French Liquidity Support Through the SFEF

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Abstract

The 2008 financial crisis originating in the U.S. subprime market sparked worldwide financial distress. After the collapse of the Lehman Brothers, financial panic and uncertainty intensified in Europe. In France, banks faced a widespread confidence crisis driven by fear that they were exposed to the U.S. subprime market. In response on October 13, 2008, the French government passed the *loi de finances rectificative pour le financement de I'economie* (French Bank Relief Act). This provided for the establishment of the *Societe de Financement de l'Economie Francaise* (SFEF), an 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 loans to major credit institutions. SFEF debt was backed by the French government and the organization proved to be quite successful at attracting investors. It was also successful at lowering the credit risk of French banks and easing the strain on the French financial system. The SFEF was active from October 2008 to September 2009 and provided approximately 77 billion euros in funding to a group of institutions including 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 financing of housing, took over the SFEF's outstanding debt management.

Keywords: *Societe de Financement de l'Economie Francaise* (SFEF), State Guarantee

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At a Glance

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	
Issuance Window Expiration Date	Closed to new issuances December 31, 2009. Officially ended October 9, 2009.
Program Size	320 billion Euros
Usage	77 billion Euros
Outcomes	SFEF used the proceeds from bonds it issued to grant loans to French credit institutions
Notable Features	Guaranteed debt issued by SPV

The collapse of Lehman Brothers on September 15, 2008 sparked an international financial panic. French banks experienced massive 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 U.S. subprime market. French credit institutions stopped lending to one another, also out of fear that banks might be exposed to the crisis. 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 *Societe de Financement de l'Economie Francaise* (SFEF), an SPV responsible for the refinancing of major credit institutions. The state owned 34% of SFEF's shares while major credit institutions owned 66%. The SFEF would raise funds by issuing debt instruments on the global market. Securities issued by the SFEF were fully backed by the French state for up to 320 billion euros. The SFEF would use the funds raised on the market to provide loans for major credit institutions. The loans had a maximum maturity of five years, as did the securities issued by the SFEF. The government does not appear to have established minimum maturity requirements for the loans or the securities issued by the SFEF. To benefit from SFEF funding, credit institutions were required to commit to a number of ethical and economic requirements, most significantly to the financing of the real economy.

In November 2008, the SFEF announced its first bond issue at a rate of 3.5% for three years. Investor interest was strong with orders totaling 12 billion euros by November 12. The SFEF used the funds raised to provide nine loans to various credit institutions. The SFEF continued to operate in this fashion and managed to maintain strong investor interest. By May 2009, the SFEF had raised 49 billion euros and thirteen major credit institutions had benefited from SFEF funding. The SFEF raised 77 billion euros 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 financing housing, 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 SFEF was designed in a way that aided the banks significantly while pressuring them to become independently stable. 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.

Table of Contents

I. Overview **1**

II. Key Design Decisions **6**

1. While SFEF guarantees were not part of a larger package, they occurred in parallel with other guarantees issued by the French State. 6

2. The guaranteed debt was issued by a special purpose vehicle which used the proceeds to provide loans to French banks. 6

3. Legal Authority came from the French Bank Relief Act, adopted on October 17, 2008. 7

4. The administrative and issuance burdens fell entirely on the SFEF. 7

5. Up to 320 billion Euros could be guaranteed. 7

6. Institutions had to be licensed in France and needed to be solvent to be eligible for the guarantee scheme. 7

7. The SFEF only granted financing collateralized by eligible receivables and set conditions to benefit from over-collateralisation. 7

8. The maximum maturity for instruments issued by the SFEF was five years. 8

9. All currencies appear to be eligible. 8

10. Institutions were capped on refinancing by the greater of the two following: 5% of its balance sheet total or EUR 500 million. 8

11. SFEF charged a high interest rate that included a fee for the state guarantee. 8

12. Beneficiary credit institutions were required to enter into an agreement with the French state that set out a number of ethical and economic commitments 8

13. Beneficiaries were required to show possession of owed funds several days before payments were due. 8

14. The guarantee was only applied to bonds issued before December 31, 2009 9

III. Evaluation **9**

IV. References **9**

V. Key Program Documents **10**

I. Overview

Background

In 2008, the financial crisis originating in the U.S. subprime market severely damaged many European banks. Shortly after Lehman Brothers collapsed, European financial markets were dominated by panic and uncertainty. France, though not as hurt as many European economies, experienced a deep recession. French banks saw massive drops in earnings and significant rises in defaults. The French financial system was under maximum strain and vulnerable to further damage (IMF 2009). French banks were hurt by a general confidence crisis and a widespread fear that European banks might be exposed to the U.S. subprime market. French banks also experienced restricted liquidity caused by 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. Despite all these problems, France was not hit as hard by the crisis as many other European countries were (Conac 2010).

Program Description

The *loi de finances rectificative pour le financement de I'economie* (French Bank Relief Act/French Finance Law) was passed on October 13, 2008 and adopted on October 17, four days later. It established the *Societe de Financement de l'Economie Francaise* (SFEF) for the refinancing of French credit institutions, as well as the *Société de prise de participations de l'État* (SPPE) for the recapitalization of French credit institutions. The SFEF was intended to ensure the continued financing of the economy and restore general confidence in the economy. The company known as the SFEF had actually existed since December 2003 under the name, Doumer Hyperion. The new law provided guidelines for this company's operations moving forward. The name of the organization was changed and its offices moved to a property owned by the Bank of France. An independent *mediateur de credit* was also set up to ensure the SFEF followed fair lending practices. State and bank representatives negotiated the terms of the plan extensively, including the nature of the SFEF. The SFEF served as an indirect way for the French state to intervene in the economy.

The SFEF was concerned with refinancing and hoped to increase lending to households, small/medium-sized businesses, and local governments. The SFEF was an SPV, mostly owned by the private sector. The organization never possessed a banking license so was never subject to Basel solvency rules. It was, however, supervised by the French banking commission. Only 34% of the SFEF's 50 million euros in capital shares were held by the French State. The remaining 66% were held by seven major credit institutions[2]. Thus, although the SFEF was technically a private company, the state held a blocking minority by

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[2] BNP Paribas, Credit Agricole, Societe Generale, Groupe Caisse d'Epargne, Banque Federative du Credit Mutuel, Groupe Banque Populaire, and HSBS France

which they could prevent key decisions. The SFEF raised money by issuing debt instruments on the international market guaranteed by the French government. The organization was given a state guarantee of up to 320 billion euros. 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 loans to major credit institutions for refinancing. Loans issued by the SFEF also had a maximum maturity of five years. The government does not appear to have established minimum maturity requirements for eligible loans or securities issued by SFEF. The total amount of refinancing a bank could receive could not exceed 5% of its balance sheet total or €500 million, depending on which value was greater.

To qualify for SFEF funding, a credit institution had to be licensed in France and meet certain capital requirements. Financing was also only available to solvent credit institutions. 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-sized companies and households, and following ethical rules on executive compensation and severance arrangements. Credit institutions borrowing from the SFEF were required to deposit the funds they owed in special accounts at the Bank of 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 of the SFEF were strict enough to provide them with the benefit of over-collateralization. Qualifying collateral had to exceed the amount being granted to the institution. 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 2008). The interest rate on loans charged by the SFEF was set to incorporate the refunding of the SFEF plus a fee for the state guarantee. As such, interest rates for SFEF funding were relatively high. More specifically, beneficiary institutions were charged an annual premium of 20 basis points plus the cost of a five year CDS on that credit institution.

Outcomes

In October 2008, the SFEF granted a loan of five-billion euros to various banks. This loan was financed by a loan from the Caisse des Depots et Consignations, France's state-owned financial institution. The state had to cover this first loan by the SFEF as efforts to issue bonds were still underway. The five billion euros were allocated as follows: 25% to Credit Agricole, 15% to BNP Paribas, 15% to Societe Generale, 15% to Credit Mutuel, 15% to Savings Bank, 10% to Banque Populaire, and 5% to Diac. The distribution was based on the size of the balance of sheet of each bank and their share of the credit market.

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 five billion

euros within the first hour of operation. By November 12, orders totaled twelve billion euros. The proceeds of this issuance were used to provide nine loans for various credit institutions. In December 2008, the SFEF launched another a\ public issuance totaling six billion euros, again using the proceeds to advance loans to credit institutions. The SFEF continued to operate in this fashion for the duration of its existence. The table below summarizes their activity up to March 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 Banques populaires, Caisses d'epargne, BNP Paribas, Societe generale, Credit agricole, Credit mutuel, PSA Finance, and RCI Banque.

In December 2008, President Sarkozy announced that the banking branches of French car manufacturers had access to SFEF funding. The banking arm of Renault had access to a maximum of 500 million euros and the banking arm of PSA Peugot Citroen had access to the same. In February 2009, however, the French government increased the maximum amount of SFEF funding available to the banking arms of French car manufacturers. Additionally, by February 2009, the SFEF had received 441 million euros in guarantee fees charged to its beneficiary credit institutions.

By May 2009, the SFEF had issued bonds worth a total of 49 billion euros, consisting of private and public issues. At this time, thirteen institutions had benefited from loans from the SFEF. The impact of the organization was broad as these beneficiary institutions represented 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. 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%. At the end of its operations, the SFEF had issued bonds for a total of about 77 billion euros. The SFEF had attracted a wide variety of investors, receiving funds from around 900 different sources. Their bonds carried AAA ratings and the SFEF became one of the most sought-after issuers on the global market (Global Capital 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) took over the SFEF's outstanding debt management. The CRH is a bank created by the French state in 1985 to issue bonds for refinancing residential mortgage home loans. It was appointed to manage the SFEF's debt services and collateral management from January 1, 2010 to December 31, 2014.

SFEF Activity

Date of Issuance	Amount of Issuance	Maturation Date	Coupon Rate	Spread	Number of Loans Advanced
November 12, 2008	5 Billion Euros	November 24, 2011	3.5%	5 bps over mid-swap rate	9 loans
December 1, 2008	6 Billion Euros	December 10, 2010	3%	4 bps over mid-swap rate	10 loans
December 9, 2008 (Private Placement)	2 Billion Euros	March 18, 2010	EURIBOR – 5 bps	N/S	9 loans
January 7, 2009	5 Billion Euros	January 16, 2014	3.25%	15 bps over mid-swap rate	11 loans
January 23, 2009	6 Billion USD	January 30, 2012	2.125%	40 bps over the mid-swap rate	9 loans
February 3, 2009	6 Billion Euros	February 10, 2011	2.25%	9 bps over the mid-swap rate	11 loans
February 18, 2009	5.5 Billion USD	February 25, 2011	2%	45 bps over mid-swap rate	N/A[3]
March 3, 2009	6 Billion Euros	March 10, 2012	2.373%	15 bps over mid-swap rate	N/A

[3] Per https://www.mayerbrown.com/publications/summary-of-government-interventions-in-financial-markets---france-09-09-2009/ indicates that any issuances marked N/A did not have loans advanced.

March 16, 2009	4 Billion USD	March 26, 2012	2.375%	50 bps over mid-swap rate	N/A
March 30, 2009	5 Billion Euros	April 7, 2014	3%	37 bps over mid-swap rate	N/A
April 15, 2009	3 Billion USD	October 29, 2010	1.5%	30 bps over interpolated 1 year 2 year USD mid-swap rate	N/A
April 22, 2009	7 Billion USD	May 5, 2014	3.375%	37 bps over mid-swap rate	N/A
May 11, 2009	5 Billion Euros	May 20, 2013	2.125%	10 bps over mid swap rate	N/A
June 2, 2009	6 Billion USD	June 11, 2012	2.25%	25 bps over mid-swap rate	N/A
June 22, 2009	5 Billion Euros	June 30, 2014	3.125%	25 bps over mid-swap rate	N/A
July 1, 2009	2 Billion CHF	July 22, 2011	Floating 3 month CHF LIBOR	N/A	N/A
July 8, 2009	3 Billion Euros	July 16, 2012	Floating 3 month CHF LIBOR + 5 bps	N/A	N/A
July 8, 2009	750 Million GBP	July 16, 2012	Floating 3 month CHF LIBOR + 5 bps	N/A	N/A
July 8, 2009	3 Billion USD	July 16, 2012	Floating 3 month USD LIBOR + 20 bps	N/A	N/A

II. Key Design Decisions

1. While SFEF guarantees were not part of a larger package, they occurred in parallel with other guarantees issued by the French State

There were several additional guarantees made. The State could, in exigent circumstances, guarantee securities issued by credit institutions provided that the state receives adequate collateral. Another guarantee stated that financing could be raised by a company whose sole shareholder is the state, and whose aim was "to subscribe to securities that have been issued by financial entities and which constitute regulatory own funds." The final, additional guarantee was a multilateral one pertaining to the rescue of Dexia, in which the French government would be liable for 36.5% of the eligible amounts.

2. The guaranteed debt was issued by a special purpose vehicle which used the proceeds to provide loans to French banks

The SFEF 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 only execute duties 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 Bank of 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 regulator responsible for operating the SFEF. Thus, in spite of being a separate vehicle, the SFEF was tightly supervised by the state and its actions closely monitored (de Kergommeaux 2008). This strategy allowed the state to be heavily involved in the intervention, while benefiting from the advantages of a separate vehicle conducting refinancing.

This scheme allowed the SFEF to be a separate vehicle rather than a government organization. This decision allowed the government to be only indirectly involved in refinancing the banks and affecting the economy. There were also many benefits to refinancing being executed by a separate vehicle as discussed above. Thus, seven credit institutions were granted ownership of 66% of the SFEF's capital shares, giving the private sector majority ownership of the organization. Yet, the state still held on to 34% of the shares, constituting a blocking minority. With this ownership scheme, the state was able to block key decisions that it disagreed with, while allowing the SFEF to be a private corporation (Jabko 2012).

3. **Legal Authority came from the French Bank Relief Act, adopted on October 17, 2008**

The *loi de finances rectificative pour le financement de I'economie* (French Bank Relief Act/French Finance Law) 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 their future operations.

4. **The administrative and issuance burdens fell entirely on the SFEF**

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. This may have been because creation of a separate vehicle allowed the French state to distinguish between state debt and debt issued to aid the banks (Conac 2010). Thus, this plan may have been advantageous for organization and clarity. Another advantage of creating a separate vehicle was that it allowed banks to raise money at rates lower than institutions that qualify for a state guarantee (Cavalier 2009). Moreover, with a single entity issuing bonds on the market, France was also able to avoid coordination problems when timing issuances (de Kergommeaux 2008). If many banks are attempting to raise funds, their interactions on the market may result in less total funds being raised. Finally, the SFEF provided a variety of credit institutions indirect access to the financial markets, likely playing an influential role in preventing France from sinking into a more devastating crisis (de Kergommeaux 2008).

5. **Up to 320 billion Euros could be guaranteed**

6. **Institutions had to be licensed in France and needed to be solvent to be eligible for the guarantee scheme**

7. **The SFEF only granted financing collateralized by eligible receivables and set conditions to benefit from over-collateralisation**

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

i) First-rate mortgages/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

According to the French Bank Relief Act, 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; and 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, very

secure and the SFEF's exposure very limited (de Kergommeaux 2008). Strict collateral requirements also communicate that banks are not simply being "bailed out". They are receiving temporary and costly assistance, to sustain them until they can repair their operations.

8. **The maximum maturity for instruments issued by the SFEF was five years**

The government does not appear to have established minimum maturity requirements for loans issued by the SFEF.

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

10. **Institutions were capped on refinancing by the greater of the two following: 5% of its balance sheet total or EUR 500 million.**

11. **SFEF charged a high interest rate that included a fee for the state guarantee.**

The interest rate charged on loans from the SFEF was intended to include the necessary compensation for the organization plus an added fee for the state guarantee. Beneficiary institutions were charged an annual premium of 20 basis points plus the cost of a five year CDS on that credit institution. This resulted in a relatively high interest rate. The high interest rate may have been intended to motivate banks to seek other sources of funding once they had established sufficient stability. Such a strategy may have been possible only because French banks were not as damaged by the crisis as banks in other countries. Furthermore, the state benefited greatly from the guarantee fee, generating 441 million euros by February 2009.

12. **Beneficiary credit institutions were required to enter into an agreement with the French state that set out a number of ethical and economic commitments**

The commitments required of the banks included providing credit to individuals, small and medium-sized companies and households, and local authorities. Banks also had to commit to following certain rules on executive compensation, severance arrangements, and reporting standards. This may have been due to the lack of confidence in the banking system that characterized this crisis. Ensuring banks are following ethical and economic priorities may have been intended to restore lost confidence in banks. These commitments also ensured the banks were active in the process of restoring the economy back to health. Such commitments reduce the risk of moral hazard.

13. **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 Bank of 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.

14. The guarantee was only applied to bonds issued before December 31, 2009

The plan was intended to be only a temporary measure. The SFEF was only to issue bonds 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 only been possible 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 2-7 percent (Xiao 09). 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 organization. It managed to raise 77 billion euros by the end of its operations and establish a reputation as a fruitful investment opportunity. The organization received funds from around 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 the SFEF was a very secure investment (Global Capital 2009). Yet, the SFEF also had many advantages as a non-government entity. It enabled banks to access funds at a lower rate than if they were to qualify for direct state funding (Cavalier 2009). It also allowed the government to be indirectly involved in managing the financial crisis and, thus, avoid devoting excessive funds or other resources to their actions. Thus, the SFEF's status as a non-government agency backed by government funds proved to be well-suited to its purposes.

The impact of SFEF funding was broad, providing loans for thirteen major credit institutions by May 2009. These institutions represented 83.5% of total loans to the economy at the time 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 3-4%. Thus, the actions of the SFEF were indeed benefiting the banks and effectively contributing to the continued financing of the real French economy (European Commission 2009). The plan effectively mitigated the liquidity problem and achieved its goals of aiding the French economy.

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