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VOLUME 1

Activity report 2012

COMPAGNIE DE FINANCEMENT FONCIER
CREDIT FONCIER GROUP

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AMF | AUTORITÉ DES MARCHÉS FINANCIERS

The original document was filed with the Autorité des marchés financiers (French Financial Market's Authority) on 5 April 2013, in accordance with Article 212-13 of its general regulation and registered under the number D.13-0299 and represents the French "Document de référence" of the Compagnie de Financement Foncier. As such, it may be used in support of a financial transaction when accompanied by a prospectus duly approved by the AMF. It was prepared by the Issuer and its signatories assume responsibility for it.

This is a free translation into English of Compagnie de Financement Foncier 2012 annual report issued in the French language and is provided solely for the convenience of English speaking readers. In case of discrepancy the French version prevails. Only the French version of the Registration document has been submitted to the AMF. It is therefore the only version that is binding in law.

Activity report 2012

Overview

Covered bonds: legal and regulatory framework

The Compagnie de Financement Foncier business model

Overview

Profile

Compagnie de Financement Foncier (AAA/Aaa/AAA) is a credit institution company and a *société de crédit foncier* (a French legal covered bonds issuer).

A fully-owned subsidiary of Crédit Foncier (A-/A2/A+) and an affiliate of BPCE (A/A2/A+), the company's sole purpose is to finance the mortgage and public-sector lending activities of both its parent company and the Group as a whole, issuing *obligations foncières,* in different formats and currencies.

The *obligations foncières* of Compagnie de Financement Foncier are French legal covered bonds that comply with European Directives UCITS 52-4 and CRD. They benefit from the AAA/Aaa/AAA rating.

Firmly supported by its parent Crédit Foncier, which has been issuing French *obligations foncières* since 1852, Compagnie de Financement Foncier continued to be a major actor in its market in 2012.

Message from the Chairman and Chief Executive Officer and the Deputy Chief Executive Officer

The covered bond market has shown that, particularly in times of crisis, it still provides banks with a diverse and resilient source of funding. It is one of its unique features and it explains why this market has already been well-established for several years.

This funding model has consistently proven its strength and ability to underpin sustainable lending to the real economy. As such, covered bonds are becoming increasingly vital in providing a stable funding base for banks, not only across Europe but throughout the world, as Canada and Australia have implemented national covered bond legal frameworks.

The European Covered Bond Council (ECBC), which represents more than 95% of the covered bond industry players, is committed to “promoting the covered bond asset class as a key instrument enabling mortgage lenders to grant mortgage loans*.

In recent years, a market-wide request for improved standards and labelling covered bonds has arisen and, in 2012 the ECBC in conjunction with the European Mortgage Federation, its parent company, responded by establishing the Covered Bond Label Foundation.

** ECBC website (http://ecbc.hypo.org).*

"Once again in 2012, the covered bond funding model has demonstrated its strength and ability to underpin sustainable lending to the real economy."

Thierry DUFOUR, Chairman and Chief Executive Officer

"The European Covered Bond Label developed by the European Covered Bond Council is another step towards increased transparency for investors."

Sandrine GUÉRIN, Deputy Chief Executive Officer

This label has one main goal: to facilitate access for investors to relevant, consistent and transparent disclosures. Indeed, these new standards will provide solutions to the new challenges that lay ahead of us, with all covered bond market players willing to demonstrate their ability to adapt. At stake is the enhancement of transparency, the preservation of high-quality underlying assets and the stimulation of the secondary market.

Compagnie de Financement Foncier has been playing an important part in developing the framework and guidelines of the Covered bond label: alongside ten other major covered bond issuers, it is a member of the ECBC's Steering Committee.

Compagnie de Financement Foncier's position in the market is extremely important, as it is among the twelve covered bond issuers rated AAA/Aaa/AAA stable outlook in the world at the filing date. These ratings reflect the strength of the French legal framework, the quality of Compagnie de Financement Foncier assets, the safety of its management rules and its overcollateralisation level.

History

1852

Creation by decree of the first French mortgage bank, Crédit Foncier. First issues of *obligations foncières*.

1860s

Crédit Foncier becomes the first lender to local authorities in France.

1950s

After the end of World War II, Crédit Foncier becomes the main actor for social housing by granting of state subsidised mortgage loans and plays a major role in post-war reconstruction in France.

1984

Banking Act of 24 January: Crédit Foncier acquires the status of Specialised Financial Institution with a public-interest assignment.

1999

Crédit Foncier is bought by Groupe Caisse d'Epargne (GCE) on 25 June. The French Savings and Financial Security Act of 25 June 1999 introduces a new legal framework for *obligations foncières*. Compagnie de Financement Foncier is created as a "société de crédit foncier" and a wholly-owned subsidiary of Crédit Foncier. Inaugural issue of €1.5 billion with an 11-year maturity on 15 November.

2004

Leading French private issuer and leading issuer in France of *obligations foncières*.

2005

Access to the Australian domestic market via setup of the AMTN programme for the issue of *obligations foncières* in AUD.

Created in 1852, Crédit Foncier de France, whose main business is to grant property loans backed by first-ranking mortgages, became the leading lender to local authorities in France and maintained that position until World War II. From the 1950s onward, Crédit Foncier was entrusted with numerous public interest assignments and has continued to play a key role in the real estate sector, becoming one of the State's main partners in this area.

2006

Launch of the first 50-year *obligations foncières:* the first non-sovereign issuer to issue with such a long maturity.

2007

Issue of first "MAPLE", *obligations foncières* in Canadian dollars in domestic format.
First issue on the German domestic market.
A record year in terms of issuances of *obligations foncières* with €23.5 billion.

2008

Compagnie de Financement Foncier receives the 2008 IFR Award in the "Covered Bond of the Year" category for its €2.5 billion 10-year issue.

2009

Creation of BPCE by merging the central bodies of the Caisses d'Épargne and the Banques Populaires, and *de facto* consolidation of Crédit Foncier and Compagnie de Financement Foncier.

2010

Inaugural issue of USD 2 billion with a 3-year maturity in 144A/RegS format. Compagnie de Financement Foncier receives the 2010 "Best Issuer of the Year" award from The Cover - Euroweek.

2012

Three *obligations foncières* benchmark issues:

- €1billion 10 year issue launched in January;
- €2 billion 3,5 year issue in February;
- €1 billion 10 year issue launched in November.

Key figures

Issuer information

Issuer: Compagnie de Financement Foncier, affiliated with Groupe BPCE

Parent company: Crédit Foncier de France (100%), a subsidiary of BPCE (100%)

Type of bonds issued: Obligations foncières

Issue programmes: EMTN, AMTN & USMTS

Sole service provider: Crédit Foncier (A-/A2/A+)(1)(2) a subsidiary of BPCE (A/A2/A+)(1)(2)

(1) *Standard & Poor's/Moody's/Fitch Ratings.*

Ratings of *obligations foncières* (2)	Long-term rating	Outlook
Standard & Poor's	AAA	Stable
Moody's	Aaa	Stable
Fitch Ratings	AAA	Stable

(2) *Ratings updated as of the Registration document's filing date.*

Simplified economic balance sheet at 31 December 2012 and 31 December 2011

(from the regulatory report on the calculation components of the coverage ratio, certified by the Specific Controller)

Including the direct and indirect public guarantees on certain outstanding loans also backed by real estate collateral, in particular loans secured by the FGAS(*), the assets secured by a public guarantee represented €51.7 billion at 31 December 2012, and 51% of total assets.

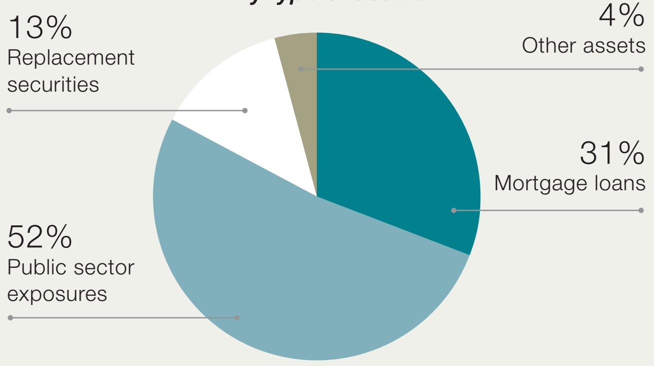
(*) FGAS: *Fonds de garantie de l'accession sociale à la propriété* (Government fund promoting access to home ownership)

ASSETS (by type of exposure)	At 31 Dec. 2012		At 31 Dec. 2011	
	€bn	%	€bn	%
Mortgage loans	31.7	31.4%	36.2	34.2%
Mortgage loans and related items	26.4	26.2%	26.0	24.6%
European senior residential mortgage-backed securities	5.3	5.2%	10.2	9.6%
Public sector exposures	51.7	51.4%	51.7	48.9%
Mortgage loans guaranteed by the French state or a European public institution	11.6	11.5%	10.0	9.4%
French public sector loans	19.4	19.2%	18.1	17.1%
International public sector values	20.8	20.7%	23.7	22.4%
Other assets and replacement values	17.4	17.2%	17.9	16.9%
Replacement values	13.3	13.2%	14.6	13.8%
Other assets	4.1	4.0%	3.3	3.1%
TOTAL ASSETS	100.8	100.0%	105.8	100.0%

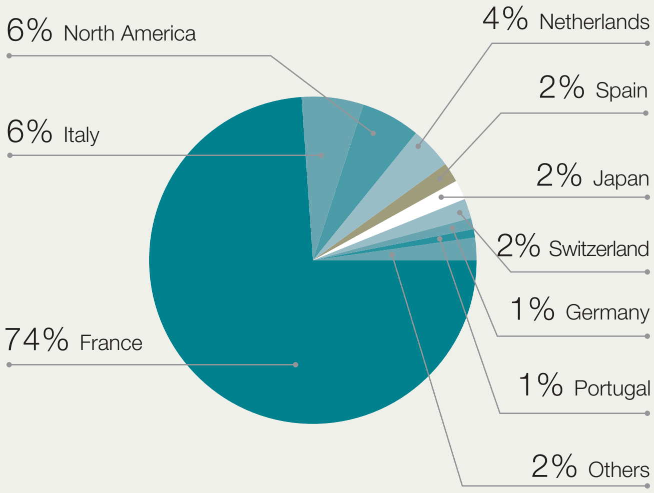
LIABILITIES	At 31 Dec. 2012		At 31 Dec. 2011	
	€bn	%	€bn	%
Privileged resources	85.2	84.5%	91.1	86.1%
Obligations foncières	84.4	83.8%	89.8	84.9%
Other privileged resources	0.8	0.7%	1.3	1.2%
Non-privileged resources	15.6	15.5%	14.7	13.9%
Unsecured debt	9.9	9.8%	8.8	8.4%
Subordinated debt and similar debt	3.8	3.8%	4.0	3.8%
- of which redeemable subordinated notes (RSN)	2.1	2.1%	2.1	2.0%
- of which super-subordinated notes	1.4	1.3%	1.4	1.3%
Shareholders' equity, provisions and FRBG	1.9	1.9%	1.8	1.7%
Regulatory capital	*3.2*	*3.2%*	*3.2*	*3.0%*
TOTAL LIABILITIES	100.8	100.0%	105.8	100.0%

Breakdown of assets: €100.8 billion

By type of assets



By region



Performance indicators

€8.1 billion
Obligations foncières issued in 2012

€132.6 million
Net income

113.7%
Regulatory overcollateralisation ratio

16.4%
Non-privileged resources/privileged resources ratio (excluding BCE refinancing and repurchase agreements).

65.7%
Average LTV of mortgage loans

14.4%
Tier one ratio

Outstanding privileged liabilities at 31 December 2012
€85 billion, including €84 billion in *obligations foncières*

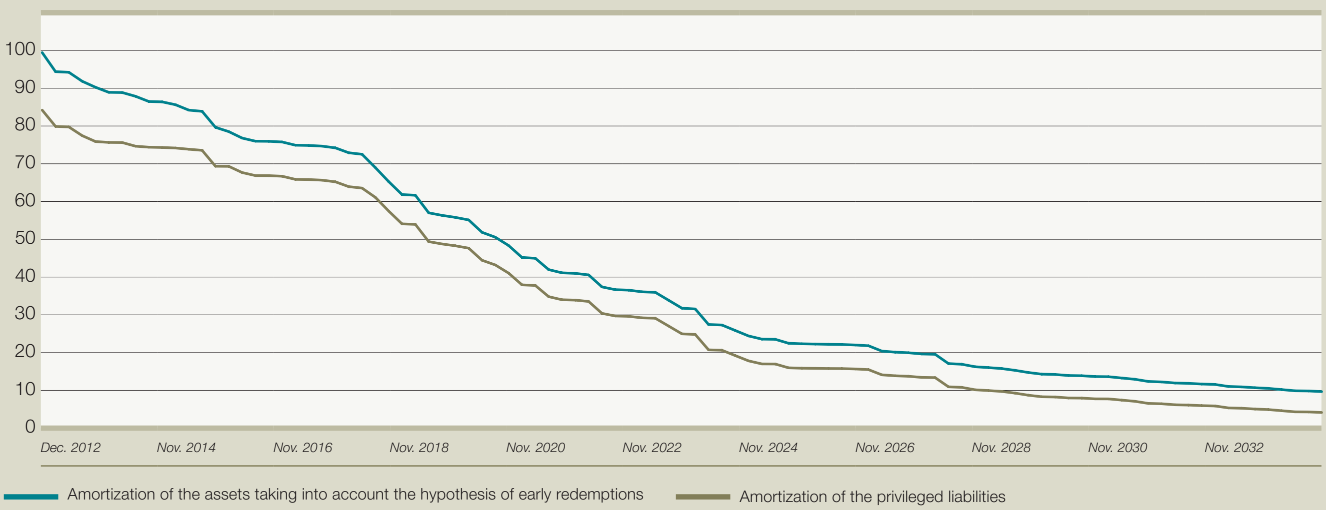
Positioning
One of the leaders in the European covered bond market.

Highlights 2012

Three *obligations foncières* benchmark issues:

- **€1bn 10 year launched on 9 January;**
- **€2bn 3,5 year launched on 10 February;**
- **€1bn 10 year launched on 9 November.**

Amortization of assets and privileged liabilities



Covered bonds: legal and regulatory framework

Covered bonds

Covered bonds are bonds backed by first-ranking mortgage loans or public sector exposures.

Article 52-4 of the amended UCITS European Directive gives a legal definition of covered bonds. They must fulfil the following criteria:

- the issuer must be a credit institution having its registered office in a European Union Member State;
- it is subject to specific legal supervision protecting holders of those bonds;
- the bondholder must be protected by cash flows deriving from assets that allow the reimbursement of the bonds. He has priority recourse in case the issuer defaults (preferential claim);
- the bondholder may hold up to 25% of their assets in the securities of a single issuer when said securities are covered bonds.

UCITS Directive[1] – Article 52-4

Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 (initial directive 85/611/EEC of 20 december 1985)

[…]

4. Member States may carry the 5% limit as set out in paragraph 1, subparagraph 1, up to a maximum of 25% for bonds issued by a credit institution whose registered office is in a Member State and which is legally subject to special oversight by the public authorities in the interest of protecting bondholders. In particular, funds resulting from the issue of these bonds are invested, in keeping with the law, in assets which, during the entire valid period of the bonds, may hedge the assets resulting from the bonds and which, should the issuer fail, would be used on a priority basis for repaying principal and paying accrued interest.

[…]

The second European text that provides a definition of covered bonds is the Capital Requirements Directive (CRD). It provides the holders of covered bonds, particularly European banks, with a favourable regulatory framework. Under the CRD/EU CAD (Capital Adequacy Directive) scheme, banks and insurers have an attractive risk weighting on covered bonds complying with this Directive and with the best rating.

CRDs[2]: 2006/48/EC (business of credit institutions) and 2006/49/EC (capital adequacy)

Regulation of the European Parliament and of the Council (prudential requirements for credit institutions and investment firms).

Article 124 - Exposures in covered bond form

1. To receive preferential treatment, detailed in paragraph 3, the "covered bonds" must be bonds within the meaning of Article 52-4, of Directive 2009/65/EC of the European Parliament and the Council of 13 July 2009 on coordination of legislative, regulatory and administrative provisions concerning certain undertakings for collective investment in transferable securities (UCITS), and their safety must be created by one of the following eligible assets:

(a) exposures to, or guaranteed by, central administrations, central governments, public sector entities, or regional or local administrations of the Union;

(b) exposures to, or guaranteed by, central administrations or central banks of third-party countries, multilateral development banks or international organisations [per certain terms];

[1] UCITS: Undertakings for collective investment in transferable securities.
[2] CRD: Capital Requirements Directive.

Article 124 (continued)

(c) exposures on institutions that belong to the first tier of credit quality set out in this chapter. Total exposures of this type do not exceed 15% of the nominal outstandings of covered bonds from the issuing institution [...];

(d) loans secured by a residential property [...] or by preferential shares issued by French securitisation vehicles or by equivalent securitisation bodies governed by the law of a Member State that cover exposures on residential properties [per certain terms]

[…]

3. Covered bonds for which there is a credit evaluation by a designated ECAI[3] are assigned a risk weighting in keeping with Table 6a, which corresponds to the credit evaluation prepared by the eligible ECAI per Article 131.

[Standard method]

Table 6a

Credit quality step	1	2	3	4	5	6
Risk weight	10%	20%	20%	50%	50%	100%

[…]

[IRBF method]

In IRBF method, covered bonds are affected to a loss given default (LGD) of 11.25%.

The main feature of covered bonds is the specific mechanism established to protect bondholders. Indeed, bondholders are protected by a priority recourse on the underlying assets of the cover pool in case of the issuer's default. This is the preferential claim granted to bondholders. To guarantee them a sufficient level of quality, said assets are strictly defined in the appropriate legislation (chiefly mortgages and claims on central or regional governments, or local authorities).

Since 2008, the covered bond market has experienced very strong growth globally. This has resulted notably in a 40% increase in outstanding bonds, a growing number of issuers and the implementation of national legislation on covered bonds in many countries.

The European Covered Bond Council, an association representing more than 95% of players created in 2012 a label for covered bonds: the European Covered Bond Label. For investors, regulators and key market players, the label will promote access to relevant and transparent disclosures. For issuers, the label will enhance transparency and in particular the quality of the underlying assets. In an ever-changing environment, the main goals of the European Covered Bond Label will be to stimulate the secondary market and bolster its liquidity, while at the same time improving regulation.

[3] *ECAI: External Credit Assessment Institutions.*

French covered bonds: *obligations foncières*

The basics of *obligations foncières*

French law and compliance with European regulations

In 1999, the French government decided to open up the possibility for French banks to issue *obligations foncières*. Until then, the texts of 1852 allowed only Crédit Foncier de France or Crédit Foncier et Communal d'Alsace et de Lorraine to issue *obligations foncières*. Since 1999, *société de crédit foncier* business activities have been governed by the French Monetary and Financial Code.
French law is the transposition of the European regulations. Thus, *sociétés de crédit foncier* are:

- credit institutions having their registered office in a European Union Member State, France;
- legally subject to specific oversight protecting the holders of those bonds: the Specific Controller, whose appointment is subject to the approval of the *Autorité de contrôle prudentiel* (ACP – French Prudential Supervisory Authority, which supervises the activity of financial institutions)[4].

Bondholders are protected by the pool of eligible underlying assets (whose eligibility criteria are defined by law) toward which it has priority recourse in case of the issuer's default: this is the preferential claim granted to bondholders.
The French legal framework has transposed the CRD since 2007 and Article 52 (4) of the UCITS Directive since 2011. It was strengthened in October 2010 by legislation imposing additional liquidity and disclosure requirements for the benefit of investors.

Sociétés de crédit foncier

Sociétés de crédit foncier are credit institutions whose sole purpose is defined in Article L. 515-13 of the French Monetary and Financial Code: granting or acquiring secured loans i.e. loans that are backed by first-ranking mortgages or real property collateral conferring at least an equivalent guarantee, or exposures on public authorities, and financing them by issuing *obligations foncières*. The business activities of a *société de crédit foncier* are restricted by law and they may not hold equity interests or share portfolios.
Their financial statements must provide a clear view of major balance sheet items, including:

- assets: secured loans, i.e. loans that are backed by first-ranking mortgages or real property collateral conferring at least an equivalent guarantee, exposures on public authorities and replacement values;
- liabilities: privileged resources among which *obligations foncières,* and non-privileged resources (unsecured debts, subordinated and assimilated debts), shareholders' equity (own capital) and reserves.

Obligations foncières, which finance eligible debts), are secured debts that have a preferential claim that confers a priority right on cash-flows deriving from assets to their holders.

Article L. 515-13

Amended by Law No. 2010-1249 of 22 October 2010 – Art. 71

I. - Sociétés de crédit foncier are credit institutions approved as financial companies by the French Prudential Supervisory Authority, whose exclusive purpose is:

1° to grant or acquire secured loans, or exposures to public authorities and securities as defined in Articles L. 515-14 to L. 515-17;

2° for the financing of these categories of loans, exposures, or securities, to issue bonds known as *obligations foncières* benefiting from the preferential claim defined in Article L. 515-19 and by raising other resources whose contract or document is intended for public information pursuant to Article L. 412-1 or any equivalent document required for admission on the foreign regulated markets that mentions this preferential claim.

[…]

[4] *For more information, please refer to the section on the Specific Controller in "Regulatory bodies" page 19.*

The eligibility criteria for *sociétés de crédit foncier's* assets are defined in Articles L. 515-14 to L. 515-17 of the French Monetary and Financial Code. The following assets are eligible:

- loans secured by a first-ranking mortgage or equivalent guarantee, when the underlying property is located in the European Economic Area or in a country with the highest credit rating;
- exposures to or guaranteed by public authorities (public entities, local authorities, etc.) in the European Economic Area, or located in Switzerland, the United States of America, Canada, Japan, Australia and New Zealand, and when they directly or indirectly have a step one credit rating;
- replacement values (limited to 15% of the nominal amount of *obligations foncières* and other resources benefiting from the preferential claim): securities and deposits that are sufficiently safe and liquid.

All eligible assets are carried by the *société de crédit foncier* in a dedicated balance sheet separate from the parent company's. The Specific controller ensures compliance with the legislative and regulatory provisions.

Investor protection

Preferential claim of holders of *obligations foncières*

Article L. 515-19 of the French Monetary Financial Code specifies the terms of the preferential claim and the guarantee that it provides. Asset cash flows shall first be allocated to the payment of *obligations foncières*.

The preferential claim is the fundamental principle of legal security for *obligations foncières'* holders. It remains valid even if the *société de crédit foncier* or its parent company goes bankrupt or enters receivership. It thus affords investors with the maximum protection.

Article L. 515-19

Amended by Ordinance No. 2007-571 of 19 April 2007 – Art. 2 official Journal of 20 April 2007

Notwithstanding any contrary legislative provisions, including those of Book VI of the French Commercial Code:

1. Sums deriving from the loans or similar debts, securities and instruments referred to in Articles L. 515-14 to L. 515-17, financial instruments referred to in Article L. 515-18, after netting, if applicable, as well as claims made in respect of deposits by the *société de crédit foncier* with credit institutions, shall first be allocated to the payment of *obligations foncières* and the other privileged resources mentioned at I.2 of Article L. 515-13.

2. When a *société de crédit foncier* is subject to a preservation procedure, recovery procedure, insolvency or conciliatory proceedings, the debts duly deriving from the transactions referred to in item 2 of I of Article L. 515-13 shall be paid on their contractual due date and in priority over all other claims, regardless of whether the latter benefit from the preferential claim or security interests, including interest resulting from contracts, of whatever duration. Until the holders of preferential claims within the meaning of the present article have been fully repaid, no other creditor of the *société de crédit foncier* may exercise any right over the company's property or rights.

3. A *société de crédit foncier*'s insolvency does not accelerate the repayment of its bonds or the other preferential claims referred to in part 1 of this article.

[…]

In order to protect *obligations foncières* bondholders, law sets out management rules so as to ensure that the *société de crédit* foncier is able to reimburse its *obligations foncières*.

- Overcollateralisation

> Article L. 515-20
>
> "The total amount of the *société de crédit foncier*'s assets must be greater than the amount of their liabilities on which there is a preferential claim as indicated in Article L. 515-19. The Minister for the Economy determines how to measure these assets and liabilities."

Article R. 515-7-2 of the CRBF (French Banking and Financial Regulatory Committee) regulation sets the minimum legal overcollateralisation ratio at 102%.

- Matching of assets and liabilities in terms of maturity and rates
  Article 12 of CRBF No. 99-10 requires that matching of maturity and rates of assets and liabilities has to be respected in the *société de crédit foncier* balance sheet management. This matching is subject to review by the Specific Controller, who refers points needing attention to the executive officers, and to the ACP if necessary.

- 180-day liquidity buffer
  At all times, *sociétés de crédit foncier* must ensure that all cash requirements are covered for a period of 180 days. Therefore, *sociétés de crédit foncier* hold replacement values, assets eligible for credit transactions by the Banque de France or other assets defined by Article R. 515-7-1 that permanently cover all identified cash requirements for the next 180 days.

> Article R. 515-7-1
>
> Created by Decree no. 2011-205 of 23 February 2011 - Art.1
>
> At all times, the *société de crédit foncier* hedges its cash requirements over a period of 180 days, recognising the hedging of forecast cash flows of principal and interest on its assets as well as net cash flows relating to forward financial instruments mentioned in Article L. 515-18. Cash requirements are covered by replacement values, assets eligible for credit transactions by the Banque de France, in keeping with the procedures and conditions determined by the Banque de France for its monetary policy and intra-day credit transactions, and by the refinancing agreements entered into with credit institutions that have top-tier short-term credit quality as established by an external credit-rating organisation recognised by the French Prudential Supervisory Authority pursuant to Article L. 511-44 or that are guaranteed by other legal persons with the same credit quality.
>
> [...]

Non-extension of the parent's insolvency to its *société de crédit foncier* subsidiary

Under French law, a *société de crédit foncier* has a specific legal framework guaranteeing that the holders of *obligations foncières* receive favourable treatment under normal management conditions and in the event of insolvency proceedings being initiated against its parent.

> Article L. 515-27
>
> "Preservation, restructuring or insolvency proceedings against a company holding shares in a *société de crédit foncier* cannot be extended to the *société de crédit foncier*."

The cash flows derived from *société de crédit foncier* assets are, under all circumstances, used to repay privileged debt. In the event of the failure of its parent, the *société de crédit foncier* and the holders of *obligations foncières* are fully protected by virtue of this non-extension rule.

If a French company is subject to insolvency proceedings, there will be no power vacuum at its level, as an administrator is appointed to ensure the continuity of management.

As a separate legal entity, the *société de crédit foncier* subsidiary is not affected by the insolvency of its parent, the management of the *société de crédit foncier* is conducted *in bonis,* i.e., under normal management conditions, by the managers of the *société de crédit foncier.*

If the parent is subject to preservation or insolvency proceedings, the *société de crédit foncier* subsidiary may terminate its service and asset management contracts if it deems this course to be appropriate. The *société de crédit foncier* may therefore change its service provider at any time to ensure the continued management of its assets and liabilities.

Immunity of *obligations foncières* holders

In the event of insolvency proceedings being initiated against a *société de crédit foncier,* cash flows derived from assets are in priority allocated to repayment of privileged debts and the following rules apply:

Repayment schedule of privileged debt is maintained

In the event of judicial liquidation, debt payment is not accelerated. The debts duly deriving from the transactions shall be paid on their contractual due date and repayment of debts that do not have the preferential claim will only take place after repayment of *obligations foncières* and other privileged debts. All other creditors (including the French State) are not paid until all *obligations foncières* holders' claims have been satisfied, as set out in the initial timetable. In contrast with the general law that transactions made when companies are in financial difficulty may be invalidated, *sociétés de crédit foncier* assets transfers made prior to a declaration of insolvency remain valid.

Continuity of management in the event of *société de crédit foncier* insolvency

Article L. 613-18 of the French Monetary and Financial Code provides that, depending on the situation, a provisional administrator may oversee or advise management, or be given full managerial authority. The provisional administrator can use the same asset-liability management (ALM) tools that are normally available to a *société de crédit foncier:*

- selling assets;
- assigning assets;
- issuing new *obligations foncières;*
- issuing non privileged liabilities.

The rules applicable to a *société de crédit foncier* continue to be followed, regardless of the situation.

Thus, the *société de crédit foncier* does business as usual, because the provisional administrator has the same duties as managers did previously. All activities are carried on to ensure the company is well managed, and all privileged debts are repaid in compliance with existing commitments.

Article L. 613-18

The banking commission may appoint a temporary administrator to a credit institution, payment institution or any one of the persons mentioned in paragraph one of Article L. 613-2, to which all of the legal entity's administrative, management and representative powers are transferred.

[…]

In the event of insolvency of a *société de crédit foncier*, the Specific Controller, as set out in Article L. 515-31 of the French Monetary and Financial Code, must file claim statements on behalf of privileged creditors. Thus, he or she also takes on the role of court-ordered liquidator, and has extensive investigative rights to carry out all assignments.

The Specific Controller continues to inform and notify the French Prudential Supervisory Authority (ACP), just as he or she must do when the *société de crédit foncier* is operating normally.

Affiliation to a central body

Mutualist banking groups have a central body: some subsidiaries may use a securing specific mechanism: the affiliation. In Compagnie de Financement Foncier's case, it is affiliated with BPCE SA which is the central body of Groupe BPCE. Crédit Foncier is part of Groupe BPCE.

> Article L. 511-31
>
> The central bodies represent the credit institutions with which they are affiliated near Banque de France and ACP. They are responsible for the solidity of their network and for ensuring that the institutions affiliated with them function property. To this end, they take any necessary steps to guarantee the liquidity and the solvency of each of those institutions and of the entire network (...).

Regulatory bodies

The *Autorité de contrôle prudentiel* (ACP - French Prudential Supervisory Authority)

As authorised credit institutions, *sociétés de crédit foncier* are placed under the French Prudential Supervisory Authority (ACP).
The ACP monitors these companies by examining reports and financial statements that they are required to provide and by conducting on-site investigations.
As credit institutions, *sociétés de crédit foncier* also provide information about:
- internal control (Articles 42 and 43 of French Banking and Financial Regulatory Committee (CRBF, Regulation No. 97-02, as amended);
- liquidity, via the liquidity ratio and observation ratios.

In addition to this, *sociétés de crédit foncier* must publish reports about:
- the quality of its financed assets and, in particular, the characteristics and breakdown of loans and guarantees, liquidity at 180 days in a run-off scenario, as well as the level and sensitivity of interest rate positions.
  This report on these points is published on the Compagnie de Financement Foncier's website and submitted to the ACP four times a year, within 45 days after the end of each quarter;
- the calculation of the overcollateralisation ratio, which includes limits on the composition of assets, and the calculation of amounts eligible for refinancing using privileged resources.
  This report on this information, certified by the Specific Controller must be submitted to the ACP within three months following the end of each half-year.

These audits performed by the ACP are an additional guarantee for the holders of *obligations foncières. Sociétés de crédit foncier* determine the solvency ratio and the regulatory overcollateralisation ratio to the French Prudential Supervisory Authority, on an individual basis.

Regulation 97-02, as amended – Article 43

At least once a year, reporting institutions and financial holding companies supervised on a consolidated basis shall draw up a report on risk assessment and monitoring that provides an overall picture of all of the risks to which they are exposed, including the risks associated with banking and non-banking activities [...].

For reporting institutions and financial holding companies, this report shall include an appendix relating to the security of means of payment [...].shall describe the assessment, measurement and monitoring of the security of the means of payment they issue or manage with regard to their internal standards, if any, and to the recommendations that the Banque de France or the European System of Central Banks bring to their attention.

For the institutions that are subject to the French ministerial order concerning the identification, assessment, management and control of liquidity risk, this report must include changes in cost-of-liquidity indicators over the period.

"For the standardised approach to assessing liquidity risk, [...] this report must include:

- an appendix that presents the assumptions used to prepare the liquidity statement [...] and, if necessary, any material modifications made during the period;
- an analysis of the change in the calculated liquidity gaps in the liquidity statements prepared during the period.

With regard to the monitoring of liquidity [...], the report shall indicate the assumptions used.

This report shall also include:

a) an appendix containing the assumptions and methodological principles used as well as the results of stress tests performed by reporting institutions [...];

b) an appendix indicating the methods, including stress tests, used for identifying the risks resulting from the use of credit risk mitigation techniques [...], in particular the risk of concentration and residual risk.

This report may be included in the report provided for in Article 42 of this Regulation.

Risk assessment and monitoring

Credit institutions subject to these rules must also implement risk assessment tools and methods that are capable of ensuring effective management of their risk, including for loan approval (limits, approval delegations and analytical methods), and also tools and procedures for regularly monitoring and assessing risk levels.

Regulations require a periodic review of these assessment methods and tools.

These tools and procedures are used to assess, select and monitor the following types of risks:

- credit;
- liquidity;
- interest rate;
- currency;
- compliance;
- settlement and intermediation;
- legal;
- operational;
- extreme events (solutions provided in the business continuity plan).

Documentation and information

Credit institutions are required to document the following:
- their control organisation and the responsibilities of control staff;
- their systems security procedures;
- risk assessment systems and their operational characteristics (limits, approval rules, monitoring, etc.).

The following supervisory and control entities must be kept informed:
- decision-making body: the Board of Directors and its Audit Committee;
- the company's central body or its shareholder;
- external auditors (Statutory Auditors and the Specific Controller);
- regulatory authorities (ACP, AMF [Autorité des Marchés Financiers: French Financial Markets Authority]).

Statutory Auditors

Appointment of the Statutory Auditors

As a French public limited company, *sociétés de crédit foncier*'s financial statements must be audited by Statutory Auditors. Article L. 511-38 of the French Monetary and Financial Code requires that credit institutions be audited by at least two statutory auditors, employed by two different auditing firms (whereas other countries require only one).

The statutory auditors must be appointed for a six-year term, by shareholders at the General Meeting and not by the Company's Executive Directors.
As credit institutions, *sociétés de crédit foncier* must first have their statutory auditors approved by the General Meeting.

The Statutory Auditors have a permanent legal obligation to ensure the quality and reliability of the financial and accounting information provided by their clients. Their duties include:

Audit and certification
Pursuant to the French Commercial Code, the Statutory Auditors must certify, while justifying their opinion, whether or not the annual financial statements give a true and fair view of the company's results for the accounting period concerned, and of its financial situation and assets and liabilities at the end of each period. Their certification is published in this registration document. For this purpose they carry out an audit, in accordance with the professional standards of the National Association of Statutory Auditors (CNCC, *Compagnie nationale des Commissaires aux comptes*).

General report
In their report to the Ordinary Shareholders' Meeting, the Statutory Auditors must report on the execution of their assignment.
By certifying the Company's financial statements, they express that during the course of their assignment they have obtained reasonable assurance that the financial statements are free of material misstatement.
They must inform the Shareholders' Meeting of any irregularities or inaccurate information they may have observed during their assignment.

Specific verifications
The Statutory Auditors verify the fairness of the following information and its consistency with the annual and interim financial statements:
- the information provided in the management report;
- the documents provided to shareholders concerning the financial situation and annual financial statements.

To carry out their assignment, the Statutory Auditors hold extended investigative powers.

Pursuant to the law, at any time of year, the Statutory Auditors, together or individually, may carry out all verifications and controls they deem appropriate and may go to the company and request any documents they consider necessary for their assignment, including contracts, accounting records and documents, and minutes of meetings.
These investigations may be conducted at the company or at its parent, or if necessary at any subsidiary or at any entity included in the consolidation scope.

Liability of the Statutory Auditors

Liability of Statutory Auditors and Specific Controller

The statutory auditors and the Specific Controller can be held liable as follows:
- civilly liable, per Article L. 515-30 of the French Monetary and Financial Code regarding the Specific Controller and Article L. 822-17 of the Commercial Code regarding any statutory auditors, stating that they are liable, toward both the company and third parties, for any harmful consequences of any torts or negligences of which they are guilty in the exercise of their duties.
- disciplinarily liable, per Article R. 822-32 of the French Commercial Code, because the Specific Controller is a registered statutory auditor;
- criminally liable, under Articles L. 820-6 and L. 820-7 of the Commercial Code.

Specific Controller

The Specific Controller is selected from the official list of Statutory Auditors (CNCC); his appointment, proposed by the executive management of the *société de crédit foncier,* is subject to the approval of the ACP for a four-year mandate. He is responsible for verifying that operations are functioning correctly and for ensuring strict compliance with laws and regulations. To avoid any conflict of interest, the Specific Controller may not be a Statutory Auditor for the group that consolidates the *société de crédit foncier* on its balance sheet.

His responsibilities, as defined by law under Articles L. 515-30 and 31, and for which he has extensive investigative rights, are essentially to:
- ensure compliance with the legislative and regulatory provisions specific to *sociétés de crédit foncier;*
- verify that the repurchases made by a *société de crédit foncier* are in accordance with the purpose defined in Article L. 515-13 and meet the conditions provided for by Article L. 515-14 to L. 515-17;
- certify the documents sent to the ACP, in particular, regulatory ratios, limits and LTV at 30 June and 31 December of each year;
- prepare, for management and decision-making entities, an annual report on the achievement of its assignment, a copy of which is sent to the ACP.

In accordance with the law and regulations, the Specific Controller must ensure that the *société de crédit foncier* is taking all necessary steps to secure the redemption of *obligations foncières* and other privileged resources. For this purpose, the Specific Controller must, either on an ongoing basis, or in response to specific events:
- assess the quality of the risk management and monitoring procedures that the *société de crédit foncier* has implemented in order to respect the principles above;
- control the eligibility of loans and other assets held by the *société de crédit foncier;*
- ensure the appropriate overcollateralisation of privileged resources by eligible assets, the compliance with regulatory limits and the LTV eligible for preferential refinancing;
- certify previous ratios, limits and LTV twice a year for the ACP;
- issue certifications of quarterly bond issue programmes for issues in euro equivalent of 500 million or more;

- verify the matching of maturities and interest rates of the *société de crédit foncier's* assets and liabilities (Article 12 of French Banking and Financial Regulatory Committee (CRBF) Regulation No. 99-10);
- appraise the valuation and periodic review procedures of the assets underlying the eligible loans, per CRBF No. 99-10.

The Specific Controller's controls supplement the company's standard internal controls and those conducted by the Statutory Auditors.

In the event the *société de crédit foncier* enters recovery or insolvency proceedings, the Specific Controller would become the legal representative of the holders of *obligations foncières* and other privileged resources.

Article L. 515-30

Amended by Ordinance no. 2010-76 of 21 January 2010 - Art. 18 (V)

The Specific Controller

In each *société de crédit foncier*, a Specific Controller and an alternative Specific Controller, chosen among the persons on the official list of auditors, shall be appointed by its executives for a term of four years, with the approval of the French Prudential Supervisory Authority.

[…]

The Specific Controller shall supervise compliance by the *société de crédit foncier* with Articles L. 515-13 to L. 515-20. He shall verify that the contributions made to a *société de crédit foncier* are in accordance with the purpose defined in Article L. 515-13 and meet the conditions provided for by Article L. 515-14 to L. 515-17.

The Specific Controller shall certify the documents sent to the French Prudential Supervisory Authority in compliance with the foregoing provisions.

He shall prepare an annual report on the fulfilment of his mission for the attention of the executives and deliberative bodies of the *société de crédit foncier*, a copy of which shall be sent to the French Prudential Supervisory Authority.

He shall attend all shareholder meetings and at his request shall be heard by the Board of Directors or the Executive Board.

The Specific Controller, as well as his colleagues and experts, is bound by professional secrecy in respect of the facts, acts and information of which he may obtain knowledge by reason of his duties. However, he is released from the professional secrecy requirement with regard to the French Prudential Supervisory Authority, to which he must immediately report any fact or decision of which he obtains knowledge in the course of his assignment that is liable to be detrimental to the operating conditions or continued operations of the *société de crédit foncier* […].The Specific Controller shall be responsible, as regards both the *société de crédit foncier* and third parties, for damage caused by faults and negligence committed by him in the performance of his office.

Article L. 515-31

Amended by Ordinance no. 2010-76 of 21 January 2010 - Art. 5 and Art. 18 (V)

The Specific Controller

When a *société de crédit foncier* is the subject of preservation procedure, recovery procedure or insolvency proceeding, the Specific Controller makes the declaration as stipulated in the Commercial Code for and on behalf of the holders of the privileged debt referred to in Article L. 515-19.

[…]

By exception to Article L. 823-14 of the French Commercial Code, the Specific Controller's right to information may extend to communication of the contracts and other documents held by the company responsible for administering or recovering the loans, exposures, similar debts, securities and instruments, bonds and other resources, pursuant to Article L. 515-22, provided that those contracts and other documents are directly related to the tasks performed by that company on behalf of the *société de crédit foncier*.

The *Autorité des Marchés financiers* (AMF - French Financial Markets Authority)

The purpose of the European Prospectus Directive, inaugurated in 2003 is to harmonise the format of bonds issued by all European issuers. It was transposed into French law in 2005.
Specifically, it requires choosing a place for registering securities from the issuing programme that matches either the issuer's home country or the country in which the issuer wants to have them listed.

Sociétés de crédit foncier who choose Paris as the place of registration must submit to the approval of the French Financial Markets Authority (AMF), in its capacity as the regulatory authority for issuers who register their programme in Paris, a prospectus that contains information intended for the public pursuant to Article L. 212-1 of the AMF's General Regulation and Articles L. 412-1 and L. 621-8 and seq. of the French Monetary and Financial Code.

This prospectus is valid for 12 months and must be supplemented with addenda, if "any new material event, mistake or inaccuracy in relation to the information in the prospectus may have a material effect on the valuation of investment securities".
The AMF has the right to suspend or prohibit transactions if necessary.
Article L. 212-13 of the General Regulation also stipulates that, as issuers, *sociétés de crédit foncier* must provide a Registration Document as well as the half-year update of the document.

In addition, the Transparency Directive of 2004 – transposed into French law by the Act of 26 July 2005 and the changes to the General Regulation of the AMF by the decree of 4 January 2007 – introduces transparency requirements for the quality of the information that investors must have on the company's performance and financial situation. Thus it helps to guarantee better protection of investors and deepen their trust. Specifically, it harmonises the content and frequency of the publication of information.
By the same token, as issuers of debt securities admitted to trading on a regulated market, *sociétés de crédit foncier,* are required to comply with the ongoing and periodic disclosure requirement as defined in the AMF General Regulation.

Thus, Article 221-1 1° of the AMF General Regulation provides a list of the information that the company is required to disclose "effectively and in full" (Article 221-3 I of the AMF General Regulation). This disclosure consists in filing this information with the AMF and posting it on the issuer's website as soon as it has been filed (Article 221-3 II of the AMF General Regulation). This list includes the annual financial report, the half-year financial report, and the statement of statutory auditors' fees.

Article L. 412-1

Amended by Ordinance no. 2009-80 of 22 January 2009 – Art. 1

I. - Without prejudice to the other provisions applicable thereto, persons or entities making a public offering shall, prior to doing so, publish and make available to any interested party a document designed to inform the public concerning the content and terms and conditions of the process which is the subject thereof and the issuer's organisation, financial situation and business prospects and those of any guarantor of the financial instruments included in that process, as determined in the General Regulations of the French Financial Markets Authority.

[…]

Article L. 621-8-1

Created by Law no. 2005-842 of 26 July 2005 – Art. 26 Official Journal of 27 July 2005

The French Financial Markets Authority

I. - The Financial Markets Authority verifies that the document is complete and comprehensible, and that the information it contains is correctly presented before delivering the visa referred to in Article L. 621-8. The Financial Markets Authority indicates any statements to be altered or additional information to be inserted.

The Financial Markets Authority may also request any explanation or proof, particularly in regard to the issuer's situation, business and results and concerning any guarantors of the financial instruments to which the transaction relates.

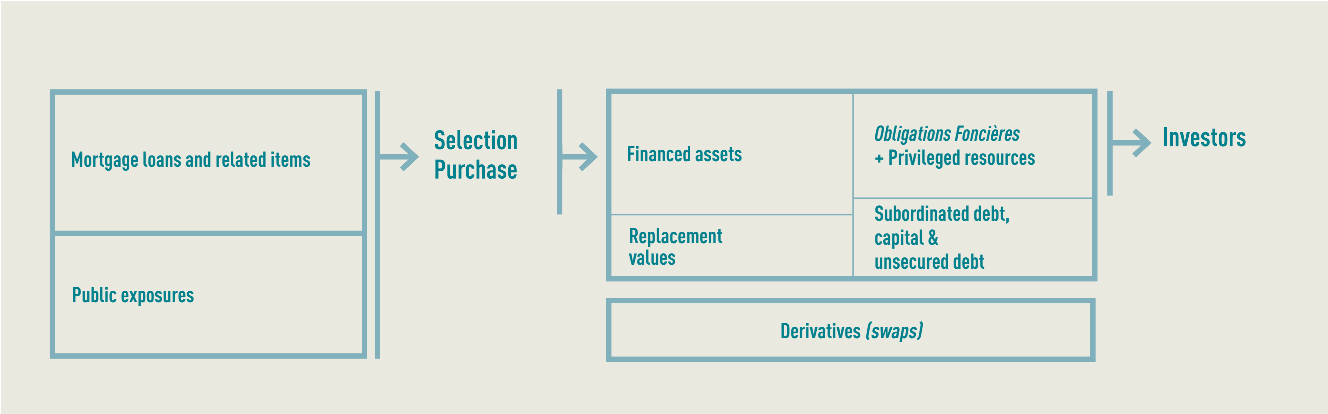
II. - The Financial Markets Authority may suspend the transaction for a period which shall not exceed a limit set by its General Regulation when it has reasonable grounds for suspecting that it is contrary to the laws or regulations applicable to it.

[…]

The Compagnie de Financement Foncier business model

Compagnie de Financement Foncier is a credit institution licensed as a financial company and a *société de crédit foncier.* A wholly owned subsidiary of Crédit Foncier, affiliated with BPCE, it enjoys the support of France's second-largest banking group. Its AAA/Aaa/AAA credit rating allows it to benefit from favourable refinancing conditions and confirm the strength and profitability of its business model.

This model is based on the selection and purchase of eligible assets originated by its parent company, Crédit Foncier, or by Groupe BPCE's entities. These assets are funded by the issue of covered bonds benefiting from the legal preferential claim.
The selection and purchase of assets is based on precise criteria. Indeed, only loans for housing backed by a first-ranking mortgage with a maximum loan to value (LTV) of 80% in the case of individuals and 60% for other cases, or guaranteed by FGAS[5] (maximum LTV 100%) as well as public sector exposures may be included on Compagnie de Financement Foncier's balance sheet.
An exposures asset-selection process allows Compagnie de Financement Foncier to buy only quality loans, in line with its risk policy.



Asset selection, management rules and control

Market and context

The French mortgage market

> The French residential real estate market is built around two main types of homes: individual houses, either stand-alone or on housing developments, and apartment buildings.
Most housing, whether new or existing, is in the private sector. But there is also a system of social housing for low-income households, which receive grants from the French government[6].
France has always sought to foster free choice regarding the status of occupation (home-ownership, social housing, buy-to-let). This is demonstrated by the support for the various sectors provided by the State through tax advantages. A balanced split between the various modes of occupation, combined with limited levels of debt, helps to provide stability and safety for the market.
In terms of location, the aspiration to single-family houses led the French population to settle in the suburban areas since the 1970s.

> Residential mortgage loans in France are, in accordance with the applicable regulations, granted on basis of the ability of borrowers to meet their loan repayments, and not on the value of the property.

[5] *FGAS : Fonds de Garantie à l'Accession Sociale. (Government fund promoting access to home ownership). A financial body funded primarily by the French government, FGAS guarantees any loans in default for the lowest-income households. Thus, it provides maximum surety for the loan and therefore the lending body.*
[6] *State aid falls into two categories: "building grants" (via social housing bodies) and "personal assistance". The system has a specific funding circuit, managed by a state-owned bank (Caisse des Dépôts et Consignations, CDC) and interest rates subsidised by the State.*

Guarantee requirements are associated with the granting of a loan. The main types of safeguards are mortgages, the "privilege of the money lender" *(privilège de prêteur de deniers)* and sureties.

- Mortgage: surety taken on the property itself, which allows the lender, in the case of default by the borrower, to be repaid before other creditors, on the proceeds raised by the sale of the property. The lender has other legal remedies against the borrower in addition to the mortgage, such as wage garnishment.
- Privilege of the money lender: operates on the same principle as a mortgage. It therefore allows the lender to seize the property and sell it through legal channels if the borrower fails to repay the loan terms.
- Surety: a surety operates in a similar fashion to insurance. The borrower pays a contribution to the surety company so that it takes over in case of default.

Most mortgages are amortising loans: the outstanding principal therefore decreases with time. The financing plan for the purchase of a house often combines a down payment and one or more loans.

To promote purchases by individuals on low income, the government has established subsidies corresponding to different levels of income. They include, for instance, the low-income home loan (*prêt d'accession sociale,* PAS), reserved for home-owners. This loan entitles the borrower to personalised housing aid (*aide personnalisée au logement,* APL), i.e. State financial assistance to reduce the monthly mortgage payment. It can be supplemented, for new construction and subject to income thresholds, by a capped interest-free loan, known as PTZ+ (new interest-free loan).

The structural features of the French mortgage market

Change in the profile of home buyers

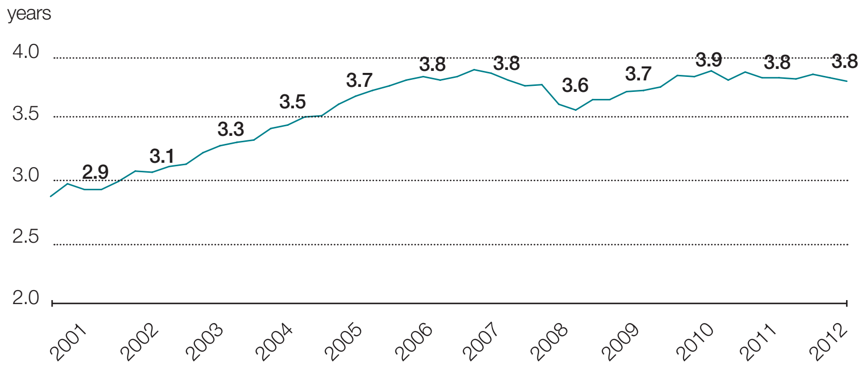
At the end of 2012, there were 33.2 million homes in France, 1% more than in 2011[7].

Housing mainly comprises principal residences (83%). The weight of second residences has been stabilising around 10% for more than ten years. More than one in two French people (56%) live in single-family homes. Approximately 14% of households live in subsidised housing. Households renting in the private rental sector remain stable at 22%[7].

Since 2007, in the new property sector, the average age of home buyers has fallen, with 52% of buyers now under 35 years old (compared to 50% in 2007). On the other hand, in the existing property sector, young buyers are less represented. Improved lending conditions were not offset by the economic crisis and the removal of interest-free loans in the existing property sector (see: mortgage interest rates for Individuals)[8].

The average transaction amount has increased steadily since 2001, as a result of property prices, rising much more quickly than incomes. Households now have to spend an average of nearly four years' income to purchase their home.

Average mortgage debts for individuals in years of income



[7] *http://www.insee.fr/fr/* - Conditions de vie – Société / Logement *(Living conditions – Society / Housing).*
[8] Crédit Logement/*CSA:* Observatoire du Financement des Marchés Résidentiels *(French Residential Market Financing Observatory).*

Conditions for granting loans in France: a very secure system

In France, loans are granted after an examination of the borrower's situation. This review covers both the amount of the borrower's income and his or her non-inclusion on the Banque de France register of payment incidents among individuals. The examination also ensures that the customer has sufficient residual income[9]. In practice, French lenders agree to cap the maximum debt load of individual borrowers at one third of their disposable income, so as to facilitate repayments. The down payment is usually set at a minimum of 10% of the total amount of the loan required.

In addition to the requirement that French mortgage lending be approved on the basis of the borrower's ability to repay, and not the value of the underlying property, the French mortgage market offers other features that increase safety:

- For the borrower: the existence of a usury rate, which is the maximum total effective rate at which a loan may be made, set by Banque de France. It prevents borrowers from being faced with too high a borrowing rate, which could put them in difficulty when repaying their debts. This helps limit arrears.
- For the lender: a clearly identified role and liability. The lender is required to examine the situation of each borrower, and therefore only to grant loans to people with the strongest records. As a rule of jurisprudential origin, the lender is also under an obligation to caution borrowers against taking out excessive debt. Lending policy is very prudent and the default rate by French households is very low.

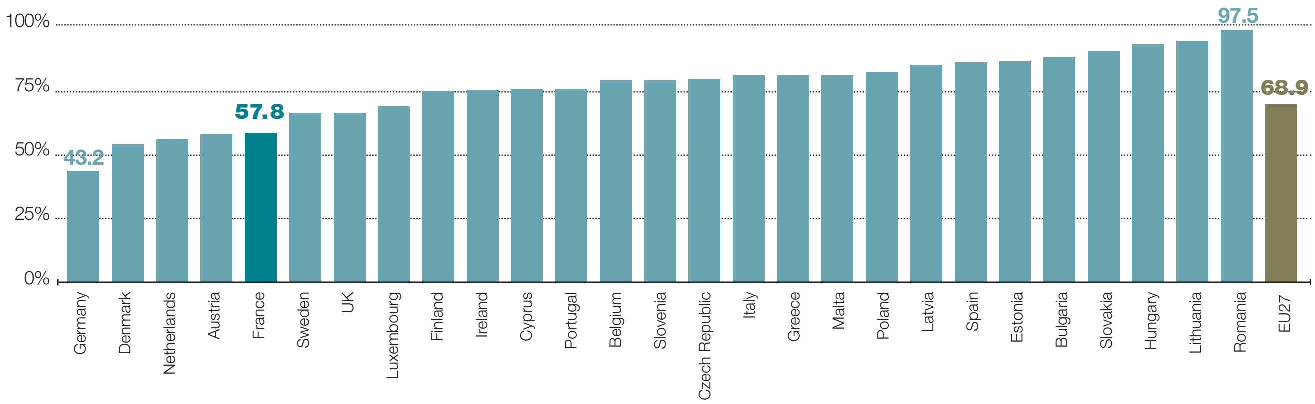
Trend data of the French mortgage market

Strong demand for housing, but insufficient supply

The French housing market is supported by demographic growth (the estimated natural rate of increase in 2011 was 0.55%[10]), resulting in higher housing demand.

The low rate of home ownership in France (58% vs the EU average of 69%) also supports the market. The strong demand stemming from the low rate of home ownership and positive population growth therefore supports property sales.

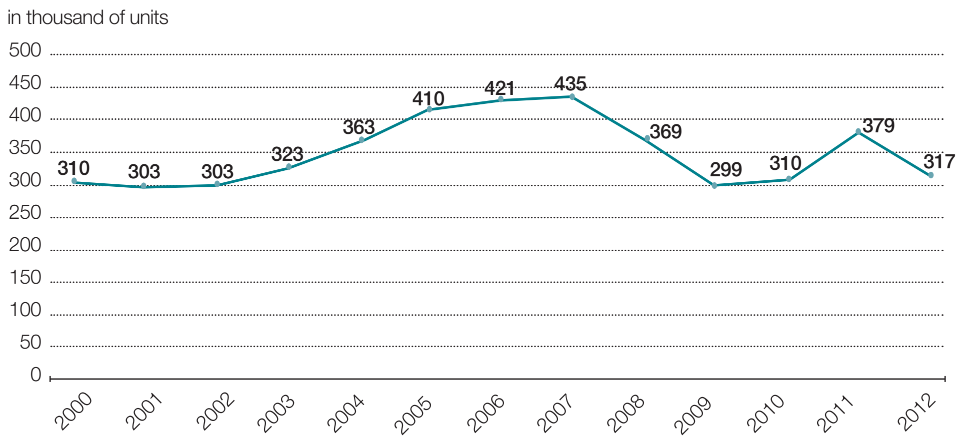
Home ownership rates in Europe



[9] *The funds remaining for the borrower's living expenses after repayments of all of his or her debts.*
[10] *European Mortgage Federation (EMF) - Hypostat 2011.*

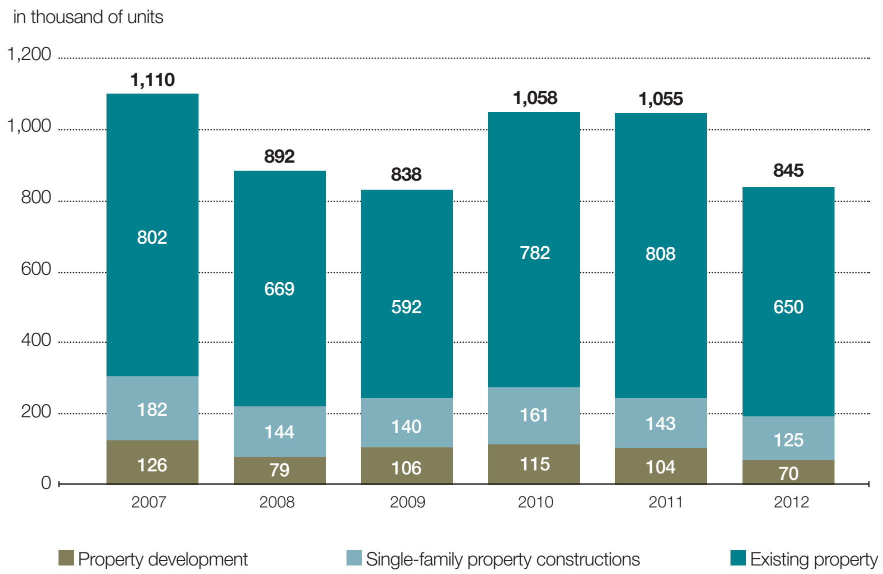
Housing supply, composed of housing starts and renovations of existing houses, does not cover this growing demand, which is between 350,000 and 500,000 housing units per year, according to reasonable assumptions of vacancy and renewal of existing houses. It is clear on the graph below that the number of housing starts only rarely reaches that number[11].

Housing starts in France



In 2012, 845,000 sales were carried out in residential real estate markets (650,000 for existing properties and 195,000 for new properties)[12]. In 2012, the average budget available to households for the purchase of real estate amounts to €228,400 for new properties and €238,700 for existing properties[13].

Total number of transactions in France



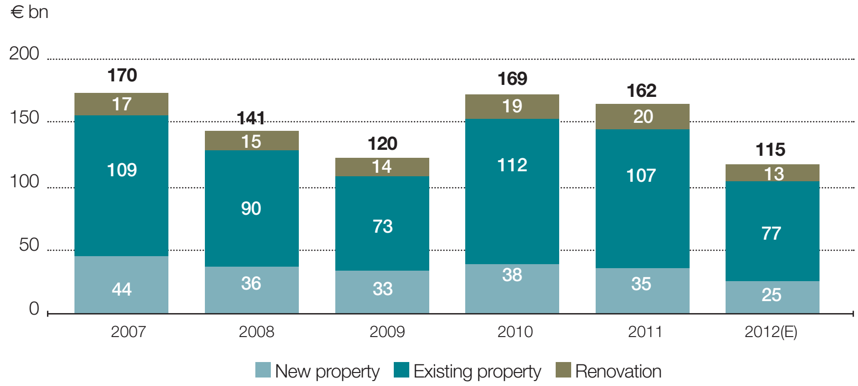
[11] Commissariat général au développement durable - Ministère de l'écologie, du développement durable et de l'énergie *(Sustainable development commission – French Ministry of Ecology, Sustainable Development and Energy).*
[12] *Markemetron, FPC (Federation of Developers and Builders), Notaries, Fnaim (National Federation of Real Estate Agents).*
[13] Crédit Logement/CSA : Observatoire du financement des marchés résidentiels *(French Residential Market Financing Observatory).*

Severe recession in real estate funding in 2012

In 2012, real estate lending by banks totalled almost €115 billion, a decline of 29% compared with 2011, and well below the €170 billion in 2007.

This change in trends came after the regular increase in lending since the turn of the century, which contributed to the good performance of the property market in France: €144 billion in 2005, €166 billion in 2006 and €170 billion in 2007[14].

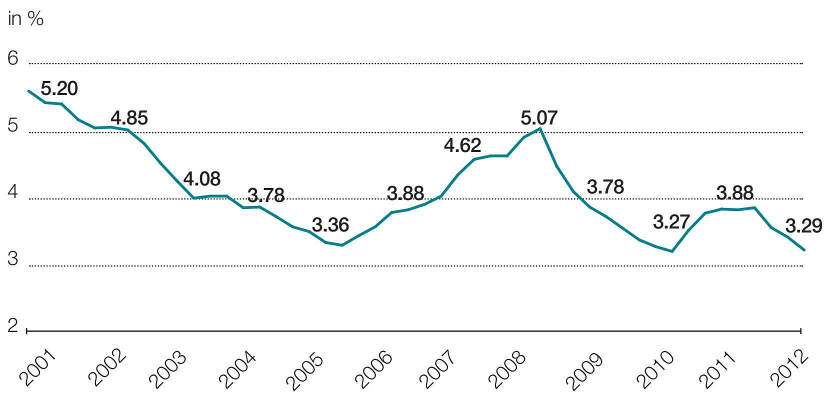
Mortage loan origination to individuals



Lending rates averaged 3.29% in the fourth quarter of 2012 (3.22% in December 2012), close to the lowest record since 1945[15] (3.25% in average).

Low interest rates allow higher loan amounts which is a real support to house prices.

Mortgage interest rates for Individuals



Since 2001, the housing market across the country has been supported by incentive schemes, contrasted to the ambient economic gloom – with a favourable period in terms of bank lending rates. The market has been driven by favourable conditions, both economic through lower interest rates and in respect of government aid.

The public sector in France

Regional and local authorities are French administrative structures separate from the State, which support the interests of the population of a specific region and are defined by three criteria:

[14] Observatoire de la production de crédits immobiliers – *OPCI (Property Loan Origination Observatory).*
[15] Crédit Logement/CSA: Observatoire du financement des marchés résidentiels *(French Residential Market Financing Observatory).*

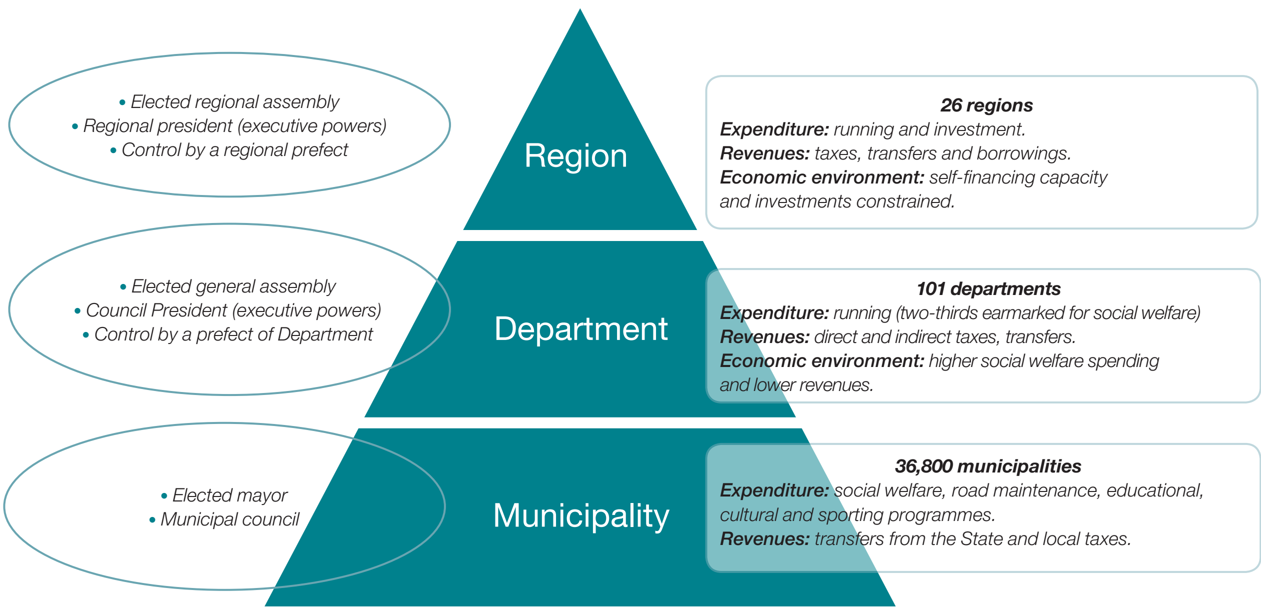
- contrary to State administration, they are endowed with legal personality. As they are decentralised, they have administrative autonomy. Thus, they have their own personnel and budget;
- they have their own powers entrusted to them by Parliament and, as such, by the legislative authority;
- they have regulatory decision-making power that is exercised by deliberation within a council of elected representatives. The decisions are then applied by local executive powers.

Organisation

The French public sector covers nearly 40,000 public structures. The biggest are the regions, departments and municipalities.

- A region is a territorial unit with an elected regional council run by a president with executive powers, under the retrospective control of the regional prefect (Senior member of the French civil service, responsible for the administration by the State at the territorial level). A region has financial autonomy, and as such its own budget. Its main focus is economic development, vocational training and education (high school).
  Operating expenses and investment make up the lion's share of spending by the region. Its revenues include taxes, incoming transfers[16] and borrowings.
  The regions hand out nearly €800 million every year in direct and indirect subsidies to businesses[17]. The current economic situation has undermined their capacity to self-finance and restricted their investments.
- A department (general council) is a territorial subdivision between the region and the municipality, with an elected general council run by a president with executive powers, under the retrospective control of the prefect of department. A general council has financial autonomy and as such its own budget. The role of department covers social affairs, large road infrastructure, education (secondary chool) and rural development. It has a key social role. Nearly two-thirds of its operating expenses are allocated to social welfare[17].
  Departments' social welfare spending is currently on the rise, at a time when their revenues are falling.
- A municipality is in charge of local government programmes. It is run by a municipal council and a mayor. Its spending is focused mainly on social welfare, road maintenance and the organisation of educational, cultural and sporting activities. A municipality has budgets consisting chiefly of transfers from the State and direct local taxes (property, housing and professional taxes); it is responsible for local government (water management, building permits, etc.). Its presence is mainly felt in land control, industrial development, architectural heritage and environment. Municipalities are behind nearly 60% of public investment.[18]

The public sector is subject to controls and managed with balanced budgets

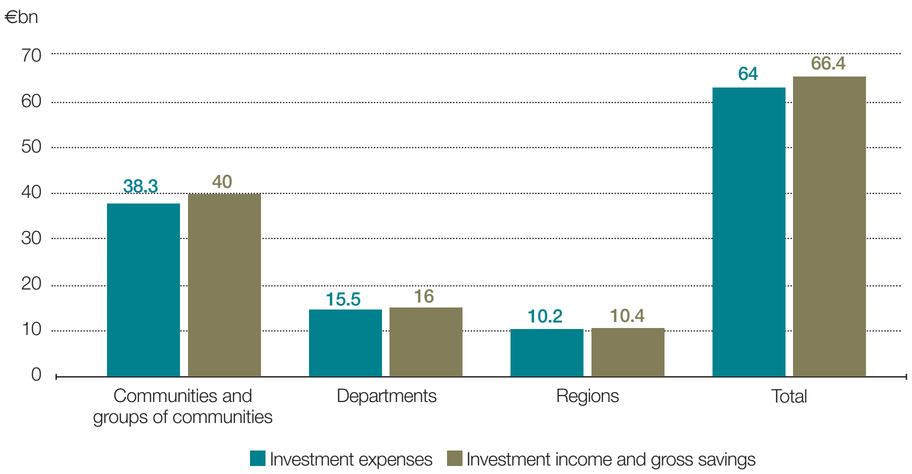


[16] *Transfers: local tax rebates, transferred taxes, general operating allocation, levy on revenues etc.*
[17] *http://www.vie-publique.fr/decouverte-institutions/finances-publiques/collectivites-territoriales/depenses.*
[18] Les chiffres clés 2012 des collectivités locales, Direction générale des collectivités locales *(2012 Key figures of French Local Authorities (French Ministry).*

Funding

The French legislative framework makes the public sector a highly controlled sector. The 1984 budget[19] endowed public structures with management autonomy. As they are responsible for investment decisions to which they commit, they are bound to repay all of their debts at any time.
In the budget estimates submitted to the Prefect's approval, revenues must be equal to or greater than expenditures to ensure debts are payable at any time.
Borrowings are the number-three resource for French regional and local authorities after taxes and transfers and support from the State. Regional and local authorities must follow a budgetary "golden rule", according to which the borrowing can only be used to finance investments and must be repaid from own resources.
As a public legal entity, a local authority cannot go bankrupt (Article L. 620-2 of the French commercial code).
Repayment of borrowings is considered a mandatory expenditure for the authorities. Thus, should an authority fail to make a payment, the matter is referred to the Prefect, who enters this expenditure in the corrected budget. In this way, the expenditure must be entered into the budget, and is thereby paid to the creditor.

Type and financing of public investment transactions in 2010[20]

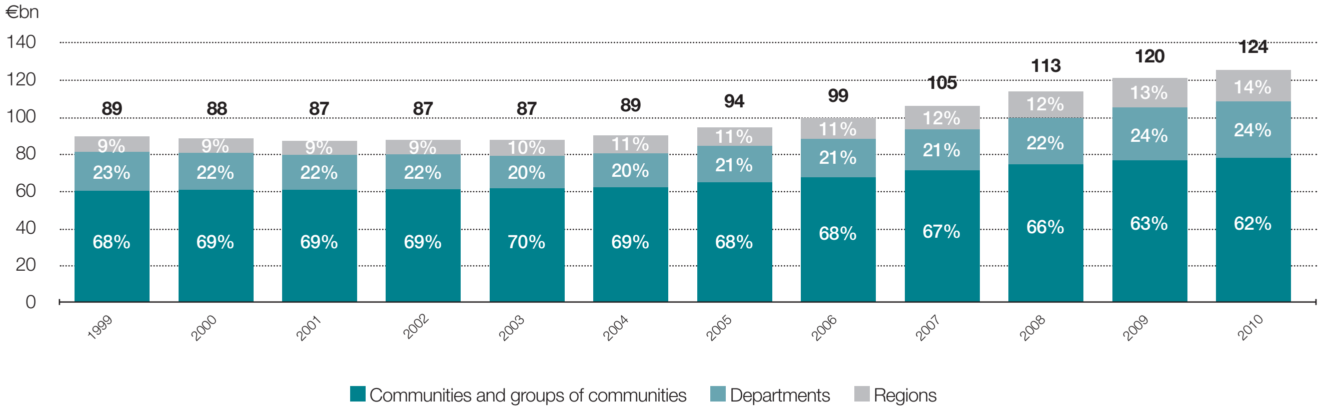


Market and environment

In view of its fundamentals, the French public sector is stable: the rules of budgetary supervision encourage elected officials to practise rigorous management. This system is protective for bodies that lend to local authorities, as such authorities have a very low probability of default.
Until the autumn of 2011, the market for financing loans to local authorities was highly consolidated. Since then, market players have become scarcer. So-called "traditional" banks withdrew or opted not to increase their market share, with the Basel III banking regulations requiring a higher level of capital to offset their commitments.
Local authorities are therefore making increase refinancing throught financial markets, alone or in groups, and borrowing record amounts in the bond market. In 2012, they issued €1.1 billion in bonds. This compares with approximately €800 million in 2011 (11 issues).
In 2012, public sector financing requirements could total €25 billion. La Banque Postale started a credit activity for French local authorities in 2012 and Caisse des dépôts et consignations (CDC) also contributed to financing that sector. Both actors enabled to face the decreasing activity of Dexia. La Banque Postale and CDC implement a credit offer for the public sector in 2013, which will take back Dexia's businesses. An agency dedicated to the financing of local authorities was created in early 2013 so as to cover up the insufficiency of financing by traditional banks.

[19] Law No. 83-1179 of 29 December 1983, the 1984 budget.
[20] "2012 Key figures of French Local Authorities" (French Ministry).

Local authority debt



Compagnie de Financement Foncier's assets

Composition of assets, selection and management rules

Composition of assets

The rules observed by Compagnie de Financement Foncier when selecting assets are strictly defined and closely monitored:

- these assets must meet the legal requirements for acquisition by *sociétés de crédit foncier;*
- their acquisition is subject to Compagnie de Financement Foncier's own additional requirements, such as the exclusion of commercial mortgage loans;
- these assets are purchased with a margin so as to ensure Compagnie de Financement Foncier's return at all times.

The quality of Compagnie de Financement Foncier's assets is also guaranteed by their intrinsic characteristics. They benefit from either a public or equivalent guarantee, or a first-ranking mortgage or equivalent surety.

More precisely, these assets include loans to public sector entities or guaranteed by the public sector and residential first-ranking mortgage loans.

Asset selection

In addition to legal eligibility criteria and guarantees required before acquisition, another distinguishing feature of Compagnie de Financement Foncier's business model is its rigorous asset selection process based on specific know-how, building on the expertise of Crédit Foncier's experienced teams dedicated to these activities.

Asset selection is based on a combination of the Basel rating and the loan-to-value regulatory ratio.

This selection process is subject to an ongoing audit process to ensure the highest level of safety for *obligations foncières*'s holders. The price that the Compagnie de Financement Foncier pays for its assets is determined on the basis of its funding costs, hedging costs, default and loss probabilities, servicing costs and its profitability.

Management of payment defaults

Loan management is assigned to Crédit Foncier by an agreement.

The recoverage process involves preventing problems, carrying out precise analysis of risk, making use of safeguards if necessary, and ensuring the rigorous processing of loan applications.
For private individuals, the debt-collection policy comprises three phases, depending on the length of arrears:

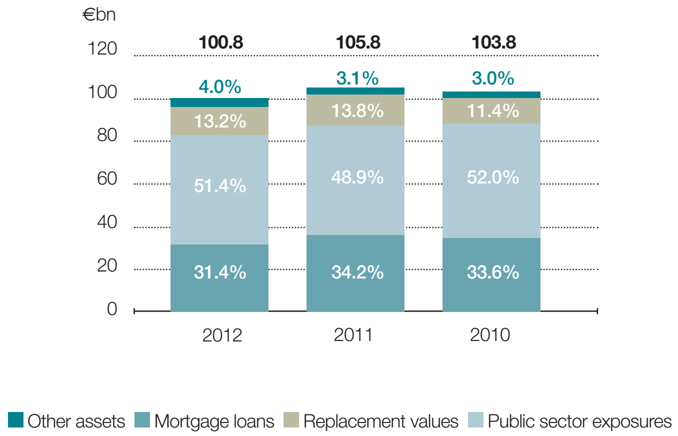
- automated collection (arrears under two months) allowing arrears to be limited to three months;
- amicable recovery (arrears between two and three months), with a rate of return to normal management in excess of 80%;
- initiation of legal action (arrears between six and eight months) resulting in the settlement of a third of cases in the subsequent year.

Change in assets

In 2012, Compagnie de Financement Foncier mainly acquired mortgage loans granted by its parent company to private individuals in France, by means of direct purchases in the amount of €5.0 billion or by subscribing mortgage notes issued by Crédit Foncier for an amount maintening their oustandings at €9.3 billion. In the public sector, Compagnie de Financement Foncier increased its exposures for €0,1 billion in loans to Crédit Foncier guaranteed by public assets, in application of article L. 211-38.
In 2012, Compagnie de Financement Foncier started reducing its balance sheet by selling international assets for an amount of €6.2 billion. In the meantime, Compagnie de Financement Foncier bought back and cancelled €2.1 billion in *obligations foncières*.

Loans with direct or indirect public guarantees make up 51.4% of Compagnie de Financement Foncier's total assets with mortgage-based assets accounting for 31.4%.

Change in assets



Management rules

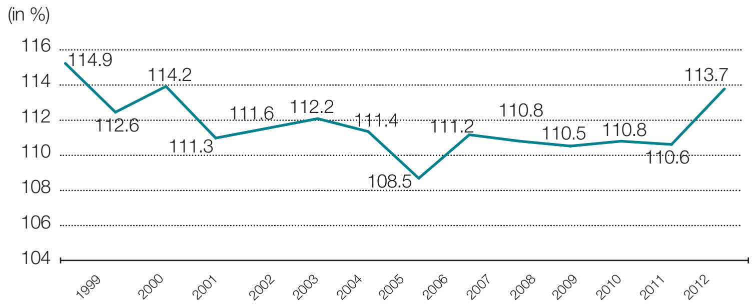
Overcollateralisation

Compliance with the regulatory overcollateralisation ratio (coverage ratio)

Overcollateralisation, defined by law (Article L. 515-20) requires that total *société de crédit foncier* weighted assets (specified in the chapter on the basics of *obligations foncières*) are always at least 102% of the total amount of liabilities benefitting from the preferential claim. One of the Specific Controller's duties is to monitor compliance with this regulatory overcollateralisation rule. When calculating regulatory overcollateralisation, as stated in CRBF Regulation No. 99-10 as amended[21], assets must be weighted in accordance with their quality and their nature.

With €1.9 billion in capital, €3.8 billion in subordinated debt and €9.9 billion in unsecured debt, regulatory overcollateralisation ratio is well above the legal minimum of 102%.
Since the company's inception in 1999, this regulatory ratio has always been above 108%. On 31 December, 2012 it was 113.7% (compared to 110.6% on 31 December 2011).

Overcollateralisation since 1999



Maintaining a high overcollateralisation ratio specific to Compagnie de Financement Foncier

In addition to the safety provided by the institutional framework and to ensure the best ratings from the principal agencies, Compagnie de Financement Foncier has taken supplementary management measures since 1999.
These measures will result in compliance with a specific collateralisation ratio for each agency based on its methodologies.
In particular, since 2009, it set up measures to maintain at all times a volume of non-privileged liabilities at least equal to 5% of the liabilities that benefit from the preferential claim. As of 31 December 2012, this ratio was 16.4% (excluding ECB refinancing and repurchase agreements).
This level of non-preferential liabilities contributes to investors' protection in the company's privileged debt, such as the holders of *obligations foncières*.

As part of its internal rules, two minimum overcollateralisation levels, based on asset quality and interest rate risk, are regularly calculated in relation with the quality of its assets and with the interest rate risk estimated on Compagnie de Financement Foncier.
The first ratio is calculated to cover the credit risk on its assets, while the second ensures that the overall interest rate risk on its balance sheet is covered.

The sum of these two ratios must of course meet Compagnie de Financement Foncier's minimum overcollateralisation commitment of 5%. Overcollateralisation – which in Compagnie de Financement Foncier's case consists of equity and long-term subordinated and unsecured liabilities – must enable a *société de crédit foncier* to withstand stress test scenarios on credit, interest rate and liquidity risk.

[21] *Regulation No. 99-10 of 9 July 1999 concerning* sociétés de crédit foncier *and Sociétés* de financement de l'habitat, *as amended by regulations No. 2001-02 of 26 June 2001 and 2002-02 of 15 July 2002, and by orders of 7 May 2007 and 23 February 2011.*

If some or all of these risk scenarios occur, this high level of overcollateralisation will enable the company to maintain payments on its *obligations foncières*.

> Regarding overcollateralisation associated with credit risk, Compagnie de Financement Foncier's loan portfolio is divided into six sub-categories, by type of borrower, type of property being financed and type of collateral provided. Each sub category has its own minimum overcollateralisation ratio for outstanding loans (see table below) and an overcollateralisation for the estimated loans anticipating a two years-production.

The following minimum overcollateralisation ratios are currently applied

Asset class	Outstanding	Origination
Subsidised sector (in run-off)	3.0%	n.a.
Low-income home loans + Interest-free loans	2.5%	3.0%
Residential/Subsidised purchases	3.0%	3.5%
Residential/Buy-to-let	25.0%	30.0%
Public sector	3.0%	3.0%
Social housing	4.5%	4.5%

> The overcollateralisation required to cover Compagnie de Financement Foncier's overall interest rate risk depends on the size of its balance sheet and on its estimated future earnings. It equals 0.5% of Compagnie de Financement Foncier's assets, minus the net present value of estimated earnings over the next 10 years.

To ensure a high security level, several net present values are calculated in a run-off scenario without new lending and by combining the following assumptions:

- three prepayment assumptions: no prepayment, likely prepayment rate and a stressed prepayment rate that is three times greater than the likely rate;
- three market interest rate assumptions: benchmark yield curve, stressed cash flow assuming unfavourable borrowing and lending conditions at EONIA +1% and EONIA -0.5% respectively, and a 200 bp upward shift in the yield curve.

The lowest net present value among the nine calculated is used to calculate the overcollateralisation ratio.

> The overcollateralisation required in order to obtain the best rating by the credit rating agencies is at least equal to the most important of the two credit overcollateralisations (on the oustanding and the two-year projection), to which is added the overcollateralisation related to the interest rate risk.

Continuous monitoring of overcollateralisation levels

To ensure that compliance with the overcollateralisation requirements is maintained at all times, it is monitored on an ongoing basis. In addition to the compliance of the regulatory ratio, if Compagnie de Financement de Foncier wishes to maintain its rating and that the overcollaterisation according to the relevant rating agency, quaterly observed, turns out to be less than one of the specified minimum levels, all asset purchases are immediately suspended and non-privileged resources are used to increase overcollateralisation above the minimum required amount.

Principle of financed LTV for residential mortgage loans

The LTV ratio on residential mortgage loans (€31.7 billion at end-2012) is the ratio of the outstanding principal over the value of the underlying real estate. Collateral is revalued annually to monitor compliance with this ratio.

The regulatory annual valuation of underlying assets, as required by the regulation, is based on a prudent assessment of the property's long-term characteristics, local market conditions, the current use of the property and other possible uses. All of this information is provided by Foncier Expertise, Crédit Foncier's wholly-owned, Veritas-certified subsidiary. Their experts are either certified by a court or qualified as chartered surveyors (MRICS[22]). The Specific Controller monitors these appraisals each year to verify compliance with the real-estate market parameters used in the valuation process, as described in the risk report section of the Registration Document.

[22] *MRICS: Member accredited by the Royal Institution of Chartered Surveyors (RICS). The RICS is a professional organisation whose mission is to regulate and promote the real estate profession.*

On the basis of these rules, at 31 December, 2012 the company's LTV ratio on its mortgage portfolio was relatively stable at 65.7% (vs. 61.6% at 31 December, 2011).

Credit risk

Asset purchasing criteria by category

Although regulations require that a *société de crédit foncier* invest only in high quality assets, Compagnie de Financement Foncier implements additional asset purchasing criteria for each asset category, so as to limit its exposure to credit risk. Compagnie de Financement Foncier will not, for example, buy commercial real estate assets. Compagnie de Financement Foncier selects the assets that it wishes to acquire based on their rating, probability of default, score at origination, expected loss and any hedging of assets, as well as yield curves. The assets that meet the Compagnie de Financement Foncier's criteria are then purchased at a price determined by the previous study.

Furthermore, Compagnie de Financement Foncier replacement values have very good external credit ratings. The minimum acceptable credit rating for each asset (except for intragroup assets) depends on the investment horizon and must meet the minimum rating criteria of each of the three main agencies, as shown below:

	Standard & Poor's	Moody's	Fitch Ratings
From 0 to 1 month	ST: A-1; LT: A	ST: P1	ST: F1
From 1 to 12 months	ST: A-1; LT: A	ST: P1	ST: F1+
More than 1 year	LT: AAA	LT: Aaa	LT: AAA

Limiting market counterparty risk

Crédit Foncier group's risk policy specifies per-market counterparty risk limits and Compagnie de Financement Foncier observes these limits in its decision process.

For its hedging transactions and the company executes a framework agreement with each of its counterparties, with asymmetrical collateralisation and other specific terms set forth in an appendix to this agreement.
Each counterparty agrees to pay Compagnie de Financement Foncier on a daily basis (or on a weekly basis for some of them) depending on the counterparty's rating a security deposit equal to its net debt position, with no compensation for this.

On 9 January 2013, Compagnie de Financement Foncier made the following committments:

- in the event of a counterparty's downgrade rating below a certain level, new circumstance allowing Compagnie de Financement Foncier to terminate a swap contract: committment to find under sixty days an equivalent coverage or to have the necessary overcollateralisation to set off the risk that has become uncovered for swaps overpassing 5% of *obligations foncières* outstanding;
- in the event of BPCE's downgrade rating below A1 (Standard & Poor's rating): committment to put in order under sixty days non-compliant swap contracts and whose outstandings overpass 5% of the privileged resources, or to replace the counterparties.

Managing balance sheet risks

Managing interest rate risk

Compagnie de Financement Foncier is committed to keeping its interest rate gaps within the specific limits set for each period and to correct any excess observed by the following quarter:

Interest rate gap observation periods	Maximum interest rate gap as a % of projected balance sheet
Less than 2 years	2%
2-5 years	3%
5-10 years	5%
More than 10 years	10%

Hedging liquidity risk

Beyond the legislative constraints requiring that *sociétés de crédit foncier* ensure that, at all times, all of their cash flow requirements are hedged for a period of 180 days, Compagnie de Financement Foncier has its own additional strict rules. These rules guarantee that it always maintains enough liquidity to honour its privileged liability commitments with no need for new resources for one year in a run-off scenario (i.e. with no new activity).

The high quality of Compagnie de Financement Foncier's assets, and in particular of its eligible securities and receivables, give it immediate access to funding from central banks, such as the ECB for large amounts.
Thus, the Company's cash position is sufficient at any given time to meet the contractual payments on its privileged debt over the coming twelve months.
With the volume of Compagnie de Financement Foncier's assets eligible for the European Central Bank's liquidity facility (€46.5 billion), it could service its payments and build up its liquidity for much longer than the 12 months to which it is committed. Thus it could obtain an amount estimated at €20 billion after haircut and based on the ECB's current rules, while respecting its management rules including the regulatory overcollateralisation ratio.

Compagnie de Financement Foncier also limits the duration gap between its assets and its overall liabilities to two years at most. At 31 December, 2012, the duration gap was insignificant (asset duration was 6.6 years and liability duration was 7.0 years).

No currency risk

Compagnie de Financement Foncier prohibits any open foreign exchange positions. As such, all asset purchase or refinancing transactions that are not denominated in euros are systematically hedged against currency risk.
In practice, Compagnie de Financement Foncier limits its residual currency positions to €3 million by currency with a €5 million cap for all currencies.

Organisation of controls

The organisation of Compagnie de Financement Foncier's controls is managed at Crédit Foncier group level. Compagnie de Financement Foncier's risks are monitored by Crédit Foncier's Risk department, under formal agreements between the two. The Risk Department performs ex-ante risk analyses based on exposure and delegation limits, and ex-post analyses and controls. It reports functionally to central body BPCE's Risk Department.

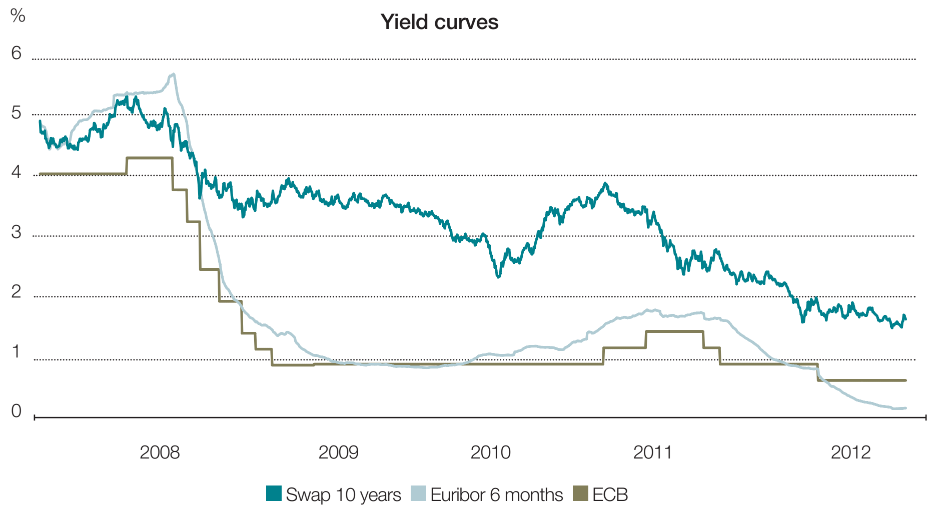
In addition to this group-level monitoring, *Compagnie de Financement Foncier* committees also support risk monitoring and control. Their operations are described in detail in the Risk Management section of this document.

Moreover, in accordance with the legal framework that provides a preferential claim option for holders of *obligations foncières,* the law stipulates that *sociétés de crédit foncier* do not have their own personnel. Compagnie de Financement Foncier draws on the resources of its parent company, Crédit Foncier, to carry out its activities, except the Secretary General appointed from Crédit Foncier. Crédit Foncier provides the company with a number of services, under a series of agreements that were updated in 2006 and early 2007, particularly with regard to internal control and compliance services. These outsourced activities are set out in the Report of the Chairman of the Board of Directors, in this document.

Refinancing via the issue of AAA/Aaa/AAA rated *obligations foncières*

The market environment

The primary covered bond market held up well in 2012 against the tough environment, in spite of the sovereign debt crisis, the competition due to the LTRO transactions[23] by the ECB and the reopening of the senior unsecured market.
At the close of the first half of 2012, tension on the financial markets was confirmed by the significant spreads between the 10-year Bund rate and Spanish and Italian sovereign rates. The setting of a monetary policy very favourable with the introduction of VLTRO, allowing unlimited fixed-rate refinancing at three years, and the ECB's lowering of the refinancing rate by 25 basis points to 0.75% in July 2012 was a major event. It was the first time the rate had gone below 1% since its creation. Short-maturity rates (specifically the six-month Euribor) hit very low levels – demonstrating abundant liquidity and lower banking risk. Since 2011, the ten-year swap has been down overall.



On 13 January 2012, France's rating was downgraded by S&P (from AAA to AA+), and on 19 November 2012 by Moody's (Aaa to AA1 with a negative outlook). This had no impact on the *obligations foncières* issued by Compagnie de Financement Foncier, which keep their AAA/Aaa/AAA rating.
Globally, issuance in covered bonds reached €102 billion (including €79 billion in *jumbo* issues) in 2012 by 64 issuers from 16 countries, i.e. 44% less than in 2011 (€183 billion)[24]. As the previous years, the French market continued to grow and remained the most active in the covered bond market with €24.6 billion, ahead of the German market (€14.6 billion)[24].
As to currency breakdown, the USD covered bond market keeps strengthening every year. At end-2012, the offer amounted to $41.1 billion coming from nine jurisdictions. While the Canadian issuers represented the most important region in terms of issuance volume ($15.1 billion), Australian, French, German, Scandinavian, Swiss and British issuers steadily entered the USD covered bond market[24]. At end-2012, the global outstanding of Jumbo covered bonds was €919 billion. The French market is the second one with an outstanding of €235 billion[24].
In this resilient covered bond market, 95% of its participants, grouped in the European Covered Bond Council (ECBC), implemented in 2013, a covered bond label. For investors, regulators and key participants in the market, this label will promote access to relevant, uniform and transparent information. For issuers, the label will improve information transparency and in particular the quality of underlying assets. Stimulating the secondary market, increasing liquidity and improving regulation are the main goals of the European Covered Bond label. Compagnie de Financement Foncier was part of the first issuers benefiting from this labelling. The Company is represented by its Deputy CEO in its Steering committee.

[23] *LTRO - Long term refinancing operations: granting of credit (maturity of three years) by the ECB at monthly auctions to provide additional longer-term refinancing to the financial sector.*
[24] *Natixis - Spreads & Credit - Credit Research - November 2012.*

Compagnie de Financement Foncier bond issuance in 2012

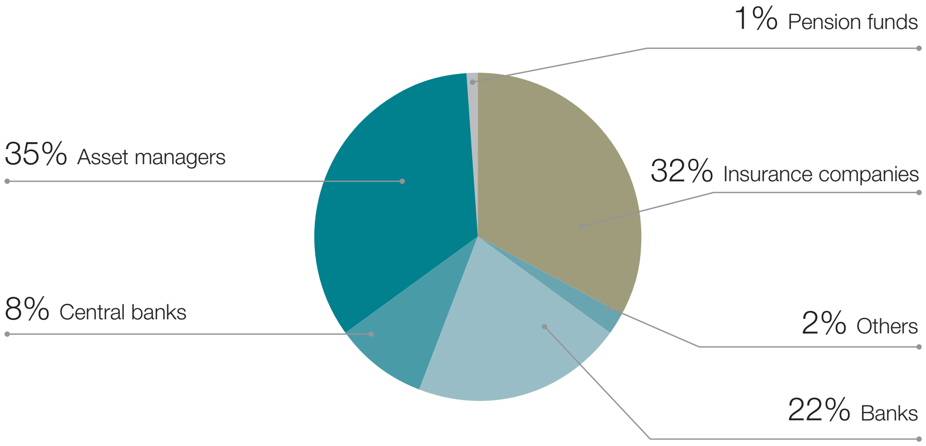
Compagnie de Financement Foncier took part in the sustained activity of the covered bonds segment, successfully completing its annual funding programme in 2012.

Asset financing was secured by the issuance of €8.1 billion in *obligations foncières*. The breakdown was as follows: €5.6 billion in public issuance with an average duration of 8.8 years and €2.5 billion in private placements with an average duration of 13.9 years.

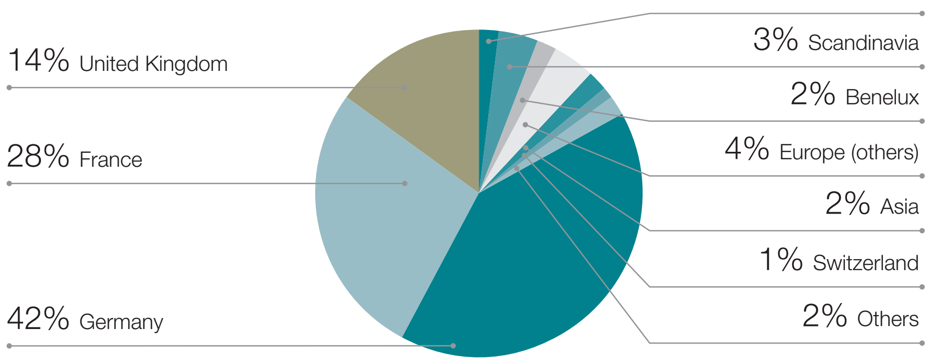
Compagnie de Financement Foncier made three benchmark issues in euros: two benchmark issues of €1 billion each with a maturity of 10 years, in January and in November 2012 and one benchmark issue of €2 billion in February 2012 with a maturity of 3.5 years.

Breakdown of issues of *obligations foncières* in 2012: €8.1 bn

By investor type



By region



Compagnie de Financement Foncier's ratings

Compagnie de Financement Foncier's AAA/Aaa/AAA stable outlook (as of 28 March 2013) rating reflects both the strength of the legal framework (ensuring the minimum level of security offered to holders of *obligations foncières*) and additional commitments by Compagnie de Financement Foncier to the market, which the rating agencies take into account.

Standard & Poor's methodology

To warrant a AAA rating, *obligations foncières* must be strong enough to withstand losses from the cover pool associated with this rating. Flows from these assets must be sufficient to pay the interest and capital when the debt matures.
Depending on the type of collateral (mortgages or loans to the public sector), the agency analyses the quality of the collateral to determine unrealised losses under stressed scenarios.
To quantify these losses, the level of overcollateralisation needed to receive an AAA rating is determined by two factors, namely the probability of default and the recovery rate.

Fitch Ratings methodology

Fitch issues ratings based on three stages of analysis: discontinuity risk analysis, covering factors that could lead to a payment default; required overcollateralisation analysis, through stress tests on cash flows, and analysis of the recovery percentage following default. Overall discontinuity risk is determined by the highest risk. Fitch has introduced systemic, sovereign and banking risk into its liquidity risk analysis.

Moody's methodology

The methodology used by Moody's takes into account two criteria: the credit capacity of the parent and the cover pool, mainly including parent company assets.
Moody's believes that the affiliation mechanism allows the issuer to benefit from the parent's creditworthiness. In practice, the parent ensures the liquidity and solvency of the issuing company, a wholly owned subsidiary of Crédit Foncier, which itself belongs to Groupe BPCE.

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