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Everest Fang

*Yale Program on Financial Stability*

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# French Liquidity Support through the SFEF<sup>1</sup>

*Everest Fang*<sup>2</sup>

Yale Program on Financial Stability Case Study  
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## **Abstract**

After the collapse of the Lehman Brothers in September 2008, financial panic and uncertainty intensified in Europe. In France, banks faced a widespread confidence crisis driven by fear that they were exposed to the US subprime market. In response, on October 13, 2008, the French government passed the “loi de finances rectificative pour le financement de l’économie.” This provided for the establishment of the Société de Financement de l’Economie Française (SFEF), a special purpose vehicle (SPV) jointly owned by the State and a group of banks and responsible for refinancing major French credit institutions. The SFEF raised funds on the international market and used the proceeds to provide collateralized loans to major credit institutions. SFEF debt was guaranteed by the French government. The SFEF was active from October 2008 to September 2009 and provided approximately €77 billion in funding to a group of institutions that included the vast majority of the major French banks. In September 2009, the Caisse de Refinancement de l’Habitat, a French credit institution specifically focused on housing finance, took over the SFEF’s outstanding debt management.

**Keywords:** Société de Financement de l’Economie Française (SFEF), State Guarantee

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<sup>1</sup> This case study is part of the Yale Program on Financial Stability (YPFS) selection of New Bagehot Project modules considering the responses to the global financial crisis that pertain to bank debt guarantee programs. Cases are available from the Journal of Financial Crises at <https://elischolar.library.yale.edu/journal-of-financial-crises/>.

<sup>2</sup> Everest Fang – Research intern, YPFS, Yale School of Management.

# French Liquidity Support through the SFEF

## At a Glance

The collapse of Lehman Brothers on September 15, 2008, sparked an international financial panic. French banks experienced significant drops in earnings and rising defaults. The financial system was strained by a confidence crisis caused by fear that French banks were exposed to the US subprime mortgage market. French credit institutions stopped lending to one another. The result was a severe liquidity freeze and a deep recession.

To inject liquidity into the financial system and ensure access to financing for French households and businesses on October 17, 2008, the French government established the Société de Financement de l'Économie Française (SFEF), a special purpose vehicle (SPV) responsible for the refinancing of major credit institutions. The state owned

34% of SFEF's shares, while major credit institutions owned the remaining 66%. The SFEF would raise funds by issuing debt instruments on the global market. These securities were fully backed by the French state for up to €265 billion. The SFEF would use the funds raised on the market to provide loans for eligible institutions. The loans had a maximum maturity of five years, as did the securities issued by the SFEF. To participate, credit institutions were required to commit to a number of ethical and economic requirements, most significantly, pledging to the financing of the real economy.

By May 2009, the SFEF had raised €49 billion and 13 major credit institutions had benefited from SFEF funding. The SFEF raised €77 billion in total by the end of its operation. In September 2009, the Caisse de Refinancement de l'Habitat, a credit institution created by the French state in 1985 to focus on housing finance, took over the SFEF's outstanding debt management.

## Summary Evaluation

The SFEF is generally seen as having been successful in both its effort to raise funds from investors as well as its goal of injecting liquidity into the economy. The State's guarantee on debt instruments issued by the SFEF made them a popular investment opportunity. Furthermore, the credit institutions benefiting from SFEF funding represented the vast majority of total loans to the economy and experienced a substantial increase in loans.

Summary of Key Terms	
Purpose:	To ensure the continued financing of households and businesses and inject liquidity into the banking system.
Announcement Date	October 12, 2008
Operational Date	October 17, 2008
Date of First Guaranteed Loan Issuance	November 12, 2008
Issuance Window Expiration Date	Closed to new issuances December 31, 2009. Officially ended October 9, 2009
Program Size	€265 billion
Usage	€77 billion
Outcomes	No defaults; more than €1 billion in fees
Notable Features	Guaranteed debt issued by SPV

<b>French Liquidity Support through the SFEF: France Context</b>	
<b>GDP (SAAR, Nominal GDP in LCU converted to USD)</b>	\$2,664.5 billion in 2007 \$2,930.2 billion in 2008  <i>Source: Bloomberg</i>
<b>GDP per capita (SAAR, Nominal GDP in LCU converted to USD)</b>	\$41,508 in 2007 \$45,334 in 2008  <i>Source: Bloomberg</i>
<b>Sovereign credit rating (5-year senior debt)</b>	As of Q4, 2007:  Fitch: AAA Moody's: Aaa S&P: AAA  As of Q4, 2008:  Fitch: AAA Moody's: Aaa S&P: AAA  <i>Source: Bloomberg</i>
<b>Size of banking system</b>	\$2,672.8 billion in total assets in 2007 \$3,118.1 billion in total assets in 2008  <i>Source: Bloomberg</i>
<b>Size of banking system as a percentage of GDP</b>	100.4% in 2007 106.4% in 2008  <i>Source: Bloomberg</i>
<b>Size of banking system as a percentage of financial system</b>	Data not available.  <i>Source: World Bank Global Financial Development Database</i>
<b>5-bank concentration of banking system</b>	74.2% of total banking assets in 2007 73.3% of total banking assets in 2008  <i>Source: World Bank Global Financial Development Database</i>

<b>Foreign involvement in banking system</b>	6.0% of total banking assets in 2007 6.0% of total banking assets in 2008  <i>Source: World Bank Global Financial Development Database</i>
<b>Government ownership of banking system</b>	Data not available.  <i>Source: World Bank Global Financial Development Database</i>
<b>Existence of deposit insurance</b>	Limits to full coverage:  \$100,000 in early December 2008  <i>Source: Fonds de Garantie des Dépôts et de Résolution, OECD</i>

## I. Overview

### Background

In 2008, the financial crisis originating in the US subprime lending market severely damaged many European banks. Shortly after Lehman Brothers collapsed in September, European financial markets were dominated by panic and uncertainty. The French financial system was under maximum strain and vulnerable to further damage (IMF 2009). French banks, hurt by a general crisis in confidence and widespread fear that European banks might be exposed to the US subprime market, saw a significant drop in earnings and rise in defaults. Restricted liquidity caused mistrust among credit institutions. Banks stopped lending to one another out of fear that they were exposed to the crisis (Detzer 2014). Sources of financing became increasingly rare as the flow of funds through the economy ground to a halt. Unemployment in France rose steeply as did the government's budget deficit. The nation experienced a deep recession. Despite all these problems, France was not hit as hard by the crisis as many other European countries (Conac 2010).

### Program Description

Against this backdrop, the "loi de finances rectificative pour le financement de l'économie" was passed on October 13, 2008, and adopted on October 17, four days later. It established the Société de Financement de l'Economie Française (SFEF) for the refinancing of French credit institutions, as well as the Société de Prise de Participations de l'Etat (SPPE) for the recapitalization of French credit institutions. The SFEF took the form of a special purpose vehicle (SPV) jointly owned by a group of seven banks representing 80% of the balance sheet of the French banking industry.<sup>3</sup> The banks took a 66% ownership stake and the French state 34% ownership. SFEF did not possess a banking license and was thus not subject to such regulations as the Basel capital requirements, but it was overseen by the French Banking Commission. Although majority owned by French banks, SFEF had a board of directors chaired by the French state and over which the government exercised a veto. Additionally, the bank shareholders of the SFEF could earn a profit only on its invested capital equivalent to the rate of return on a government bond.

The SFEF raised money by issuing debt instruments on the international market guaranteed by the French government. The organization was given a state guarantee for up to €265 billion. Securities issued by the SFEF had a maximum maturity of five years, and the state guarantee only applied to bonds issued before December 31, 2009. The SFEF used the funds raised on the market to issue collateralized loans to eligible credit institutions for refinancing. Loans made by the SFEF also had a maximum maturity of five years, with a cap of 30% of total loans on loans of more than 3 years. The government does not appear to have established minimum maturity requirements for eligible loans or securities issued by SFEF.

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<sup>3</sup> BNP Paribas, Crédit Agricole, Société Générale, Groupe Caisse d'Épargne, Banque Fédérative du Crédit Mutuel, Groupe Banque Populaire, and HSBC France.

The total amount of refinancing a bank could receive could not exceed 5% of its balance sheet total, or €500 million, whichever value was greater.

To qualify for SFEF funding, a credit institution had to be licensed in France and meet certain capital requirements. Funds were to be allocated to eligible institutions based on a formula tied to the size of an institution's balance sheet in France and the amount of French loans it had outstanding. Beneficiary credit institutions were required to enter into an agreement with the French state laying out a number of economic and ethical obligations. These included providing credit to small and medium-size companies and households, and following ethical rules on executive compensation and severance arrangements. Credit institutions borrowing from the SFEF were also required to deposit the funds they owed in special accounts at the Banque de France pledged to the SFEF several days before payments were due. This would give the SFEF time to notify the government of a failure to pay in advance and thus acquire funds from the guarantee. Through this process, the SFEF ensured its debt holders were repaid in a timely manner.

The SFEF only granted loans collateralized by eligible receivables. Collateral requirements were strict enough to provide the SFEF with the benefit of over-collateralization. In the event of a default by the beneficiary credit institution, the SFEF was given "a direct right over any sums paid with respect to the underlying receivables and the enforcement proceeds of any security rights attached to those receivables" (de Kergommeaux et al. 2008). The SFEF charged an interest rate on loans that was set to incorporate the refunding of the SFEF plus a fee for the state guarantee based on the maturity of the loan and the credit profile of the borrower.

## Outcomes

In October 2008, the SFEF granted a loan of €5 billion to various banks. This loan was financed by a loan to SFEF from the Caisse des Depots et Consignations, France's state-owned financial institution. The state had to cover this first SFEF loan, as efforts to issue bonds were still underway. The €5 billion was allocated as follows: 25% to Credit Agricole, 15% to BNP Paribas, Société Générale, Crédit Mutuel, and Caisse d'Epargne, 10% to Banques Populaires, and 5% to RCI Banque.

In November 2008, the SFEF announced its first bond issue at a rate of 3.5% for three years, maturing in November 2011. Investor interest was strong with orders exceeding €5 billion within the first hour of operation. By November 12, orders totaled €12 billion. The proceeds of this issuance were used to provide nine loans for various credit institutions. In December 2008, the SFEF launched another public issuance, this one totaling €6 billion, again using the proceeds to advance loans to credit institutions. The SFEF continued to operate in this fashion for the duration of its existence. (Appendix A summarizes its activity up to July 2009.) The identities of the credit institutions receiving each round of loans have not been released, though the primary recipients of SFEF funding are known to be Banque Populaires, Caisse d'Epargne, BNP Paribas, Société Générale, Crédit Agricole, Crédit Mutuel, PSA Finance, and RCI Banque.

In December 2008, President Nicolas Sarkozy announced that the banking branches of French car manufacturers also had access to SFEF funding. The banking arms of Renault and PSA Peugeot Citroën each had access to a maximum of €500 million. In February 2009, the French government increased the maximum amount of SFEF funding available to the banking arms of French car manufacturers.

In early 2009, total outstanding loans from beneficiary banks of the SFEF had already grown by 7.2% in comparison to 2008. This was well over the goal of the refinancing mechanism to increase outstanding loans by 3-4%. By May 2009, the SFEF had issued bonds worth a total of €49 billion, consisting of private and public issues. By this time, 13 institutions had benefited from loans from the SFEF. The impact of the program was broad, with beneficiary institutions representing 83.5% of total loans to the economy at the time. Also at this time, the French state requested and was granted a six-month extension of the refinancing plan from the European Commission.

At the end of its operations, the SFEF had issued a total of about €77 billion in debt denominated in euros, US dollars, Swiss francs and pounds sterling, with maturities ranging from 15 months to 5 years. The SFEF attracted a wide variety of investors, receiving funds from some 900 different sources. SFEF bonds carried triple-A ratings and the SFEF became one of the most sought-after issuers on the global market (GlobalCapital 2009). In September 2009, the board of directors decided to stop the SFEF's operations due to the market improvement, and the Caisse de Refinancement de l'Habitat (CRH), a bank created by the French state in 1985 to issue bonds for refinancing residential mortgage home loans, took over the operation's outstanding-debt management. The CRH was appointed to manage the SFEF's debt services and collateral management from January 1, 2010, to December 31, 2014. Ultimately, none of the loans made by SFEF defaulted and it generated more than €1 billion in fees.

## II. Key Design Decisions

### 1. SFEF was launched alongside a recapitalization program as part of a two-pronged approach to the crisis.

Following a meeting of Group of Seven (G-7) industrialized nations on October 10, 2008, which focused on guiding principles for action during the financial crisis, the French government pursued a dual approach to aid their banking system that included the SFEF and Société de Prise de Participation de l'Etat (SPPE). The French government created the SPPE in October 2008 as a limited liability company to perform recapitalizations. Its first injection was €1 billion toward the international bailout of Dexia SA, a troubled Belgium-based bank with operations across Europe, in return for a 5.7% stake in the company. In December 2008, SPPE began a broad recapitalization scheme for French banks to ensure they continued lending to the economy.

### 2. Legal Authority came from the "loi de finances rectificative pour le financement de l'économie, adopted on October 17, 2008"



The “loi de finances rectificative pour le financement de l’économie” was passed on October 13, 2008, and adopted on October 17, four days later. SFEF itself had actually existed as a company called Doumer Hyperion since 2003, but was given new guidelines for its future operations. The use of Doumer Hyperion was a convenience intended to avoid the delay involved in establishing a new entity.

### **3. European Commission approval was required for the SFEF.**

On October 28, 2008, French authorities notified the European Commission (EC) of the SFEF. On October 30, 2008 the EC determined that the SFEF was compatible with State aid requirements. The EC also approved a six-month extension of the program in May 2009. As discussed in more detail below, the need to structure the SFEF in such a way as to ensure EC approval significantly influenced the design of certain program features.

### **4. Up to €265 billion of debt issued by the SFEF could be guaranteed.**

Documents establishing the SFEF did not disclose the specific motivation for this figure.

### **5. The SFEF issued guaranteed debt, using the proceeds to provide loans to credit institutions in France (including subsidiaries of foreign banks) that met capital requirements established by French law.**

The creation of the SFEF was a unique aspect of the French rescue plan. Most European states decided to directly guarantee the issuances of their major banks. France chose to consolidate issuances and refinancing responsibility with the SFEF, creating a much more indirect form of intervention. Through the SFEF, French authorities were able to exercise control of the allocation of credit to eligible institutions, based on a formula tied to the size of an institution’s balance sheet in France and the amount of French loans it had outstanding. Moreover, with a single entity issuing bonds on the market, France was also able to avoid coordination problems when timing issuances (de Kergommeaux et al. 2008). If many banks are attempting to raise funds, their interactions on the market may result in less total funds being raised. Last, because investors would be buying guaranteed debt issued by an SPV making collateralized loans to a range of institutions rather than guaranteed debt issued by a single such institution, SFEF may have enabled banks to access funds at a lower rate than they would have through a direct guarantee (Cavalier 2010).

The SFEF had initial capital of €50 million and was jointly owned by a group of seven banks representing 80% of the balance sheet total of the French banking industry. The banks held a 66% ownership stake and the French state 34%. This ownership structure was driven by French authorities’ desire to exclude SFEF liabilities from the state’s public debt. A decision by Eurostat, the body responsible for harmonizing economic statistics across the EU, during the crisis held that the guaranteed liabilities of special purpose entities established on a temporary basis to address the crisis could be excluded from public debt if they were majority privately owned.

Despite this private ownership, the French state bore the risk of the guarantee, and thus had significant control over the SFEF, which was governed by a board of directors composed of

10 members. The board included two representatives of the state, one of which acted as chairman of the board. The members of the board could execute duties only with the permission of the Minister of the Economy, bringing their actions under direct scrutiny of the government. Furthermore, board meetings were attended by a state commissioner with full veto power on decisions that could influence the French state's interests in relation to its guarantee. These meetings were also attended by the governor of the Banque de France who was responsible for the smooth conduct of the SFEF's affairs. On top of this, the SFEF, while not a credit institution, was supervised by the French Banking Commission. Thus, in spite of being a separate vehicle, the SFEF was tightly supervised by the state and its actions closely monitored (de Kergommeaux et al. 2008).

The bank shareholders of the SFEF could only earn a profit on their invested capital equivalent to the rate of return on a government bond. This was consistent with the shareholders' being compensated for having their capital tied up rather than fully put at risk.

#### **6. The SFEF only granted financing collateralized by eligible receivables and set conditions to benefit from over-collateralization**

This was intended to limit the exposure of the SFEF. Eligible collateral included:

- i) First-rate mortgages and real estate loans of equivalent security
- ii) Loans made for the financing of a real estate asset in France (in the form of a lease or guaranteed by some credit institution)
- iii) Loans to highly rated corporations
- iv) Loans to particular public entities
- v) Credit export loans confirmed by particular credit export agencies

Collateral was subject to haircuts ranging from 10% to 40%, depending on the category of pledged assets.

According to the legislation establishing SFEF, beneficiary credit institutions owed the SFEF a claim for an amount equal to principal, interest, and ancillary rights of the loan granted by SFEF to such credit institution; in case of default, a direct right over any sums paid with respect to the underlying receivables together with the enforcement proceeds of any security rights attached to such receivables. Loans made by the SFEF were, thus, highly secure and the SFEF's exposure very limited (de Kergommeaux 2008).

#### **7. The maximum maturity for debt issued by the SFEF and for the loans that it then made with the proceeds was five years.**

No more than 30% of guaranteed debt could have a maturity of greater than three years.

The government does not appear to have established minimum maturity requirements for debt issued by the SFEF or the loans it made with the proceeds.

**8. All currencies appear to be eligible.**

Program documents do not appear to contain any restrictions on the currencies eligible to be used under the SFEF.

**9. Institutions were capped on refinancing by the greater of 5% of their balance sheet total or €500 million.**

In allocating loans among eligible institutions, French used a formula tied to the size of an institution's balance sheet in France and the amount of French loans it had outstanding.

**10. SFEF made loans at an interest rate that included a guarantee fee based on the maturity of the loan and the risk profile of the borrower.**

The interest rate charged on loans from the SFEF was intended to cover SFEF's financing costs plus an additional fee for the state guarantee. French authorities followed October 2008 guidance from the European Central Bank (ECB) in developing their approach to the guarantee fee. For loans of greater than one year, the guarantee fee was equal to the bank's median value 5-year credit default swap (CDS) spread over the period from January 1, 2007, to August 31, 2008, plus an add-on fee. Banks without CDS spreads would use representative CDS spreads based on their credit ratings. For loans of one year or less, only the add-on fee would be charged.

Under the ECB's guidance, the add-on fee was set at 50 basis points (bps). However, given the collateralized nature of the loans made by SFEF, the European Commission approved a lower add-on fee of 20 bps.

These fees were required to be paid up front.

**11. Beneficiary credit institutions were required to enter into an agreement with the French state that set out a number of ethical and economic commitments, particularly with regard to lending to the real economy.**

Guidance issued by the European Commission in October 2008 on the creation of credit guarantee programs called for the inclusion in such programs of a set of safeguards to minimize distortions and avoid moral hazard. This guidance did not specify exactly what safeguards a program should include, but required "an adequate combination" of elements, including restrictions on advertising based on the guarantee, balance sheet growth, share buybacks, and executive compensation, some of which France adopted.

The specific commitments required of the institutions accessing funding from the SFEF included providing credit to individuals, households, small and medium-size companies, and local authorities. In particular, institutions had to maintain annual growth in loans to the French economy of 3% to 4% until December 31, 2009. Participating institutions had to

submit monthly reports on loan volumes and could be excluded from the program for failure to meet targets. In addition, they agreed to seek ad hoc solutions for customers experiencing payment difficulties.

Banks also had to commit to following certain rules on executive compensation, severance arrangements, balance sheet growth, and advertising.

### **12. Beneficiaries were required to show possession of owed funds several days before payments were due.**

Credit institutions were required to deposit funds owed to the SFEF in special accounts at the Banque de France pledged to the SFEF several days before payments were actually due. This requirement ensured that beneficiary credit institutions were prepared to repay borrowed funds on time or else provide the SFEF with advanced warning of inability to pay. If an institution was unable to deposit owed funds ahead of time, the SFEF would notify the government of an inability to pay. This would give the SFEF time to acquire funds from the state guarantee, and then repay its own debt holders on time. Through this strategy, the SFEF ensured its debt holders were repaid in a timely manner and thus maintained a positive reputation for the SFEF as a solid investment opportunity.

### **13. The guarantee was applied only to bonds issued before December 31, 2009.**

The plan was intended to be only a temporary measure. The SFEF was to issue bonds only until the end of 2009. Like many other design decisions, this measure may have been intended to ensure the banks were not excessively dependent on state assistance. The goal was to provide some aid to the institutions until market conditions improved. Also like many design decisions, this provision may have been possible only due to the subdued nature of the crisis in France.

## **III. Evaluation**

The French state's intervention in the financial crisis is generally considered relatively successful. Their actions resulted in substantial drops in the credit risk of French banks and an increase in their debt valuation. The gross impact on bank equity was an increase of 2% to 7% (Xiao 2009). These estimates, however, describe the impact of the full range of the French state's interventions, not just the SFEF's operations.

The SFEF is generally considered a successful intervention. It managed to raise €77 billion by the end of its operations and establish a reputation as a fruitful investment opportunity. The organization received funds from about 900 different sources during the relatively short span of its operations. The state guarantee played a notable role in the SFEF's success, assuring investors that it was a very secure investment (GlobalCapital 2009).

The impact of SFEF funding was broad, providing loans for 13 major credit institutions by May 2009. These institutions represented 83.5% of total loans to the economy at the time,

and so were very influential in the financial markets. Additionally, the financing appears to have served its purpose well. In early 2009, total loans from beneficiary banks of the SFEF had grown by 7.2% from 2008, well exceeding the target of 3% to 4%. Thus, the actions of the SFEF were indeed benefiting the banks and effectively contributing to the continued financing of the French real economy (European Commission 2009). The plan effectively mitigated the liquidity problem it was designed to address and achieved its goals of aiding the French economy.

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## V. Key Program Documents

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## VI. Appendix

### Appendix A: SFEF Activity

#### SFEF Activity

Date of Issuance	Amount of Issuance	Maturation Date	Coupon Rate	Spread	Number of Loans Advanced
Nov. 12, 2008 <sup>4</sup>	€5 billion	Nov. 24, 2011	3.5%	5 bps over mid-swap rate	9 loans
Dec. 1, 2008	€6 billion	Dec. 10, 2010	3%	4 bps over mid-swap rate	10 loans
Dec. 9, 2008 (private placement)	€2 billion	March 18, 2010	EURIBOR minus 5 bps	N/S	9 loans
Jan. 7, 2009	€5 billion	Jan. 16, 2014	3.25%	15 bps over mid-swap rate	11 loans
Jan. 23, 2009	\$6 billion	Jan. 30, 2012	2.125%	40 bps over the mid-swap rate	9 loans
Feb. 3, 2009	€6 billion	Feb. 10, 2011	2.25%	9 bps over the mid-swap rate	11 loans
Feb. 18, 2009	\$5.5 billion	Feb. 25, 2011	2%	45 bps over mid-swap rate	N/A <sup>5</sup>
March 3, 2009	€6 billion	March 10, 2012	2.373%	15 bps over mid-swap rate	N/A
March 16, 2009	\$4 billion	March 26, 2012	2.375%	50 bps over mid-swap rate	N/A
March 30, 2009	€5 billion	April 7, 2014	3%	37 bps over mid-swap rate	N/A

<sup>4</sup> This first loan was intended as a test to make sure the SFEF infrastructure worked.

<sup>5</sup> Per Mayer Brown, N/A indicates that any issuances marked N/A did not have loans advanced (<https://www.mayerbrown.com/publications/summary-of-government-interventions-in-financial-markets--france-09-09-2009/>).

April 15, 2009	\$3 billion	Oct. 29, 2010	1.5%	30 bps over interpolated one-year, two-year USD mid-swap rate	N/A
April 22, 2009	\$7 billion	May 5, 2014	3.375%	37 bps over mid-swap rate	N/A
May 11, 2009	€5 billion	May 20, 2013	2.125%	10 bps over mid-swap rate	N/A
June 2, 2009	\$6 billion	June 11, 2012	2.25%	25 bps over mid-swap rate	N/A
June 22, 2009	€5 billion	June 30, 2014	3.125%	25 bps over mid-swap rate	N/A
July 1, 2009	CHF 2 billion	July 22, 2011	Floating 3-month CHF LIBOR	N/A	N/A
July 8, 2009	€3 billion	July 16, 2012	Floating 3-month CHF LIBOR plus 5 bps	N/A	N/A
July 8, 2009	£750 million	July 16, 2012	Floating 3-month CHF LIBOR plus 5 bps	N/A	N/A
July 8, 2009	\$3 billion	July 16, 2012	Floating 3-month USD LIBOR plus 20 bps	N/A	N/A

Source: Mayer Brown: Summary of Government Interventions – France, 2009

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