

Supervisory Board (as of December 31, 2018)

Philippe Mills
Chairman

François Laugier
Vice Chairman

Nathalie Argourd
Member

Anne Crépin
Member

Béatrice Gosserez
Member

Sami Gotrane
Member

Florent Lecinq
Member

The Board met four times in fiscal year 2018. The attendance rate of the Supervisory Board members is shown in the table below.

Members of the Supervisory Board	Attendance rate at Supervisory Board meetings
Philippe Mills – Chairman	100%
François Laugier – Vice Chairman	75%
Nathalie Argourd – Member	100%
Anne Crépin – Member	100%
Béatrice Gosserez - Member	75%
Sami Gotrane - Member	0%
Florent Lecinq - Member	100%

1.2 – THE EXECUTIVE BOARD

1.2.1. The role of the Executive Board

The Executive Board is in charge of Caisse Française de Financement Local's management and administration, with the capacity to represent and commit it. As such, its role is to take all decisions impacting Caisse Française de Financement Local's activity and results. Moreover, the Executive Board is the first guarantor of the proper functioning of Caisse Française de Financement Local's internal control procedures (see section 8.1 of the Management Report).

More specifically, the Executive Board's responsibilities include:
- convening Shareholders' Meetings;
- deciding, by delegation from the Extraordinary Shareholders' Meeting, to increase the share capital and/or determining the terms of this increase, and if necessary carrying out a capital reduction;
- amending the share capital at any time following the conversion of convertible bonds, subscriptions using rights detached from hybrid securities containing share subscription options, and the exercise of share subscription options;
- issuing *obligations foncières* and registered covered bonds;
- acquiring assets under the two assignments entrusted by the French State to Caisse Française de Financement Local: refinancing of loans to French local governments and public hospitals and refinancing of large export credits;
- selling assets;
- managing balance sheet and off-balance sheet transactions;
- validating the Company's risk appetite and its application in the risk analysis and measurement oversight systems and procedures;
- defining SFIL's servicing conditions, notably by (i) approving and monitoring the management contract and amendments thereto, the service level agreement and the associated quality indicators, and (ii) approving Caisse Française de Financement Local's operational management policies;
- preparing the quarterly financial and activity reports for submission to the Supervisory Board;
- preparing the financial statements in accordance with IFRS and French GAAP.

Furthermore, for activities delegated to SFIL, Caisse Française de Financement Local's Executive Board is specifically informed of and, if appropriate, required to act on, the following:
- litigation;
- risks, including non-compliance risks;
- internal control.

In 2018, the Executive Board was composed of five members. Its members are appointed by Caisse Française de Financement Local's Supervisory Board after approval by SFIL's Governance and Appointments Committee. The term of office of the members of the Company's Executive Board is set at four years.

The Executive Board meets on average twice a month; each quarter a meeting is devoted to preparing the next Supervisory Board meeting. One-off meetings may also be held on the basis of current events and urgent subjects in need of approval.

The statutory auditors are invited to Executive Board meetings if their attendance is mandatory, which applies specifically for the review of the annual or interim financial statements. Depending on the agenda items, the Chairman of the Executive Board may decide, in particular on the proposal of another Board member, to invite any person that he or she deems useful to present a subject or assist with preparatory discussions of said items.

1.2.2. Composition of the Executive Board

Executive Board (as of December 31, 2018)

Gilles Gallerne
Chairman

Romain Bailly
Chief Executive Officer

Olivier Eudes
Member

Patrick Galland
Member

Emmanuel Moritz
Member

2. Directorships and positions of members of supervisory and management bodies

In application of article L.225-102-1 of the Code of Commerce, the following list presents the directorships and positions exercised in 2018 by every member of the supervisory and management bodies of Caisse Française de Financement Local who served during the year.

2.1 – THE SUPERVISORY BOARD

The members of Caisse Française de Financement Local's Supervisory Board are qualified experts in the Company's main areas of activity as a *société de crédit foncier*. They are all employees of SFIL, members of its Executive Committee or directors. The Chairman of Caisse Française de Financement Local's Supervisory Board is also a member of the Board of Directors and the Chief Executive Officer of SFIL.

CHAIRMAN

Philippe Mills
53 years old – French nationality
Professional address: SFIL - 1-3, rue du Passeur de Boulogne 92130 Issy-les-Moulineaux
Date mandate begins and ends: May 30, 2017 - 2021
Date of first mandate: January 31, 2013
Principal function: Member of the Board of Directors, Chief Executive Officer, SFIL
Other mandates and responsibilities:
- Chairman of the Executive Committee, SFIL
- Alternate Expert, Board of Directors, European Investment Bank (EIB)
- Chairman of the Board of Directors, European Association of Public Banks (EAPB)

VICE CHAIRMAN

François Laugier
54 years old – French nationality
Professional address: SFIL - 1-3, rue du Passeur de Boulogne 92130 Issy-les-Moulineaux
Date mandate begins and ends: May 30, 2017 - 2021
Date of first mandate: January 31, 2013
Principal function: Deputy Chief Executive Officer, SFIL
Other mandates and responsibilities: Member of the Executive Committee, SFIL

MEMBERS

Nathalie Argourd
47 years old – French nationality
Professional address: SFIL - 1-3, rue du Passeur de Boulogne 92130 Issy-les-Moulineaux
Date mandate begins and ends: May 30, 2017 - 2021
Date of first mandate: May 30, 2017
Principal function: Director, Middle Office and Customer's Debt Management Applications, SFIL
Other mandates and responsibilities: none

Anne Crépin
49 years old – French nationality
Professional address: SFIL - 1-3, rue du Passeur de Boulogne 92130 Issy-les-Moulineaux
Date mandate begins and ends: May 30, 2017 - 2021
Date of first mandate: May 30, 2017
Principal function: Deputy Director, Export Credit, SFIL
Other mandates and responsibilities: none

Béatrice Gosserez
53 years old – French nationality
Professional address: SFIL - 1-3, rue du Passeur de Boulogne 92130 Issy-les-Moulineaux
Date mandate begins and ends: May 25, 2016-2020.
Date of first mandate: December 12, 2012
Principal function: General Secretary, SFIL
Other mandates and responsibilities: Member of the Executive Committee, SFIL

Sami Gotrane
54 years old – French nationality
Professional address: SFIL - 1-3, rue du Passeur de Boulogne 92130 Issy-les-Moulineaux
Date mandate begins and ends: May 30, 2017 - 2021
Date of first mandate: January 31, 2013
Principal function: Director, Treasury and Financial Markets, SFIL
Other mandates and responsibilities:
- Member of the Executive Committee, SFIL
- Chairman, CTG Financial Consulting

Florent Lecinq
43 years old – French nationality
Professional address: SFIL - 1-3, rue du Passeur de Boulogne 92130 Issy-les-Moulineaux
Date mandate begins and ends: May 30, 2017 - 2021
Date of first mandate: February 25, 2013
Principal function: Chief Financial Officer, SFIL
Other mandates and responsibilities: Member of the Executive Committee, SFIL

2.2 – THE EXECUTIVE BOARD

CHAIRMAN

Gilles Gallerne
55 years old – French nationality
Professional address: SFIL - 1-3, rue du Passeur de Boulogne 92130 Issy-les-Moulineaux
Date mandate begins and ends: January 31, 2017 – 2021
Date of first mandate: January 1, 2008
Principal function: Director, CAFFIL Coordination, SFIL
Other mandates and responsibilities:
- Member of the Executive Committee, SFIL
- Member of the Board, Association Française des Sociétés Financières (ASF)

CHIEF EXECUTIVE OFFICER

Romain Bailly
37 years old – French nationality
Professional address: SFIL - 1-3, rue du Passeur de Boulogne 92130 Issy-les-Moulineaux
Date mandate begins and ends: January 31, 2017 - 2021
Date of first mandate: December 7, 2016
Principal function: Head of CAFFIL Coordination division, SFIL
Other mandates and responsibilities: none

MEMBERS

Olivier Eudes
50 years old - French nationality
Professional address: SFIL - 1-3, rue du Passeur de Boulogne 92130 Issy-les-Moulineaux
Date mandate begins and ends: January 31, 2017 - 2021
Date of first mandate: May 27, 2015
Principal function: Director, Financial Markets, SFIL
Other mandates and responsibilities: Manager, SCI Phoenix

Patrick Galland
52 years old – French nationality
Professional address: SFIL - 1-3, rue du Passeur de Boulogne 92130 Issy-les-Moulineaux
Date mandate begins and ends: January 31, 2017 - 2021
Date of first mandate: December 7, 2016
Principal function: Director, Coordination Financial Performance Management division, SFIL
Other mandates and responsibilities: none

Emmanuel Moritz
43 years old – French nationality
Professional address: SFIL - 1-3, rue du Passeur de Boulogne 92130 Issy-les-Moulineaux
Date mandate begins and ends: January 31, 2017 - 2021
Date of first mandate: January 31, 2013
Principal function: Director, Credit Risks, SFIL
Other mandates and responsibilities: none

3. Compensation of members of supervisory and management bodies

In 2018, Caisse Française de Financement Local paid no compensation to the members of its supervisory and management bodies who were employees of SFIL and who exercised their mandates with no specific compensation, except for the Chairman of the Supervisory Board, who is also a member of the parent company's Board of Directors and only in this role receives any compensation.

Readers are reminded that Caisse Française de Financement Local has no compensation committee and that reference is made to the Governance and Appointments Committee and the Compensation Committee that exist at the level of its parent company, SFIL.

4. Statutory auditors

The statutory auditors of Caisse Française de Financement Local are:

Deloitte & Associés

6, place de la Pyramide – 92908 Paris-La Défense Cedex
Represented by Sylvie Bourguignon, Partner
Re-appointed by the Shareholders' Meeting of May 30, 2017, for a term of six years, i.e. until after the Shareholders' Meeting called to approve the financial statements for the year ending December 31, 2022.

Ernst & Young et Autres

1-2, place des Saisons – 92400 Courbevoie – Paris-La Défense 1
Represented by Vincent Roty, Partner
Appointed by the Shareholders' Meeting of May 30, 2017, for a term of six years, i.e. until after the Shareholders' Meeting called to approve the financial statements for the year ending December 31, 2022.

5. Specific Controller

Fidus

26, rue Cambacérès – 75008 Paris
Represented by Jean-Michel Thierry, Partner
Re-appointed by the Executive Board on March 18, 2019, for a term of four years.
Alternate: Eric Lebègue
Re-appointed by the Executive Board on March 18, 2019, for a term of four years.

6. Information on elements likely to have a material impact in the event of a takeover or share exchange offer

Given that the Company's shares are not listed and that the securities (*obligations foncières*) it issues do not give access to its capital, there is no requirement to give specific information in relation to the provisions of article L.225-37-5 of the Code of Commerce. The composition of the share capital is specified below.

6.1 – INFORMATION ABOUT CAPITAL AND SHARES

6.1.1. Amount of capital; number and nature of the shares making up the capital

The Company's share capital currently stands at EUR 1,350,000,000, represented by 13,500,000 registered shares each with a face value of EUR 100. There are no other securities that give access to Caisse Française de Financement Local's capital.

6.1.2. Breakdown of capital

The capital of Caisse Française de Financement Local is owned by SFIL with the exception of one share which was lent to an individual (*prêt de consommation d'action*), a member of the Supervisory Board.

6.2 – INFORMATION CONCERNING VOTING RIGHTS (ARTICLE 31 OF THE BY-LAWS)

The voting rights attached to the shares are proportional to the percentage of capital those shares represent. Each share carries one voting right. At Shareholders' Meetings, the number of votes that may be cast by each shareholder corresponds to the number of shares held plus the number of shares for which the shareholder holds proxies.

6.3 - INFORMATION CONCERNING TRANSACTIONS BY EXECUTIVE OFFICERS ON THE COMPANY'S SHARES

No transaction is to be reported (cf. article 223-26 of the General Regulations of the Autorité des Marchés Financiers).

6.4 - CONVENTIONS SUBJECT TO ARTICLE L.225.37.4.2° OF THE CODE OF COMMERCE

No convention subject to article L.225.37.4.2° of the Code of Commerce requires mention.

IFRS Financial Statements

As a reminder, the financial statements for the 2017 fiscal year were prepared in accordance with IAS 39 (the accounting principles applied for this fiscal year were described in the 2017 annual financial report). Since January 1, 2018, the financial statements are prepared in accordance with IFRS 9.

The impact of this change is reflected in the column headed 1/1/2018 of the balance sheet below and is detailed in Note 8.

Assets

EUR millions	Note	12/31/2017	1/1/2018(1)	12/31/2018
Central banks	*2.1*	1,706	1,706	1,271
Financial Assets at fair value through profit or loss	*2.2*	-	6,951	5,584
Hedging derivatives	*4.1*	4,629	4,623	4,134
Financial assets available for sale	*2.3*	2,048	N/A	N/A
Financial Assets at fair value through equity	*2.4*	N/A	200	124
Loans and advances due from banks at amortized cost	*2.5*	867	867	2,132
Loans and advances to customers at amortized cost	*2.6*	56,892	43,485	43,781
Bonds at amortized cost	*2.7*	N/A	8,391	9,384
Fair value revaluation of portfolio hedge		2,518	2,518	2,552
Financial assets held to maturity		-	N/A	N/A
Current tax assets	*2.8*	0	0	-
Deferred tax assets	*2.8*	69	43	79
Accruals and other assets	*2.9*	48	48	15
TOTAL ASSETS		**68,777**	**68,832**	**69,056**

(1) Balance sheet presentation taking into account IFRS 9, applicable from 1st January 2018 (see Note 8).

Liabilities

EUR millions	Note	12/31/2017	1/1/2018(1)	12/31/2018
Central banks		-	-	-
Financial liabilities at fair value through profit or loss	*3.1*	4	1,480	1,195
Hedging derivatives	*4.1*	7,930	6,454	5,994
Due to banks at amortized cost	*3.2*	4,821	4,821	4,941
Customer borrowings and deposits at amortized cost		-	-	-
Debt securities at amortized cost	*3.3*	52,898	52,897	54,442
Fair value revaluation of portfolio hedge		883	883	342
Current tax liabilities	*3.4*	0	0	8
Deferred tax liabilities	*3.4*	-	-	-
Accruals and other liabilities	*3.5*	823	823	681
Provisions	*3.6*	41	47	13
Subordinated debt		-	-	-
EQUITY		**1,377**	**1,427**	**1,440**
Capital		1,350	1,350	1,350
Reserves and retained earnings		89	56	47
Net result through equity	4.4	(103)	(20)	(19)
Net income		41	41	62
TOTAL LIABILITIES		**68,777**	**68,832**	**69,056**

(1) Balance sheet presentation taking into account IFRS 9, applicable from 1st January 2018 (see Note 8).

Income Statement

EUR millions	Note	2017	2018
Interest income	*5.1*	2,645	2,653
Interest expense	*5.1*	(2,460)	(2,525)
Fee and commission income	*5.2*	3	1
Fee and commission expense	*5.2*	(15)	(8)
Net result of financial instruments at fair value through profit or loss	*5.3*	(33)	36
Net result of financial instruments at fair value through equity	*5.4*	N/A	0
Gains or losses resulting from derecognition of financial instruments at amortized cost	*5.5*	N/A	14
Gains or losses resulting from reclassification of financial assets at amortized cost to fair value through profit or loss		N/A	-
Gains or losses resulting from reclassification of financial assets at fair value through equity to fair value through profit or loss		N/A	-
Net result of financial assets and liabilities	*5.6*	16	-
Other income		0	0
Other expense		(0)	(0)
NET BANKING INCOME		**156**	**171**
Operating expenses	*5.7*	(105)	(101)
GROSS OPERATING INCOME		**51**	**70**
Cost of risk	*5.8*	22	(4)
OPERATING INCOME		**73**	**66**
Net gains (losses) on other assets		-	-
INCOME BEFORE TAX		**73**	**66**
Income tax		(32)	(4)
NET INCOME		**41**	**62**
Earnings per share (EUR)			
- Basic		3.07	4.59
- Diluted		3.07	4.59

Net income and unrealized or deferred gains and losses through equity

EUR millions	2017	2018[(1)]
Net income	**41**	**62**
Item that may be reclassified as profit or loss	**24**	**(0)**
Unrealized or deferred gains and losses of financial assets available for sale	32	-
Unrealized or deferred gains and losses of financial assets at fair value through equity	-	(0)
Unrealized or deferred gains and losses of cash flow hedges	5	5
Tax on items that may subsequently be reclassified as profit or loss	(13)	(5)
Item that may not be reclassified as profit or loss	**-**	**-**
Total unrealized or deferred gains and losses through equity	**24**	**(0)**
NET INCOME AND GAINS AND LOSSES THROUGH EQUITY	**65**	**62**

(1) The data presented in the column corresponding to 2018 are presented after implementation of IFRS 9, which became applicable as from January 1, 2018.

Equity

EUR millions	Capital and reserves			Unrealized or deferred gains and losses				Total equity
	Share capital, additional paid-in capital	Retained earnings and net income for the period	Total	Net change in fair value of avalaible-for-sale financial assets, after tax	Net change in fair value of avalaible-for sale financial assets, after tax	Net change in fair value of hedging derivatives, after tax	Total	
EQUITY AS OF DECEMBER 31, 2017	**1,350**	**130**	**1,480**	**(84)**	**-**	**(19)**	**(103)**	**1,377**
IFRS 9 first time application	-	(33)	(33)	84	-	-	84	51
EQUITY AS OF JANUARY 1, 2018	**1,350**	**97**	**1,447**	**-**	**-**	**(19)**	**(19)**	**1,428**
Stocks issued	-	-	-	-	-	-	-	-
Dividends	-	(50)	(50)	-	-	-	-	(50)
Changes in fair value of financial assets through equity	-	-	-	-	(0)	-	(0)	(0)
Changes in fair value of derivatives through equity	-	-	-	-	-	(0)	(0)	(0)
Changes in fair value of financial assets through profit or loss	-	-	-	-	-	-	-	-
Changes in fair value of derivatives through profit or loss	-	-	-	-	-	-	-	-
Net income for the period	-	62	62	-	-	-	-	62
Other movements	-	-	-	-	-	-	-	-
EQUITY AS OF DECEMBER 31, 2018	**1,350**	**109**	**1,459**	**-**	**(0)**	**(19)**	**(19)**	**1,440**

The Ordinary Shareholder's meeting decided on May 28, 2018, to distribute a dividend in the amount of EUR 49.95 millions. Each share (13,500,000 shares) received a dividend of EUR 3,70.
Share capital currently stands at EUR 1,350,000,000 represented by 13,500,000 nominative shares.

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Cash flow statement

EUR millions	2017	2018
NET INCOME BEFORE TAX	**73**	**66**
+/- Depreciation and write-downs	(56)	(104)
+/- Expense/income from investing activities	124	(62)
+/- Expense/income from financing activities	(99)	(13)
+/- Other items	24	165
= Non-monetary items included in net income before tax and other adjustments	**(7)**	**(14)**
+/- Cash from interbank operations	(883)	(1,151)
+/- Cash from customer operations	620	679
+/- Cash from financing assets and liabilities	313	(934)
+/- Cash from non-financing assets and liabilities	(607)	(286)
- Income tax paid	(29)	4
= Decrease/(increase) in cash from operating activities	**(586)**	**(1,688)**
CASH FLOW FROM OPERATING ACTIVITIES (A)	**(520)**	**(1,636)**
CASH FLOW FROM INVESTING ACTIVITIES (B)	**-**	**-**
+/- Cash from or for shareholders	(0)	(50)
+/- Other cash from financing activities	(1,452)	1,246
CASH FLOW FROM FINANCING ACTIVITIES (C)(1)	**(1,452)**	**1,196**
EFFECT OF CHANGES IN EXCHANGE RATES ON CASH (D)	**-**	**-**
Increase /(decrease) in cash equivalents (A + B + C + D)	**(1,972)**	**(440)**
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD	**3,693**	**1,721**
Cash and balances with central banks (assets & liabilities)	3,684	1,706
Interbank accounts (assets & liabilities) and loans/deposits at sight	9	15
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	**1,721**	**1,281**
Cash and balances with central banks (assets & liabilities)	1,706	1,271
Interbank accounts (assets & liabilities) and loans/deposits at sight	15	10
CHANGE IN NET CASH	**(1,972)**	**(440)**

(1) As of December, 31, 2018, the net cash flow of EUR +1.2 billion linked to financing activities corresponded to the change in debt represented by a security. Compared with the variation of EUR 1.5 billion in debt represented by a security mentioned in note 3.3.1., the difference primarily reflects the change in the revaluation of hedged risk and foreign exchange variations.

Notes to the IFRS financial statements

1. ACCOUNTING AND VALUATION POLICIES

1.1 – APPLICABLE ACCOUNTING STANDARDS

1.1.1. Application of the accounting standards endorsed by the European Union

The Company prepares its individual financial statements in compliance with International Financial Reporting Standards (IFRS), as endorsed by and applicable within the European Union.

This publication is voluntary. As a reminder on July 19, 2002, the European Union published regulation EC 1606/2002, which obliged listed groups to apply IFRS as from January 1, 2005 and the Company deliberately decided to apply as from January 1, 2007 all the IAS, IFRS, SIC and IFRIC adopted by the European Union.

The individual financial statements as of December 31, 2018 were examined by the Executive Board on March 25, 2018.

Due to the entry into force of IFRS 9 for reporting periods beginning on or after January 1, 2018, the Company has disclosed in its financial statements presented below 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.

Accounting principles applied to the financial statements are detailed in chapter 1.2. below.

1.1.2. 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 recognized 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 recognized in shareholders' equity without any subsequent recycling in profit or loss.

Classification and Measurement

The management model implemented by the Company 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 the Company. These assets are accounted for and measured at fair value through the item Unrealized or deferred gains and losses 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.

Furthermore, the policy implemented by the Company 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

(1) SPPI : Solely Payments of Principal and Interest

treatment. Since the application of the standard is retroactive, the Company 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 recognized 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. The Company opted for an earlier application of this amendment from January 1, 2018, given the endorsement by the European Union on March 22, 2018 (UE Regulation n° 2018/498).

Finally, 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 Company 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 Company 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, the Company does not apply the phase-in provisions embedded within UE 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. The Company has decided to maintain the provisions of IAS 39 for hedge accounting at the date of entry into force of IFRS 9. However, the Company 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 Group executive management, the finance division, the risks division, the head of 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 partly integrated into the IT simplification and reinforcement program (Oxygen project).

The governance of the Company 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 credit validation committee, risk committee, internal control and risk committee, the latter being a specialized committee of the Board of the Group, and Caisse Française de Financement Local'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.

At each closing 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 trimestral review – and externally – through financial reports.

Finally, the accounts committee of the Group, which is an emanation of the executive board of the Group, 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:
- IAS1 Presentation of financial statements: the accounting items 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.

- **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 in particular financial instruments, insurance contracts and leases.

This standard has no material impact on individual financial statements of the Company.

- Amendment to IFRS 4 Insurance contracts: issued by IASB on September 12, 2016, endorsed by the European Union on November 9, 2017 (UE Regulation n° 2017/1988) and effective for reporting periods beginning on or after January 1, 2018, this amendment aims at addressing the temporary accounting consequences of the different effective dates of IFRS 9 and the new IFRS 17 standard dealing with insurance contracts and replacing IFRS 4 standard. Under certain conditions, it allows in particular entities whose activity is predominantly connected with insurance, and by extension under the European version the insurance sector within a financial conglomerate, to defer until January 1, 2021 (if not until January 1, 2022 given the tentative decision of IASB's Board taken on November 14, 2018) the date of application of IFRS 9 standard.

This amendment has no impact on individual financial statements of the Company given that the latter has no insurance-related activity.

- Amendments to **IAS 28 Investments in Associates and Joint Ventures / IFRS 1 First-time Adoption of International Financial Reporting Standards / IFRS 12 Disclosure of Interests in Other Entities:** issued by IASB on December 8, 2016 in the framework of its regular IFRS improvement process, endorsed by the European Union on February 7, 2018 (UE 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, these 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;

These amendments have no impact on individual financial statements of the Company given that the latter holds no interest in the scope of IFRS 5 and holds no associate or joint venture.

- Amendment to **IFRS 2 Share-based payments:** issued by IASB on June 20, 2016, endorsed by the European Union on February 26, 2018 (UE Regulation n° 2018/289) and effective for reporting periods beginning on or after January 1, 2018, this amendment aims at clarifying the way IFRS 2 shall be applied by entities in some particular cases.

This amendment has no impact on individual financial statements of the Company given that the latter is not involved in share-based payment transactions.

- Amendment to **IAS 40 Investment property:** issued by IASB on December 8, 2016, endorsed by the European Union on March 14, 2018 (UE Regulation n° 2018/400) and effective for reporting periods beginning on or after January 1, 2018, this amendment clarifies when an entity is allowed to reclassify a property to, or from, the investment-property category.

This amendment has no impact on individual financial statements of the Company given that the latter holds no investment property.

- **IFRIC 22 Foreign Currency Transactions and Advance Consideration:** issued by IASB on December 8, 2016, endorsed by the European Union on March 28, 2018 (UE Regulation n° 2018/519) and effective for reporting periods beginning on or after January 1, 2018, this interpretation clarifies that, when an entity recognizes a non monetary asset or liability arising from the receipt or payment of advance consideration in a foreign currency, the transaction date for the purpose of determining the exchange rate to use for the related asset, expense or income that are subsequently recognize is the initial recognition date of the non monetary asset or liability denominated in a foreign currency.

This interpretation has no material impact on individual financial statements of the Company given that the latter holds no non monetary asset or liability denominated in a foreign currency.

1.1.3. IASB and IFRIC texts endorsed by the European Union or in the process of being endorsed but not yet applicable

- **IFRS 16 Leases:** endorsed by the European Union on October 31, 2017 (UE 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.

This standard will have no material impact on the individual financial statements of the Company given that the latter is involved in no leases. The Company has not opted for an earlier application of this new standard.

- **IFRIC 23 Uncertainty over Income Tax Treatments:** issued by IASB on June 7, 2017, endorsed by the European Union on October 23, 2018 (UE Regulation n° 2018/1595) and effective for reporting periods beginning on or after January 1, 2019, this interpretation specifies how to reflect uncertainty over tax treatments applied when determining taxable profit, tax bases, unused tax losses, unused tax credits and tax rates. The entity shall assume that the taxation authority will perform exhaustive examinations and that, during these examinations, it will have full knowledge of all related information.

The impacts of this interpretation on individual financial statements of the Company are being analyzed. The Company has not opted for an earlier application of this new interpretation.

- Amendment to **IAS 28 Investments in associates:** issued by IASB on October 12, 2017 in the framework of its regular IFRS improvement process, endorsed by the European Union on February 8, 2019 (UE Regulation n° 2019/237) and effective for reporting periods beginning on or after January 1, 2019, this amendment confirms that IFRS 9 applies to long-term interests in an associate or joint venture to which the equity method is not applied but that, in substance, form part of the net investment in an associate or joint venture.

This amendment will have no impact on individual financial statements of the Company given that the latter holds no associate or joint venture. The Company has not opted for an earlier application of this amendment.

- Amendment to **IAS 19 Employee benefits:** issued by IASB on February 7, 2018, not yet endorsed by the European Union and effective for reporting periods beginning on or after January 1, 2019, this amendment elaborates on how the net liability (or asset) accounted for shall be subsequently re-measured in case of an amendment, curtailment or settlement of a defined contribution plan within a reporting period.

This amendment will have no material impact on individual financial statements of the Company given that the latter has no salaried employees in accordance with the provisions of article L.513-15 of the Monetary and Financial Code, the general management of its operations having been entrusted by a contract to its parent company, SFIL, a credit institution.

- Amendments to **IAS 12 Income taxes / IAS 23 Borrowing costs / IFRS 3/IFRS 11 Business combinations / IFRS 11 Joint Arrangements**: issued by IASB in December 2017 in the framework of its regular IFRS improvement process, not yet endorsed by the European Union and effective for reporting periods beginning on or after January 1, 2019, these amendments elaborate on:
  - As regards IAS 12, how income tax consequences of dividend payments shall be recognized;
  - As regards IAS 23, how the residual borrowing costs shall ceased to be incorporated in the cost of an asset when the latter is ready for its intended use or sale : these residual borrowing costs shall become part of the general borrowings used for computing the capitalization rate;
  - As regards IFRS 3, how the acquisition of control of a joint operation shall be accounted for;
  - As regards IFRS 11, how the joint acquisition of control in the framework of a joint operation shall be accounted for.

The impacts of these amendments on individual financial statements of the Company are being analyzed. The amendments of IAS 23, IFRS 3 and IFRS 11 will at a first sight have no impact on individual financial statements of the Company given that the operations of the latter are out of the scope of these standards.

- **IFRS 17 Insurance contracts**: issued by IASB in May 2017, not yet endorsed by the European Union and effective for reporting periods beginning on or after January 1, 2021 (if not January 1, 2022 given the tentative decision of IASB's Board taken on November 14, 2018), this standard, which will replace IFRS4, clarifies in particular how all insurance contracts (life, non-life, insurance and reinsurance) shall be accounted for, contracts for which the entity is the policyholder being in particular out of the scope (excepted reinsurance contracts).

- Amendments to **IAS 1 Presentation of financial statements / IAS 8 Accounting policies, changes in accounting estimates and errors**: issued by IASB in October, 2018, not yet endorsed by the European Union and effective for reporting periods beginning on or after January 1, 2020, these amendments aim at clarifying and aligning the definition of materiality across the IFRS standards in the purpose of enhancing the consistency of its application in the financial statements.

- Amendment to **IFRS 3 Business combinations**: issued by IASB in October, 2018, not yet endorsed by the European Union and effective for reporting periods beginning on or after January 1, 2020, this amendment narrows and clarifies the definition of a business, a key concept that enables to distinguish a business combination from a mere acquisition of a group of assets.

Given the distant dates of applications of these new standard and amendments and as the European Union has not endorsed them so far, the impacts of these new standard and amendments on individual financial statements of the Company will be analyzed at a later stage.

1.2 – ACCOUNTING PRINCIPLES APPLIED TO THE FINANCIAL STATEMENTS

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

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

Judgments were principally made in the following areas:
- Classification of financial instruments;
- Determination of 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 following chapters.
- 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, especially in the framework of the definition of macroeconomic scenarios used;
- Estimates of future taxable profits for the recognition and measurement of deferred tax assets.

1.2.1. Offsetting financial assets and 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.

1.2.2. 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 profit or loss.

Financial assets denominated in a foreign currency and measured at fair value through the item Unrealized or deferred gains and losses 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 profit or loss, while further adjustments of the carrying amount (except the loss allowance for expected credit losses: see below) are recognized in equity.

The Company holds no non monetary asset or liability denominated in a foreign currency.

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

1.2.4. Financial assets

When the Company 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.

1.2.4.1. Business model

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

- Refinancing local government entities and public hospitals through the acquisition by Caisse Française de Financement Local of medium/long-run loans granted by La Banque Postale;
- Reducing the sensitivity of structured loans held by Caisse Française de Financement Local;
- Refinancing SFIL by the Company for the activity of export financing covered by French State.

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 Company 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 Company'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 Company only uses the Hold-To-Collect (HTC) model and the Holt-To-Collect-and-Sell (HTCS) model. The Company holds no financial assets for trading purposes, i.e. the Company 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.

1.2.4.2. Characteristics of contractual cash flows (SPPI criterion)

The SPPI (Solely Payments 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 derived from the outstanding principal for a given time period, 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 the ones of a benchmark asset. If the gap assessed through this comparison is not material, the asset is assimilated to a basic lending agreement.

1.2.4.3. Financial assets measured at amortized cost

A financial asset is classified and subsequently measured at amortized cost if it is compliant with both of the two following conditions:
- This financial asset is held within a business model, 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 Company recognizes 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 and transaction costs 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 profit or loss as cost of risk.

Due and accrued interest on loans and fixed income securities belonging to this category as well as the amortization of premium / discount and transaction costs, 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 instrument or, if the underlying instrument is a purchased or originated credit-impaired financial asset or has been subsequently impaired (see below), its net carrying amount (which takes into account in particular 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.

1.2.4.4. Financial assets measured at fair value through the item Unrealized or deferred gains and losses of equity

A financial asset is classified and subsequently measured at fair value through the item Unrealized or deferred gains and losses of equity if it is compliant with both of 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);

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- 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 Company recognizes 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 as other comprehensive income in equity, except an amount corresponding to the loss allowance for expected credit losses, which is recognized in profit or loss as cost of risk.

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

1.2.4.5. Financial assets measured at fair value through profit or loss

A financial asset which does not belong to any of the two categories described above (amortized cost and fair value through the item Unrealized or deferred gains and losses of equity) falls under this category and is classified and subsequently measured at fair value through profit or loss: this category is mainly composed of financial assets that are not SPPI compliant.

At initial recognition, the Company recognizes 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 profit or loss as net banking income.

So as to be in line with the accounting principles applied at Group level and stated under ANC Recommendation 2017-02 issued on June 2, 2017, the Company decided to recognize separately:
- The fair value variations excluding accrued interest; they are recognized under the item Net result of financial instruments at fair value through profit or loss of the net banking income;
- Due and accrued interest; they are recognized in the net interest margin.

1.2.4.6. Designation options

The Company does not use the following options:
- Option to designate a financial asset as measured at fair value through profit or loss: 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 Company does not hold such instruments.

1.2.4.7. 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 item Unrealized or deferred gains and losses 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 of a financial asset 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 to maturity 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 Company 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 Company 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 Company 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 or the other 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 Company 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 accountings: the assessment of credit risk significant increase is performed at counterparty level.

Stages 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>Measuring the amount of the expected credit loss</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 respective 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 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 Company 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 Company and the sequence of cash flows that the Company expects to recover, both discounted at the original effective interest rate. Depending on the materiality of the contract, the cash flows that the Company 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 through 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.

<u>Recognizing the impairment</u>

Positive and negative variations of the amount of the loss allowance for expected credit losses are recognized in profit or loss as cost of risk.

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

1.2.4.8. 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 Company'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 profit or loss of the period considered as net banking income.

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 item Unrealized or deferred gains and losses of equity, cumulative gains or losses previously recognized in equity are, applying FIFO method, reversed in profit or loss on disposal, under the item of the net banking income used for recognizing 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 recognized as 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 recognized off-balance sheet and the corresponding loans are recognized on the balance sheet as 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 contract 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 cash flows of the restructured loan 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 profit or loss of the period, within the net interest margin. Furthermore, for financial assets measured at amortized cost or at fair value through the item Unrealized or deferred gains and losses of equity, the Company 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 profit or loss of the period, under the item of the net banking income used for recognizing the net gains and losses of the category of the derecognized financial asset.

1.2.5. Financial liabilities

1.2.5.1. Financial liabilities held for trading
The Company does not hold financial liabilities belonging to this category.

1.2.5.2. Financial liabilities designated at fair value through profit or loss
The Company does not use this option.

1.2.5.3. Financial liabilities at amortized cost
Financial liabilities at amortized cost are mainly obligations foncières and other resources that benefit from the privilege defined in article L.513-11 of the Monetary and Financial Code.

At initial recognition, the Company recognizes a financial liability belonging to this category at fair value, which is its nominal value including if applicable any reimbursement and issue premiums and transaction costs (mainly fees and commissions on bond issues). Subsequently, the financial liability is measured at amortized cost, which corresponds to its carrying amount at initial recognition plus or minus as appropriate the amortization of premiums and transaction costs calculated using the effective interest rate method.

Due and accrued interest on financial liability belonging to this category as well as the amortization of premiums and transaction costs calculated using the effective interest rate method, are recognized in the net interest margin.

Bonds issued which are denominated in foreign currencies are accounted for using the same method as foreign currency transactions (see above).

1.2.5.4. 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 (see above).

1.2.6. Derivatives

Applying the provisions of IFRS 9, the Company has decided to maintain the provisions of IAS 39 for hedge accounting at the date of entry into force of IFRS 9. However, the Company 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 recognized as assets if their fair value is positive and as liabilities if it is negative.

1.2.6.1. Derivatives not documented in a hedging relationship
The Company enters into derivative contracts for the unique purpose of hedging its exposures to interest rate or foreign exchange positions. However, some derivatives must be measured at fair value through profit or loss at closing date; they are:
- The ones which failed hedge effectiveness tests at closing date;
- The ones which hedge financial assets that are measured at fair value through profit or loss. In this case, the revaluation of the derivative hedges natively the revaluation of the hedged risk of the hedged item, making pointless the documentation of a hedging relationship;
- The ones that hedge the foreign exchange risk related to export credit financing loans denominated in a currency other than the euro. These derivatives are concluded before the end of the drawing phase of the hedged loans but foreign exchange hedging relationship has been documented only from the complete payment in the Company's balance sheet.

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

1.2.6.2. 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 profit or loss 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 profit or loss.

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 recognized in profit or loss, 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 profit or loss. Amounts deferred in equity are recycled to profit or loss and classified as income or expense in the periods during which the hedged firm commitment or forecast transaction affects the profit or loss.

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 portion attributable to the hedged risk of 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 profit or loss when or as the item formerly hedged impacts profit or loss.

1.2.6.3. Hedging of the interest rate risk of a portfolio

The Company uses the provisions of IAS 39 as adopted by the European Union (IAS 39 carve-out) because it better reflects the way the Company 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 Company 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. The Company 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 Company 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 Company 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 Company 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 date) 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 recognized in profit or loss.

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.

1.2.7. 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 Company has access to on that date. The fair value of a liability reflects its non-performance risk, which includes in particular the Company'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 Company.

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 if any, 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 the instrument; for example modifications in the credit risk quality of the underlying financial instruments and market liquidity. Within this framework, the Company 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 closing date.

1.2.7.1. 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 penalties are included in determining the fair value these instruments.

1.2.7.2. Financial instruments measured at fair value

Non derivative financial assets measured at fair value, either through the item Unrealized or deferred gains and losses of equity or through profit or loss, and derivative instruments are measured at fair value by reference to listed market prices when available. When listed market prices are not available, fair value is estimated on the basis of valuation models or discounted cash flows method, 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 model attempts 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 Company uses different discount curves depending on whether collateral was actually exchanged. When the Company receives collateral, related future cash-flows are discounted using an OIS-based curve while uncollateralized derivatives related future cash-flows 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 Company'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.

1.2.8. 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 closing date are used to determine deferred taxes.

Deferred tax assets are recognized to the extent that it is probable that sufficient 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 item Unrealized or deferred gains and losses 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.

1.2.9. Provisions

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

Regarding mainly litigations and restructuring, under IAS 37, a provision is recognized when and only when:

- The Company 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):
- Loan commitments measured at fair value through profit or loss: they are fully in the scope of IFRS 9. Therefore, they are not impaired for expected credit losses but valued and their valuation is recognized on the asset side;
- 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 item Unrealized or deferred gains and losses of equity. The assessment of whether credit risk has significantly increased since initial recognition is performed from the date on which the Company 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 with an offsetting entry to profit or loss as cost of risk.

1.2.10. Interest income and expense

For all interest-bearing instruments, interest income and expense are recognized in profit or loss using the effective interest rate method (see above).

Accrued interest is recognized on the balance sheet under the same item as the related financial assets or liabilities.

1.2.11. Commissions

Most of the commissions arising from the Company'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 recognized in net interest margin if the loan is granted.

1.2.12. 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 date.

1.2.13. 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.

1.2.14. 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. The parent company of the Company is SFIL, a société anonyme incorporated in France, which 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.

1.2.15. Segment reporting

The Company's sole activity involves the financing or refinancing of loans to public sector (loans to French local governments and public hospitals, or loans to SFIL with an unconditional and irrevocable 100% guarantee by the French State, as part of the financing of large export credits).

The Company 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.

2. NOTES TO THE ASSETS (EUR millions)

2.1 - CENTRAL BANKS

	12/31/2017	12/31/2018
Mandatory reserve deposits with central banks	-	-
Other deposits	1,706	1,271
TOTAL	**1,706**	**1,271**

2.2 - FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

2.2.1. Analysis by nature

	12/31/2017	12/31/2018
Loans and advances to customers	-	5,572
Non Hedging derivatives	-	12
TOTAL	**-**	**5,584**

2.2.2. Loans and advances to customers analysis by counterparty

	12/31/2017	12/31/2018
Public sector	-	5,098
Other - guaranteed by a State or local government	-	474
TOTAL	**-**	**5,572**
of which eligible for central bank refinancing	*-*	*4,737*
of which assets assigned in guarantee to the central bank	*-*	*-*

2.2.3. Analysis by residual maturity

See note 7.4

2.3 - FINANCIAL ASSETS AVAILABLE FOR SALE

2.3.1. Analysis by nature

	12/31/2017	12/31/2018
Loans	-	N/A
Bonds	2,048	N/A
TOTAL	**2,048**	**N/A**

2.3.2. Analysis by counterparty

	12/31/2017	12/31/2018
Public sector	1,474	N/A
Credit institutions guaranteed by the public sector	-	N/A
Total public sector	**1,474**	**N/A**
Credit institutions	574	N/A
Total replacement assets	**574**	**N/A**
TOTAL	**2,048**	**N/A**
of which eligible for central bank refinancing	*1,830*	*N/A*

2.3.3. Impairment

	12/31/2017	12/31/2018
Public sector	1,474	N/A
Replacement assets	574	N/A
Total performing assets	**2,048**	**N/A**
Public sector	-	N/A
Replacement assets	-	N/A
Total impaired assets	**-**	**N/A**
Specific impairment	-	N/A
TOTAL ASSETS AFTER IMPAIRMENT	**2,048**	**N/A**

2.3.4. Unrealized or deferred gains and losses, breakdown by country

See note 4.4

Management report
Report on corporate governance
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2.4 - FINANCIAL ASSETS AT FAIR VALUE THROUGH EQUITY

2.4.1. Analysis by nature

	12/31/2017	12/31/2018
Stocks	N/A	-
Debt securities	N/A	124
TOTAL	**N/A**	**124**

2.4.2. Analysis by counterparty

	12/31/2017	12/31/2018
Public sector	N/A	94
Credit institutions	N/A	30
TOTAL	**N/A**	**124**
of which replacement assets	*N/A*	*30*
of which eligible for central bank refinancing	*N/A*	*124*

2.4.3. Analysis by residual maturity

See note 7.4

2.5 - LOANS AND ADVANCES DUE FROM BANKS AT AMORTIZED COST

2.5.1. Analysis by nature

	12/31/2017	12/31/2018
Sight accounts	11	3
Other loans and advances due from banks	856	2,129
TOTAL	**867**	**2,132**
of which eligible for central bank refinancing	-	-

2.5.2. Analysis by counterparty

	12/31/2017	12/31/2018
SFIL - loans to refinance large export credit guaranteed by the French state(1)	218	1,099
Replacement assets	371	801
Swiss cantonal banks benefiting from their canton's legal guarantee	30	-
Banks guaranteed by a local government, crédits municipaux	22	9
Other credit institutions of which loans benefiting from the assignment in guarantee of refinanced public debt	226	223
TOTAL	**867**	**2,132**
of which eligible for central bank refinancing	-	-

(1) Caisse Française de Financement Local grants loans to its parent company, SFIL, to refinance large export credits it has granted. Such loans benefit from an irrevocable and unconditional 100% guarantee by the French State, referred to as an enhanced guarantee.

2.5.3. Replacement assets

	12/31/2017	12/31/2018
SFIL - other loans non secured by public sector assets(1)	360	798
Sight accounts	11	3
TOTAL	**371**	**801**

(1) Since 2017, Caisse Française de Financement Local has invested some of its surplus cash in loans granted to its parent company SFIL.

2.5.4. Breakdown by stage of credit risk and impairment:

	12/31/2017
Sight accounts	11
Other loans and advances due from banks	856
Performing assets	**867**
Impaired loans and advances	-
Impaired assets	**-**
Total assets before impairment	**867**
Specific impairment	-
Collective impairment	-
TOTAL	**867**

	12/31/2018									
	Gross amount				Impairment			Net Amount	Partial reversals amount	Total reversals amount
	Stage 1	Stage 2	Stage 3	**TOTAL**	Stage 1	Stage 2	Stage 3			
Sight accounts	3	-	-	**3**	-	-	-	3	-	-
Other loans and advances due from banks	2,129	-	-	**2,129**	(0)	-	-	2,129	-	-
TOTAL	**2,132**	**-**	**-**	**2,132**	**(0)**	**-**	**-**	**2,132**	**-**	**-**

2.5.5. Analysis by residual maturity

See note 7.4

2.5.6. Unrealized or deferred gains and losses, breakdown by country

See note 4.4

2.6 - LOANS AND ADVANCES TO CUSTOMERS AT AMORTIZED COST

2.6.1. Analysis by counterparty, stage of credit risk and impairment:

	12/31/2017
Loans to public sector	53,946
Loans guaranteed by public sector	2,441
Performing assets	**56,387**
Loans to public sector	558
Loans guaranteed by public sector	-
Impaired assets	**558**
Total assets before impairment	**56,945**
Specific impairment	(23)
Collective impairment	(30)
TOTAL	**56,892**

	12/31/2018									
	Gross amount				Impairment			Net Amount	Partial reversals amount	Total reversals amount
	Stage 1	Stage 2	Stage 3	**TOTAL**	Stage 1	Stage 2	Stage 3			
Loans to public sector	38,084	3,153	1,091	**42,328**	(2)	(20)	(10)	42,296	-	-
Loans guaranteed by public sector	1,267	219	-	**1,486**	(0)	(1)	-	1,485	-	-
TOTAL	**39,351**	**3,372**	**1,091**	**43,814**	**(2)**	**(21)**	**(10)**	**43,781**	**-**	**-**
of which eligible for central bank refinancing				*33,440*						

Assets considered as forborne by Caisse Française de Financement Local concern exposures to loan contracts for which concessions have been granted in light of the borrower's financial difficulties (recognized or to come) that would not have been granted in other circumstances. These concessions may either be 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 aiming to reduce the sensitivity of the loan.

There were 173 forborne contracts as of December 31, 2018, with 88 borrowers, for a total of EUR 1,039 million.

2.6.2. Analysis by residual maturity

See note 7.4

2.6.3. Unrealized or deferred gains and losses, breakdown by country

See note 4.4

2.7 - BONDS AT AMORTIZED COST

2.7.1. Analysis by counterparty

	12/31/2017	12/31/2018
Bonds to public sector	N/A	7,181
Replacement assets	N/A	2,011
Other bonds guaranteed by a State or local government	N/A	192
TOTAL	**N/A**	**9,384**
of which eligible for central bank refinancing	*N/A*	*5,421*

2.7.2. Breakdown by stage of credit risk and impairment:

	12/31/2018									
	Gross amount				Impairment			Net Amount	Partial reversals amount	Total reversals amount
	Stage 1	Stage 2	Stage 3	TOTAL	Stage 1	Stage 2	Stage 3			
Bonds to public sector	4,424	2,778	5	**7,207**	(3)	(24)	(0)	7,180	-	-
Replacement assets	2,011	-	-	**2,011**	(0)	-	-	2,011	-	-
Other bonds guaranteed by a State or local government	118	75	-	**193**	(0)	-	-	193	-	-
TOTAL	**6,553**	**2,853**	**5**	**9,411**	**(3)**	**(24)**	**(0)**	**9,384**	**-**	**-**
of which eligible for central bank refinancing				***5,421***						

2.7.3. Analysis by residual maturity

See note 7.4

2.7.4. Unrealized or deferred gains and losses, breakdown by country

See note 4.4

2.8 - TAX ASSETS

	12/31/2017	12/31/2018
Current income tax	-	-
Other taxes	0	-
Current tax assets	**0**	**-**
Deferred tax assets (see note 4.2)	**69**	**79**
TOTAL	**69**	**79**

Deferred tax assets were submitted to a recoverability test taking into account the business plans presented to the Supervisory Board according to realistic hypotheses. Deferred taxes as of December 31, 2018, are recoverable on the basis of this analysis within a reasonable horizon by taking into account the tax rules governing the treatment of past deficits. As of December 31, 2018, Caisse Française de Financement Local has no deferred tax assets related to carry forward tax losses.
In addition, Caisse Française de Financement Local takes into account the legislative measures designed to reduce the corporate income tax rate to 25.83% as of 2022.

2.9 - ACCRUALS AND OTHER ASSETS

	12/31/2017	12/31/2018
Cash collateral paid	-	-
Other accounts receivable	1	1
Prepaid charges	2	4
Other assets	45	10
TOTAL	**48**	**15**

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	12/31/2018
Non hedging derivatives[1]	4	1,195
TOTAL	**4**	**1,195**

(1) Caisse Française de Financement Local is only authorized to enter into derivative transactions for hedging purposes. However, as certain hedging derivatives do not meet all the conditions required by IFRS to be classified as hedging instruments for accounting purposes, they are classified as derivative instruments at fair value through profit or loss.
Furthermore, as from 1st January 2018 and the entry into force of IFRS 9, derivatives used to hedge assets reclassified as assets measured at fair value through profit or loss can no longer be classified as hedging instruments for accounting purposes. They are therefore now allocated to this category.

3.1.2. Analysis by residual maturity

See note 7.4

3.2 - DUE TO BANKS AT AMORTIZED COST

3.2.1. Analysis by nature

	12/31/2017	12/31/2018
Term borrowing - parent company	4,821	4,943
Interest accrued not yet due	0	(2)
Sight accounts	-	-
TOTAL	**4,821**	**4,941**

A the end of December 2018, the funding borrowed from SFIL within the framework of the financing agreement was comprised of different loans with maturities that could initially run from one day to ten years with an Euribor or Eonia index.

3.2.2. Analysis by residual maturity

See note 7.4

3.3 - DEBT SECURITIES AT AMORTIZED COST

3.3.1. Analysis by nature

	12/31/2017	12/31/2018
Obligations foncières	45,157	46,794
Registered covered bonds	7,741	7,648
TOTAL	**52,898**	**54,442**

3.3.2. Analysis by residual maturity

See note 7.4

3.4 - TAX LIABILITIES

	12/31/2017	12/31/2018
Current income tax	0	7
Other taxes	0	1
Current tax liabilities	**0**	**8**
Deferred tax liabilities (see note 4.2)	**-**	**-**
TOTAL	**0**	**8**

3.5 - ACCRUALS AND OTHER LIABILITIES

	12/31/2017	12/31/2018
Cash collateral received	687	514
Other accrued charges	24	54
Deferred income	-	-
Contribution to support fund[1]	110	100
Other accounts payable and other liabilities	2	13
TOTAL	**823**	**681**

(1) This item includes the residual balance of the commitments that Caisse Française de Financement Local made in 2013 to contribute EUR 10 million a year for 15 years, i.e. EUR 150 million, to the multi-year support funds for local government entities.

3.6 - PROVISIONS

	12/31/2017	Additions, including increases in existing provisions	Amounts used	Unused amounts reversed during the period	Increase in the discounted amount (passage of time) and effect of any change in the discount rate	Other movements	12/31/2018
Legal issues and tax litigation[1]	41	-	-	(34)	-	-	7
Commitments and guarantees given[2]	-	0	-	-	-	6	6
TOTAL	**41**	**0**	**-**	**(34)**	**-**	**6**	**13**

(1) As of the end of 2018, the tax authority had levied adjustments relating to the 2012 and 2013 tax audit. It nevertheless reduced the amount of the adjustment relating to the add-back of the results of the former branch in Ireland, but maintained the principle of taxation of these results in France. Caisse Française de Financement Local settled this adjustment and reversed the relevant provisions. It kept in its accounts the amount of the provision set aside in respect of sums not yet paid. The 2018 accounting result consequently shows income corresponding to the provision's adjustment.
(2) In connection with the implementation of IFRS 9, Caisse Française de Financement Local reclassified provisions for commitments as liabilities.

4. OTHER NOTES TO THE BALANCE SHEET (EUR millions)

4.1 - DERIVATIVES

Hedging derivatives, presented below, are made following Caisse Française de Financement Local risk policy detailed in the Management report (see notes 9.2.3.3. and 9.2.3.4.).

4.1.1. Analysis by nature

	12/31/2017		12/31/2018	
	Assets	Liabilities	Assets	Liabilities
Derivatives at fair value through profit or loss[1]	**-**	**4**	**12**	**1,195**
Derivatives designated as fair value hedges	3,268	5,288	3,023	3,600
Derivatives designated as cash flow hedges	2	56	(2)	68
Derivatives designated as portfolio hedges	1,360	2,587	1,114	2,358
Hedging derivatives	**4,630**	**7,931**	**4,135**	**6,026**
CVA / DVA Impact	**(1)**	**(1)**	**(1)**	**(32)**
TOTAL DERIVATIVES	**4,629**	**7,934**	**4,146**	**7,189**

(1) Caisse Française de Financement Local is only authorized to enter into derivative transactions for hedging purposes. However, as certain hedging derivatives do not meet all the conditions required by IFRS to be classified as hedging instruments for accounting purposes, they are classified as derivative instruments at fair value through profit or loss.
Furthermore, as from 1st January 2018 and the entry into force of IFRS 9, derivatives used to hedge assets reclassified as assets measured at fair value through profit or loss can no longer be classified as hedging instruments for accounting purposes. They are therefore now allocated to this category.

4.1.2. Detail of derivatives designated as fair value through profit or loss

	12/31/2017			
	Notional amount		Assets	Liabilities
	To receive	To deliver		
Foreign exchange derivatives	1,725	1,611	-	-
Interest rate derivatives	20	20	-	4
TOTAL	**1,745**	**1,631**	**-**	**4**

	12/31/2018			
	Notional amount		Assets	Liabilities
	To receive	To deliver		
Foreign exchange derivatives	1,551	1,531	7	25
Interest rate derivatives	4,518	4,518	5	1,170

TOTAL	**6,069**	**6,049**	**12**	**1,195**

4.1.3. Detail of derivatives designated as fair value hedges

	12/31/2017			
	Notional amount		Assets	Liabilities
	To receive	To deliver		
Foreign exchange derivatives	6,484	6,601	174	323
Interest rate derivatives	67,666	67,661	3,094	4,965
TOTAL	**74,150**	**74,262**	**3,268**	**5,288**

	12/31/2018			
	Notional amount		Assets	Liabilities
	To receive	To deliver		
Foreign exchange derivatives	2,243	2,427	112	329
Interest rate derivatives	50,913	50,903	2,911	3,271
TOTAL	**53,156**	**53,330**	**3,023**	**3,600**

4.1.4. Detail of derivatives designated as cash flow hedges

	12/31/2017			
	Notional amount		Assets	Liabilities
	To receive	To deliver		
Foreign exchange derivatives	499	521	2	56
Interest rate derivatives	-	-	-	-
TOTAL	**499**	**521**	**2**	**56**

	12/31/2018			
	Notional amount		Assets	Liabilities
	To receive	To deliver		
Foreign exchange derivatives	697	729	(2)	68
Interest rate derivatives	-	-	-	-
TOTAL	**697**	**729**	**(2)**	**68**

	12/31/2017	12/31/2018
Amount removed from cash flow hedge reserve and included in the carrying amount of a non-financial instrument (hedging of cash flows of a highly probable transaction)	-	-

4.1.5. Detail of derivatives designated as portfolio hedges

	12/31/2017			
	Notional amount		Assets	Liabilities
	To receive	To deliver		
Interest rate derivatives	55,848	55,813	1,360	2,587
TOTAL	**55,848**	**55,813**	**1,360**	**2,587**

	12/31/2018			
	Notional amount		Assets	Liabilities
	To receive	To deliver		
Interest rate derivatives	51,809	51,804	1,114	2,358
TOTAL	**51,809**	**51,804**	**1,114**	**2,358**

4.2 - DEFERRED TAXES

Deferred tax assets and liabilities are netted out when they concern the same tax entity.

4.2.1. Analysis by nature

	12/31/2017	12/31/2018
Deferred tax assets before impairment	69	79
Impairment on deferred tax assets	-	-
Deferred tax assets	**69**	**79**

Deferred tax liabilities	-	-
TOTAL	**69**	**79**

4.2.2. Movements

	12/31/2017	12/31/2018
As of January 1	**109**	**69**
Charge/credit recognized in the income statement	(25)	(6)
Effect of change in tax rates - impact on the income statement(1)	(2)	-
Movements directly recognized in equity	(13)	(48)
Effect of change in tax rates - impact on equity	-	-
Translation adjustment	-	-
Tax audit effects	-	64
Other movements	-	-
As of end of period	**69**	**79**

(1) Caisse Française de Financement Local took into account the legislative measures designed to reduce the corporate income tax rate to 25,83% as of 2022.

4.2.3. Deferred taxes from assets on the balance sheet

	12/31/2017	12/31/2018
Loans and loan loss provisions	725	1,199
Securities	61	(192)
Derivatives	(198)	(591)
Accruals and other assets	14	13
TOTAL	**602**	**429**

4.2.4. Deferred taxes from liabilities on the balance sheet

	12/31/2017	12/31/2018
Borrowings, deposits and issues of debt securities	(533)	(352)
Derivatives	-	-
Provisions	-	2
Accruals and other liabilities	-	-
TOTAL	**(533)**	**(350)**

4.3 - TRANSACTIONS WITH RELATED-PARTIES

Analysis by nature

	Parent company(1)		Other related parties(2)	
	12/31/2017	12/31/2018	12/31/2017	12/31/2018
ASSETS				
Loans and advances due from banks at amortized cost	578	1,897	-	-
Bonds at amortized cost	-	-	9	145
LIABILITIES				
Due to banks at amortized cost	4,821	4,941	-	-
INCOME STATEMENT				
Interest income on loans and advances due from banks at amortized cost	1	5	(11)	(10)
Interest income on bonds at amortized cost	-	-	(0)	(0)
Interest expense due to banks on borrowings at amortized cost	(11)	3	-	-
Fees and commissions	(11)	(5)	(0)	(0)
Net results on derecognition of financial assets at amortized cost	-	(1)	-	-
OFF BALANCE SHEET				
Foreign exchange derivatives	1,490	1,202	-	-
Interest rate derivatives	14,018	14,302	-	-
Commitments and guarantees received	50	270	-	-
Commitments and guarantees given	3,028	6,284	-	-

(1) This item includes transactions with SFIL, the parent company of Caisse Française de Financement Local.
(2) This items may includes transactions with Caisse des dépôts et Consignations and La Banque Postale, shareholders of SFIL.

4.4 - UNREALIZED OR DEFERRED GAINS AND LOSSES, BREAKDOWN BY COUNTRY

	12/31/2017	12/31/2018
Unrealized gains and losses on available for sale securities	**(49)**	**N/A**
Belgium	0	N/A
Canada	-	N/A
Spain	1	N/A
United States	0	N/A
France	(2)	N/A
Italy	(48)	N/A
Norway	(0)	N/A
Sweden	(0)	N/A
Unrealized gains and losses on loans and receivable securities	**(78)**	**N/A**
Spain	(1)	N/A
France	2	N/A
Italy	(79)	N/A
Unrealized gains and losses on financial assets at fair value through equity	**-**	**(0)**
Unrealized gains and losses on derivatives designated as cash-flow hedges	**(30)**	**(25)**
TOTAL	**(157)**	**(25)**
Deferred taxes on gains and losses, available for sale securities	17	N/A
Deferred taxes on gains ans losses, loans and receivable securities	27	N/A
Deferred taxes on gains ans losses, financial assets at fair value through equity	-	0
Deferred taxes on gains and losses, derivatives designated as cash-flow hedges	10	6
TOTAL AFTER TAXES	**(103)**	**(19)**

5. NOTES TO THE INCOME STATEMENT (EUR millions)

5.1 - INTEREST INCOME - INTEREST EXPENSE

Caisse Française de Financement Local presents interest calculated using the effective interest rate method on financial instruments measured at amortized cost or at market value through equity under the headings "Interest income" and "Interest expense".
These headings also include interest income and expense on financial instruments recognized at fair value through profit or loss because they do not meet the SPPI criterion due to the fact that the cash flows received do not consist solely of principal and interest payments. However, the change in value calculated excluding accrued interest on these financial instruments at fair value through profit or loss is recorded under Net result of financial instruments at fair value through profit or loss (see section 5.3).
Interest income and expense on hedging derivatives are included with the revenue generated by the associated hedged items. Meanwhile, certain derivatives not classified as hedging instruments for accounting purposes are held as economic hedges of financial instruments carried at fair value through profit or loss; the interest income and expense on these economic hedge derivatives are included in the headings recording the interest on these financial instruments.

	2017	2018[1]
INTEREST INCOME	**2,645**	**2,653**
Central banks	-	-
Financial assets at fair value through profit or loss	N/A	192
Financial assets at fair value through equity	N/A	5
Loans ans advances due from banks at amortized cost	9	7
Loans and advances to customers at amortized cost	1,330	860
Bonds at amortized cost	N/A	151
Financial assets available for sale	36	N/A
Financial assets held to maturity	-	N/A
Derivatives used for hedging	1,271	1,437
Impaired assets	-	-
Other	(1)	1
INTEREST EXPENSE	**(2,460)**	**(2,525)**
Central banks	(13)	(9)
Financial Liabilities at fair value through profit or loss	-	(175)
Due to banks at amortized cost	(7)	3
Due to cutomers at amortized cost	-	-
Debt securities at amortized cost	(1,299)	(1,169)
Subordinated debt	-	-
Derivatives used for hedging	(1,141)	(1,175)
Other	(0)	-
INTEREST MARGIN	**185**	**128**

(1) Of which interest income and expense, measured using the effective interest rate method for assets and liabilities measured at amortized cost, of EUR 1,018 million and EUR -1,166 million, respectively.

5.2 - FEES AND COMMISSIONS

	2017			2018		
	Income	Expense	Net	Income	Expense	Net
Lending activity	0	-	0	0	-	0
Purchase and sale of securities	-	(1)	(1)	-	(0)	(0)
Services on securities	-	(3)	(3)	-	(3)	(3)
Commissions on financial instruments	3	-	3	1	(0)	1
Rebilling by parent company	-	(11)	(11)	-	(5)	(5)
TOTAL	**3**	**(15)**	**(12)**	**1**	**(8)**	**(7)**

5.3 - NET RESULT OF FINANCIAL INSTRUMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS

All interest received and paid on assets, liabilities and derivatives is recorded in net interest income, as required by IFRS. Thus, net gains (losses) on hedging transactions include only the change in the clean value of derivatives and the revaluation of assets and liabilities qualified as hedge relation.

	2017	2018
Net income from derivatives not documented in a hedging relationship	4	70
Net result on financial Assets or liabilities at fair value through profit or loss	N/A	(64)
Net result of hedge accounting	(37)	30
Net result of foreign exchange transactions	0	0
TOTAL	**(33)**	**36**

Analysis of net result of hedge accounting

	2017	2018
Fair value hedges	**5**	**(1)**
Fair value changes in the hedged item attributable to the hedged risk	3	20
Fair value changes in the hedging derivatives	2	(21)
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	(223)	49
Fair value changes in the hedging derivatives	223	(49)
CVA / DVA Impact(1)	**(42)**	**31**
TOTAL	**(37)**	**30**

(1) As of December 31, 2018, the application of IFRS 13 shows a net income of EUR 31 million comprised of EUR +31 million for DVA.

5.4 - NET RESULT OF FINANCIAL INSTRUMENTS AT FAIR VALUE THROUGH EQUITY

	2017	2018
Net result of disposals of bonds at fair value through equity	N/A	-
Net result of disposals of loans at fair value through equity	N/A	0
TOTAL	**N/A**	**0**

5.5 - GAINS AND LOSSES RESULTING FROM DERECOGNITION OF FINANCIAL INSTRUMENTS AT AMORTIZED COSTS

	2017	2018
Net result of disposals or prepayments of bonds at amortized cost	N/A	0
Net result of disposals or prepayments of debt to banks at amortized cost	N/A	(1)
Net result of disposals or prepayments of loans and advances to customers at amortized cost	N/A	15
Net result of disposals or prepayments of debt securities at amortized cost	N/A	-
TOTAL	**N/A**	**14**

Detail on derecognition of assets and liabilities at amortized cost

	2018	
	Amount balance sheet	Impact net result
Prepayments of securities	5	0
Net result of disposals or prepayments of securities at amortized cost	**5**	**0**
Prepayments of loans and advances to customers	47	6
Restructuring of loans and advances to customers	68	9
Net result of disposals or prepayments of loans and advances to customers at amortized cost	**115**	**15**
Sub-total Assets	**120**	**15**
Prepayments of debt to banks	1,275	(1)
Net result of prepayments of debt to banks at amortized cost	**1,275**	**(1)**
Prepayments of debt securities	-	-
Net result of prepayments of debt securities at amortized cost	**-**	**-**
Sub-total Liabilities	**1,275**	**(1)**
TOTAL		**14**

5.6 - NET RESULT OF FINANCIAL ASSETS AND LIABILITIES

	2017	2018
Net result of disposals of loans and securities available for sale	-	N/A
Net result of disposals of debt securities	(1)	N/A
Net result of the sale or cancellation of loans and advances	17	N/A
TOTAL	**16**	**N/A**

5.7 - OPERATING EXPENSE

	2017	2018
Payroll costs	-	-
Other general and administrative expense(1)	(98)	(96)
Taxes	(7)	(5)
TOTAL	**(105)**	**(101)**

(1) Of which EUR 93 million to the benefit of SFIL as of December 31, 2018.

Caisse Française de Financement Local has no salaried employees in accordance with article L.513-15 of the Monetary and Financial Code. The general management of the operations of Caisse Française de Financement Local has been entrusted by an agreement to its parent company, SFIL, a credit institution.

Specific individual agreements have been established with entities that have transferred assets to the société de crédit foncier, and continue to ensure management for their national clients. These assets are managed in a run-off mode. At the end of December 2018, there were agreements with the following entities : Kommunalkredit Austria (Austria), Belfius Banque et Assurances (Belgium), and Dexia Crediop (Italy). These agreements already existed in previous years.

Management of registered covered bonds (RCB) issued since 2015 is entrusted to Landesbank Baden-Württemberg (LBBW). Dexia Kommunalbank Deutschland continues to manage registered covered bonds issued prior to 2015.

5.8 - COST OF RISK

	2017		
	Collective impairment	Specific impairment and losses	Total
Credit (loans, advances and commitments)	16	6	22
Fixed income securities available for sale	-	-	-
TOTAL	**16**	**6**	**22**

Detail of collective and specific impairments

Collective impairment	2017		
	Allocations	Reversals	Total
Credit (loans, advances and commitments)	(1)	17	16
Fixed income securities available for sale	-	-	-
TOTAL	**(1)**	**17**	**16**

Specific Impairment	2017				
	Allocations	Reversals	Losses	Recoveries	Total
Loans and advances due from banks	-	-	-	-	-
Loans and advances to customers	(0)	6	-	-	6
Financial assets held to maturity	-	-	-	-	-
Off-balance sheet commitments	-	-	-	-	-
Total credit	**(0)**	**6**	**-**	**-**	**6**
Fixed income securities	-	-	-	-	-
TOTAL	**(0)**	**6**	**-**	**-**	**6**

	2018				
	1/1/2018	Impairments	Reversals	Losses	12/31/2018
Stage 1	-	*(0)*	*0*	-	*(0)*
Stage 2	-	-	-	-	-
Stage 3	-	-	-	-	-
Financial assets at fair value through equity	**-**	**(0)**	**0**	**-**	**(0)**
Stage 1	*(0)*	*(0)*	*0*	-	*(0)*
Stage 2	-	-	-	-	-
Stage 3	-	-	-	-	-
Loans and advances due from banks at amortized cost	**(0)**	**(0)**	**0**	**-**	**(0)**
Stage 1	*(2)*	*(0)*	*1*	*(0)*	*(1)*
Stage 2	*(21)*	*(5)*	*5*	*(0)*	*(21)*
Stage 3	*(11)*	*(7)*	*8*	*(0)*	*(10)*
Loans and advances to customers at amortized cost	**(34)**	**(12)**	**14**	**(0)**	**(32)**
Stage 1	*(4)*	*(0)*	*1*	-	*(3)*
Stage 2	*(18)*	*(11)*	*5*	-	*(24)*
Stage 3	-	*(0)*	-	-	*(0)*
Bonds at amortized cost	**(22)**	**(11)**	**6**	**-**	**(27)**
Stage 1	*(0)*	*(0)*	*0*	-	*(0)*
Stage 2	*(0)*	*(0)*	*0*	-	*(0)*
Stage 3	-	-	-	-	-
Off-balance sheet commitments at amortized cost	**(0)**	**(0)**	**0**	**-**	**(0)**
TOTAL	**(56)**	**(24)**	**20**	**(0)**	**(60)**

5.9 - CORPORATE INCOME TAX

5.9.1. Breakdown of tax expense

	2017	2018
Current taxes	(2)	(12)
Deferred taxes	(27)	(6)
Tax adjustment effects	(3)	14
TOTAL	**(32)**	**(4)**

5.9.2. Effective tax expense

The difference between the actual corporate income tax rate and the French tax rate can be analysed as follow:

	2017	2018
INCOME BEFORE INCOME TAXES	**73**	**66**
TAX BASE	**73**	**66**
Applicable tax rate at end of the period	34.43%	34.43%
THEORETICAL CORPORATE INCOME TAX AT THE STANDARD RATE	**(26)**	**(23)**
Tax effect of non-deductible expenses	(1)	(1)
Tax effect of non-taxable income	-	
Impact of items taxed at a reduced rate	-	-
Tax audit effects(1)	(3)	14
Use of corporate income tax rate applicable to the future fiscal years(2)	(2)	6
CORPORATE INCOME TAX RECORDED IN THE INCOME STATEMENT	**(32)**	**(4)**

(1) As of the end of 2018, the tax authority had levied adjustments relating to the 2012 and 2013 tax audit. It nevertheless reduced the amount of the adjustment relating to the add-back of the results of the former branch in Ireland, but maintained the principle of taxation of these results in France. Caisse Française de Financement Local settled this adjustment, assessed related deferred taxes and reversed the relevant provisions. It kept in its accounts the amount of the provision set aside in respect of sums not yet paid. The 2018 accounting result consequently shows income corresponding to the provision's and deferred taxes' adjustment.

(2) Caisse Française de Financement Local has took into account the legislative measures designed to reduce the corporate income tax rate to 25,85% as of 2022.

5.9.3. Tax consolidation

Since January 1, 2014, Caisse Française de Financement Local has been a member of the SFIL tax group.

6. NOTE ON THE OFF-BALANCE SHEET ITEMS (EUR millions)

6.1 - REGULAR WAY TRADE

	12/31/2017	12/31/2018
Assets to be delivered	-	-
Liabilities to be received	-	-

6.2 - GUARANTEES

	12/31/2017	12/31/2018
Guarantees received from credit institutions	22	8
Enhanced guarantees(1)	3,247	7,383
Guarantees received from customers(2)	2,549	2,232

(1) Irrevocable and unconditional guarantee issued by the French State to the benefit of Caisse Française de Financement Local for the refinancing of large export credits.

(2) Guarantees received from customers are generally granted by local governments.

6.3 - FINANCING COMMITMENTS

	12/31/2017	12/31/2018
Loan commitments granted to credit institutions(1)	3,028	6,284
Loan commitments granted to customers(2)	90	28
Loan commitments received from credit institutions(3)	50	270
Loan commitments received from customers	-	-

(1) Within the framework of the large export credit refinancing business, the balance corresponded to a commitment of Caisse Française de Financement Local to finance its parent company (SFIL).

(2) The financing commitments on loans and lines of credit corresponded to contracts issued but not paid out.

(3) This item concerned the amount of the overdraft authorized on the current account with SFIL, which totaled EUR 50 million.

6.4 - OTHER COMMITMENTS

	12/31/2017	12/31/2018
Commitments given(1)	3	4
Commitments received(2)	226	223

(1) It concerns the irrevocable payment commitment to the Fonds de grantie des dépôts et de résolution.

(2) It mainly concerns a loan granted to a credit institution and guaranteed by a public sector entity.

6.5 - FINANCING COMMITMENTS AND OTHER COMMITMENTS GRANTED

	Financing commitments and financial guarantees under IFRS 9								Commitments and financial guarantees measured at fair value	
	Gross amount				Impairment			Net amount	Nominal amount	Accumulated negative changes in fair value due to credit risk on non-performing commitments
	Stage 1	Stage 2	Stage 3	TOTAL	Stage 1	Stage 2	Stage 3			
Granted to credit intitutions	6,284	-	-	**6,284**	-	-	-	**6,284**	-	-
Granted to customers	5	23	-	**28**	(0)	(0)	-	**28**	-	-
TOTAL	**6,289**	**23**	**-**	**6,312**	**(0)**	**(0)**	**-**	**6,312**	**-**	**-**

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 assimilated. The breakdown of assets and liabilities as a function of the method used to determine their fair value is shown in Note 7.1.3. 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	1,706	1,706	-
Loans and advances due from banks at amortized cost	867	879	12
Loans and advances to customers at amortized cost	56,892	54,015	(2,877)
Financial assets available for sale	2,048	2,048	-
Hedging derivatives	4,629	4,629	-
TOTAL	**66,142**	**63,277**	**(2,865)**

	12/31/2018		
	Book value	Fair value	Unrecognized fair value adjustment
Central banks	1,271	1,271	-
Financial assets at fair value through profit or loss	5,584	5,584	-
Financial assets at fair value through equity	124	124	-
Loans and advances due from banks at amortized cost	2,132	2,150	18
Loans and advances to customers at amortized cost	43,781	43,166	(615)
Bonds at amortized cost	9,384	8,165	(1,219)
Hedging derivatives	4,134	4,134	-
TOTAL	**66,410**	**64,594**	**(1,816)**

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 at amortized cost	4,821	4,834	13
Debt securities at amortized cost	52,898	54,205	1,307
Hedging derivatives	7,934	7,934	-
TOTAL	**65,653**	**66,973**	**1,320**

	12/31/2018		
	Book value	Fair value	Unrecognized fair value adjustment
Financial liabilities at fair value through profit or loss	1,195	1,195	-
Due to banks at amortized cost	4,941	4,897	(44)
Debt securities at amortized cost	54,442	54,381	(61)
Hedging derivatives	5,994	5,994	-
TOTAL	**66,572**	**66,467**	**(105)**

7.1.3. Methods used to determine the fair value of financial instruments

The fair value of a fnancial instrument is determined on the basis of prices that can be observed in the market for the instrument itself or for a comparable instrument, or with the help of a technical evaluation utilizing observable market data. A hierarchy of the methods used to establish fair value has been drawn up. It is composed of the following three levels:

- Level 1 corresponds to the instruments considered to be liquid, i.e. that their valuation is based on the price observed in a liquid market, for which Caisse Française de Financement Local assured itself of the existence of a large number of contributors. Level 1 securities include in particular certain government bonds.
- Level 2 uses another method to determine the value of instruments for which Caisse Française de Financement Local can not observe market prices, but observes such for similar instruments by the same issuer or guarantor listed in the market. In this case, observable prices and other data observable in the market are used and an adjustment is made to account for the degree of the security's lack of liquidity.
- In level 3, when there is no active market or observable market data, the fair value of instruments is determined by using a valuation spread developed from an internal model. Derivatives are valued using these internal 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 tems of efciency to provide a valuation in market consensus. The result of this application is that the derivatives used by Caisse Française de Financement Local in hedging its activities are primarily of level 2.

For the derivatives in level 3, this classifcation mainly involves hybrid, structured products (interest rate – foreign exchange), spread (correlation) products and options on interest rates. This classifcation is mainly due to the fact that these products present complex payoffs which require an advanced statistical model with variable parameters which are sometimes unable to be seen in the market.

Fair value of financial assets	12/31/2017			
	Level 1	Level 2	Level 3	Total
Central banks	1,706	-	-	1,706
Loans and advances due from banks	10	579	290	879
Loans and advances to customers	488	2,868	50,659	54,015
Sub-total assets at amortized cost	**2,204**	**3,447**	**50,949**	**56,600**
Financial assets available for sale	1,561	487	-	2,048
Hedging derivatives	-	4,067	562	4,629
Sub-total fair value assets	**1,561**	**4,554**	**562**	**6,677**
TOTAL	**3,765**	**8,001**	**51,511**	**63,277**

Fair value of financial assets	12/31/2018			
	Level 1	Level 2	Level 3	Total
Central banks	1,271	-	-	1,271
Financial assets at fair value through profit or loss	-	2	5,582	5,584
Financial assets at fair value through equity	-	114	10	124
Loans and advances due from banks at amortized cost	3	1,900	247	2,150
Loans and advances to customers at amortized cost	-	-	43,166	43,166
Bonds at amortized cost	2,488	3,782	1,895	8,165
Hedging derivatives	-	3,391	743	4,134
TOTAL	**3,762**	**9,189**	**51,643**	**64,594**

Fair value of financial liabilities	12/31/2017			
	Level 1	Level 2	Level 3	Total
Due to the banks	-	4,834	-	4,834
Debt securities	-	54,205	-	54,205
Sub-total liabilities at amortized cost	**-**	**59,039**	**-**	**59,039**
Hedging derivatives	-	7,092	842	7,934
Sub-total liabilities at fair value	**-**	**7,092**	**842**	**7,934**
TOTAL	**-**	**66,131**	**842**	**66,973**

Fair value of financial liabilities	12/31/2018			
	Level 1	Level 2	Level 3	Total
Financial assets at fair value through profit or loss	-	823	372	1,195
Debt due to the banks at amortized cost	-	4,897	-	4,897
Debt securities at amortized cost	-	54,381	-	54,381
Hedging derivatives	-	5,683	311	5,994
TOTAL	**-**	**65,784**	**683**	**66,467**

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

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

	12/31/2017	12/31/2018
Uncertainty inherent in level 3 market parameters	5	8
Uncertainty inherent in level 3 derivatives valuation models	36	37
SENSITIVITY OF THE MARKET VALUE OF LEVEL 3 FINANCIAL INSTRUMENTS	**41**	**45**

7.1.4. Transfer between level 1 and 2

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

7.1.5. Level 3: flow analysis

	IAS 39		IFRS 9			
Fair value of financial assets	**Financial assets available for sale**	**Derivatives**	**Financial assets at fair value through profit or los**	**Financial assets at fair value through equity**	**Derivatives**	**Total financial assets**
12/31/2017	**-**	562	-	-	-	**562**
IFRS 9 first time application on loans	-	-	6,945	-	-	6,945
IFRS 9 first time application on derivatives	-	(562)	2	-	560	-
1/1/2018	**-**	-	6,947	-	560	**7,507**
Total gains and losses through profit or loss	-	-	-	-	1	1
Total unrealized or deferred gains and losses through profit or loss	-	-	(276)	-	189	(87)
Total unrealized or deferred gains and losses through equity	-	-	-	-	-	-
Purchase	-	-	-	10	-	10
Sale	-	-	-	-	-	-
Direct origination	-	-	-	-	-	-
Settlement	-	-	(1,089)	-	-	(1,089)
Transfer in activities destined to be sold	-	-	-	-	-	-
Transfer to level 3	-	-	-	-	2	2
Transfer out of level 3	-	-	-	-	(8)	(8)
Other variations	-	-	-	-	(1)	(1)
12/31/2018	-	-	5,582	10	743	**6,335**

Fair value of financial liabilities	IAS 39	IFRS 9		
	Derivatives	Financial liabilities at fair value through profit or loss	Derivatives	Total financial liabilities
12/31/2017	842	-	-	**842**
IFRS 9 first time application	(842)	237	605	-
01/01/18	-	237	605	**842**
Total gains and losses through profit or loss	-	-	(95)	(95)
Total unrealized or deferred gains and losses through profit or loss	-	135	(303)	(168)
Total unrealized or deferred gains and losses through equity	-	-	-	-
Purchase	-	-	6	6
Sale	-	-	(126)	(126)
Direct origination	-	-	-	-
Settlement	-	-	-	-
Transfer in activities destined to be sold	-	-	-	-
Transfer to level 3	-	-	256	256
Transfer out of level 3	-	-	(36)	(36)
Other variations	-	-	4	4
12/31/2018	-	372	311	**683**

7.2 - OFF-SETTING FINANCIAL ASSETS AND LIABILITIES

7.2.1. Financial assets subject to off-setting, enforceable master netting arrangements and similar agreements

	12/31/2017					
	Gross amounts before off-setting	Gross amounts off-set 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)	4,629	-	4,629	(3,964)	(605)	60
Loans and advances due from banks	867	-	867	-	-	867
Loans and advances to customers	56,892	-	56,892	-	-	56,892
TOTAL	**62,388**	**-**	**62,388**	**(3,964)**	**(605)**	**57,819**

	12/31/2018					
	Gross amounts before off-setting	Gross amounts off-set 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)	4,146	-	4,146	(3,629)	(471)	46
Loans and advances at fair value through profit or loss	5,572	-	5,572	-	-	5,572
Loans and advances due from banks at amortized cost	2,132	-	2,132	-	-	2,132
Loans and advances to customers at amortized cost	43,781	-	43,781	-	-	43,781
TOTAL	**55,631**	**-**	**55,631**	**(3,629)**	**(471)**	**51,531**

7.2.2. Financial liabilities subject to off-setting, enforceable master netting arrangements and similar agreements

	12/31/2017					
	Gross amounts before off-setting	Gross amounts off-set according to IAS 32	Net Amounts presented in the balance sheet	Other amounts in the application scope but not offset: Effect of master netting arrangements	Other amounts in the application scope but not offset: Financial Instruments received as collateral	Net Amounts according to IFRS 7 and 13
Derivatives (including hedging instruments)	7,934	-	7,934	(3,964)	-	3,970
Loans and advances due to banks	4,821	-	4,821	-	-	4,821
Loans and advances to customers	-	-	-	-	-	-
TOTAL	**12,755**	**-**	**12,755**	**(3,964)**	**-**	**8,791**

	12/31/2018					
	Gross amounts before off-setting	Gross amounts offset according to IAS 32	Net Amounts presented in the balance sheet	Other amounts in the application scope but not offset: Effect of master netting arrangements	Other amounts in the application scope but not offset: Financial Instruments received as collateral	Net Amounts according to IFRS 7 and 13
Derivatives (including hedging instruments)	7,188	-	7,188	(3,629)	-	3,559
Due to banks at amortized cost	4,941	-	4,941	-	-	4,941
Customer borrowings and deposits at amortized cost	-	-	-	-	-	-
TOTAL	**12,129**	**-**	**12,129**	**(3,629)**	**-**	**8,500**

7.3 - EXPOSURE TO CREDIT RISK

In 2018, exposure to credit risks, as presented to management, includes the following:

- for assets other than derivatives: the amount on the balance sheet;
- for derivatives: the derivative's market value (marked-to-market), the amount of collateral exchanged and a flat-rate add-on, depending on the derivative's maturity and the nature of the underlying;
- for off-balance sheet commitments: the undrawn amount of financing commitments, which is stated in the notes to the financial statements.

The metric used is exposure at default (EAD).

Exposure to credit risk is broken down by region and by counterparty, taking into account the guarantees received. This means that when the credit risk is guaranteed by a third party whose weighted risk (within the meaning of Basel regulations) is less than that of the direct borrower, the exposure is included in the guarantor's region and business sector.

7.3.1. Breakdown of exposure to credit risks

Analysis of exposure by geographic region

	12/31/2017	12/31/2018
France	57,703	61,996
Italy	6,156	6,097
Germany	341	374
Spain	378	307
United Kingdom	199	436
Belgium	159	281
Other European Union countries	359	634
Norway	79	255
Switzerland	1,339	1,025
United States and Canada	513	673
Japan	39	38
TOTAL EXPOSURE	**67,265**	**72,116**

Analysis of exposure by category of counterparty

	12/31/2017	12/31/2018
Sovereigns	7,430	9,917
Local public sector	58,753	58,197
Other assets guaranteed by public sector entities	12	12
Financial institutions	1,070	3,990
TOTAL EXPOSURE	**67,265**	**72,116**

Exposure on financial institutions is primarily comprised of counterparties in hedging derivatives and replacement assets. As of December 31, 2018, Caisse Française de Financement Local had no asset-backed securities.

Analysis of exposure by category of instrument

	12/31/2017	12/31/2018
Debt securities	2,066	N/A
Loans and advances	62,047	N/A
Loans at fair value through net income	N/A	5,839
Bonds at fair value through equity	N/A	124
Hedging derivatives	34	977
Loans and advances at amortized cost	N/A	49,048
Bonds at amortized cost	N/A	9,816
Financing commitments on loans	3,118	6,312
TOTAL EXPOSURE	**67,265**	**72,116**

7.3.2. Evaluation of asset credit quality

Caisse Française de Financement Local decided to use the advanced method recommended by the regulators in relation to the Basel III reforms on the capital adequacy ratio and capital requirements. Caisse Française de Financement Local has developed internal rating models covering the main client segments. These models were validated by the banking supervisors who authorized the Group to use these advanced internal models for the calculation and reporting of equity requirements for credit risk as of January 1, 2008. This enables Caisse Française de Financement Local to present on June 30, 2018, an analysis of its exposures, broken down by risk weighting, as used to calculate equity requirements. Credit weighting is mainly calculated on the basis of the probability of default of the counterparty and of the loss incurred in the event of default.

This analysis confirms the excellent quality of the assets in Caisse Française de Financement Local's portfolio. 76% of the portfolio has a weighting of 5% or less and more than 96% of the portfolio has a weighting that is less than or equal to 20%.

	Risk weighting (Basel III)				
	from 0 to 5%	**from 5% to 20%**	**from 20% to 50%**	**more than 50%**	**Total**
Loans at fair value through net income	5,071	576	-	192	5,839
Bonds at fair value through equity	94	30	-	-	124
Hedging derivatives	513	12	422	30	977
Loans and advances at amortized cost	41,043	7,220	93	692	49,048
Bonds at amortized cost	1,731	6,808	426	851	9,816
Financing commitments on loans	6,312	-	-	-	6,312
TOTAL EXPOSURE	**54,764**	**14,646**	**941**	**1,765**	**72,116**
SHARE	**75.9%**	**20.3%**	**1.3%**	**2.4%**	**100.0%**

Certain exposures do not yet benefit from an internal evaluation system validated by banking supervisors; in this case, their weighting is the one in the standard method, which is, for example, 20% for local governments.

7.4 - LIQUIDITY RISK : ANALYSIS BY TERM TO MATURITY

7.4.1. Breakdown of assets

	12/31/2018						
	Sight	Less than 3 months	3 months to 1 year	1 to 5 years	More than 5 years	No fixed maturity	Total broken down
Central banks	1,271	-	-	-	-	-	1,271
Financial assets at fair value through profit or loss	-	162	341	1,433	2,884	-	4,820
Hedging derivatives	-	-	-	-	-	-	-
Financial assets at fair value through equity	-	84	40	-	-	-	124
Loans and advances due from banks at amortized cost	3	152	665	30	1,281	-	2,131
Loans and advances to customers at amortized cost	7	1,108	2,922	13,887	24,423	-	42,347
Bonds at amortized cost	-	580	991	2,972	3,726	-	8,269
Fair value revaluation of portfolio hedge	-	-	-	-	-	-	-
Tax assets	-	-	-	-	-	79	79
Accruals and other assets	-	4	2	-	9	-	15
TOTAL	**1,281**	**2,090**	**4,961**	**18,322**	**32,323**	**79**	**59,056**

	12/31/2018				
	Total broken down	Accrued interest	Fair value adjustment	Impairment	Total
Central banks	1,271	(0)	-	-	1,271
Financial assets at fair value through profit or loss	4,820	78	686	-	5,584
Hedging derivatives	-	680	3,454	-	4,134
Financial assets at fair value through equity	124	0	(0)	-	124
Loans and advances due from banks at amortized cost	2,131	1	-	(0)	2,132
Loans and advances to customers at amortized cost	42,347	412	1,055	(33)	43,781
Bonds at amortized cost	8,269	81	1,061	(27)	9,384
Fair value revaluation of portfolio hedge	-	-	2,552	-	2,552
Tax assets	79	-	-	-	79
Accruals and other assets	15	-	-	-	15
TOTAL	**59,056**	**1,252**	**8,808**	**(60)**	**69,056**

7.4.2. Breakdown of liabilities, excluding equity

	12/31/2018						
	Sight	Less than 3 months	3 months to 1 year	1 to 5 years	More than 5 years	No fixed maturity	Total broken down
Central banks	-	-	-	-	-	-	-
Financial assets at fair value through profit or loss	-	-	-	-	-	-	-
Hedging derivatives	-	-	-	-	-	-	-
Due to banks at amortized cost	-	253	123	2,804	1,763	-	4,943
Customer borrowing and deposits at amortized cost	-	-	-	-	-	-	-
Debt securities at amortized cost	-	2,066	2,500	16,546	29,484	-	50,596
Fair value revaluation of portfolio hedge	-	-	-	-	-	-	-
Tax liabilities	-	-	1	-	-	-	1
Accruals and other liabilities	-	598	-	40	50	-	688
Provisions	-	-	-	13	0	-	13
Subordinated debt	-	-	-	-	-	-	-
TOTAL	**-**	**2,917**	**2,624**	**19,403**	**31,297**	**-**	**56,241**

	12/31/2018			
	Total broken down	Accrued interest	Fair value adjustment	Total
Central banks	-	-	-	-
Financial liabilities at fair value through profit or loss	-	69	1,126	1,195
Hedging derivatives	-	445	5,549	5,994
Due to banks at amortized cost	4,943	(2)	-	4,941
Customer borrowing and deposits at amortized cost	-	-	-	-
Debt securities at amortized cost	50,596	790	3,056	54,442
Fair value revaluation of portfolio hedge	-	-	342	342
Tax liabilities	1	-	-	1
Accruals and other liabilities	688	(0)	-	688
Provisions	13	-	-	13
Subordinated debt	-	-	-	-
TOTAL	**56,241**	**1,302**	**10,073**	**67,616**

7.4.3. Net liquidity gap

	12/31/2018							
	Sight	Less than 3 months	3 months to 1 year	1 to 5 years	More than 5 years	No fixed maturity	Total not broken down	Total
MONTANT	**1,281**	**(827)**	**2,337**	**(1,081)**	**1,026**	**79**	**(1,375)**	**1,440**

This table presents the balance sheet at the closing date; it does not take into account the management decisions that will make it possible to manage differences in maturity or the future production of assets and liabilities. Caisse Française de Financement Local's liquidity is provided by its refnancing agreement with SFIL. In addition, the Company may obtain funding from the Banque de France, by giving certain of these assets in guarantee. In addition to access to the central bank in its own name, Caisse Française de Financement Local can also mobilize certain of these eligible assets by using interbank fnancing in the form of repurchase agreements. If necessary, these transactions would easily cover its cash flow requirements.

7.5 - CURRENCY RISK

Classification by original currency	12/31/2017				
	EUR	Other EU currencies	USD	Other currencies	Total
Total assets	66,381	1,380	429	587	68,777
Total liabilities	66,381	1,380	429	587	68,777
NET BALANCE SHEET POSITION	**-**	**-**	**-**	**-**	**-**

Classification by original currency	12/31/2018				
	EUR	Other EU currencies	USD	Other currencies	Total
Total assets	67,364	978	173	541	69,056
Total liabilities	67,364	978	173	541	69,056
NET BALANCE SHEET POSITION	**-**	**-**	**-**	**-**	**-**

Caisse Française de Financement Local takes no foreign exchange risk. Assets and liabilities originally in non-euro currencies are swapped against Euribor as soon as they are recognized on the balance sheet.

7.6 - SENSITIVITY TO INTEREST RATE RISK

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

- In the first stage, all the assets and the liabilities benefiting from the privilege which do not naturally have a floating rate are hedged against Euribor until maturity as soon as they are recorded on the balance sheet. In practice, acquisitions of loan portfolios (in which the unit amount is generally small) are usually macro-hedged. Loans granted individually or bond issues can be micro- or macro-hedged. Hedging of assets and liabilities is more often obtained in using new interest rate swaps, but the same effect can also be obtained whenever possible by the cancelation of swaps of opposite direction.
- In the second stage, Euribor lending and borrowing flows (naturally or after hedges) are swapped against Eonia in order to eliminate the basis risk generated by differences in the tenor (Euribor 1, 3, 6 or 12 months) and the fixing risk due to refixing dates of reference indices that differ for the assets and the liabilities. The residual risk is managed using macro-hedges with a management horizon of one week.
  - These hedges can be entered into either directly on the market by Caisse Française de Financement Local, or through SFIL, which in turn hedges its resulting position in the market.

Non-privileged debt is not concerned by these hedging operations. In fact, debt contracted by Caisse Française de Financement Local with its shareholder to finance over-collateralization is borrowed either directly with a Eonia index and does not need to be swapped, or with a Euribor index and thus finances assets also indexed on Euribor. Short-term debt owed the Banque de France with a fixed rate (if any) is not hedged, but finances fixed rate assets.

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

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

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

Limiting directional risk

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

Directional risk
Total sensitivity

(EUR millions)	Limit	3/31/2018	6/30/2018	9/30/2018	12/31/2018
Sensitivity	25/(25)	(1.5)	1.7	(2.0)	0.9

Measurement of the slope/rotation risk

The quarter-end sensitivity measurements are presented below.

Risk of slope between two distant points on the rate curve
Sum of sensitivities

(EUR millions)	Limit	3/31/2018	6/30/2018	9/30/2018	12/31/2018
Short term	10/(10)	(7.1)	(4.3)	(5.5)	(5.8)
Medium term	10/(10)	(2.1)	(1.0)	(4.9)	0.0
Long term	10/(10)	5.6	4.6	4.6	2.5
Very long term	10/(10)	2.0	2.4	3.8	4.3

Risk of slope between two close points on the rate curve
Sum of sensitivities in absolute value

(EUR millions)	Limit	3/31/2018	6/30/2018	9/30/2018	12/31/2018
Short term	20	11.5	8.8	10.3	9.2
Medium term	20	4.6	14.4	9.9	10.0
Long term	20	7.9	8.7	13.0	12.9
Very long term	20	10.5	10.8	14.1	13.3

8. FIRST TIME APPLICATION IMPACT OF IFRS 9 STANDARD ON THE BALANCE SHEET AS OF JANUARY 1, 2018

RECLASSIFICATIONS

	IAS 39 12/31/2017	Reclassifications				Net amount after restatement phase 1
		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)]	
ASSETS						
Central banks	1,706	-	-	-	-	**1,706**
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	4,629	-	-	-	(6)	**4,623**
Financial assets available for sale	2,048	(2,048)	-	-	-	**-**
Financial assets at fair value through equity	-	200	-	-	-	**200**
Loans and advances due from banks at amortized cost	867	-	-	-	-	**867**
Loans and advances to customers at amortized cost	56,892	-	(6,422)	(7,168)	-	**43,303**
Bonds at amortized cost	-	1,848	6,422		-	**8,269**
Fair value revaluation of portfolio hedge	2,518	-	-	-	-	**2,518**
Financial assets held to maturity	-	-	-	-	-	**-**
Current tax assets	0	-	-	-	-	**0**
Deferred tax assets	69	-	-	-	-	**69**
Other assets	48	-	-	-	-	**48**
TOTAL	**68,777**	**-**	**-**	**-**	**-**	**68,777**
LIABILITIES						
Central banks	-	-	-	-	-	**-**
Derivatives at fair value through profit or loss	4	-	-	-	1,476	**1,480**
Hedging derivatives	7,930	-	-	-	(1,476)	**6,454**
Due to banks at amortized cost	4,821	-	-	-	-	**4,821**
Customer borrowing and deposits at amortized cost	-	-	-	-	-	**-**
Debt securities at amortized cost	52,898	-	-	-	-	**52,898**
Fair value revaluation of portfolio hedge	883	-	-	-	-	**883**
Current tax liabilities	0	-	-	-	-	**0**
Deferred tax liabilities	-	-	-	-	-	**-**
Other liabilities	823	-	-	-	-	**823**
Provisions	41	-	-	-	-	**41**
Subordinated debt	-	-	-	-	-	**-**
EQUITY	**1,377**	**-**	**-**	**-**	**-**	**1,377**
Capital	1,350	-	-	-	-	**1,350**
Reserves and retained earnings	89	-	-	-	-	**89**
Gains and losses recognised in equity	(103)	-	-	-	-	**(103)**
Net income for the period	41	-	-	-	-	**41**
TOTAL	**68,777**	**-**	**-**	**-**	**-**	**68,777**

(a) Instruments classified as Available for sale financial asset under IAS 39 standard 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 Bonds at amortized cost.

(b) Debt securities classified as Loans and advances to customers at amortized cost under IAS 39 standard 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 standard, 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 profit or loss 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 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.
(d) Hedging derivative instruments for which the hedged financial asset has been reclassified as Financial assets at fair value through profit or loss have been disqualified and reclassified, on the asset side or the liability side of the balance sheet, as Derivatives at fair value through profit or loss.

VALUE ADJUSTMENTS

	Amount after restatement phase 1	Adjustment value Phase 1				Adjustment phase 2	IFRS 9 1/1/2018
		Restatment of financial assets available for sale[(a)]	restatment of Bonds assimilated to loans and advances in IAS 39[(b)]	restatment of loans and advances non SPPI[(c)]	other restatment[(d)]	Provisions for credit risk[(e)]	
ASSETS							
Central banks	1,706	-	-	-	-	-	**1,706**
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	4,623	-	-	-	-	-	**4,623**
Financial assets available for sale	-	-	-	-	-	-	**-**
Financial assets at fair value through equity	200	-	-	-	-	-	**200**
Loans and advances due from banks at amortized cost	867	-	-	-	-	-	**867**
Loans and advances to customers at amortized cost	43,303	-	-	-	198	(16)	**43,485**
Bonds at amortized cost	8,269	49	78	-	-	(5)	**8,391**
Fair value revaluation of portfolio hedge	2,518	-	-	-	-	-	**2,518**
Financial assets held to maturity	-	-	-	-	-	-	**-**
Current tax assets	0	-	-	-	-	-	**0**
Deferred tax assets	69	(17)	(27)	83	(68)	3	**43**
Other assets	48	-	-	-	-	-	**48**
TOTAL	**68,777**	**32**	**51**	**(158)**	**130**	**(0)**	**68,832**

	Amount after restatment phase 1	Adjustment value Phase 1				Adjustment phase 2	IFRS 9 1/1/2018
		Restatment of financial assets available for sale[(a)]	restatment of Bonds assimilated to loans and advances in IAS 39[(b)]	restatment of loans and advances non SPPI[(c)]	other restatment[(d)]	Provisions for credit risk[(e)]	
LIABILITIES							
Central banks	-	-	-	-	-	-	**-**
Derivatives at fair value through profit or loss	1,480	-	-	-	-	-	**1,480**
Hedging derivatives	6,454	-	-	-	-	-	**6,454**
Due to banks at amortized cost	4,821	-	-	-	-	-	**4,821**
Customer borrowing and deposits at amortized cost	-	-	-	-	-	-	**-**
Debt securities at amortized cost	52,898	-	-	-	(1)	-	**52,897**
Fair value revaluation of portfolio hedge	883	-	-	-	-	-	**883**
Current tax liabilities	0	-	-	-	-	-	**0**
Deferred tax liabilities	-	-	-	-	-	-	**-**
Other liabilities	823	-	-	-	-	-	**823**
Provisions	41	-	-	-	-	6	**47**
Subordinated debt	-	-	-	-	-	-	**-**
EQUITY	**1,377**	**32**	**51**	**(158)**	**131**	**(6)**	**1,427**
Capital	1,350	-	-	-	-	-	**1,350**
Reserves and retained earnings	89	-	-	(158)	131	(6)	**56**
Gains and losses recognised in equity	(103)	32	51	-	-	-	**(20)**
Net income for the period	41	-	-	-	-	-	**41**
TOTAL	**68,777**	**32**	**51**	**(158)**	**130**	**(0)**	**68,832**

(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 Bonds at amortized cost under IFRS 9 standard has been reversed.
(b) Most od 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 standard results in the reversal of the fraction yet not amortized of this reserve.
(c) The measurement at fair value through profit or loss 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 standard 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 force of the new impairment model for credit risk has resulted on January 1, 2018 in a EUR 9 millions increase of impairments (without considering tax effects), which can be broken down into the following effects:
- Recognition of loss allowances on Bucket 1 contracts: EUR -6 millions;
- Recognition of loss allowances on Bucket 2 contracts: EUR -39 millions;
- Complete reversal of the stock of collective impairments previously recognized: EUR +24 millions;
- Variations of specific impairment on Bucket 3 contracts (base changing): EUR +12 millions, the main effect of this impact is the reversal of the impairment on assets measured at amor-tized cost until December 31, 2017 under IAS 39 and that are measured at fair value through profit or loss from January 1, 2018 under IFRS 9.

BREAKDOWN OF FINANCIAL ASSETS BY STAGE OF CREDIT RISK

	1/1/2018							
	Gross amount				Impairment			Net Amount
	Stage 1	Stage 2	Stage 3	**TOTAL**	Stage 1	Stage 2	Stage 3	
Financial assets at fair value through equity	200	-	-	**200**	-	-	-	**200**
Loans and advances due from banks at amortized cost	867	-	-	**867**	(0)	-	-	**867**
Loans and advances to customers at amortized cost	38,498	3,610	1,432	**43,540**	(5)	(39)	(11)	**43,485**
Bonds at amortized cost	6,475	1,831	86	**8,392**	(1)	(0)	-	**8,391**
TOTAL FINANCIAL ASSETS	**46,040**	**5,441**	**1,518**	**52,999**	**(6)**	**(39)**	**(11)**	**52,943**

GAP ANALYSIS BETWEEN PROVISIONS UNDER IAS 39 AND EXPECTED LOSSES UNDER IFRS 9

	IAS 39	Restatments	Adjustment value	IFRS 9
	12/31/2017	Asset impacts of restatments	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	**53**	**(24)**	**27**	**56**

9. POST-CLOSING EVENTS

No significant event that influences the Company's financial situation has occurred since the closing on December 31, 2018.

Statutory auditors' report on the financial statements established under IFRS standards

Year ended December 31, 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 should be read in conjunction with, and is construed in accordance with, French law and professional standards applicable in France.

To the Chief Executive Officer,

In our capacity as statutory auditors of Caisse Française de Financement Local (the "Company") and pursuant to your request, in the context of the wish of your Company to provide more extensive financial information to investors, we have audited the accompanying interim financial statements of Caisse Française de Financement Local for the year ended December 31, 2018 established in accordance with IFRS as adopted by the European Union.

These financial statements have been prepared under the responsibility of your Executive Board . Our role is to express an opinion on these financial statements, based on our audit.

We conducted our audit in accordance with professional standards applicable in France and the professional guidance issued by the French Institute of statutory auditors (Compagnie nationale des commissaires aux comptes) relating to this engagement. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the annual financial statements are free of material misstatement. An audit includes examining, using sample testing techniques or other selection methods, evidence supporting the amounts and disclosures in the annual financial statements. An audit also includes evaluating the appropriateness of accounting policies used and significant accounting estimates made, as well as evaluating the overall financial statement presentation. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

In our opinion, the financial statements present fairly, in all material respects, the assets and liabilities and the financial position of the Company as of year-end, and the results of its operations for the year then ended in accordance with IFRS as adopted by the European Union.

Without qualifying the conclusion expressed above, we draw your attention to the changes in accounting policy relating to the application of the new IFRS 9 "Financial Instruments" and IFRS 15 "Revenue from Contracts with Customers" set out in the note 1 "Accounting policies and valuation methods", as well as in the other notes presenting the figures related to this first application for IFRS 9.

This report is governed by French law. The courts of France shall have exclusive jurisdiction over any claim, dispute or difference resulting from our engagement letter or the present report, or any related matters. Each party irrevocably waives its right to oppose any action brought before French courts, to claim that the action is being brought before an illegitimate court or that the courts have no jurisdiction.

Paris-La Défense, March 29, 2019

The Statutory Auditors
French original signed by

DELOITTE & ASSOCIÉS	**ERNST & YOUNG ET Autres**
Sylvie Bourguignon	Vincent Roty

French GAAP Financial Statements

Assets

EUR millions	Notes	12/31/2017	12/31/2018
Central banks	*2.1*	1,706	1,271
Government and public securities	*2.2*	4,091	3,160
Loans and advances due from banks	*2.3*	905	2,157
Loans and advances to customers	*2.4*	46,871	46,114
Bonds and other fixed income securities	*2.5*	3,401	5,299
Equities and other variable income securities		-	-
Investments in non-consolidated companies and other long-term investments		-	-
Investments in consolidated companies		-	-
Intangible assets		-	-
Property and equipment		-	-
Unpaid capital		-	-
Uncalled subscribed capital		-	-
Treasury stock		-	-
Other assets	*2.6*	17	7
Accruals and other assets	*2.7*	2,723	2,576
TOTAL ASSETS	*2.8*	**59,714**	**60,584**

Liabilities

EUR millions	Notes	12/31/2017	12/31/2018
Central banks		-	-
Due to banks	*3.1*	4,821	4,941
Customer borrowings and deposits		-	-
Debt securities	*3.2*	49,919	51,052
Other liabilities	*3.3*	797	635
Accruals and other liabilities	*3.4*	2,552	2,418
Provisions	*3.5*	173	92
Subordinated debt		-	-
Equity		**1,452**	**1,446**
Share capital	*3.6*	1,350	1,350
Additional paid-in capital	*3.6*	-	-
Reserves and retained earnings	*3.6*	72	52
Net income	*3.6*	30	44
TOTAL LIABILITIES	*3.7*	**59,714**	**60,584**

Off-balance sheet items

EUR millions	Notes	31/12/17	31/12/18
COMMITMENTS GRANTED	***4.1***	**3,121**	**6,316**
Financing commitments		3,118	6,312
Guarantees granted		-	-
Commitments on securities		-	-
Other commitments granted		3	4
COMMITMENTS RECEIVED	***4.2***	**6,093**	**10,117**
Financing commitments		50	270
Guarantees received		6,043	9,847
Commitments on securities		-	-
Forward commitments		-	-
Other commitments received		-	-
Foreign currency transactions	*4.3*	14,244	12,449
Interest rate derivatives	*4.4*	123,616	107,325

Income statement

EUR millions	Notes	2017	2018
Interest income	*5.1*	963	1,013
Interest expense	*5.1*	(836)	(863)
Income from variable income securities		-	-
Commission income	*5.2*	3	1
Commission expense	*5.2*	(15)	(8)
Net gains (losses) on held for trading portfolio		0	-
Net gains (losses) on placement portfolio	*5.3*	3	(9)
Other banking income		0	-
Other banking expense		(0)	-
NET BANKING INCOME		**118**	**134**
General operating expenses	*5.4*	(105)	(101)
Depreciation and amortization		-	-
GROSS OPERATING INCOME		**13**	**33**
Cost of risk	*5.5*	22	(16)
INCOME FROM OPERATIONS		**35**	**17**
Gains or losses on fixed assets		-	-
INCOME BEFORE NON-RECURRING ITEMS AND TAXES		**35**	**17**
Non-recurring items		-	-
Income tax	*5.6*	(5)	27
NET INCOME		**30**	**44**
Basic earnings per share		2.20	3.23
Diluted earnings per share		2.20	3.23

Equity

EUR millions	Amount
AS OF 12/31/2017	
Share capital	1,350
Additional paid-in capital	-
Commitments to increase share capital and additional paid-in capital	-
Reserves and retained earnings	72
Net income for the year	30
Interim dividends	-
EQUITY AS OF 12/31/2017	**1,452**
MOVEMENTS FOR THE PERIOD	
Changes in share capital	-
Changes in additional paid-in capital	-
Changes in commitments to increase share capital and additional paid-in capital	-
Changes in reserves and retained earnings	30
Dividends paid (-)	(50)
Changes in net income for the period	14
Other movements	-
AS OF 12/31/2018	
Share capital	1,350
Additional paid-in capital	-
Commitments to increase share capital and additional paid-in capital	-
Reserves and retained earnings	52
Net income for the period	44
EQUITY AS OF 12/31/2018	**1,446**

Cash flow statement

EUR millions	2017	2018
NET INCOME BEFORE TAXES	**35**	**27**
+/- Depreciation and write-downs	(40)	(108)
+/- Expense / income from operating activities	146	(19)
+/- Expense / income from financing activities	(99)	(13)
+/- Other items	24	165
= Non monetary elements included in net income before tax and other adjustments	**31**	**25**
+/- Cash from interbank operations	(883)	(1,151)
+/- Cash from customer operations (loans)	620	679
+/- Cash from customer financing assets	313	(934)
+/- Cash from hedging financial instruments	(607)	(286)
- Income tax paid	(29)	4
= Decrease / (increase) in cash from operating activities	**(586)**	**(1,688)**
CASH FLOW FROM OPERATING ACTIVITIES (A)	**(520)**	**(1,636)**
CASH FLOW FROM INVESTING ACTIVITIES (B)	**-**	**-**
+/- Cash from or for shareholders	(0)	(50)
+/- Other cash from financing activities	(1,452)	1,246
CASH FLOW FROM FINANCING ACTIVITIES (C)	**(1,452)**	**1,196**
EFFECT OF EXCHANGE RATES CHANGES ON CASH (D)	**-**	**-**
Increase / (decrease) in cash equivalents (A + B+ C + D)	**(1,972)**	**(440)**
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD	**3,693**	**1,721**
Central banks (assets and liabilities)	3,684	1,706
Interbank accounts (assets and liabilities) and loans / deposits at sight	9	15
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	**1,721**	**1,281**
Central banks (assets and liabilities)	1,706	1,271
Interbank accounts (assets and liabilities) and loans / deposits at sight	15	10
NET CHANGE IN CASH	**(1,972)**	**(440)**

Notes to the French GAAP financial statements

1. SIGNIFICANT ACCOUNTING AND VALUATION POLICIES

1.1 – APPLICABLE ACCOUNTING STANDARDS: RULES ADOPTED BY THE FRENCH ACCOUNTING STANDARDS BOARD (AUTORITÉ DES NORMES COMPTABLES – ANC)

The financial statements as of December 31, 2018, were examined by the Executive Board on March 25, 2019.

Caisse Française de Financement Local prepares its financial statements in compliance with ANC Regulation n°2014-07 issued on November 26, 2014 and related to the accounts for the reporting entities of the banking sector, and in particular credit institutions. As stated in it article 3 and subject to the provisions of the latter regulation, these reporting entities prepare their financial statements in compliance with ANC Regulation n°2014-03 issued on June 5, 2014 and related to general accounting plan. The financial statements are furthermore in accordance with the indications of Directive 86/635/EEC of the Council of European Communities.

The financial statements as of December 31, 2018, were prepared using the same accounting policies as those used in the financial statements as of December 31, 2017. Between these two dates, the applicable regulation has in particular been amended as such:

- **ANC Regulation n°2018-01 issued on April 20, 2018 (amending ANC Regulation n°2014-03):** this regulation redefines the changes in "accounting policies", the changes in "accounting estimates" and "errors corrections" under French GAAP, more closely into line with the definitions under international accounting standards (IAS 8). Applicable to the reporting periods opened at the date when it was published (i.e. 2018 annual period for Caisse Française de Financement Local), this regulation reaffirms the accounting principle of consistency in applying accounting policies and further elaborates that only one or the other of the following exemptions shall be retained: either the change is required by an amendment of the accounting regulation, or, when the accounting regulation has not been amended, a choice between several accounting policies is provided and the change ultimately enhances the quality of financial information. The accounting treatments to recognize these changes and corrections are further detailed but these treatments are not significantly amended, a change in accounting policies remaining in practice the only case to result in a retrospective retreatment. Moreover, ANC reviews the listing of the "reference methods", formerly referred as "preferential methods".

  This regulation has no material impact on Caisse Française de Financement Local financial statements presented below, mainly due to the fact that during the 2018 annual reporting period Caisse Française de Financement Local has enforced no change in accounting policies within the meaning of this regulation.

- **ANC Regulation n°2018-02 issued on July 6, 2018 (amending ANC Regulation n°2014-03):** this regulation amends the general accounting plan so as to adapt it to the entry into force of the income tax at source on January 1, 2019. Applicable from this date, the regulation clarifies the principles of recognition of the income tax at source and introduces the new accounts created in that purpose.

  This regulation has and will have no impact on Caisse Française de Financement Local financial statements, given that the latter has no salaried employees in accordance with the provisions of article L.513-15 of the Monetary and Financial Code, the general management of its operations having been entrusted by an agreement to its parent Company, SFIL, a credit institution.

- **ANC Regulation n°2018-07 issued on December 10, 2018 (amending ANC Regulation n°2014-03):** this regulation amends the general accounting plan so as to clarify the way crypto-assets, referred as "jetons" in the regulation, issued in particular in the event of ICOs (Initial Coin Offerings) or subsequently purchased in the secondary market shall be recognized in the accounts of both the issuer and the holder. In addition to the clarification of the accounting principles governing these instruments, this regulation introduces the new items of the individual financial statements created to recognize these "jetons" and the underlying accounts.

  This regulation has no impact on Caisse Française de Financement Local financial statements presented below, given that it has issued and holds no crypto-assets ("jetons").

1.2 – ACCOUNTING PRINCIPLES APPLIED TO THE FINANCIAL STATEMENTS

The financial statements have been prepared in accordance with French generally accepted accounting principles, respecting the principles of prudence, sincerity and true and faithful image, on the basis of the following assumptions:
- going concern principle,
- segregation of accounting periods,
- consistency of methods,
- historical costs,
- no netting principle,
- intangibility of the opening balance sheet.

1.2.1. Loans and advances to banks and to customers

Loans and advances to banks include all loans connected to banking transactions with credit institutions, except securities. They are broken down into sight accounts and term loans. They include in particular loans granted to SFIL refinancing export credit transactions.

Loans and advances to customers comprise loans granted to local governments.

Loans and advances to customers are recognized in the balance sheet net of impairment for possible losses. The undrawn portion of signed loan agreements is recognized as an off-balance sheet item.

Interest on loans is recognized as Interest income, *prorata temporis* for accrued amounts due and not yet due, as is interest on past-dues.

Commissions received and marginal transaction costs related to the granting or the acquisition of a loan, if they are significant, are amortized over the maturity of the loan. Other commission income is immediately recognized in the income statement.

Prepayment indemnities are recognized in the income statement at the date they occur.

A loan is considered as non-performing when it presents one of the following characteristics:
- a probable or certain risk that it will not be repaid (past-due for more than nine months for local government borrowers, and for more than three months for the other counterparties);
- the existence of a factual counterparty risk (worsening of the financial situation, alert procedures).

Compromised non-performing loans are loans to borrowers whose recovery outlook is so downgraded that they might be ultimately written off. Loans accounted for as non-performing for more than one year are transferred to this category.

Impairment charges are recognized for non-performing and compromised non-performing loans:
- the fraction of principal impaired is determined by Risk Management in function of incurred losses. Underlying impairment charges and subsequent reversals are recognized as Cost of risk as well as the losses and subsequent recoveries on the principal of non-recoverable loans;
- interest is fully impaired. Underlying impairment charges and subsequent reversals are recognized as net interest margin as well as the losses and subsequent recoveries on the interest of non-recoverable loans.

1.2.2. Securities

Securities held by Caisse Française de Financement Local are recognized on the asset side of the balance sheet under the item Government and public securities or Bonds and other fixed income securities.

The item Government and public securities includes securities issued by public sector entities that may be refinanced through the European system of central banks.

The item Bonds and other fixed income securities includes:
- securities issued by public sector entities that are not eligible for refinancing by central banks;
- securities guaranteed by public sector entities.

Securities held by Caisse Française de Financement Local are recognized as either investment securities or placement securities.

1.2.2.1. Investment securities

Fixed income securities with a specified maturity are recognized as investment securities when there is the intention and the capacity to hold them to maturity. Securities in this category are subject to back-financing or interest-rate hedging over their residual maturity.

Investment securities are recognized on the date of purchase at acquisition clean price, excluding fees. Accrued interest at the date of acquisition and subsequently accrued interest at the end of each reporting period is recognized on the balance sheet in the same categories as the corresponding security. Interest on these securities is recognized as Interest income.

The difference between the redemption value and the acquisition clean cost (discount or premium) is amortized according to a quasi-actuarial method over the residual maturity of the security.

At closing date, unrealized gains are not recognized and unrealized losses are generally not impaired. By way of exception, unrealized losses are impaired in the following cases:
- a doubt about the issuer's ability to meet his obligations;
- the probability that the Company will not hold these securities until maturity due to new circumstances.

1.2.2.2. Placement securities

Securities that do no fit in investment securities are recognized as placement securities.

Placement securities are recognized on the date of purchase at acquisition clean price, excluding fees. Accrued interest at the date of acquisition and subsequently accrued interest at the end of each reporting period is recognized on the balance sheet in the same categories as the corresponding security. Interest on these securities is recognized as Interest income.

The difference between the redemption value and the acquisition clean cost (discount or premium) is amortized according to a quasi-actuarial method over the residual maturity of the security.

In application of the principle of prudence, placement securities are recognized on the balance sheet at their acquisition cost including if applicable the amortization of discount or premium or selling price at closing, whichever is lower, after accounting, when relevant, for the value of the micro-hedge swap.

If the market for a financial instrument is not active, valuation techniques are used to calculate its selling price. The valuation model should take into account all the factors that market players would consider to valuate the asset. Within this framework, Caisse Française de Financement Local relies on its own valuation models, making every effort to take into account the market conditions at the date of the valuation as well as any changes in the credit quality of these financial instruments and market liquidity.

When the decrease in the value of the security exceeds the unrealized gain on the micro-hedge, the decrease in net value is recognized as asset impairment in Net gains (losses) on placement portfolio transactions, as well as subsequent impairment reversals and capital gains and losses on sales.

Placement securities transferred to investment securities are recognized at their acquisition cost and previously recognized impairment is reversed over the residual maturity of the securities concerned.

1.2.3. Debt due to banks

Debt due to banks is broken down according to the type of debt (sight accounts, current accounts, long-term loans or non-allocated receivables) and the initial maturity (sight or term debt).

Interest accrued on this debt is recognized in liabilities, offsetting income statement.

1.2.4. Debt securities

Debt securities comprise *obligations foncières* and other resources benefiting from the privilege defined in article L.513-11 of the Monetary and Financial Code (Registered covered bonds).

Debt securities are recognized at nominal value.

Redemption and issue premiums are amortized according to a quasi-actuarial method over the maturity of the securities concerned prorata temporis. They are recognized on the balance sheet in the same categories as the corresponding debt. Amortization of these premiums is recognized in the income statement as Interest expense. If securities are issued above par, amortization of issue premiums is deducted from Interest expense.

Interest is recognized in the net interest margin for accrued amounts calculated prorata temporis.

Issuance costs and commissions related to issued securities are amortized according to a quasi-actuarial method over the maturity of the related debts and are recognized in the net interest margin as Interest expense.

Bonds issued which are denominated in foreign currencies are accounted for using the same method as foreign currency transactions (see below).

1.2.5. Provisions

Provisions are recognized based on their discounted value when the three following conditions are met:
- Caisse Française de Financement Local has a present legal or constructive obligation as a result of past events;
- it is probable that an outflow of resources representing economic benefits will be required to settle the obligation;
- a reliable estimate of the amount of the obligation can be made.

Collective provision covers the risk of loss in value among the population of loans, bonds and loan commitments not yet covered by any specific loss allowance at closing date. Among this population, counterparties that are reviewed in watchlist committee or might be reviewed in a foreseeable future are identified through the use of automatic criteria (based in particular on internal ratings and warning indicators for rating migration determined to be risky) and ad-hoc analysis based on the use of professional judgement and expert opinion: outstanding on these counterparties forms the base of the collective provision. Losses on these counterparties are estimated on the basis of past events (use of historical patterns), current economic environment and expectations on future economic environment. For this purpose, Caisse Française de Financement Local uses a credit risk model based on an approach derived from Basel approach; this model is subject to regular back-testing.

On January 1, 2018, Caisse Française de Financement Local expanded the scope of calculation of collective provision so as to include some of the exposures which have experimented a significant increase in credit risk since initial recognition. For these exposures, the characterization of such an increase in risk is realized for the IFRS accounts in compliance with IFRS 9, and their provisioning in the annual accounts is compliant with the principle of prudence under which is based the recognition under French GAAP of collective provision, base of which is portfolios of homogeneous and performing exposures. This expansion of the scope of collective provision corresponds to a development of judgment and hypothesis when applying impairment accounting method, which constitutes a change in accounting estimates under ANC Regulation, n°2018-01 issued on April 20, 2018; as such it resulted in the recognition of an incremental loss allowance in cost of risk during the 2018 reporting period.

1.2.6. Derivative transactions

Caisse Française de Financement Local engages in derivative transactions only to hedge the interest rate and foreign exchange risks to which it is exposed in its activity. Depending on their purpose, these transactions are assigned to micro-hedge or macro-hedge portfolios. The valuation and accounting treatments of these financial instruments depends on the chosen category.

Pursuant to article L.513-10 of the Monetary and Financial Code, these transactions benefit from the privilege defined in article L.513-11 of the Monetary and Financial Code provided that their purpose is to hedge the assets or debt benefiting from the privilege and the overall risk on the assets, liabilities and off-balance sheet items. The law stipulates that derivative transactions do not benefit from the privilege when related to sources of financing that do not benefit from the privilege. For Caisse Française de Financement Local, the only resources that do not benefit from the privilege comprise the debt contracted from SFIL and Caisse Française de Financement Locas's equity, which are not hedged.

The notional amount of these transactions is recognized off-balance sheet over the maturity of the instruments, i.e. from the date the contract is signed (including forward contracts) up to maturity. The amount recognized is adjusted to reflect any changes in notional amounts so as to represent the current or future maximum commitment.

Payments made at the inception of financial instruments are amortized over their maturity for the time remaining according to a quasi-actuarial method.

1.2.6.1 Micro-hedge transactions

Derivatives are booked as micro-hedges when they are designed to hedge against the interest rate risk or the foreign exchange risk related to an item or a set of homogeneous items identified from the outset.

Expense and income on these transactions are recognized in the nincome statement the same way as income and expense on the hedged item or set of homogeneous items.

Termination fees received or paid because of the early interruption of the hedging instrument are recognized in the income statement at the termination date.

1.2.6.2. Macro-hedge transactions

This category includes transactions designed to hedge and manage the Company's overall exposure to interest rate risk on assets, liabilities and off-balance sheet items, excluding micro-hedge transactions. They were authorized on December 1, 1999, by a specific decision of the Executive Board of Caisse Française de Financement Local.

Expense and income on these transactions are recognized in the income statement *prorata temporis*, respectively as Interest expense and Interest income. The counterpart is recognized in accruals until the payment date.

If the prepayment of a loan leads to the cancellation of macro-hedge swaps, the swaps termination fee is recognized in the net result at the termination date.

1.2.7. Foreign currency transactions

Caisse Française de Financement Local recognizes foreign currency transactions in accounts opened and denominated in each of the currencies used.

Specific foreign exchange position accounts and foreign exchange position equivalent accounts are opened in each currency.

At each closing date, differences between on the one hand the amounts resulting from a market price valuation at closing date of the foreign exchange position accounts and on the other hand the amounts recognized in the foreign exchange position equivalent accounts are recognized in the income statement.

1.2.8. Foreign exchange transactions

In the course of systematic hedging of its foreign exchange risk, Caisse Française de Financement Local enters into currency swaps. These currency swaps are initiated to eliminate the risk of foreign exchange rate fluctuations that might affect an asset or liability as soon as such a risk is identified. They are mainly used to hedge certain liabilities, debt securities and customer loans.

Results of foreign exchange hedging transactions are accounted for by recognizing the difference between the hedging rate and the spot rate – contango or backwardation – *prorata temporis* in the income statement.

1.2.9. Guarantees

As part of its activity to refinance large export credits, Caisse Française de Financement Local benefits from an irrevocable and unconditional 100% guarantee by the French State, called an enhanced guarantee. Expenses related to these guarantees are recognized *prorata temporis* in the net interest margin.

1.2.10. Non-recurring income and expense

Non-recurring income and expense result from events or transactions that do not relate to ordinary business operations or routine management of the Company's assets and liabilities.

Furthermore, the income or expense involved does not depend on decisions taken within the framework of usual management of the Company's activities or assets, but results from external events of a completely exceptional nature. Only items of this nature that have a significant impact on the period's income statement are recognized as non-recurring income and expense.

1.2.11. Tax consolidation

Since January 1, 2014, Caisse Française de Financement Local belongs to the tax group that is headed up by SFIL. This entity pays the total income tax and lump-sum annual tax owed by the Group. Caisse Française de Financement Local recognizes in its accounts the tax expense for which it would be liable if it were not a member of the tax group.

Tax savings realized by the tax group are recognized in the accounts of SFIL.

1.2.12. Offices and activities in uncooperative States and territories

In application of article L.511-45 of the Monetary and Financial Code, it should be noted that Caisse Française de Financement Local has no offices in States that have not signed an administrative assistance agreement with France (subsidiaries, branches, including *ad hoc* entities, and equity interest in other entities over which the Company has exclusive or joint (or *de facto*) control).

1.2.13. Identity of the parent Company consolidating the accounts of Caisse Française de Financement Local as of December 31, 2018

SFIL
1-3 rue du Passeur de Boulogne
92130 Issy-les-Moulineaux

2. NOTES TO THE ASSETS (EUR millions)

2.1 - CENTRAL BANKS

	12/31/2017	12/31/2018
Mandatory reserves	-	-
Other deposits	1,706	1,271
TOTAL	**1,706**	**1,271**

2.2 - GOVERNMENT AND PUBLIC ENTITY SECURITIES ELIGIBLE FOR CENTRAL BANK REFINANCING

2.2.1. Accrued interest included in this item: 22

2.2.2. Analysis by residual maturity excluding accrued interest

Less than 3 months	3 months to 1 year	1 year to 5 years	More than 5 years	Total
194	223	728	1,993	**3,138**

2.2.3. Analysis by listed securities and other securities excluding accrued interest

	Amount as of 12/31/2018	Amount as of 12/31/2018	Impairment as of 12/31/2018	Unrealized capital gain or loss as of 12/31/2018(2)
Listed securities(1)	3,755	2,858	(0)	(495)
Other securities	283	280	-	(46)
TOTAL	**4,038**	**3,138**	**(0)**	**(541)**

(1) Listed securities are registered for trading on a stock exchange.
(2) The unrealized capital gain or loss is calculated as the difference between the book value and the market value, taking derivatives into account.

2.2.4. Analysis by type of portfolio excluding accrued interest and changes during the year

Portfolio	Net amount as of 12/31/2017	Gross amount as of 12/31/2017	Acquisitions	Amortization, redemption or disposals	Transfers(1)	Subtotal as of 12/31/2018
Trading	-	-	-	-	-	-
Placement	1,076	1,076	214	(398)	-	891
Investment	2,962	2,962	-	(53)	(663)	2,246
TOTAL	**4,038**	**4,038**	**214**	**(451)**	**(663)**	**3,137**

Portfolio	Subtotal as of 12/31/2018	Translation adjustments	Gross amount as of 12/31/2018	Impairment as of 12/31/2018	Net amount as of 12/31/2018(2)	Unrealized capital gain or loss as of 12/31/2018(3)
Trading	-	-	-	-	-	-
Placement	891	-	891	(0)	891	(37)
Investment	2,246	1	2,247	-	2,247	(504)
TOTAL	**3,137**	**1**	**3,138**	**(0)**	**3,138**	**(541)**

(1) The transfer corresponds to a reclassification in the Bonds portfolio and to the fixed income securities detailed in 2.5. in the same accounting portfolio category.
(2) This amount includes a premium / discount of EUR 13 million for the placement portfolio and of EUR 110 million for the investment portfolio.
(3) The unrealized capital gain or loss is calculated as the difference between the book value and the market value, taking derivatives into account.

2.2.5. Impairment breakdown by country

See note 2.9

2.3 - LOANS AND ADVANCES DUE FROM BANKS

2.3.1. Sight loans and advances due from banks

	12/31/2017	12/31/2018
Sight accounts	10	3
Unallocated sums	13	-
TOTAL	**23**	**3**
of which replacement assets	*10*	*3*

2.3.2. Term loans and advances due from banks

2.3.2.1. Accrued interest included in this item: 1

2.3.2.2. Analysis by residual maturity excluding accrued interest

Less than 3 months	3 months to 1 year	1 year to 5 years	More than 5 years	Total
152	665	30	1,306	**2,153**

2.3.2.3. Analysis by initial maturity excluding accrued interest

	Net amount as of 12/31/2017	Gross amount as of 12/31/2018	Decrease in value as of 12/31/2018	Net amount as of 12/31/2018
Loans of less than 1 year	-	110	-	110
Loans of more than 1 year	880	2,043	-	2,043
TOTAL	**880**	**2,153**	**-**	**2,153**

2.3.2.4. Breakdown by counterparty

	12/31/2017	12/31/2018
SFIL - Export credits refinancing loans guaranteed by the French State(1)	218	1,097
SFIL - Others loans(2)	360	800
Swiss cantonal banks benefiting from their cantons' legal guarantee	29	-
Banks guaranteed by a local government, *crédits municipaux*	21	8
Other credit institutions: loans benefiting from the assignment in guarantee of refinanced public debt	252	248
TOTAL	**880**	**2,153**
of which replacement assets	*360*	*800*

(1) Caisse Française de Financement Local grants loans to its parent company, SFIL, to refinance large export credits granted by SFIL. These loans benefit from an irrevocable and unconditional 100% guarantee by the French State, referred to as enhanced guarantee.
(2) Caisse Française de Financement Local has invested some of its surplus cash in loans granted to its parent company SFIL.

2.4 - CUSTOMER LOANS AND ADVANCES

2.4.1. Accrued interest included in this item: 489

2.4.2. Analysis by residual maturity excluding accrued interest

Less than 3 months	3 months to 1 year	1 year to 5 years	More than 5 years	Total
1,373	3,217	15,074	25,961	**45,625**

2.4.3. Analysis of commitments by the counterparty's economic sector excluding accrued interest

Economic sector	12/31/2017	12/31/2018(1)
Public sector	44,173	43,681
Other sectors	2,168	1,944
TOTAL	**46,341**	**45,625**

(1) Of which EUR 39,807 eligible for central bank refinancing

2.4.4. Analysis by initial maturity excluding accrued interest

	Net amount as of 12/31/2017	Gross amount as of 12/31/2018	Impairment as of 12/31/2018	Net amount as of 12/31/2018
Loans of less than 1 year	5	7	-	7
Loans of more than 1 year	46,336	45,645	(27)	45,618
TOTAL	**46,341**	**45,652**	**(27)**	**45,625**

2.4.5. Analysis of loans by category of outstanding loans excluding accrued interest

	Net amount as of 12/31/2017	Gross amount as of 12/31/2018	Impairment as of 12/31/2018	Net amount as of 12/31/2018
Performing commitments	45,828	45,275	-	45,275
Non-performing loans	273	197	(3)	194
Compromised non-performing loans	240	180	(24)	156
TOTAL	**46,341**	**45,652**	**(27)**	**45,625**

Assets considered as forborne by Caisse Française de Financement Local concern exposures to loan contracts for which concessions have been granted in light of the borrower's financial difficulties (recognized or to come) that would not have been granted in other circumstances. These concessions may either be 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 targeting the reduction of the sensitivity of the loan.
There were 173 forborne contracts as of December 31, 2018, with 88 borrowers, for a total of EUR 1,039 million.

2.4.6. Depreciation for non-performing loans - changes during the year

	12/31/2017	Allocations	Reversals	Transfers	12/31/2018
For non-performing loans					
On loans	-	-	-	-	-
On interest	(6)	(2)	5	-	(3)
For compromised non-performing loans					
On loans	(0)	-	0	-	-
On interest	(30)	(4)	10	-	(24)
TOTAL	**(36)**	**(6)**	**15**	**-**	**(27)**

Provisions on interest are recorded in Net banking income and provisions on nominal are recorded in Cost of risk.

2.4.7. Impairment breakdown by country

See note 2.9

2.5 - BONDS AND OTHER FIXED INCOME SECURITIES

2.5.1. Accrued interest included in this item: 59

2.5.2. Analysis by residual maturity excluding accrued interest

Less than 3 months	3 months to 1 year	1 year to 5 years	More than 5 years	Total
418	572	1,546	2,704	**5,240**

2.5.3. Analysis by the issuer's economic sector excluding accrued interest

	12/31/2017	12/31/2018
Public sector	2,550	3,039
Other sectors (guaranteed by a State or by a local government)	246	171
Credit institutions	581	2,030
TOTAL	**3,377**	**5,240**
of which eligible for central bank refinancing	*629*	*2,017*
of which replacement assets	*581*	*2,030*

2.5.4. Analysis by listed securities and other securities excluding accrued interest

	Amount as of 12/31/2017	Amount as of 12/31/2018	Impairment as of 12/31/2018	Unrealized capital gain or loss as of 6/30/2018(2)
Listed securities(1)	1,563	2,990	(0)	(474)
Other securities	1,814	2,250	(1)	(361)
TOTAL	**3,377**	**5,240**	(1)	**(835)**

(1) Listed securities are registered for trading on a stock exchange
(2) The unrealized capital gain or loss is calculated as the difference between the book value and the market value, taking derivatives into account.

2.5.5. Analysis by type of portfolio excluding accrued interest and changes during the year

Portfolio	Net amount as of 12/31/2017	Gross amount as of 12/31/2018	Acquisitions	Amortization, redemption or disposals	Transfers(1)	Subtotal as of 12/31/2018
Trading	-	-	-	-	-	-
Placement	920	920	1,620	(214)	-	2,326
Investment	2,457	2,457	-	(221)	663	2,899
TOTAL	**3,377**	**3,377**	**1,620**	**(435)**	**663**	**5,225**

Portfolio	Subtotal as of 12/31/2018	Translation adjustments	Gross amount as of 12/31/2018	Impairment as of 6/30/2018	Net amount as of 6/30/2018(2)	Unrealized capital gain or loss as of 6/30/2018(3)
Trading	-	-	-	-	-	-
Placement	2,326	5	2,331	(1)	2,330	3
Investment	2,899	11	2,910	-	2,910	(838)
TOTAL	**5,225**	**16**	**5,241**	**(1)**	**5,240**	**(835)**

(1) The transfer corresponds to a reclassification from the government securities portfolio detailed in 2.2. in the same accounting portfolio category.
(2) This amount includes a premium / discount of EUR 32 million for the placement portfolio and of EUR 77 million for the investment portfolio.
(3) The unrealized capital gain or loss is calculated as the difference between the book value and the market value, taking derivatives into account.

2.5.6. Breakdown of impairment by country

See note 2.9

2.6 - OTHER ASSETS

	12/31/2017	12/31/2018
Other receivables	17	7
TOTAL	**17**	**7**

2.7 - ACCRUALS AND OTHER ASSETS

	12/31/2017	12/31/2018
Deferred losses on hedging transactions	1,472	1,310
Deferred charges on bond issues	48	51
Prepaid charges on hedging transactions	183	154
Premiums on acquisition of loans	256	304
Other prepaid charges	-	-
Accrued interest not yet due on hedging transactions	748	752
Translation adjustments	-	-
Other deferred income	1	1
Other accruals	15	4
TOTAL	**2,723**	**2,576**

2.8 - BREAKDOWN OF ASSETS BY ORIGINAL CURRENCY

Analysis by original currency	Amount in original currency as of 12/31/2017	Amount in euros as of 12/31/2017	Amount in original currency as of 12/31/2018	Amount in euros as of 12/31/2018
EUR	57,725	57,725	59,188	59,188
AUD	20	13	20	12
CAD	511	340	510	327
CHF	1,035	884	609	540
GBP	129	145	129	144
HKD	0	0	-	-
JPY	21,168	157	16,115	128
NOK	1,039	105	1,039	105
PLN	43	10	45	10
SEK	0	0	0	0
USD	402	335	148	130
TOTAL		**59,714**		**60,584**

2.9 - BREAKDOWN OF IMPAIRMENT BY COUNTRY

	Amount as of 12/31/2018	Amount as of 12/31/2018
Government and public entity - placement securities	**(0)**	**(0)**
France	(0)	(0)
Bonds and other fixed income - placement securities	**(0)**	**(1)**
France	(0)	(1)
Belgium	(0)	(0)
Denmark	-	(0)
Norway	(0)	(0)
The Netherlands	-	(0)
United kingdom	-	(0)
Sweden	(0)	(0)
Bonds and other fixed income - investment securities	**-**	**-**
Bonds and other fixed income - investment securities	**(36)**	**(27)**
France	(36)	(27)

3. NOTES TO THE LIABILITIES (EUR millions)

3.1 - DUE FROM BANKS

At the end of December 2018, funding obtained from SFIL, within the framework of the financing agreement, was comprised of different loans with maturities initially between one day and ten years, indexed on Euribor or Eonia.

	12/31/2017	12/31/2018
Sight accounts	-	-
Current account - parent company	-	-
Interest accrued not yet due	-	-
Term borrowing - parent company	4,821	4,943
Interest accrued not yet due	0	(2)
Unallocated sums	-	-
TOTAL	**4,821**	**4,941**

Analysis by residual maturity excluding accrued interest

	Less than 3 months	3 months to 1 year	1 year to 5 years	More than 5 years	Total
Sight	-	-	-	-	-
Term	253	123	2,804	1,763	4,943
TOTAL	**253**	**123**	**2,804**	**1,763**	**4,943**

3.2 - DEBT SECURITIES

3.2.1. Debt securities (*obligations foncières*)

3.2.1.1. Accrued interest included in this item: 631

3.2.1.2. Analysis by residual maturity excluding accrued interest

Type of securities	Less than 3 months	3 months to 1 year	1 year to 5 years	More than 5 years	Total
Obligations foncières	2,036	2,440	15,880	23,515	**43,871**
of which net issue premiums(1)	*(0)*	*(0)*	*(6)*	*(70)*	***(76)***

(1) The gross amount of positive and negative issue premiums totaled EUR -173 million before amortization.

3.2.1.3. Changes during the year excluding accrued interest

Type of securities	Amount as of 12/31/2017	Increases	Decreases	Translation adjustments	Amount as of 12/31/2018
Obligations foncières	42,719	4,783	(3,500)	(131)	**43,871**

3.2.2. Other bonds (registered covered bonds)

3.2.2.1. Accrued interest included in this item: 159

3.2.2.2. Analysis by residual maturity excluding accrued interest

Type of securities	Less than 3 months	3 months to 1 year	1 year to 5 years	More than 5 years	Total
Registered covered bonds	30	58	527	5,776	**6,391**
of which net issue premiums(1)	-	-	*(0)*	*41*	***41***

(1) The gross amount of positive and negative issue premiums totaled EUR 50 million before amortization.

3.2.2.3. Changes during the year excluding accrued interest

Type of securities	Amount as of 12/31/2017	Increases	Decreases	Translation adjustments	Amount as of 12/31/2018
Registered covered bonds	6,459	111	(179)	-	**6,391**

3.3 - OTHER LIABILITIES

	12/31/2017	Amount as of 12/31/2018
Cash collateral received	687	514
Accrued interest not yet due on cash collateral received	(0)	(0)
Taxes	0	8
Balances to pay on unwound hedging contracts	-	-
Contribution to the support fund(1)	110	100
Other creditors	0	13
TOTAL	**797**	**635**

(1) This item includes the residual balance of the commitments made in 2013 by Caisse Française de Financement Local to contribute EUR 10 million per year over 15 years to the multi-year local government entity support funds, for a total of EUR 150 million.

3.4 - ACCRUALS AND OTHER LIABILITIES

	12/31/2017	12/31/2018
Deferred gains on hedging transactions	-	-
Deferred income on hedging transactions	1,569	1,399
Deferred income on loans	160	157
Accrued interest not yet due on hedging transactions	658	585
Other accrued charges	24	54
Translation adjustments	139	223
Other accruals	2	0
TOTAL	**2,552**	**2,418**

3.5 - PROVISIONS FOR RISKS AND CHARGES

	Amount as of 12/31/2017	Increases	Decreases	Translation adjustments	Amount as of 12/31/2018
Loans and commitments(1)	30	23	(6)	-	47
Financial instruments(2)	30	8	(0)	-	38
Other provisions(3)	113	7	(113)	-	7
TOTAL	**173**	**38**	**(119)**	**-**	**92**

(1) In 2018, Caisse Française de Financement Local broadened the collective provision calculation scope to include exposures similar to those used to calculate provisions under IFRS accounting rules. This calculation change had an estimated impact of EUR 7 million, recorded in cost of risk. Other movements relate to entries and exits from the watchlist scope decided in 2018.

(2) The change in provisions for risks and charges on financial instruments relates to the change in the market value of the hedged investment securities concerned.

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

3.6 - EQUITY

	Amount as of 12/31/2017	Amount as of 12/31/2018
Share capital	1,350	1,350
Legal reserve	49	50
Retained earnings (+/-)	23	2
Net income (+/-)	30	44
TOTAL	**1,452**	**1,446**

On May 28, 2018, the Shareholders' Meeting decided to allocate the 2017 net profit, ie EUR 52 millions after taking into account of positive retained earnings, to payment of a dividend in the amount of EUR 50 million, the difference EUR 2 million has been allocated to the retained earnings.
Caisse Française de Financement Local's share capital totaled EUR 1,350 million, comprising 13,500,000 shares.

3.7 - BREAKDOWN OF LIABILITIES BY ORIGINAL CURRENCY

Analysis by original currency	Amount in original currency as of 12/31/2017	Amount in euros as of 12/31/2017	Amount in original currency as of 12/31/2018	Amount in euros as of 12/31/2018
EUR	57,725	57,725	59,188	59,188
AUD	20	13	20	12
CAD	511	340	510	327
CHF	1,035	884	609	540
GBP	129	145	129	144
HKD	0	0	-	-
JPY	21,168	157	16,115	128
NOK	1,039	105	1,039	105
PLN	43	10	45	10
SEK	0	0	0	0
USD	402	335	148	130
TOTAL		**59,714**		**60,584**

3.8 - TRANSACTIONS WITH RELATED PARTIES

Analysis by nature	Parent company[1]		Other related parties[2]	
	12/31/2017	12/31/2018	12/31/2017	12/31/2018
ASSETS				
Loans and advances due from banks - sight	-	-	-	-
Loans and advances due from banks - term	578	1,897	-	-
Bonds and other fixed income securities	-	-	9	145
LIABILITIES				
Due to banks - sight	-	-	-	-
Due to banks - term	4,821	4,941	-	-
INCOME STATEMENT				
Interest income on loans and advances	1	2	(11)	(10)
Interest income on debt securities	-	-	0	(0)
Interest expense on borrowings	(11)	2	-	-
Net commissions	(11)	(5)	0	(0)
OFF-BALANCE SHEET				
Interest rate derivatives	14,029	14,313	-	-
Foreign exchange derivatives	1,271	1,022	-	-
Commitments and guarantees received	50	270	-	-
Commitments and guarantees given	3,028	6,284	-	-

(1) This item includes transactions with SFIL, the parent company of Caisse Française de Financement Local.
(2) This item may include transactions with Caisse des dépôts et consignations and La Banque Postale, shareholders of SFIL.

4. NOTES TO THE OFF-BALANCE SHEET ITEMS (EUR millions)

4.1 - COMMITMENTS GRANTED

	12/31/2017	12/31/2018
Financing commitments granted to credit institutions[1]	3,028	6,284
Financing commitments granted to customers[2]	90	28
Other commitments given, assets assigned in guarantee[3]	3	4
TOTAL	**3,121**	**6,316**

(1) Within the framework of the export credit business, this amount corresponds to a commitment by Caisse Francaise de Financement Local to refinance its parent company, SFIL.
(2) Financing commitments granted to customers correspond to contracts signed for loans not yet paid out to customers at year-end.
(3) It means the irrevocable payment commitment to the Fonds de garantie et de résolution.

4.2 - COMMITMENTS RECEIVED

	12/31/2017	12/31/2018
Financing commitments received from credit institutions[1]	50	270
Currencies borrowed	-	-
Guarantees received from credit institutions	22	8
Enhanced guarantees[2]	3,247	7,383
Guarantees received from local governments and asset transfers as guarantees of commitments on local governments	2,774	2,456
Other commitments received	-	-
TOTAL	**6,093**	**10,117**

(1) It comprises the authorized overdraft in the current account as stipulated in the financing agreement signed with SFIL, for EUR 50 million.
(2) The financing and financing commitments granted to SFIL by Caisse de Financement Local to refinance the former's large export credits benefit from a 100% unconditional and irrevocable guarantee of the French State, referred to as an enhanced guarantee.

4.3 - FOREIGN CURRENCY TRANSACTIONS

Cash and forward foreign exchange transactions are recorded at their value in foreign currencies translated at the exchange rate at the end of the period.

The items Currencies to receive and Currencies to deliver are composed of long currency swaps with intermediate payment flows corresponding to hedging transactions.

	12/31/2017	12/31/2018	Fair value as of 12/31/2018
Currencies to receive	6,983	6,002	(131)
Currencies to deliver	7,122	6,225	50
TOTAL	**14,105**	**12,227**	**(81)**

4.4 - COMMITMENTS ON INTEREST RATE DERIVATIVES

Commitments on interest rate derivatives are recorded in accordance with CRB standards 88-02 and 90-15: amounts related to unconditional operations are recorded at the contractual notional value.

4.4.1. Analysis of over-the-counter interest rate transactions by residual maturity

Type of transaction	Amount as of 12/31/2017	Less than 1 year	1 year to 5 years	More than 5 years	12/31/2018
Notional amount	123,616	22,609	40,028	44,688	107,325
of which deferred start	*3,957*	*1,800*	*630*	*206*	***2,636***

These hedging transactions include micro-hedge and macro-hedge transactions.

4.4.2. Analysis of interest rate transactions by product type

	12/31/2017	12/31/2018
Interest rate swaps	123,616	107,325
Term contracts	-	-
Interest rate options	-	-
TOTAL	**123,616**	**107,325**

4.4.3. Analysis of interest rate swap transactions

	12/31/2017	12/31/2018	Fair value as of 12/31/2018
Micro-hedge	62,306	61,760	(485)
Macro-hedge	61,310	45,565	(2,254)
TOTAL	**123,616**	**107,325**	**(2,739)**

4.4.4. Analysis of interest rate transactions by counterparty

	12/31/2017	12/31/2018
Related parties	14,029	14,313
Other counterparties	109,587	93,012
TOTAL	**123,616**	**107,325**

5. NOTES TO THE STATEMENT OF INCOME (EUR millions)

5.1 - INTEREST AND RELATED INCOME / EXPENSE

	2017	2018
INCOME	**963**	**1,013**
Due from banks	9	5
Due from customers	1,029	879
Bonds and other fixed income securities	71	73
Macro-hedge transactions	(146)	56
Other commitments	-	-
EXPENSE	**(836)**	**(863)**
Due to banks	(20)	(4)
Due to customers	(273)	(190)
Bonds and other fixed income securities	(152)	(197)
Macro-hedge transactions	(391)	(472)
Other commitments	-	-
INTEREST MARGIN	**127**	**150**

5.2 - COMMISSIONS

	2017			2018		
	Income	Expense	Net	Income	Expense	Net
Lending activity	0	-	0	0	-	0
Purchase and sale of securities	-	(1)	(1)	-	(0)	(0)
Services on securities	-	(3)	(3)	-	(3)	(3)
Commissions on financial instruments	3	-	3	1	-	1
Rebilling by parent company	-	(11)	(11)	-	(5)	(5)
TOTAL	**3**	**(15)**	**(12)**	**1**	**(8)**	**(7)**

5.3 - ANALYSIS OF GAINS AND LOSSES ON PORTFOLIO TRANSACTIONS

	2017	2018
Transactions on placement securities [(1)]	3	(9)
Transactions on investment securities	-	0
Transactions on interest rate derivatives	-	0
Foreign exchange transactions	0	(0)
TOTAL	**3**	**(9)**

(1) This item regroups capital gains and losses on sales and provisions and reversals on this portfolio amount after swaps.

5.4 - GENERAL EXPENSES

Caisse Française de Financement Local has no salaried employees in accordance with article L.513-15 of the Monetary and Financial Code. The general management of the operations of Caisse Française de Financement Local has been entrusted by an agreement to its parent company, SFIL, a credit institution.
Specific individual agreements have been established with entities that have transferred assets to the société de crédit foncier, and continue to ensure management for their national clientele. These assets are managed in a run-off mode. At the end of 2018, there were agreements with the following entities: Kommunalkredit Austria (Austria), Belfius Banque et Assurances (Belgium), and Dexia Crediop (Italy). These agreements already existed in previous years.
Starting in 2015, management of new registered covered bonds (RCB) is entrusted to Landesbank Baden-Württemberg (LBBW). Dexia Kommunalbank Deutschland continues to manage registered covered bonds issued prior to 2015.

General operating expense can be broken down as follows:

	2017	2018
Payroll costs	-	-
Other general operating expense[(1)]	(98)	(96)
Taxes	(7)	(5)
TOTAL	**(105)**	**(101)**

(1) of which EUR 93 million with SFIL.

5.5 - COST OF RISK

	2017	2018
Collective and specific impairments	22	(16)
TOTAL	**22**	**(16)**

5.6 - CORPORATE INCOME TAX

	2017	2018
Income tax for the year(1)	(2)	(12)
Tax adjusment effects(2)	(3)	39
TOTAL	**(5)**	**27**

(1) The corporate taxe rate in France is 34.43%.
(2) As of the end of 2018, the tax authority had levied adjustments relating to the 2012 and 2013 tax audit. It nevertheless reduced the amount of the adjustment relating to the add-back of the results of the former branch in Ireland, but maintained the principle of taxation of these results in France. Caisse Française de Financement Local settled this adjustment and reversed the relevant provisions. It kept in its accounts the amount of the provision set aside in respect of sums not yet paid. The 2018 accounting result consequently shows income corresponding to the provision's adjustment.

6. POST-CLOSING EVENTS

No significant event that influenced the Company's financial situation has occured since the closing on December 31, 2018.

Statutory Auditors' report on the financial statements

Year ended December 31, 2018

This is a translation into English of the statutory auditors' report on the financial statements of the Company, issued in French and it is provided solely for the convenience of English speaking users.

This statutory auditors' report includes information required by European regulation and French law, such as information about the appointment of the statutory auditors or verification of the management report and other documents provided to shareholders.

This report should be read in conjunction with, and construed in accordance with, French law and professional auditing standards applicable in France.

To the Shareholders' Meeting of Caisse Française de Financement Local,

Opinion

In compliance with the engagement entrusted to us by your Shareholders' Meeting, we have audited the accompanying financial statements of Caisse Française de Financement Local for the year ended December 31, 2018.

In our opinion, the financial statements give a true and fair view of the assets and liabilities and of the financial position of the Company as at December 31, 2018 and of the results of its operations for the year then ended in accordance with French accounting principles.

The audit opinion expressed above is consistent with our report to the Financial Statements Committee of SFIL, the parent company of Caisse Française de Financement Local and also acting as the Audit Committee of the latter.

Basis for opinion

Audit framework

We conducted our audit in accordance with professional standards applicable in France. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our responsibilities under those standards are further described in the "Statutory Auditors' Responsibilities for the Audit of the Financial Statements" section of our report.

Independence

We conducted our audit engagement in compliance with independence rules applicable to us, for the period from January 1, 2018, to the date of our report and specifically we did not provide any prohibited non-audit services referred to in Article 5(1) of Regulation (EU) No 537/2014 or in the French Code of ethics (Code de déontologie) for statutory auditors.

Justification of Assessments - Key Audit Matters

In accordance with the requirements of Articles L.823-9 and R.823-7 of the French Commercial Code relating to the justification of our assessments, we inform you of the key audit matters relating to risks of material misstatement that, in our professional judgment, were of most significance in our audit of the financial statements of the current period, as well as how we addressed those risks.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on specific items of the financial statements.

Credit risk relating to customer loans

Risk identified	Our response
Customer loans and advances, appearing on the balance sheet as of December 31, 2018 for a net amount of EUR 46.1 billion, is one of the most significant items on the Caisse Française de Financement Local's balance sheet. CAFFIL is exposed to credit risk if a counterparty cannot meet its financial commitments. The main accounting principles for valuing individual impairments and collective provisions are set forth in Note 2.4 « Impairment and provisions » to the financial statements. As indicated in Note 3.5 to the financial statements, in 2018, CAFFIL changed the scope and the assumptions adopted for applying the calculation methods for its collective provision, to align them with those adopted to calculate provisions in the IFRS accounts. The impact of this change in estimate is EUR 7 million and was recorded in Cost of risk. Furthermore, CAFFIL exercises judgment and makes accounting estimates to value the individual impairments of doubtful outstandings. We considered the change in estimates for calculating the collective provisions and the valuation of individual impairments, to be a key audit matter.	• Our audit approach consisted in familiarizing ourselves with the process for valuing individual impairments and collective provisions. We tested the key controls set up by management to determine the assumptions and parameters used as a basis for this valuation. • Concerning performing loans that have deteriorated and for which provisions are determined on a collective basis, our procedures, with the support of our experts, consisted in: – analyzing the assumptions and the documentation to identify counterparties under watchlist and those which have a significant increase of credit risk ; – familiarizing ourselves with the governance framework; – examining the main parameters adopted to value collective provisions; – examining the disclosures published in the notes to the financial statements in respect of the change in estimate made in 2018. • For doubtful outstandings, our procedures consisted in testing as of December 31, 2018, from a selection of the most significant loans, the main assumptions adopted to estimate individual impairments. • We have also examined the qualitative and quantitative disclosures described in Notes 2.4 « Advances to customers » and 3.5 « Provisions for contingencies and losses» to the financial statements.

IT migration

Risk identified	Our response
SFIL group, which CAFFIL is a part of, rolled out a program to overhaul its IT system. On April 1, 2018, this project resulted in the migration of, notably, the management of all market transactions (derivatives and securities) towards a new IT system integrating a new management application and the creation of an data warehouse. The transactions of CAFFIL are managed in the IT system of SFIL, its parent company and servicer. Considering the risks inherent in such a project, notably the correct recovery of data and carryforward of historical balances in the new IT system, as well as the changes related to a new IT system in the processes of the activities, we considered this project to be a key audit matter.	Our procedures, with the support of our experts who are part of the audit team, consisted in: • Examining the documentation related to the different phases of the project and its governance framework; • Examining the controls set up by the permanent control and internal audit reports ; • Analyzing coverage of acceptance testing; • Examining the control mechanism framing the recovery of post-migration transactions; • Examining the application authorizations for the new IT tools and applications having been impacted by the simplification of the IT system; • Examining the developments of new application program interfaces; • Analyzing internal developments enabling non-assured functionalities to be repaired by the new IT system as of the production starting date.

Verification of the management report

We have also performed, in accordance with professional standards applicable in France, the specific verifications required by French law.

Information given in the Management Report and in the other documents provided to the Shareholders with respect to the financial position and the financial statements

We have no matters to report as to the fair presentation and the consistency with the financial statements of the information given in the management report of Executive Board and in the other documents provided to Shareholders with respect to the financial position and the financial statements.

Based on this work, the fair presentation and the consistency with the financial statements of the information relating to payment deadlines mentioned in Article D.441-4 of the French Commercial Code lead us to make the following remark: as stated in the management report, the information does not include bank transactions and related transactions, as your company considers that they do not fall within the scope of the information to be provided.

Report on corporate governance

We attest that the Supervisory Board's Report on corporate governance sets out the information required by Articles L.225-37-3 and L.225-37-4 of the French Commercial Code.

Concerning the information given in accordance with the requirements of Article L.225-37-3 of the French Commercial Code relating to remunerations and benefits received by the directors and any other commitments made in their favour, we have verified its consistency with the financial statements, or with the underlying information used to prepare these financial statements and, where applicable, with the information obtained by your company from controlling and controlled companies.

Report on other legal and regulatory requirements

Appointment of the Statutory Auditors

We were appointed as statutory auditors of Caisse Française de Financement Local by the annual general meeting held on May 26, 2008, for DELOITTE & ASSOCIES and on May 31, 2017, for ERNST & YOUNG et Autres.

As of December 31, 2018, DELOITTE & ASSOCIES was in the 11th year of total uninterrupted engagement and ERNST & YOUNG et Autres in the 2^{nd} year.

Responsibilities of management and those charged with governance for the financial statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with French accounting principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless it is expected to liquidate the Company or to cease operations.

The Financial Statements Committee of SFIL entity, acting as the Audit Committee of the Caisse Française de Financement Local, is responsible for monitoring the financial reporting process and the effectiveness of internal control and risks management systems and where applicable, its internal audit, regarding the accounting and financial reporting procedures.

The financial statements were approved by the Executive Board.

Statutory Auditors' responsibilities for the audit of the financial statements

Objectives and audit approach

Our role is to issue a report on the financial statements. Our objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with professional standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As specified in Article L.823-10-1 of the French Commercial Code, our statutory audit does not include assurance on the viability of the Company or the quality of management of the affairs of the Company.

As part of an audit conducted in accordance with professional standards applicable in France, the statutory auditor exercises professional judgment throughout the audit and furthermore:

- Identifies and assesses the risks of material misstatement of the financial statements, whether due to fraud or error, designs and performs audit procedures responsive to those risks, and obtains audit evidence considered to be sufficient and appropriate to provide a basis for his opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtains an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the internal control.

- Evaluates the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management in the financial statements.

- Assesses the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. This assessment is based on the audit evidence obtained up to the date of his audit report. However, future events or conditions may cause the Company to cease to continue as a going concern. If the statutory auditor concludes that a material uncertainty exists, there is a requirement to draw attention in the audit report to the related disclosures in the financial statements or, if such disclosures are not provided or inadequate, to modify the opinion expressed therein.

- Evaluates the overall presentation of the financial statements and assesses whether these statements represent the underlying transactions and events in a manner that achieves fair presentation

Report to the Financial Statements Committee of SFIL entity, acting as the Audit Committee of the Caisse Française de Financement Local

We submit a report to the Financial Statements Committee of SFIL entity, acting as the Audit Committee of the Caisse Française de Financement Local, which includes in particular a description of the scope of the audit and the audit program implemented, as well as the results of our audit. We also report, if any, significant deficiencies in internal control regarding the accounting and financial reporting procedures that we have identified.

Our report to the Financial Statements Committee of SFIL entity, acting as the Audit Committee of the Caisse Française de Financement Local includes the risks of material misstatement that, in our professional judgment, were of most significance in the audit of the financial statements of the current period and which are therefore the key audit matters that we are required to describe in this report.

We also provide the Financial Statements Committee of SFIL entity, acting as the Audit Committee of the Caisse Française de Financement Local with the declaration provided for in Article 6 of Regulation (EU) N° 537/2014, confirming our independence within the meaning of the rules applicable in France such as they are set in particular by Articles L.822-10 to L.822-14 of the French Commercial Code and in the French Code of Ethics (code de déontologie) for statutory auditors. Where appropriate, we discuss with the Financial Statements Committee of SFIL entity, acting as the Audit Committee of the Caisse Française de Financement Local the risks that may reasonably be thought to bear on our independence, and the related safeguards.

Paris-La Défense, March 29, 2019

The Statutory Auditors
French original signed by

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

Supplemental disclosures

Over-collateralization ratio

Pursuant to articles L.513-12 and R.513-8 of the Monetary and Financial Code, the total of the assets of *sociétés de crédit foncier* must always exceed by at least 5% liabilities benefiting from the privilege referred to in article L.513-11 of the Monetary and Financial Code.

Assets covering liabilities benefiting from the privilege (weighted amounts in EUR millions)	**12/31/2018**
Exposures on public sector entities	53,168
Shares in funds or similar entities that meet the conditions of L.513-5 of the Monetary and Financial Code	-
Replacement assets	2,809
Other assets	2,506
Operations deducted from the assets	-
TOTAL ASSETS	**58,483**

Liabilities benefiting from the privilege defined in article L.513-11 of the Monetary anf Financial Code (weighted amounts in EUR millions)	**12/31/2018**
Obligations foncières	43,947
Other bonds benefiting from the privilege	6,349
Liabilities related to these securities	790
Amounts owed under the contract provided for in article L.513-15 of the Monetary and Financial Code	53
Amounts owed for derivatives benefiting from the privilege defined in article L.513-11 of the Monetary and Financial Code	1,322
Debt attributable to miscellaneous expense mentioned in the last section of the article L.513-11 of the Monetary and Financial Code	0
TOTAL LIABILITIES	**52,461**

OVER-COLLATERALIZATION RATIO	**111.5%**

Statutory auditors' fees

EUR thousands	**Deloitte & Associés**				**Ernst & Young et Autres**			
	Amount including VAT		**%**		**Amount including VAT**		**%**	
	2017	**2018**	**2017**	**2018**	**2017**	**2018**	**2017**	**2018**
Statutory audit	240	413	83%	86%	240	413	91%	87%
Services other than statutory audit	50	68	17%	14%	23	64	9%	13%
TOTAL	**290**	**481**	**100%**	**100%**	**263**	**477**	**100%**	**100%**

Services other than statutory audit principally cover expenses related to the review of issue programs and comfort letters to public issues, and audit or review of IFRS financial statements.

Shareholders Meeting of May 28, 2019

Statutory Auditors' special report on regulated agreements and commitments

Shareholders' Meeting held to approve the financial statements for the year ended December 31, 2018

This is a free translation into English of the statutory auditors' special report on regulated agreements and commitments issued in French and is provided solely for the convenience of English speaking readers. This report should be read in conjunction with, and is construed in accordance with, French law and professional standards applicable in France.

To the Shareholders,

In our capacity as Statutory Auditors of your Company, we hereby report to you on regulated agreements and commitments.

The terms of our engagement require us to communicate to you, based on information provided to us, the principal terms and conditions of those agreements and commitments brought to our attention or which we may have discovered during the course of our audit, without expressing an opinion on their usefulness and appropriateness or identifying such other agreements and commitments, if any. It is your responsibility, pursuant to article R.225-58 of the French Commercial Code, to assess the interest involved in respect of the conclusion of these agreements and commitments for the purpose of approving them.

Our role is also to provide you with the information stipulated in article R.225-58 of the French Commercial Code relating to the implementation during the past year of agreements and commitments previously approved by the Shareholders' Meeting, if any.

We conducted the procedures we deemed necessary in accordance with the professional guidelines of the French National Institute of Statutory Auditors (Compagnie Nationale des Commissaires aux Comptes) relating to this engagement.

AGREEMENTS AND COMMITMENTS SUBMITTED TO THE APPROVAL OF THE SHAREHOLDERS' MEETING

We hereby inform you that we have not been advised of any agreement or commitment authorized during the year to be submitted to the approval of the Shareholders' Meeting pursuant to article L.225-86 of the French Commercial Code.

AGREEMENTS AND COMMITMENTS PREVIOUSLY APPROVED BY THE SHAREHOLDERS' MEETING

We hereby inform you that we have not been advised of any agreement or commitment previously approved by the Share-holders' Meeting which remained in force during the year.

Paris-La Défense, on March 29, 2019

The Statutory Auditors
French original signed by

DELOITTE & ASSOCIÉS
Sylvie Bourguignon

ERNST & YOUNG et Autres
Vincent Roty

Observations of the Supervisory Board

Pursuant to the provisions of article L.225-68 of the Code of Commerce, we hereby state that we have no comment to make on the management report of the Executive Board or on the financial statements for the year ended December 31, 2018.

The Supervisory Board wishes to thank the Executive Board for the initiatives taken and the results achieved during the year ended December 31, 2018.

The Supervisory Board

Resolutions proposed to the Ordinary Shareholders' Meeting of May 28, 2019

First resolution: approval of the financial statements

The Shareholders' Meeting, voting according to the conditions governing the quorum and majority required for ordinary shareholders' meetings, after hearing the reports of the Executive Board, the Chairman of the Supervisory Board and the statutory auditors, as well as the observations of the Supervisory Board, approves the financial statements for the year ended December 31, 2018, as presented, with all the transactions that generated these financial statements or are mentioned in the above reports, showing a net income of EUR 43,608,129.09.

The Shareholders' Meeting notes that no expense mentioned in article 39, 4 of the French General Tax Code, non-deductible from corporate income tax, was recorded in the year ended December 31, 2018.

Second resolution: allocation of net income

The Shareholders' Meeting, voting according to the conditions governing the quorum and majority required for ordinary shareholders' meetings, resolves to allocate the net income for the year as follows.

ALLOCATION OF NET INCOME	EUROS
Net income for the year	**43,608,129.09**
Legal reserve (5%)	(2,180,406.45)
Income available	**41,427,722.64**
Retained earnings	1,909,851.11
Income available for distribution	**43,337,573.75**
Dividends distributed	(40,500,000.00)
Retained earnings after allocation	**2,837,573.75**

Each share will receive a dividend of EUR 3.00 eligible for a rebate of 40% according to article 158.3-2° of the French General Tax Code.

The dividend will be paid on June 6, 2019.
The Ordinary Shareholders' Meeting recalls, in accordance with article 243 bis of the French General Tax Code that the following dividends were paid corresponding to the previous three years:

EUR	2015	2016	2017	2018
Net amount per share	-	-	2.67	3.70
Amount per share eligible for a rebate (article 158.3-2° of the French General Tax Code)	-	-	2.67(1)	3.70(1)
Total amount eligible for a rebate (article 158.3-2° of the French General Tax Code)	-	-	35,110,500(1)	49,950,000(1)

(1) rate of 40%.

Third resolution: approval of regulated agreements and commitments

After hearing the statutory auditors' special report on regulated agreements and commitments, governed by article L.225-86 of the Code of Commerce, the Shareholders' Meeting, voting according to the conditions governing the quorum and majority required for ordinary shareholders' meetings, notes, under the conditions of article L.225-88 of the same code, that no agreement was mentioned with reference to the year ended December 31, 2018.

Fourth resolution: discharge to members of the management bodies

The Shareholders' Meeting, voting according to the conditions governing the quorum and majority required for ordinary shareholders' meetings, gives full discharge to the management bodies for the performance of their duties during the year ended December 31, 2018.

Fifth resolution: certification of the financial statements

In application of article L.822-14 of the Code of Commerce, the Shareholders' Meeting, voting according to the conditions governing the quorum and majority required for ordinary shareholders' meetings, takes note that the financial statements for the year ended December 31, 2018, were certified by the statutory auditors:
- Sylvie Bourguignon, Partner, representing the firm Deloitte & Associés, on one hand,
- Vincent Roty, Partner, representing the firm Ernst & Young et Autres, on the other hand.

Sixth resolution: powers

The Shareholders' Meeting, voting in accordance with the conditions governing the quorum and majority required for ordinary shareholders' meetings, gives full powers to the bearer of an original, a copy or an excerpt of the minutes of this meeting to carry out all legal formalities in respect of registration and publication required by law.

General Information

Legal and administrative information

Corporate name
Caisse Française de Financement Local

Acronym
CAFFIL

Registered office
1-3, rue du Passeur de Boulogne
92130 Issy-les-Moulineaux

Legal structure
Société anonyme à directoire et conseil de surveillance, a joint-stock corporation with an Executive Board and a Supervisory Board.

Official approval
The Company was approved by the Comité des établissements de crédit et des entreprises d'investissement (CECEI) on July 23, 1999, as a *société financière – société de crédit foncier*. This approval became definitive on October 1, 1999. *Ordonnance* 2013-544 of June 27, 2013, modified the legal status of *sociétés de crédit foncier* (article L.513-2 of the Monetary and Financial Code). Since January 1, 2014, *sociétés de crédit foncier* are no longer financial companies (*sociétés financières*), but specialized credit institutions (*établissements de crédit spécialisés*).

Applicable legislation
A corporation under the provisions of articles L.210-1 and following of the Code of Commerce, articles L.511-1 and following of the Monetary and Financial Code and articles L.513-2 and following of the Monetary and Financial Code.

Incorporation date
The Company was created on December 29, 1998, for a period of 99 years.

Corporate purpose (article 2 of the by-laws)
The Company's exclusive purpose is:
- to grant or acquire exposures on public sector entities as defined in article L.513-4 of the Monetary and Financial Code as well as shares and units of assets considered as exposures on public sector entities as defined in article L.513-5 of the same code;
- to hold assets, securities and deposits according to the conditions defined by decree to be considered as replacement assets;
- in order to finance the above-mentioned exposures, to issue *obligations foncières* benefiting from the privilege defined in article L.513-11 of the Monetary and Financial Code and finance and raise other funds, for which the contract or document intended for the general public in the sense of article L.412-1 of the Monetary and Financial Code, or any equivalent document required for admission to foreign regulated markets mentions this privilege.

The Company may also fund the above-mentioned activities by issuing bonds or other sources of financing that do not benefit from the privilege defined in article L.513-11 of the Monetary and Financial Code.
The Company may mobilize, in accordance with articles L.211-36 to L.211-40 of the Monetary and Financial Code or in accordance with articles L.313-23 to L.313-35 of the Monetary and Financial Code, all or part of the assets it holds, whatever the nature, be it professional or not, of these assets.
Within the framework of the achievement of the exclusive purpose mentioned above, the Company may conduct all related operations linked directly or indirectly to its activities or contributing to this exclusive objective, as long as these operations are carried out in accordance with the terms of articles L.513-2 and following and R.513-1 and following of the Monetary and Financial Code related to *sociétés de crédit foncier*.

Company registration and APE business identification code
Caisse Française de Financement Local is registered as a corporate entity under the designation NANTERRE 421 318 064 (Registre du Commerce et des Sociétés). Its APE code is 6492Z.

Availability of information
Legal documents concerning Caisse Française de Financement Local may be consulted at the Company's registered office:
1-3, rue du Passeur de Boulogne
92130 Issy-les-Moulineaux

Fiscal year (article 38 of the by-laws)
The Company's fiscal year begins on January 1 and ends on December 31.

Management report
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Exceptional events and legal proceedings

See the section on litigation in part 9.2.5. of the management report of this annual financial report.

Allocation of income (article 39 of the by-laws)

Income available for distribution comprises net income for the year minus any prior year losses and any allocations to reserves pursuant to current legislation, plus any retained earnings carried forward from previous years.
From the available surplus, the Ordinary Shareholders' Meeting, voting on a recommendation of the Executive Board, may allocate all or a part of the remaining income to retained earnings.
There are no priority shares or priority dividends.

Annual Shareholders' Meetings
Calling of meetings (article 27 of the by-laws)

Annual shareholders' meetings are called as required by current legislation. They are held at the Company's registered office or any other location specified in the notice of meeting.
All shareholders have the right to obtain copies of the documents required to make an informed decision concerning the overall management and control of the Company.
The types of documents concerned and the terms of their availability and dispatch are determined by applicable legislation and regulations.

Right to attend annual shareholders' meetings

Legal rights apply.

Voting rights (article 31 of the by-laws)

The voting rights attached to the shares are proportional to the percentage of capital the shares represent. Each share conveys one voting right. At shareholders' meetings, the number of votes that may be cast by each shareholder corresponds to the number of shares held plus the number of shares for which the shareholder holds proxy.

Capital and shares
Amount of the capital

Share capital currently stands at EUR 1,350,000,000 represented by 13,500,000 nominative shares with a face value of EUR 100.
There are no other securities that grant rights to shares in the capital of Caisse Française de Financement Local.

Capital in the last five years

Date of the Shareholders' Meeting	Date of the capital increase	Amount of the capital increase EUR	Cumulated capital EUR
5/22/14			1,315,000,000
5/26/15			1,315,000,000
5/25/16			1,315,000,000
5/30/17	6/8/17	35,000,000	1,350,000,000
5/28/18			1,350,000,000

Breakdown of capital	2014	2015	2016	2017	2018
SFIL	99.99%	99.99%	99.99%	99.99%	99.99%
Individual investors	0.01%	0.01%	0.01%	0.01%	0.01%

From January 31, 2013 to May 18, 2016, Caisse Française de Financement Local was 99.99%-owned by SFIL (previously denominated Société de Financement Local), and 0.01% of its capital was in the hands of private investors (individuals, members of the Supervisory Board, to whom SFIL had lent shares).
Since May 18, 2016, only one individual, a member of the Supervisory Board, has kept a share of the Company (lent by SFIL as a *prêt de consommation d'action*).

Declaration of financial support

On January 31, 2013, SFIL (previously denominated Société de Financement Local) formalized a declaration of financial support for its subsidiary Caisse Française de Financement Local.

"Société de Financement Local acquired Caisse Française de Financement Local, previously called Dexia Municipal Agency, a société de crédit foncier, governed by articles L.515-13[1] *and following of the Monetary and Financial Code.*

"Société de Financement Local will hold more than 99% of the capital of Caisse Française de Financement Local on a long-term basis.

"Société de Financement Local and the French State, its reference shareholder, will ensure that Caisse Française de Financement Local always be able to pursue its activity in an ongoing manner and honor its financial commitments, in compliance with the requirements of banking regulations currently in effect."

(1) Now article L.513-2 of the Monetary and Financial Code in application of ordonnance 2013-544 of June 27, 2013.

Statement by the person responsible

I, Gilles Gallerne, Chairman of the Executive Board of Caisse Française de Financement Local, hereby affirm that to the best of my knowledge, the financial statements have been prepared in conformity with applicable accounting standards and present fairly, in all material aspects, the assets and liabilities, financial position and results of Caisse Française de Financement Local, and that the management report presents a fair image of trends in the Company's business, results and financial position, as well as a description of the main risks and uncertainties it faces.

Issy-les-Moulineaux, March 29, 2019

Gilles Gallerne
Chairman of the Executive Board

Caisse Française de Financement Local
Société anonyme à directoire et conseil de surveillance
A French joint-stock corporation with an Executive Board and a Supervisory Board
Capital of EUR 1,350,000,000
R.C.S. NANTERRE 421 318 064

Headquarters
1-3, rue du Passeur de Boulogne
92130 Issy-les-Moulineaux
Tel. (33) 1 73 28 90 99

Investor relations
Email: investorrelations@sfil.fr
Ralf Berninger
Tel. (33) 1 73 28 88 07
Email: ralf.berninger@sfil.fr

This annual financial report is available in French and in English at
www.caissefrancaisedefinancementlocal.fr
www.caffil.fr

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Group

SFIL

Supporting local investment and export