

Risk Report 2009

PILLAR 3 OF BASEL II

DEXIA

Contents

Introduction.....	3
1. Risk Management Objectives and Policies	6
1.1 Mission and Objectives	6
1.2 Risk Governance and Organization	6
1.3 Dexia Risk Cartography.....	9
2. Own Funds and Capital Adequacy.....	10
2.1. Own Funds.....	10
2.2. Capital Requirements by Type of Risk	11
2.3. Capital Adequacy	12
2.4. Significant Banking Subsidiaries	15
3. Credit Risk	16
3.1. Credit Risk Management and Governance	16
3.2. Credit Risk Exposure	17
3.3. Impairment, Past-Due and Related Provisions	21
3.4. Credit Risk Mitigation Techniques	23
3.5. AIRB Approaches	26
3.6. Standardized Approaches	29
3.7. Counterparty Risk on Derivatives.....	32
3.8. Focus on Equity Exposure.....	33
3.9. Focus on Securitization Activities.....	34
4. Market and Balance Sheet Management Risks.....	39
4.1. Market Risk	39
4.2. Balance Sheet Management Risk	44
5. Operational Risk	48
5.1. Definition	48
5.2. Governance.....	48
5.3. Management of the Risk.....	48
6. Pillar 2 Risks.....	51
6.1. Behavioural Risk	51
6.2. Business Risk	51
6.3. Strategic Risk.....	52
6.4. Reputation Risk	52
6.5. Model Risk	53
6.6. Pension Risk	53
6.7. Insurance Risk.....	54
6.8. Settlement Risk.....	54
6.9. Securitization Risk.....	55
Appendix 1 – Glossary.....	56
Appendix 2 – Internal Rating Systems	59
Appendix 3 – Dexia Originations	71

Introduction

In 2009, Risk Management activities were severely impacted by the financial crisis and by the transformation plan implemented by Dexia at the end of 2008 to re-establish the Group's solid foundation. The transformation plan aims at refocusing Dexia on its core client franchises, at reducing the Group's risk profile and at optimizing its cost base.

The reduction of the Group's risk profile was realized in 2009 through a certain number of divestments, including the sale of FSA Insurance finalized in July 2009, and by a voluntary deleveraging policy of the bond portfolio in run-off. EUR -16.5 billion of bonds were sold in 2009 (EUR 15 billion of net sales within the bond portfolio in run-off and EUR 1.5 billion from ALM portfolios). The divestments and the reduction of the portfolio in run-off were reflected by a reduction of EUR 371 billion in the Group's exposure to credit risk in 2009. Weighted risks have naturally followed the same trend and decreased by EUR -9.6 billion over the year, whilst the Tier 1 ratio improved, from 10.6% at the end of 2008 to 12.3% at the end of 2009. A normalization is also to be noted in the cost of risk, which was EUR 1,096 million in 2009 against EUR 3,291 million in 2008.

Significant progress was made in terms of liquidity consolidation. The Group in fact faced a serious liquidity crisis following the bankruptcy of Lehman Brothers in September 2008 and the severe drying-up of the money and capital markets which followed. In October 2008, the Belgian, French and Luxembourg governments granted Dexia a guarantee on its short and long-term financing. That guarantee was extended until 31 October 2010. The guaranteed amounts reached EUR 50.4 billion as at 31 December 2009, compared with a maximum of EUR 95.8 billion in May 2009, and evidence of the improvement of the Group's funding and of the balance-sheet deleveraging process.

Risk Management also accompanied the reorganization of the "financial markets" activity, the reduction of trading activities and in particular the complete abandonment of credit trading activities. This is reflected by a reduction of market limits (VaR limit 99%-10 days from EUR 130 million to EUR 100 million) and by a global reshaping of procedures.

Another notable achievement in 2009 was the extension of the implementation of a mark-to-model valuation of illiquid assets. Applied from the beginning of the year to available-for-sale assets, it was extended for year-end valuation to assets classified in loans and receivables.

In the field of operational risk, 2009 was a year of consolidation via the constant gathering of incidents and the updating of self-valuation scenarios. The collaboration with other departments responsible for Risk and Control (in particular Audit, Compliance and Legal Services) was also strengthened, by virtue of the development of a common tool for monitoring action plans motivated by recommendations from audit and by risk assessments.

Finally, the principal transversal projects were continued and developed:

- new models were developed and will be progressively used for the calculation of regulatory capital as from 31 December 2010;
- the scope of application of Pillar 1 and 2 stress tests has been extended across the Group;
- a formal framework of risk appetite indicators has been defined;
- economic capital measures were refined and recalibrated in order to integrate the lessons learnt from the crisis.

In 2010, efforts will continue to consolidate liquidity and to reduce the risk profile.

Numerous tasks will have to be undertaken as a consequence of the regulatory framework: answer to recommendations from the Pillar 2 mission led by regulators; fulfilment of the requirements linked to the calculation of capital in market activities (in particular the deployment of an integrated system for the calculation of historical VaR and the definition of stressed VaR); evolution of the IFRS regulations concerning the provisioning and valuation of assets; developments associated with the new regulatory framework proposed by the BIS (Bank for International Settlements) within the context of a Quantitative Impact Study particularly on the aspects of defining capital, capital buffer, leverage ratio and counterparty risk.

Finally, 2010 will see the finalization of the reorganization of Risk Management in accordance with a simplified governance approach and aligned to the new organization of the Group.

Basel II Framework

Basel II refers to the revision of the 1988 regulatory framework defining the capital requirements for banking institutions.

The main objectives of the capital agreement ("Basel II framework") put in place by the Basel Committee on Banking Supervision are to improve the regulatory framework in order i) further to strengthen the soundness and stability of the international banking system ii) to promote the adoption of stronger risk management practices by the banking industry and iii) to prevent any competitive regulatory inequality among internationally active banks.

In order to achieve these objectives, the Basel II framework is based on three pillars:

- The first pillar – minimum capital requirements – defines the way banking institutions calculate their regulatory capital requirements in order to cover credit risk, market risk and operational risk. The revised framework provides different approaches for calculating credit risk (3 approaches: Standardized, Foundation Internal Rating-Based and Advanced Internal Rating-Based), market risk (2 approaches: Standardized Approach and Internal Model Approach) and operational risk (3 approaches: Basic Indicator Approach, Standardized Approach and Advanced Measurement Approach).
- The second pillar – supervisory review – provides the national regulators with a framework to help them in assessing the adequacy of banks' internal capital to be used to cover credit risk, market risk and operational risk but also other risks not identified in the first pillar such as concentration risk.
- The third pillar – market discipline – encourages market discipline by developing a set of qualitative and quantitative disclosures which will allow market participants to make a better assessment of capital, risk exposure, risk assessment processes, and hence the capital adequacy of the institution.

The requirements of the third pillar are fulfilled by this publication.

Basel II Implementation

Pillar 1

Credit Risk – AIRB Approach approval

The Dexia homologation application file was successfully presented for final decision to the Management Board of the Banking, Finance and Insurance Commission by 18 December 2007. Consequently, since 1 January 2008, Dexia has been authorized to use the Advanced Internal Rating-Based Approach (AIRB Approach) for the determination of its regulatory capital requirements under Basel II Pillar 1 for credit risk and for the calculation of its solvency ratios.

This acceptance is applicable to all entities and subsidiaries consolidated within the Dexia Group, which are established in a Member State of the European Union and subject to the Capital Requirement Directive.

Dexia has also decided to maintain a Standardized Approach for some portfolios for which this approach is specifically authorized by the Basel II framework, such as small business units, non-material portfolios, portfolios corresponding to activities in run-off or to be sold or portfolios and entities for which Dexia has adopted a phased rollout of the AIRB Approach.

Market Risk

In terms of market risk, Dexia calculates its capital requirements on the basis of the Internal Model Approach for general interest rate risk and foreign exchange risk and the Standardized Approach for specific interest rate risk and equity risk (refer to part 4 – Market and ALM risks). In the future, Dexia intends to switch to the Internal Model Approach for equity risk.

Operational Risk

For operational risk, Dexia applies the Standardized Approach. In this regard, an information file was submitted to the Regulator in June 2007. Incident reporting is at cruising speed and the Risk and Control Self-Assessment (RCSA) process covers the entire bank, including foreign subsidiaries and branches (refer to part 5 – Operational risk).

COREP

The COREP (COmmon solvency ratio REPorting – European Basel II reporting which includes prudential information on own funds, credit risk, market risk and operational risk quantitative disclosures) is produced by virtue of close collaboration between the various departments and entities of the Dexia Group.

Pillar 2

The year 2009 was marked by progress in the implementation of Pillar 2. This mechanism requires banks to demonstrate to their regulators the appropriateness of their risk profile and their capital. To do so, they must in particular have internal systems for the calculation and management of their risks, capable of making a valid assessment of their economic capital needs (Internal Capital Adequacy Assessment Process – ICAAP). This process is thus based on two main processes: risk analysis by Risk Management and the financial plan (including a capital allocation and an analysis of the evolution of the results of business lines as well as the internal capital supply) by Finance. As Pillar 2 of Basel II is a totally integrated and transversal process, the Pillar 2 file essentially consists of the file established at Dexia SA level, of which some parts have been set at entity level.

The first quantitative ICAAP report was submitted on 15 March 2009. The complete file was submitted on 30 June 2009 on the basis of the Group's strategic reorientation. In-depth Pillar 2 inspections were performed by the college of regulators in the fourth quarter of 2009.

The Board of Directors and the Management Board of Dexia SA have been kept fully informed of developments with regard to Pillar 2.

Pillar 3 – Disclosure policy

Frequency of Disclosure

Pillar 3 document has been published since 2008 in line with the Circular PPB-2007-15-CPB-CPA – Titre XIV (Belgian transposition of the Capital Adequacy Directive – Annex XII).

Pillar 3 disclosure is organized on an annual basis together with publication of the annual report. Nevertheless, a subsequent release may be published if considered relevant by Dexia due to significant changes in its risk profile.

Support

Dexia will release the Pillar 3 document on its website (www.dexia.com).

Currency

The figures in the following tables are provided in millions of euro (EUR) unless otherwise stated.

Scope of Application

The Pillar 3 disclosure requirements under the new Basel II capital framework are applicable to the upper level of consolidation, the Dexia Group. This consolidation is realized at Dexia SA, based at 11 Place Rogier, B-1210 Brussels, Belgium.

In line with regulatory capital, Dexia has chosen to link the scope of Pillar 3 to banking institutions (for further information, refer to part 2.1.1.).

Pillar 3 Contents

Part of the information provided within Pillar 3 is similar to the Annual Report. However, to facilitate the reading of the present document, this information has been duplicated in the Pillar 3 document.

Quality of the information provided is guaranteed by a strong process of validation within the Dexia SA Management Board.

When applicable, a comparison with the previous year is available. This comparison depends on stability of scope of application and methodologies applied. Comparison is not available in part 3 – Credit Risks due to changes of scope between 2008 and 2009 (i.e. inclusion of Financial Products & Global Funding and RBC Dexia portfolios).

Dexia SA is authorized, like other financial institutions, not to communicate information if it is considered as non significant or confidential.

1. Risk Management Objectives and Policies

1.1. Mission and Objectives

In November 2008, Dexia launched a major transformation plan strongly impacting the Risk Management organization. This transformation aims at reinforcing the normative and control role of Dexia SA through a clear, streamlined corporate governance structure of the different support lines including Risk Management. This organizational change has been gradually implemented since the beginning of 2010.

In this context, Dexia Risk Management mission statement has been readdressed. Its key challenges are to define Dexia's risk appetite, to implement an independent and integrated risk measurement within a holistic risk management framework for all types of risks, to manage all risks and to identify and proactively to address emerging risks.

The main responsibilities of Dexia Risk Management are to oversee Dexia's global risk policy and guidelines under the guidance of Dexia's Management Board or specialist risk committees, to establish credit limits and delegation authorities, to set and manage the risk surveillance function and decision processes and to implement Group-wide risk assessment methods for each of Dexia's activities and operating entities.

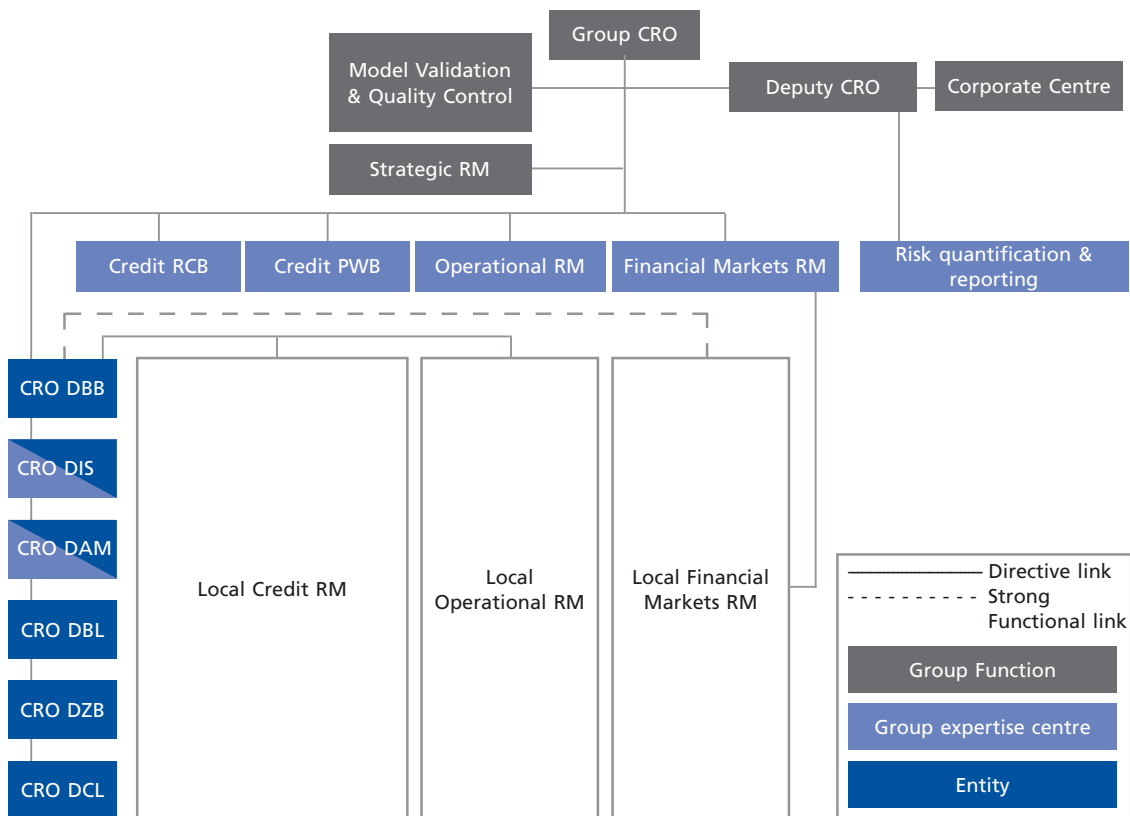
1.2. Risk Governance and Organization

1.2.1. Organization

The new Risk Management organization is aligned on the overall Dexia Group organization and is based on a directive model with the local Chief Risk Officer (local CRO) directly reporting to the Group CRO (hierarchical link). Dexia Risk management is composed of:

- Group expertise centres: Retail and Commercial Banking (RCB) Credit Risk Management, Public and Wholesale Banking (PWB) Credit Risk Management, Risk Management Financial Markets, Operational Risk Management and Risk Quantification and Reporting;
- Group functions such as the Risk Management Corporate center, Strategic Risk Management and Internal validation & Quality Control;
- Entities focusing on local Risk Management activities.

The following diagram presents the new Dexia Risk Management Organization.



Note:

DBB: Dexia Bank Belgium – DIS: Dexia Insurance Services – DAM: Dexia Asset Management – DBL: Dexia Banque Internationale à Luxembourg – DZB: DenizBank – DCL: Dexia Crédit Local.

Expertise Centres

Credit Risk Management has been split into three expertise centres aligned with the Dexia corporate organization.

Retail and Commercial Banking (RCB) Credit Risk

RCB credit risk management is mainly responsible for defining policies and guidelines on RCB credit risk, monitoring the RCB portfolio and coordinating the local model management process.

Public and Wholesale Banking (PWB) Credit Risk

PWB credit risk is responsible for defining policies and guidelines on PWB credit risks, of analyzing PWB counterparties, and monitoring transversal PWB portfolios through four different teams:

- Three Credit Risk Analysis Centres (CRAC), respectively for project finance counterparties, corporate and real estate counterparties, country and international local authority counterparties. The Credit Risk Analysis Centres are responsible for assigning internal ratings to Dexia counterparties and play the part of a “rating agency” for all entities of the Group.
- PWB model management responsible for developing and maintaining Internal Rating System (IRS) for PWB counterparties.

Credit risk governance and management of the risk is detailed in part 3.1.

Financial Market Risk Management

Financial Market Risk Management (FMRM) acts as an expertise centre covering all financial market risk issues, on both credit (including bank and ABS CRACs), and market risk, on a Group-wide basis. FMRM is an integrated support line within the Group organization responsible for defining policies and guidelines on financial market activities, identifying, analysing, monitoring (including valuation, model management) and reporting on risks and results with a holistic view of risk management.

Operational Risk

The management of operational risk at Dexia relies on four key building blocks: operational risk event data collection, risk and control self assessment, transversal scenario analysis and definition and follow-up of action plans. The Operational Risk Group expertise centre is responsible for defining the policies and guidelines on operational risk and for monitoring Group operational risk. Operational risk governance and management of the risk are detailed in part 5.

Risk Quantification and Reporting

Risk quantification and reporting teams are responsible for defining and developing the risk quantification approaches (quantitative risk modeling for Pillar 1 and Pillar 2/economic capital models, RAROC, pricing models, Mark to model...) and producing Pillar 1 and Pillar 2 internal and external reports.

Dexia Insurance Services (DIS) and Dexia Asset Management (DAM)

Dexia Insurance Services (DIS) and Dexia Asset Management (DAM) are both an expertise centre and an entity as they are the only entities in the Group respectively dealing with insurance and asset management business.

Group Functions

Strategic Risk Management

Strategic risk management assignment is proactively to anticipate emerging risks, to define stress testing framework and scenarios and to run them, to overview the regulatory framework and to anticipate any impacting changes for Dexia.

Model Validation and Quality Control

Model validation and quality control is responsible for two main areas:

- Model validation provides an independent review of all the models used by Dexia (both Basel II models, market risk models, pricing models and ECAP models) and proposes their validation to the Validation Committee and then consecutively to the Risk Policy Committee.
- Quality control ensures the proper use of the Internal Rating System (IRS).

Corporate Centre

The corporate centre is responsible for the development and the maintenance of all risk systems, transversal project management and overall Basel II coordination, as well as for the administrative support of the Risk Management support line (Organization, Budget, and Human Resources issues).

Local Risk Management

Local risk management is organized through 3 main functions:

- local credit risk responsible for analyzing and monitoring local counterparties including developing and maintaining the local Internal Rating System (IRS) and for producing local reportings;
- local operational risk responsible for local risk assessment and monitoring but also producing local reportings;
- local financial market risk management responsible for the day-to-day activity i.e. local risk assessment, local risk monitoring (computation of risk indicators, control of limits, triggers and so on), local reporting, reconciliation with local strategic planning and accounting but also with local information systems.

Each operational entity is also responsible for the monitoring and reporting of entities' risks to local supervisory and regulatory bodies.

1.2.2. Governance

The Dexia risk committees are organized under the same governance as for chairmanship, decision rules and general delegations. This governance is fully in line with the Basel II requirements.

The Dexia risk governance model defines four types of committees:

- Transversal Committees;
- Credit Risk Committees;
- Market and Balance Sheet Management (BSM) Committees;
- Operational Risk Committees.

Transversal Committees

Risk Policy Committees

The Risk Policy Committee, composed of Dexia Management Board Members, concentrates on developing Group-wide policy frameworks for all types of risks and defining an overall risk profile for the different activities within the Dexia Group. The Risk Policy Committee delegates to the Validation Committee and the Guideline Committees for each of the main types of risks (credit, market and operational risk).

Risk Management Executive Committee

The Risk Executive Committee decides on the risk management strategy, key issues and organization and closely monitors key risk indicators. It is organized on a weekly basis and is composed of Dexia CRO, Dexia Deputy CRO, Dexia Head of FMRM, Dexia Head of RCB Credit Risk Management and Dexia Head of PWB Credit Risk Management.

Credit Risk Committees

The decision-making process applied to transactions is organized via a series of credit committees. These are organized per specialist expertise centre, and approve transactions which are not delegated to the entities. All of these committees operate under the delegation of the Management Credit Committee. A transaction delegation has been set, depending upon the type of counterparty, rating levels and credit risk exposure. Subcommittees have been created within the Group (entities, subsidiaries and branches) to deal with credit delegations.

Credit Risk Committees also include the Rating Committees, Special Mention and Watch List Committee, Impairment Committee and Default Committees. These committees are detailed in part 3.

Market and Balance Sheet Management (BSM) Committees

Market and BSM Committees include the Dexia Group Assets & Liabilities Committee (Group ALCo), the Funding and Liquidity Committee (FLC) and the Market Risk and Guidelines Committee. These committees are detailed in part 4.

Operational Risk Committees

Operational Risk Committees include the Operational Risk Guidelines Committee, and the Operational Risk Management Committee. These committees are detailed in part 5.

1.3. Dexia Risk Cartography

The following table illustrates the risk identification process within Dexia.

		Pillar 1	Pillar 2
Credit risk	Solvency risk	x	x
	Country risk	x	x
	Securitization risk		x
	Settlement risk ⁽¹⁾		x
Market and balance sheet Management risk	Interest rate risk	x	x
	Price risk ⁽²⁾	x	x
	Currency risk	x	x
	Spread risk	x	x
	Liquidity risk		x
	Funding risk		x
	Other market risks	x	x
Operational risk		x	x
Other risks	Behavioural risk		x
	Business risk		x
	Pension risk		x
	Insurance risk		x
	Model risk		x
	Reputation risk		x
	Strategic risk		x

(1) Pillar 1 settlement risk is reported as part of market risk.

(2) Price risk includes risk on equity exposures booked in the banking book.

The risks listed above are described more in detail in the following parts of the disclosure:

- Credit risk: part 3;
- Market risk and balance sheet management risk: part 4;
- Operational risk: part 5;
- Other risks: part 6.

2. Own Funds and Capital Adequacy

2.1. Own Funds

2.1.1. Accounting and Regulatory Equity Figures

In line with regulatory capital, Dexia has chosen to limit the scope of Pillar 3 to banking institutions. Therefore, the scope of consolidation of Pillar 3 differs from the scope of consolidation of the financial statements (as released in the Dexia Group annual report).

For Dexia, the differences in consolidation between the accounting methods and the prudential methods are:

- Insurance companies are consolidated using the equity method for prudential purposes instead of full consolidation for accounting purposes. Dexia Insurance Belgium is the main insurance company of Dexia. The insurance activities of FSA were sold in 2009;
- Very small securitization vehicles (Special Purpose Vehicles – SPV) are consolidated using the equity method for prudential purposes instead of full consolidation for accounting purposes. This is due to the very specific accounting treatment of SPV. The exhaustive list of the insurance companies and SPV concerned is available on request.

The following table shows a comparison between total equity as per financial statements and total equity as start base of Tier 1 and total regulatory capital at year-end.

	31/12/2008		31/12/2009	
	Financial statements	Regulatory purposes	Financial statements	Regulatory purposes
Total shareholders' equity	3,916	3,916	10,182	10,182
of which core equity	17,488	17,488	18,498	18,498
of which gains and losses not recognized in the statement of income	(13,572)	(13,572)	(8,316)	(8,316)
Minority interests	1,702	1,694	1,805	1,796
of which core equity	1,757	1,749	1,813	1,805
of which gains and losses not recognized in the statement of income	(55)	(55)	(8)	(9)
Discretionary participation features of insurance contracts	0	0	1	0
TOTAL	5,618	5,610	11,988	11,978

Notes:

- Comments on regulatory requirements are given in note 4.5. of the accounting principles and rules of consolidated financial statements published in the Annual Report 2009.

- For regulatory purposes, insurance companies are accounted for by the equity method. Therefore, minority interests differ from those published in the Financial Statements. Discretionary Participation Features only relate to insurance companies.

Total shareholders' equity of the Dexia Group improved by EUR 6.3 billion in 2009 mainly as a result of the contraction of the negative available-for-sale reserve on securities which improved by EUR 4.8 billion. Such improvement is principally explained by the tightening of secondary spreads which reduced the negative AFS reserve related to the Group's bond portfolio in run-off. Core shareholders' equity was EUR 18.5 billion at the end of 2009, up by 5.8% as compared to December 2008. After recording a loss of EUR 3.3 billion in 2008, Dexia returned to profit in 2009 and posted a net income Group share of EUR 1.0 billion.

2.1.2. Regulatory Capital

Total regulatory capital is the addition of Tier 1 and Tier 2 (i.e. additional own funds) capital.

Tier 1 capital comprises share capital, share premium, retained earnings, consolidated reserves, own shares, current year profit after deduction of the estimated dividend to be paid, foreign currency translation and hybrid capital less intangible assets, goodwill and short positions in own shares.

Tier 2 capital includes the eligible portion of subordinated long-term debt, less subordinated debt from and equities in financial institutions.

The following table shows Dexia Group regulatory capital calculated under Basel II at year-end.

	31/12/2008	31/12/2009
TOTAL REGULATORY CAPITAL (AFTER PROFIT APPROPRIATION)	18,077	20,251
Tier 1 capital	16,126	17,573
Core shareholders' equity	17,488	18,498
Cumulative translation adjustments-Group	(540)	(531)
Minority interests (eligible in Tier 1) ⁽¹⁾	557	613
Deductions and prudential filters	(2,800)	(2,428)
Hybrid regulatory Tier 1 capital ⁽²⁾	1,421	1,421
Additional own funds	1,951	2,678
Perpetuals	815	755
Subordinated liabilities	2,795	2,630
Deductions and prudential filters	(1,659)	(707)

(1) On a regulatory approach, the amounts booked in minority interests and eligible as hybrid regulatory Tier 1 capital are presented separately. As at 31 December 2008 and as at 31 December 2009 EUR 1,196 million eligible as hybrid regulatory Tier 1 capital is included in minority interests' core equity.

(2) This amount is the result of three operations:

- undated deeply subordinated non-cumulative notes for EUR 700 million, issued by Dexia Crédit Local and booked for EUR 698 million in minority interests;
- undated subordinated non-cumulative notes for EUR 500 million, issued by Dexia Funding Luxembourg and booked in minority interests for EUR 498 million;
- hybrid capital issued by Dexia Banque Internationale à Luxembourg on 6 July 2001 for an amount of EUR 225 million bearing a 6.821% interest and booked in subordinated debts in the financial statements.

The AFS reserves on bonds and cash-flow hedge reserves are not part of the regulatory equity. The positive AFS reserves on shares are added to Tier 2 equity. They would have been deducted from Tier 1 equity if negative. This is explained in the accounting principles and rules of consolidated financial statements published in the annual report.

At the end of 2009, Tier 1 capital amounted to EUR 17,573 million, a 9% increase due to higher retained earnings. The contribution of hybrid instruments to Tier 1 capital was and remained low: it amounted to EUR 1,421 million (i.e. 9% of Tier 1).

2.2. Capital Requirements by Type of Risk

The following table shows the weighted risks and capital requirements for each type of risk (and exposure class for credit risk) at year-end 2009. The minimum capital requirements correspond to 8% of the risk weighted assets.

Regarding credit risk, the breakdown by exposure class presented in the following table is more detailed than the advanced regulatory approach, reflecting Dexia activity on public sector entities and project finance counterparties. An explanation of each exposure class is provided in annex 2.

Type of risk	Basel II treatment	Exposure class	Weighted risks	Capital requirements		
Credit risk	Advanced	Corporate	26,336	2,107		
		Equities	958	77		
		Financial institutions	11,453	916		
		Monolines	2,230	178		
		Project finance	5,563	445		
		Public sector entities	4,733	379		
		Retail				
			Mortgage loans	1,220	98	
			Revolving loans	105	8	
			Other loans	2,285	183	
			Securitization	27,445	2,196	
			Sovereign	3,335	267	
			Others	136	11	
		Total	85,800	6,864		
		Standard	Corporate	10,954	876	
			Equities	896	72	
			Institutions	2,362	189	
			Monolines	0	0	
			Project finance	899	72	
			Public sector entities	18,101	1,448	
			Retail			
				Mortgage loans	0	0
				Revolving loans	9	1
			Other loans	4,767	381	
		Securitization	0	0		
		Sovereign	5,480	438		
		Others	489	39		
		Total	43,958	3,517		
Market risk	Internal model	Interest rate & foreign exchange risk	841	67		
		Position risk on equities	0	0		
		Other market risks	0	0		
		Total	841	67		
		Standard	Interest rate risk	1,646	132	
			Foreign exchange risk	354	28	
			Position risk on equities	152	12	
			Other market risks	0	0	
			Total	2,152	172	
Operational risk	Basic		10,419	834		
TOTAL			143,170	11,454		

Note: the counterparties are the final counterparties, i.e. after taking into account the Basel II eligible guarantee (substitution principle). Monoline exposure is essentially an indirect exposure.

At year-end, Dexia's total weighted risks amounted to EUR 143.2 billion as compared to EUR 152.8 billion at the end of 2008. This EUR 9.6 billion reduction is mainly due to deleveraging efforts and reduction of the Group's risk profile, combined with the depreciation of the US dollar against the euro.

2.3. Capital Adequacy

Capital adequacy is assessed through the level of capital by type of risk.

2.3.1. Regulatory Solvency Ratios

The adequacy of Dexia's capital is monitored using, among other measures, the rules and ratios established by the Circular PPB-2007-15-CPB-CPA issued by the Belgian Banking, Finance and Insurance Commission (CBFA). The CBFA ratios compare the amount of eligible capital (in Total and Tier 1) with the total of weighted risks. Dexia monitors and reports its capital ratios and the capital requirements underpinning Dexia's business following the banking prudential rules and the prudential rules of conglomerates to the CBFA.

Dexia complied with all regulatory capital rules for all periods reported.

The following table shows Dexia Group weighted risks and solvency ratios at year-end. Since 1 January 2008 onwards, Dexia has used the Basel II framework to calculate the capital requirements for credit risks and to publish its solvency ratios. Regulatory floor has no impact on Dexia regulatory capital. This transition rule may be extended until 2012.

		31/12/2008	31/12/2009
Tier 1 capital		16,126	17,573
Total regulatory capital		18,077	20,251
Total weighted risks		152,837	143,170
Credit risk	Advanced	94,770	85,800
	Standard	44,724	43,958
Market risk	Advanced	838	841
	Standard	2,238	2,152
Operational risk	Basic	10,269	10,419
Tier 1 ratio		10.6%	12.3%
Capital adequacy ratio		11.8%	14.1%

In 2009, Tier 1 ratio further improved by 172 bps to 12.3% supported by organic generation of Tier 1 capital of EUR 1.45 billion (equivalent to 95 bps) and by a decrease of total weighted risks by EUR 9.6 billion (equivalent to 77 bps). The core Tier 1 ratio reached 11.3%, up by 170 bps compared to the end 2009 illustrating the Group's solid solvency situation.

Since the fourth quarter of 2008, the Financial Products portfolio, which was kept on the balance sheet of Dexia after the sale of the insurance activities of FSA, entered into the banking scope. The States of Belgium and France guarantee 75% of the assets held in the Financial Products portfolio and by way of this guarantee, the States will cover losses above a first loss of USD 4.5 billion. As at 31 December 2009, Dexia had booked a total provision of USD 2 billion in relation to the Financial Products portfolio. As a consequence, the solvency ratios were immunized against potential losses of the guaranteed Financial Products portfolio.

2.3.2. Internal Capital Adequacy

In 2009, Dexia progressively formalized and implemented its internal capital adequacy framework, in line with the Pillar 2 requirements of Basel II. Beyond those external requirements, this process is at the heart of management of the bank and responds to its capital adequacy target in line with its risk profile. It relies on a comparison between the available financial resources and the demand for capital necessary to cover risks measured as economic capital.

Risk Appetite

Risk appetite expresses the level of risk an institution is ready to take, given the expectations of the principal stakeholders (shareholders, creditors, regulators, rating agencies and clients among all others), in order to achieve its strategic, commercial and financial objectives.

In 2009, the Group further strengthened its risk appetite approach. Based on a holistic approach, risk appetite is a central benchmark to:

- support strategy and planning;
- support performance in terms of growth and value creation;
- assist in daily investment decisions.

A formalized risk appetite framework was developed in 2009, integrating a series of ratios constituting a key element in defining the overall limit framework. The framework is based on a mix of accounting ratios (gearing), regulatory ratios (Tier 1, weighted risks), economic ratios (economic capital, earnings at risk), and integrates liquidity and funding structure ratios as well as credit concentration limits.

Limits are defined on each of these ratios, and validated by the Board of Directors each year. The Group financial plan is analyzed taking these objectives into account for the entire risk appetite framework. Risk Management and Finance departments are responsible for monitoring these ratios, and if necessary propose measures to the Management Board to ensure the limits are respected.

This risk appetite approach will be formalized and applicable in 2010.

Economic Capital

Definition

Economic capital is defined as the potential deviation of the Group's economic value in relation to the value expected at a determined interval of confidence and time horizon. The economic capital quantification process is organized in three phases: risk identification (definition and cartography updated annually up to a local level), risk assessment (essentially on the basis of statistical methodologies) and risk aggregation on the basis of an inter-risks diversification matrix. The main risks are capitalized in relation to a measure of expected loss; certain risks are not however capitalized if overall management processes (limits, scenarios, governance and so on) are considered more appropriate to cover them.

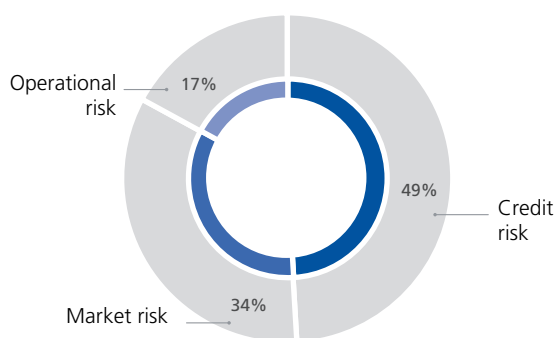
Capitalized risks are assessed at a high level of severity (99.97% at one year).

Over the year 2009, the quality of the process for economic capital calculation was further improved. Analyses and reporting were adjusted to the Group's new organization and economic capital projections have been integrated into the process of the Group financial plan, in particular via risk appetite and analysis of the profitability of new production.

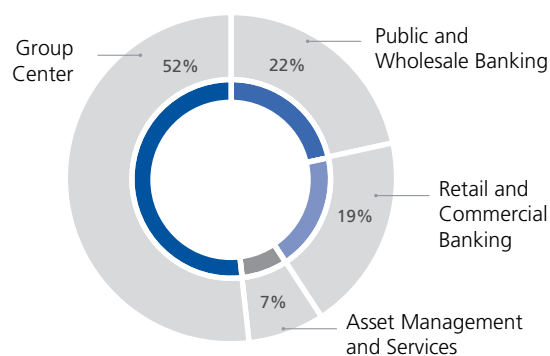
Economic Capital – 2009 figures

Dexia's economic capital is EUR 14,196 million at year-end 2009.

Economic Capital by Type of Risk
as at 31/12/2009



Economic Capital by Business Line
as at 31/12/2009



Credit risk represents approximately half of the economic capital use. Market risk including interest rate risks, foreign exchange risks and the equity price risk, is the second risk factor. Operational risk (including commercial risk) represents 17% of the economic capital.

The Group Center business line is the first consumer of economic capital; it includes mainly the treasury activities and the bond portfolios in run-off (Public bonds and Financial Products portfolios previously in Public and Wholesale Banking; Credit Spread Portfolios and some trading portfolios previously included in the Treasury and Financial Markets business line). Public and Wholesale Banking consequently becomes the second consumer of economic capital, closely followed by the Retail and Commercial Banking business line.

Economic Capital Adequacy

Created in 2009, the mission of the Economic Performance Analysis Committee (EPAC) is to put in place forward-looking management of needs (related to risk) and availability of capital (related to finance), from a regulatory and economic perspective, to support Dexia strategy. Organized on a monthly basis, the EPAC proposes Risk Management and Finance common denominators in risk appetite and capital management frameworks and supports the application of these frameworks, implements and manages the ICAAP process with regard to capital adequacy and capital allocation, including analysis on changes in risk profile compared to/versus changes in available capital. The EPAC recommends actions to the Management Board and follows up the implementation of actions decided by the Management Board.

Stress Tests

The Dexia stress tests programme was enhanced during the year 2009, covering Dexia at a global level.

- In terms of Pillar 1 stress tests (individual stress tests on Basel II internal rating models), Dexia covers more than 80% of weighted credit risks.
- Currently Pillar 2 stress tests performed by Dexia on the basis of historical scenarios or expert scenarios of economic recession resulted in a Tier 1 ratio exceeding 8%.

Dexia was one of 22 European financial institutions subjected by the Committee of European Banking Supervisors (CEBS) to the performance of a joint stress test, on the basis of different scenarios of credit quality deterioration. This exercise resulted in a Tier 1 ratio exceeding 8%.

In addition to the "traditional" stress tests for market and liquidity risks, Dexia applies a range of stress tests (sensitivity analyses, the implementation of stress scenarios and potential vulnerability assessments), enabling an assessment to be made of the potential effects of a series of events on its financial health, and a global view to be obtained of the possible impacts on its statement of income or its capital ratios under stress.

2.4. Significant Banking Subsidiaries

Significant subsidiaries of the Dexia Group are Dexia Bank Belgium (DBB), Dexia Crédit Local (DCL) and Dexia Banque Internationale à Luxembourg (DBL), based on their contribution to the Group (in terms of earnings and balance sheet) and/or to the importance of their market share. Dexia Bank Belgium and Dexia Banque Internationale à Luxembourg are respectively in the top three financial institutions in Belgium and Luxembourg.

Regulatory capital and solvency ratios under Basel II at year-end 2009 and 2008 for significant subsidiaries are disclosed in the following table.

	DBL		DBB		DCL	
	31/12/2008	31/12/2009	31/12/2008	31/12/2009	31/12/2008	31/12/2009
Tier 1 capital	2,061	2,288	6,691	6,887	6,007	6,668
Total regulatory capital	2,589	2,759	7,622	7,748	9,982	11,123
Total weighted risks	16,199	13,167	51,805	49,929	79,961	74,890
Tier 1 ratio	12.72%	17.38%	12.91%	13.79%	7.51%	8.90%
Capital adequacy ratio	15.98%	20.96%	14.71%	15.52%	12.48%	14.85%

Note: the reported figures are calculated according to IFRS figures and the guidelines issued by the local supervisory authorities. The detailed data are presented in the annual reports of the subsidiaries.

3. Credit Risk

3.1. Credit Risk Management and Governance

Credit risk represents the potential loss (decrease of asset value or payment default) which Dexia may incur as a result of deterioration in the solvency of any counterparty.

3.1.1. Governance

Dexia Risk Management oversees its credit risks under the supervision of the Management Board and specialist risk committees. It is responsible for elaborating credit risk policies and guidelines, including the decision-taking process and the framework for delegations, and supervising the rating/analysis processes as well as the exposure surveillance functions. In order to optimize the appropriateness of the skills in the risks department and their field of intervention, Risk Management will evolve over 2010 into an organization with specialist expertise centres consistent with the various Dexia business lines (Retail and Commercial Banking Credit Risk, Public and Wholesale Banking Credit Risk and Market Operations Credit Risk) giving rise to the establishment of risk committees specializing per expertise centre, the overall coordination of which will be in the hands of transversal committees.

Transversal Committees

The Risk Policy Committee, organized quarterly, approves the credit assignment rules, which are detailed in the credit risk policies.

The Risk Executive Committee, organized weekly, decides on the risk management strategy and the organization of the support line.

The Management Credit Committee, organized weekly, takes binding decisions on major files or credit files with an increased credit risk.

Committees Specializing per Expertise Centre

The decision-making process applied to transactions is organized via a series of credit committees. These are organized per specialist expertise centre, and approve transactions which are not delegated to the entities. All of these committees operate under the delegation of the Management Credit Committee. A transaction is delegated on the basis of specific delegation rules, depending upon the type of counterparty, rating levels and credit risk exposure. Subcommittees have been created within the Group (entities, subsidiaries and branches) to deal with credit delegations. Each file presented to a credit committee contains an independent analysis made by the Risk Management department.

The Special Mention and Watchlist Committees of the expertise centres and of the entities monitor "sensitive" assets placed on watch. The committees are organized quarterly.

The Default Committees of the expertise centres and of the entities define and monitor counterparties in default according to Basel II applying the rules which prevail at Dexia. These committees are organized quarterly.

The Impairments Committees of the expertise centres and of the entities draw up quarterly reports on the amount of provisions allocated and monitor the cost of risk. These committees are organized quarterly.

The Rating Committees of the expertise centres and of the entities deal with the correct application of internal rating systems as well as the adequacy of the rating processes. These committees are organized quarterly.

The Credit Line Committee attributes and checks the limits for certain counterparties monitored by the expertise centre for credit risk on market operations. This committee is organized quarterly.

3.1.2. Management of the Risk

Dexia manages its credit risk by assessing it, controlling it and taking the measures necessary to limit it.

Credit risk limits are defined in order to manage the general risk profile and to limit concentrations of risks. A limit is fixed for a given counterparty, in line with credit risk policy. Such limit represents the maximum exposure to the credit risk that Dexia is willing to accept for that given counterparty. Limits may also be imposed per economic sector and per product. In order to take more recent events into consideration, specific limits may be frozen at any time by the Risk Management department.

In order to assess its credit risk, Dexia relies in particular on a series of internal rating systems put in place under Basel II. Credit risk analysts are responsible for assigning a rating to all counterparties. Each rating corresponds to an assessment of the counterparty's risk level expressed in accordance with an internal scale which, without duly substantiated exception, takes into account the possible risk associated with the country in which it is established. On attribution, the internal rating constitutes a key element in the decision taken by the credit committee. An annual ratings review enables counterparties to be proactively identified and this requires regular monitoring which will then be entered in a quarterly watchlist, jointly reviewed by the credit risks department and the sales department, within a Special Mention & Watchlist Committee.

Credit risk management on equities, derivatives and securitization activities is further detailed in parts 3.7., 3.8. and 3.9. respectively.

The Global Credit Risk Environment in 2009

2009 will have been the year for economic recovery policies through government and central bank intervention. The economic context was unfavourable however, marked by an increase of unemployment and a loss of confidence among consumers and entrepreneurs. The year will also in many ways have been one of paradox. Indeed, although the amount of corporate debt at a global level was down for the first time in at least fifteen years, bond investors returned in large numbers to the capital market and a record volume of non-financial bonds was placed in Europe. Against a background of low rates, at the beginning of the year this segment offered substantial premiums which then tightened considerably.

The main domestic credit markets evolved similarly, with a rise of household finance and a decline of corporate finance. The latter also diversified their sources of financing by calling more on the market, particularly as the banking sector, confronted by higher capital requirements, remained constrained in its ability to provide loans. In part this explains the global downturn of this market, which was followed over the entire course of the year by clearly unseasonable negative flows. On the other hand, the mortgage market rose, in view of the low interest rates and public incentives to green investment.

Fundamentals of Dexia Credit Risk in 2009

The deterioration of the macroeconomic environment is perceptible in 2009 in the Dexia portfolio. The average rating of the portfolio declined over the year, particularly in the first quarter. Collective impairments have been made in order to face the potential consequences of this deterioration although the overall risk profile of the Group's business lines remained low. The Dexia portfolio was significantly reduced with the sale of FSA Insurance, finalized on 1 July 2009.

In its credit risk management, in 2009 Dexia continued to integrate the weakening of the economic fundamentals (increase in observed default rates, unfavourable macroeconomic situation) related to the current financial crisis, and continued to strengthen the process for identification and monitoring of sensitive files and sectors. Furthermore, limits have been revised and in particular on bank, corporate, country and sovereign counterparties; some activities have been suspended and deleveraging operations continued.

Retail and Commercial Banking saw a moderate increase in the cost of risk in Belgium and Luxembourg, but the deterioration was more severe in Turkey, where the crisis affected the commercial portfolio and resulted in unfavourable ratings migrations. In Public and Wholesale Banking, fundamentals remain globally very sound. In the field of corporate credit, close monitoring was enhanced (review of delegations, lowering of limits) on the most weakened project finance sectors (shipping, port activities and motorway infrastructure).

The year 2009 was marked by a major reduction of the bond and structured products portfolio, where production was ceased and the portfolio deleveraging programme continued. Although no incident or clear deterioration was noted in terms of performance or expected loss, the impact of the crisis resulted in rating downgrades. The deterioration was obvious above all in the segments of CLO (risks mitigated to a large extent) and Spanish RMBS, the United Kingdom and the United States. The bond portfolio remains at 97% investment grade and the Financial Products portfolio, at a longer maturity, saw its quality (43% investment grade) and its level of specific impairments stabilize.

Sovereign risk was reduced on countries presenting a high risk or considered more vulnerable. As to banking counterparties, no default was observed within the portfolio. The risk on monoliners has been substantially reduced following the cessation of liquidity line activity in New York and the disposal of certain assets.

3.2. Credit Risk Exposure

Credit risk exposure is disclosed in the present document in the same way as reported in the annual report and is:

- the net carrying amount for balance sheet assets other than derivative contracts (i.e. accounting value after deduction of specific impairment);
- the mark-to-market value for derivatives contracts;
- the full commitment amount for off-balance-sheet commitments. The full commitment amount is either the undrawn part of liquidity facilities or the maximum amount Dexia is committed to pay for the guarantees it has granted to third parties.

The tables hereafter and related comments describe Dexia credit risk profile as at 31 December 2009. The Group's total exposure amounted to EUR 574.7 billion as at 31 December 2009, excluding the insurance companies of the Group as explained in part 2.1.

3.2.1. Exposure by Type of Product and Geographic Area

The table below shows the total exposure with a breakdown by type of product and geographic area at year-end 2009.

Type of product	Eurozone ⁽¹⁾	Rest of Europe ⁽²⁾	US & Canada	Rest of the World	Total
Debt securities	107,512	3,799	26,631	16,513	154,456
Retail loans	40,472	2,066	475	3,797	46,811
Loans and advances	189,280	10,936	6,738	10,647	217,601
ABS	13,615	3	20,402	3,221	37,241
Derivatives	6,409	120	1,546	219	8,294
Given guarantees	59,080	3,319	26,622	5,294	94,316
Repo	6,121	4,044	2,768	1,406	14,339
Other assets	289	16	71	1,226	1,601
TOTAL	422,779	24,304	85,252	42,324	574,659

(1) Countries using the euro currency as at 31 December 2009.

(2) Including Turkey.

Loans and Advances represent 38% of Dexia exposure as this category mainly includes loans to the public sector. Dexia counterparties on debt securities are public sector entities, financial institutions and sovereigns.

As at 31 December 2009, the Group's exposure was predominantly concentrated in the Eurozone (73% or EUR 422.8 billion at year-end 2009), particularly in France (18%) and Belgium (19%).

3.2.2. Exposure by Type of Product and Obligor Grade

The following tables show the total exposure and the average exposure with a breakdown by type of product and obligor grade at year-end 2009.

For reporting purposes, a rating "masterscale" has been set up. This scale is structured in grades ranging from AAA to CCC and the modifiers plus, flat and minus (except for both extremes of the scale).

Exposure at 2009 Year-End

Rating	AAA+ to AA-	A+ to BBB-	Non investment grade	Default	Non rated	Total
Debt securities	71,528	71,882	8,626	146	2,274	154,456
Retail loans	12,191	13,559	11,869	756	8,437	46,811
Loans and advances	102,095	81,472	15,611	699	17,724	217,601
ABS	27,415	3,281	6,491	0	53	37,241
Derivatives	3,357	3,858	564	69	446	8,294
Given guarantees	52,824	26,956	6,423	380	7,733	94,316
Repo	7,762	6,202	369	0	5	14,339
Other assets	97	57	21	6	1,420	1,601
TOTAL	277,270	207,267	49,974	2,056	38,092	574,659

As at 31 December 2009, almost 50% of Dexia's exposure is rated AAA or AA, reflecting Dexia activity on highly rated municipal and government-related credits.

Only 8% of Dexia's exposure is classified as non-investment grade and their bulk is situated for a large part in the BB range. Corporate and retail counterparties represent 50% of these exposures. Unrated exposures are related to exposures under Standardized approach with no rating available (refer to part 3.6.).

The debt securities portfolio continues to be in the investment grade range (93%).

2009 Average Exposure

Rating	AAA+ to AA-	A+ to BBB-	Non investment grade	Default	Non rated	Total
Debt securities	74,543	73,415	7,671	130	5,009	160,768
Retail loans	11,966	13,349	11,858	725	7,813	45,711
Loans and advances	99,633	83,015	14,178	483	23,421	220,730
ABS	32,140	3,045	6,442	0	87	41,714
Derivatives	4,054	4,220	774	108	403	9,558
Given guarantees	62,971	28,039	6,647	271	8,481	106,410
Repo	9,883	6,117	290	0	20	16,309
Other assets	100	59	25	7	1,432	1,623
TOTAL	295,290	211,259	47,885	1,724	46,665	602,823

Note: average exposure is the quarterly average figure.

Total 2009 average exposure is higher than exposure at year-end 2009 due to Dexia current deleveraging efforts.

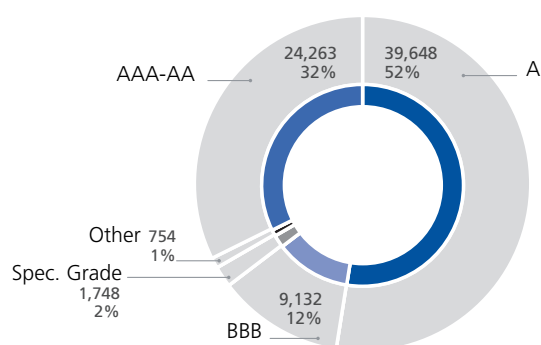
3.2.3. Exposure per Exposure Class and Economic Sector

The following table shows the total exposure with a breakdown by economic sector and exposure class at year-end 2009.

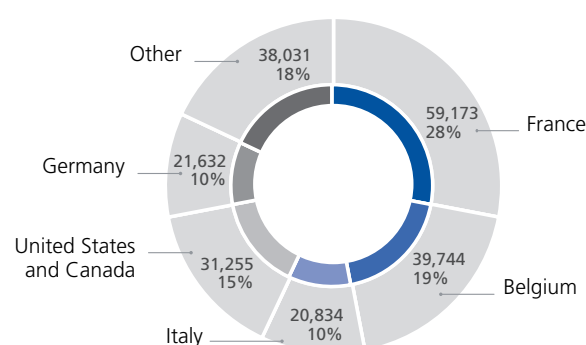
Economic sector	Corporate	Financial institutions	Monolines	Project finance	Public sector entities	Retail	Securitization	Sovereign	Others	Total
Industry	12,336	238	-	4,840	6,870	357	-	5	-	24,647
Construction	4,121	-	-	5,455	308	496	-	-	-	10,380
Trade-Tourism	4,868	-	-	147	309	1,279	-	-	-	6,604
Services										
<i>Transport, storage and communication</i>	9,556	22	-	6,371	5,863	131	-	-	-	21,943
<i>Financial intermediation</i>	3,792	75,518	11,055	-	3,843	178	9,715	9,041	12	113,154
<i>Real estate, renting and business activities</i>	9,016	11	-	382	14,443	1,887	-	-	7	25,747
<i>Public administration, compulsory social security</i>	119	4	-	43	210,669	2	652	55,264	26	266,779
<i>Health and social work</i>	474	-	-	-	15,145	585	-	-	-	16,203
<i>Other community, social and personal service activities</i>	921	-	-	561	5,357	178	-	8	-	7,025
<i>Others</i>	220	-	-	-	1,013	15	-	1,496	-	2,745
Others	2,594	7,096	-	129	1,052	39,621	26,874	1,469	596	79,432
TOTAL	48,017	82,888	11,055	17,928	264,874	44,731	37,241	67,283	642	574,659

Exposure in the coloured cells is further detailed in the following diagrams.

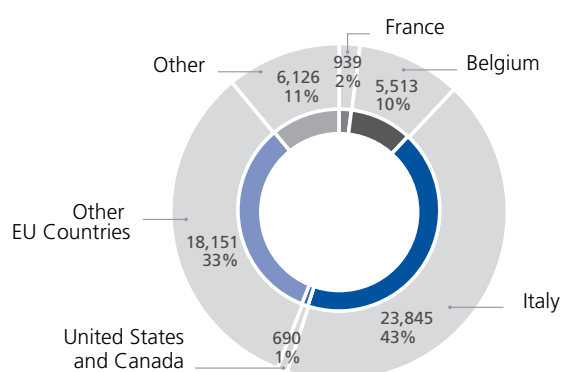
Financial Intermediation: split by Rating Class



PSE: Public Administration, Social Security: split by Country



Sovereign: Public Administration, Social Security: split by Country



The mix of counterparties in Dexia's portfolio is very stable. About half of the exposure is on the public sector (i.e. public sector entities and sovereign exposures). Dexia's exposure is mainly concentrated on public sector entities (46.1%), financial institutions (14.4%) and sovereigns (11.7%).

3.2.4. Exposure by Exposure Class and Residual Maturity

The following table shows the total exposure with a breakdown by exposure class and residual maturity at year-end 2009.

Exposure class	Less than 3 months	3 months to 1 year	1 year to 3 years	3 years to 5 years	More than 5 years	No defined maturity	Total
Corporate	6,324	4,437	6,050	6,464	22,566	2,176	48,017
Equities	0	26	8	1	0	11	46
Financial institutions	14,068	8,201	11,646	14,598	29,452	4,925	82,888
Monolines	2,096	107	2,016	0	6,834	1	11,055
Project finance	1,233	961	1,235	466	13,843	191	17,928
Public sector entities	23,772	11,140	17,789	5,033	204,990	2,150	264,874
Retail	3,471	4,806	2,712	1,880	30,758	1,104	44,731
Securitization	797	240	1,086	33	27,072	8,012	37,240
Sovereign	4,220	4,220	3,062	7,855	44,814	3,111	67,283
Others	57	41	75	91	140	192	596
TOTAL	56,038	34,179	45,679	36,419	380,470	21,874	574,659

Almost 16% of the credit risk exposure will mature in less than one year, 14% of the exposure will mature between one year and five years and 66% beyond five years.

Exposure with residual maturity exceeding five years has significantly decreased from 2008 to 2009.

3.3. Impairment, Past-Due and Related Provisions

3.3.1. Definitions of Past-Due/Impaired and Adjustments/Provisions

Dexia records allowances for impairment losses when there is objective evidence that a financial asset or group of financial assets is impaired, in accordance with IAS 39 § 58-70. The impairments represent the management's best estimates of losses at each balance-sheet date.

An interest-bearing financial asset is impaired if its carrying amount is greater than its estimated recoverable amount.

The amount of the impairment loss for assets carried at amortized cost is calculated as the difference between the asset's carrying amount and the present value of expected future cash flows discounted at the financial instrument's original effective interest rate or current effective interest rate determined under the contract for variable-rate instruments. The recoverable amount of an instrument measured at fair value is the present value of expected future cash flows discounted at the current market rate of interest for a similar financial asset.

Off-balance-sheet exposures such as credit substitutes (e.g.: guarantees and standby letters of credit) and loan commitments are usually converted into on-balance-sheet items when called. However, there may be circumstances such as uncertainty about the counterparty, where the off-balance-sheet exposure should be regarded as impaired. Loan commitments should be classified as impaired if the credit worthiness of the client has deteriorated to an extent that makes repayment of any loan and associated interest payments doubtful.

Allowances for impairment losses are recorded on assets within "Loans and advances due from banks" and "Loans and advances to customers" in the following way:

Specific impairments: the amount of the impairment on specifically identified assets is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, including amounts recoverable from guarantees and collateral, discounted using the effective interest rate at the time of impairment or using the effective interest rate at the reclassification date for reclassified assets. Assets with small balances (including retail loans) that share similar risk characteristics are generally aggregated in this measurement. When an asset is assessed as being impaired, a specific impairment loss will be recognized.

Collective impairments: loss impairments cover incurred losses where there is no specific impairment but objective evidence that losses are present in segments of the portfolio or other lending-related commitments at the balance-sheet date. Dexia distinguishes two types of collective impairments: statistical and sector provisions. These have to a large extent been estimated on the basis of historical patterns of losses in each segment, the credit ratings allocated to the borrowers and reflecting the current economic environment in which the borrowers operate. Dexia develops credit risk models for that purpose using an approach that combines appropriate default probabilities and loss given defaults subject to regular backtesting and based on Basel II data and risk models. Considering the stressed market conditions, Dexia has recalibrated its model to reflect the impact of the financial crisis on the ratings better and the expected losses.

Country risk component (included within specific and collective impairment): when an asset is determined by management as being uncollectable, it is written off against its related impairment; subsequent recoveries are reversed via the statement of income, in the heading "Impairment on loans and provisions for credit commitments". If the amount of the impairment subsequently decreases due to an event occurring after the write-down of the initial impairment, the write-back of the impairment is credited to the "Impairment on loans and provisions for credit commitments".

"Available for sale" (AFS) assets are only subject to specific impairment.

"Available for sale" quoted equities are measured at fair value through "Gains and losses on securities not recognized in the statement of income" or within the statement of income in the case of impairment. Dexia analyzes all equities that have declined by more than 25% compared to the acquisition price or when a risk is identified by management and takes the decision to impair and assess whether there is an objective evidence of impairment according to IAS 39. A significant or prolonged decline in the fair value below its cost is also objective evidence of impairment. Impairments on equity securities cannot be reversed in the statement of income due to later recovery of quoted prices.

Reversal impairment on debt securities is addressed on a case-by-case basis in accordance with the standard.

When AFS financial assets are impaired, the total impairment losses are reported in the statement of income as "Net income on investments".

With regard to past-due items, Dexia uses the IFRS standards definition, i.e. a financial asset is past-due when a counterparty has failed to make a payment when contractually due. This is considered by contract. For instance, if a counterparty fails to pay the required interests at due date, the entire loan is considered as past-due.

The reported figures refer to the regulatory scope as defined in part 2.1.1.

3.3.2. Impaired and Past-Due Exposure by Large Category of Product

The following table shows the amount of impaired and past-due credit risk exposure broken down by large category of product at year-end 2009.

Large type of product	Past-due but not impaired financial assets			Carrying amount of individually impaired financial assets	Collateral received on past due or impaired loans
	< 90 days	> 90 days > 180 days	< 180 days		
Available for sale portfolio ⁽¹⁾	1	0	0	662	0
Loans and advances (at amortized cost) ⁽²⁾	1,069	392	763	4,817	1,667
Held to maturity financial assets	0	0	0	0	0
Other financial instruments - at cost	0	3	3	335	0
TOTAL	1,070	395	766	5,814	1,667

(1) Excluding variable income securities.

(2) Carrying amount of individually impaired financial assets, before deducting any impairment loss, includes an amount of EUR 2,028 million for debt instruments accounted for in the category loans and advances.

Collateral held are mainly composed of mortgages on residential or small commercial real estate and pledges on various other assets (receivables, business goodwill). Past-due outstandings are mainly composed of retail and (mid-)corporate exposure.

The carrying amount of individually impaired financial assets of EUR 4,817 million on Loans & Advances as at 31 December 2009 includes an amount of EUR 1,780 million for Dexia Financial Products portfolio for which no collateral are declared in this disclosure. However, this amount benefits from the guarantee mechanism of the Belgian and French State.

In 2009, impaired loans increased by EUR 1.2 million mainly due to project finance and Turkish exposure. These risks are newly impaired loans (mainly secured) classified as doubtful (not identified as non-performing loans for which recovery is estimated more difficult than for doubtful loans) and most of them are senior and asset backed secured. Impaired loans and advances were at EUR 4,817 million as at 31 December 2009.

Past-due assets are stable between 2008 and 2009.

3.3.3. Past-Due and Impaired Exposure by Geographic Entity

The following table presents the amount of the impaired exposure and past-due exposure, provided separately, broken down by the main geographic entities at year-end 2009.

Geographic entity	Past due	Impaired
Dexia Banque Internationale à Luxembourg	234	480
Dexia Crédit Local	1,058	2,878
Dexia Bank Belgium	567	1,646
DenizBank	372	730
Dexia Bank Nederland		80
TOTAL	2,231	5,814

Note: core markets of Dexia Banque Internationale à Luxembourg, Dexia Crédit Local, Dexia Bank Belgium, DenizBank and Dexia Bank Nederland are respectively Luxembourg, France, Belgium, Turkey and the Netherlands.

3.3.4. Provisions for Impaired Exposure to Credit Risk by Type of Asset

The following table shows the amount of provisions for impaired exposure to credit risk broken down by type of asset at year-end 2009.

Type of Asset	As at 1 Jan. 2009	Utilization	Amounts set aside for estimated probable loan losses	Amounts reversed for estimated probable loan losses	Other adjustments	As at 31 Dec. 2009	Recoveries directly recognized in profit or loss	Charge- offs directly recognized in profit or loss
Specific allowances for individually assessed financial assets	3,178	(254)	1,067	(506)	(107)	3,377	-	-
<i>Loans and advances due from banks</i>	98	0	0	(89)	0	8	0	(6)
<i>Loans and advances to customers</i>	2,082	(85)	1,036	(271)	(105)	2,656	9	(91)
<i>Held-to-maturity investments</i>	0	0	0	0	0	0	-	-
Available-for-sale financial assets	998	(169)	31	(146)	(2)	713	0	-
<i>Of which fixed income instruments</i>	602	(1)	7	(25)	0	582	-	-
<i>Of which equity instruments</i>	396	(167)	24	(120)	(2)	131	-	-
Allowances for incurred but not reported losses on financial assets	1,506	(16)	342	(356)	(16)	1,460	-	-
TOTAL	4,683	(269)	1,409	(862)	(123)	4,838	9	(97)
Provision for off balance sheet credit commitment and guarantees	121	(6)	58	(6)	(15)	152	-	-

In 2009, "Loans and advances due to customers" portfolio impairments were impacted by the related specific impairments (EUR 574 million) of the newly-identified impaired loans.

The other categories are stable between 2008 and 2009 as well as collective provisions.

3.4. Credit Risk Mitigation Techniques

3.4.1. Description of the Main Types of Credit Risk Mitigants (CRM)

The Basel II regulation recognizes three main types of CRM:

- Collateral;
- Guarantees and credit derivatives;
- Netting agreements (applicable to on-balance-sheet and off-balance-sheet netting agreements – refer to part 3.4.2.).

Description of the Main Types of Collateral

Collateral are a financial product or a physical object set to hedge an exposure. Dexia manages a wide range of collateral types. From a regulatory point of view, three main categories of collateral, representing a comparable weight, can be distinguished:

- Pledges on financial assets: cash, blocked accounts, term deposits, insurance contracts, bonds and equity portfolios;
- Pledges on real estate (residential mortgages, commercial mortgages, mortgage mandates);
- Pledges on commercial assets.

Description of the Main Types of Guarantees

Guarantees refer to personal guarantees, first demand guarantees, support commitments and “tri-party conventions”. The credit assessment concentrates on the quality of the underlying loan or asset (refer to part 3.4.4.).

3.4.2. Policies and Processes

Policies and Processes for On and Off-Balance-Sheet Netting

Dexia does not make use of on or off-balance-sheet netting for regulatory purposes, except for over-the-counter (OTC) derivative products.

For these products, internal policies document the eligibility criteria and minimum requirements that netting agreements need to fulfill in order to be recognized for regulatory purposes under Basel II. Eligibility criteria are different for on-balance-sheet netting agreements and off-balance-sheet netting agreements. In particular they impose a formal acceptance from the regulator before considering any netting agreement as eligible. Adequate documentation should also be put in place. Appropriate internal procedures and minimum requirements have been implemented in the internal risk management process.

Policies and Processes for CRM Valuation, Eligibility and Management

Within Dexia Group, managing the CRM involves the following tasks:

- Analysis of the eligibility of all CRM under the Standardized and Advanced approaches;
- Collateral valuation in mark-to-market;
- Description of all CRM characteristics in Dexia Risk Systems, such as:
 - Mortgage: rank, amount and maturity;
 - Financial collateral: valuation frequency and holding period;
 - Guarantee/credit derivative: identification of the guarantor, analysis of the legal mandatory conditions, check whether the credit derivative covers restructuring clauses;
 - Security portfolio: description of each security.
- Periodic review of the descriptive data of its CRM.

Detailed procedures for collateral eligibility, valuation and management are documented in line with the Basel II standards.

At an operational level, different IT tools are used to manage collateral. These IT tools are used to record any relevant data needed precisely to identify collateral characteristics, eligibility criteria and estimated value, in accordance with the Basel II framework.

Information about Market or Credit Risk Concentrations

Concentration risk is related to a concentration of collateral on one issuer, country, industry or market. As a result, credit deterioration might have a significant impact on the overall value of collateral held by Dexia to mitigate its credit exposure.

Dexia monitors concentration risk at regular intervals.

3.4.3. Basel II Treatment

For netting agreements (and subject to eligibility conditions), Dexia recognizes their impact by applying the netting effect of these agreements on the calculation of its Exposure at Default (EAD) used for calculating its weighted risks.

For guarantees and credit derivatives, Dexia recognizes the impact by substituting the PD, LGD and Risk Weight formula of the guarantor to those of the borrower (i.e. the exposure is considered to be directly towards the guarantor) if the Risk Weight of the guarantor is better than the Risk Weight of the borrower.

For collateral (both financial and physical), the Dexia methodology relating to eligible CRM depends on the Basel II approach.

- AIRB Approach exposures – two methodologies might be applied:
 - CRM are incorporated into the calculation of LGD based on internal loss data and calculated by the AIRB Approach models (the “so called” preliminary LGD).
 - CRM are not incorporated into the LGD computed by the model. The impact of each individual CRM is taken into account in the LGD according to each transaction.
- Standardized exposures: eligible CRM (after regulatory haircuts) are directly taken into account in the EAD.

3.4.4. Exposure Covered by Credit Risk Mitigants by Exposure Class

This section provides with an overview on the EAD covered by Basel II eligible CRM (after regulatory haircuts) broken down by exposure class at year-end 2009. The amounts shown in the table below take netting agreements into account and include collateral values for repo transactions.

Exposure class	Financial and physical collateral	Guarantees and credit derivatives	Total
Sovereigns	18,450	1,180	19,630
Financial institutions	61,917	16,350	78,267
Corporates	1,661	8,103	9,764
SME	3,057	936	3,993
TOTAL	85,085	26,569	111,654

The table does not take account of exposure classes with CRM incorporated in the preliminary LGD as Project Finance and Retail exposures.

A very large part of the retail portfolio is covered by physical collateral (mortgage registration for example) or by financial collateral for Lombard loans. The level of the average preliminary LGD is below 15% and includes the impact of CRM.

CRM for the project finance portfolio are predominantly guarantees related to infrastructure and energy projects. The level of the average preliminary LGD is below 20% and includes the impact of CRM.

The "public sector entities" exposures represent a predominant part of the Dexia credit portfolio. A large part of this portfolio is treated in the AIRB Approach method with a very low average LGD and with ratings exceeding A-.

As to the portfolio under Standardized Approach, a large proportion of local authorities (German Länder or Japanese local authorities for instance) benefit from the State guarantee allowing the partial use to be applied.

The main comments on the exposures considered in the table above are:

- CRM for sovereign counterparties are related to funding transactions with Central Banks.
- Financial institutions are mainly composed of banks and insurers. Credit risk mitigants for financial institutions (banks and insurance companies) are mainly related to funding transactions (reverse repo) and guarantees received from banks and monoline insurance companies.
- Exposures to small and medium-sized companies (SME) are mainly covered by financial or physical collateral.

The figures are relatively stable between 2008 and 2009. An increase (EUR +15 billion) is observed for collateral on financial institutions mainly due to repo transactions.

Overview of Collateral by Nature and Credit Quality

Only collateral eligible (including repo transactions) under Basel II and directly held by Dexia is considered:

- Physical collateral (30%): mortgages on residential or small commercial real estate and pledges on various other assets (receivables, business goodwill). This physical collateral mainly covers SME and retail exposures.
- Financial collateral (70%): cash, debt securities, quoted equity and Undertaking for Collective Investment (UCI). The part of the EAD covered by collateral (including repo transactions) is predominantly composed of cash collateral (90%) and the remaining part of debt securities. Debt securities are mainly sovereigns (rated between AAA and AA-) and investment grade banks.

Overview of Guarantees and Credit Derivatives by Provider

The guarantees and credit derivatives are only taken into account when the risk weight of the guarantor is more favourable than the risk weight of the initial counterpart.

The main types of providers of guarantees and credit derivatives according to the covered EAD are main local authorities and sovereigns.

As in 2008, a large proportion of the guarantee providers are rated above investment grade.

3.5. AIRB Approaches

3.5.1. Competent Authority's Acceptance of Approach

By letter sent on 21 December 2007 by the Banking, Finance and Insurance Commission (CBFA), the Belgian Regulator, Dexia SA was authorized to use the Advanced Internal Rating-Based Approach (AIRB Approach) for the calculation and the reporting of its capital requirements for credit risk starting from 1 January 2008.

This acceptance is applicable to all entities and subsidiaries consolidated within the Dexia Group, which are established in a Member State of the European Union and are subject to the Capital Requirement Directive.

This approval has been given by virtue of significant investments both on methodological issues – internal models were largely redesigned in order to make them Basel II compliant – and on IT systems in order to cope with a large number of Basel II requirements in terms of data collection, consolidation and calculation.

Basel II is an ongoing process. Methodological studies will consequently continue in 2010, to meet the remaining regulatory and internal requirements, to enhance the Group's future developments and to optimize existing applications.

3.5.2. Internal Rating Systems

The internal rating systems developed by Dexia are set up to evaluate the three Basel II parameters: Probability of Default (PD), Loss Given Default (LGD) and Credit Conversion Factor (CCF). For each counterparty type in the advanced method, a set of three models, one for each parameter, has been or will be developed as part of the roll-out plan.

The PD models estimate the one-year probability of default. Each model has its own rating scale and each rating on the scale corresponds to a probability of default used for regulatory and reporting purposes. The correspondence between rating and PD for each scale is set during the calibration process, as part of the model development, and is reviewed and adjusted during the yearly backtesting when applicable. The number of ratings on each scale depends on the characteristics of the underlying portfolio (the number of counterparties, their homogeneity, whether it is a low default portfolio or not) and varies between 6 and 17 non-default classes. In addition each scale has been attributed two default classes (named D1 and D2).

LGD models estimate the ultimate loss incurred on a defaulting counterparty before taking the credit risk mitigants into account. The unsecured LGD depends on different factors such as the product type, the level of subordination or the rating of the counterparty. The granularity of the estimate is a function of the quantity and quality of data available.

CCF models estimate the part of off-balance-sheet commitments that would be drawn should a counterparty go into default. The regulation authorizes the use of CCF models only when CCF under the Foundation Approach is not equal to 100% (as it is for credit substitutes for instance). CCF granularity also depends on availability of data.

Internal estimates of Basel II parameters are increasingly used within Dexia in addition to the calculation of the regulatory risk-weighted exposure amounts. They are notably used in the decision-making process, credit risk management and monitoring, internal limit determination, provisioning methodology and pricing.

The control mechanisms for Internal Rating Systems (IRS) are organized in 3 levels:

- Quality Control is defined, in accordance with the regulatory directives, as an internal and independent audit to ensure that the IRS is being used properly, that it is operationally effective and that the audit trail in the rating process remains clear.
- Validation is responsible for the overall assessment of the IRS: according to the CRD minimal requirement 131, Annex VII Part 4, "Internal Audit has to include in its plan, at least once a year, a review of the IRS and its functioning, including credit scoring and estimation of PD, LGD, EL and CCF and propose their validation to the Validation Committee and then consecutively to the Risk Policy Committee." Compliance with all the minimal requirements has also to be verified; this annual verification has been delegated to the Validation department.
- Audit is responsible for auditing the general consistency and compliance with the regulation of the IRS. Audit acts then as an additional level of control, included in its Audit plan.

Refer to appendix 2 for more details regarding Internal Rating Systems.

3.5.3. Average PD, LGD and Risk Weight by Exposure Class and Obligor Grade

The following table shows the total exposure at default, average exposure at default, undrawn commitments, exposure-weighted average PD, LGD and exposure-weighted average risk weights broken down by exposure class and obligor grade at year-end 2009. The Financial Products portfolio is not included in these figures.

Exposure class	Obligor grade	EAD	Average EAD	Average PD	Average LGD	Average RW	Undrawn commitment
Corporate	AAA to AA-	973	1,238	0.03%	39%	22%	182
	A+ to A-	6,890	7,352	0.07%	38%	26%	2,879
	BBB+ to BBB-	12,333	13,785	0.45%	50%	79%	6,128
	Others	10,478	10,473	3.32%	55%	138%	3,290
	Total	30,674	32,849	1.33%	48%	85%	12,479
Financial institutions	AAA to AA-	25,735	29,271	0.04%	25%	8%	1,864
	A+ to A-	36,856	39,845	0.06%	28%	16%	1,658
	BBB+ to BBB-	7,106	7,714	0.30%	27%	29%	260
	Others	5,992	5,598	2.19%	11%	24%	301
	Total	75,690	82,429	0.24%	26%	15%	4,083
Monolines	AAA to AA-	6,997	7,471	0.04%	34%	20%	5,704
	A+ to BBB-	125	154	0.41%	47%	99%	0
	Others	173	272	22.80%	66%	393%	0
	Total	7,295	7,896	0.59%	35%	31%	5,704
Project finance	AAA to AA-	26	34	0.03%	19%	12%	0
	A+ to A-	1,378	1,880	0.06%	13%	12%	157
	BBB+ to BBB-	9,481	8,935	0.40%	16%	31%	1,992
	Others	4,047	3,747	3.15%	19%	59%	876
	Total	14,932	14,597	1.12%	16%	37%	3,025
Public sector entities	AAA	55,627	61,921	0.01%	4%	1%	19,417
	AA+ to AA-	34,842	34,999	0.03%	7%	3%	15,874
	A+ to A-	37,857	38,099	0.08%	5%	4%	3,522
	BBB+ to BBB-	30,376	30,739	0.35%	2%	4%	3,226
	Others	5,231	4,873	1.70%	2%	7%	229
	Total	163,933	170,631	0.15%	4%	3%	42,268
Retail	AAA to AA-	14,295	14,087	0.03%	16%	1%	2,181
	A+ to A-	2,251	2,134	0.08%	18%	4%	382
	BBB+ to BBB-	9,295	9,137	0.34%	16%	8%	1,336
	Others	8,669	8,891	5.87%	17%	29%	1,343
	Total	34,509	34,249	1.58%	16%	10%	5,242
Sovereign	AAA	42,726	47,690	0.00%	9%	0%	2,374
	AA+ to A-	6,319	6,996	0.06%	13%	10%	2
	BBB+ to BBB-	6,104	6,196	0.23%	22%	33%	5
	Others	1,322	995	12.09%	40%	40%	49
	Total	56,471	61,877	0.31%	12%	6%	2,430
Equities	AAA to AA-	338	417	0.09%	90%	96%	-
	A+ to A-	44	127	0.11%	90%	104%	-
	BBB+ to BBB-	298	178	0.19%	90%	137%	-
	Others	42	40	11.89%	87%	426%	-
	Total	721	762	0.82%	90%	133%	-
Default		3,029	2,900	-	-	-	241
TOTAL		387,255	408,189				75,471

Notes:

- The counterparties are the final counterparties, i.e. after taking account of the Basel II eligible guarantee (substitution principle). Monoline exposure is essentially an indirect exposure.

- Average EAD is the quarterly average figure.

A vast majority of average PD levels is situated below 1%; PDs exceeding this level are related to exposures with BBB- and lower ratings.

PD on "Others" rating class is relatively high due in particular to a small proportion of unrated counterparties for which very conservative PD levels are applied.

The bulk of non-investment grade exposures is situated in the BB range.

- Corporates: non-investment grade exposures are concentrated in Belgium (56% – mainly midcorporate loans and facilities) and in other Western European countries (30%).
- Project finance: non-investment grade exposures are concentrated in America (32%), in Western European countries (31%) and in Australia (23%).
- Retail: non-investment grade exposures are mainly related to mortgage loans and to other retail products originated in Belgium. Loans are granted to both private individuals and small companies with low LGD levels.
- Public sector entities: non-investment grade loans are mainly attributed to French local authorities.

- Financial Institutions: non-investment grade counterparties include structured covered bonds with a very low risk profile (low PD and LGD) whereas the rating of the issuer of the bond is the investment grade range.
- Average LGD is very different by exposure class: public sector entities benefit from very low LGD compared to corporate exposure.

More precisely,

- Public sector entities: Project finance and Retail LGDs are not correlated with ratings as LGD is independent from PD for these types of counterparties. Main drivers are the counterparty characteristics, the underlying activity or the product type.
- Equity positions: PD/LGD method is applied with fixed LGD (65% for not quoted equities in a diversified portfolio and 90% for other equity positions) explaining the high LGD level and the non-correlation between PD and LGD. PD for Equity positions is independent from ratings as regulatory floors are applied for ratings in the AAA to A- range. These floors depend on the type of equity exposure (quoted/not quoted in a diversified/non-diversified portfolio).
- Monolines: the referenced assets of monoline exposures are mainly related to Corporates (50%) and Corporate and Project finance (30%) and are included in the investment grade range.

3.5.4. Average PD, LGD and Risk Weight by Type of Retail Product

The following table shows the total exposure at default, average exposure at default, exposure values for undrawn commitments, exposure-weighted average PD, LGD and exposure average risk-weights broken down by retail product and obligor grade at year-end 2009. The Financial Products portfolio is not included in these figures.

Retail product	Obligor grade	EAD	Average EAD	Average PD	Average LGD	Average RW	Undrawn commitment
Retail mortgage loans	AAA to AA-	10,859	10,708	0.03%	10%	1%	0
	A+ to A-	901	871	0.08%	10%	2%	0
	BBB+ to BBB-	4,869	4,756	0.31%	10%	6%	0
	Others	2,790	2,893	6.08%	10%	29%	0
	Total	19,419	19,229	0.97%	10%	6%	0
Revolving retail consumer loans	AAA to AA-	584	153	0.03%	50%	1%	573
	A+ to A-	29	8	0.08%	55%	3%	28
	BBB+ to BBB-	253	84	0.30%	51%	8%	226
	Others	179	93	3.40%	51%	44%	117
	Total	1,046	338	0.67%	51%	10%	944
Other retail products	AAA to AA-	2,851	3,225	0.03%	33%	3%	1,608
	A+ to A-	1,321	1,255	0.08%	23%	5%	354
	BBB+ to BBB-	4,173	4,298	0.38%	20%	11%	1,110
	Others	5,699	5,905	5.85%	19%	29%	1,226
	Total	14,044	14,682	2.50%	23%	16%	4,298
Default	Total	796	760	-	-	-	32
TOTAL		35,305	35,009				5,275

Notes:

- The counterparties are the final counterparties, i.e. after taking account of the Basel II eligible guarantee (substitution principle).

- Average EAD is the quarterly average figure.

Average PD distribution is different according to the type of retail product. A majority of mortgage and revolving loans are concentrated on low PD levels, whereas higher PD are related to "other retail" products.

Average LGD differs according to the type of product: mortgage loans benefit from low LGD whereas LGD are higher for "other retail" and especially revolving loans.

As stated in the table 3.5.3., retail LGDs are not correlated with ratings as LGD is independent from PD for these types of counterparties.

3.5.5. Backtesting

The purpose of the backtest is to assess the performance of the internal rating system ensuring an appropriate balance between capital and risk. As the formulas to calculate the bank's capital are provided by the Basel Committee on Banking Supervision, the internal backtest relating to Pillar 1 rating systems is based on the backtest of the input parameters PD, LGD and EAD in the Basel II credit risk portfolio model.

The backtest is the evaluation of the predictive power of the rating system and the assessment of its time evolution to detect any reduced performance of the rating system early. Decreased performance of the rating system decision tool may reduce the

bank's profitability and will impact the risk assessments of the defined risk buckets. The performance is tracked by analyzing the ability to discriminate between high and low risk and the stability of the data inputs into the rating system.

The backtest procedure is mainly related to backtesting:

Calibration

Calibration normally denotes the mapping of the Probability of Default (PD) to the rating grades. A rating system is well calibrated if the estimated PDs (or LGD) deviate only marginally from the actual default rates (or loss).

Discriminatory Power

The discriminatory power of rating systems denotes their ex-ante ability to identify borrowers in danger of defaulting. A rating system with maximum power would be able precisely to identify in advance all borrowers that subsequently default. In practice, however, such perfect rating systems do not exist. A rating system demonstrates a high discriminatory power if the "good" grades subsequently turn out to contain only a small percentage of defaulters and a large percentage of non-defaulters, with the converse applying to the "poor" grades.

Stability

The stability of the population and its data characteristics: the aim is to make sure that the model applied is in line with the reference data sets the model where key risk parameters are estimated upon or that the population characteristics do not change significantly over time.

The results of the backtesting will be assessed using statistical significance tests. The outcome of the significance tests will drive required action plans.

The additional part of the backtest procedure is related to the impact of judgemental aspects i.e. the importance of judgemental qualitative variables in the final rating and the effect of the expert overrulings.

The backtestings resulted in some limited recalibrations of parameters. Impacts on Dexia "through the cycle" models of the 2008 financial crisis will be integrated in coming years.

3.5.6. Stress Testing

Pillar 1 stress tests are defined within Basel II to deal with minimum capital requirements. They assess how the risk parameter levels (weighted risk levels, expected loss levels and realized loss levels) may vary in the credit portfolio during periods of stress, in order to draw conclusions on individual asset classes and portfolios, as well as on the whole portfolio itself.

The different stress tests impact either full portfolio quality or risk parameters. They are organized as follows:

- Sensitivity stress tests: sensitivity of the weighted risks, EL and losses towards changes in explanatory risk parameters (PD, LGD, CCF).
- Scenario stress tests: impact of unlikely but plausible scenarios on the weighted risks, EL and losses. These scenarios can be historical or expert-based and are checked via benchmarking of the hypotheses when possible.

Sensitivity tests and scenario based stress tests are performed for the main internal rating systems (IRS).

These stress tests are performed on an annual basis on a firm-wide basis. Dexia opted for a level of severity of a "once in 25 years" event. Time horizon of scenario stress tests, set in accordance with the maturity and the liquidity of the positions, is at least 3 years.

Stress test reports are presented initially to the Validation Advisory Committee. After validation of the overall process of the stress test implementation, a report underlying the main portfolio weaknesses and strengths is produced in order to allow proposals for management actions. The final files are submitted to the Risk Executive Committee and the Risk Policy Committee. In terms of Pillar 1 stress tests (individual stress tests on Basel II internal rating models), Dexia covers more than 80% of weighted credit risks.

3.6. Standardized Approaches

3.6.1. Introduction

On the basis of the principles of Basel II, Dexia adopted the Advanced Internal Rating-Based Approach (AIRB Approach) to calculate its capital requirements for credit risk. Nevertheless, Dexia Group applies the Standardized Approach for some portfolios corresponding to cases specifically authorized by regulation such as:

- small business units;
- non-material portfolios;
- portfolios corresponding to activities in run-off or to be sold;
- portfolios for which Dexia has adopted a phased roll-out of the AIRB Approach.

3.6.2. Roll-Out Plan

Within the Basel II homologation process, Dexia informed the regulator of the models to be developed in the coming months on business segments and Basel II parameters.

Models Validated Internally in Use Test Period

The main internal rating models in use test period for the PD and/or the LGD and/or the CCF parameters:

- *Groupements de communes sans fiscalité propre*;
- Public satellites;
- Japanese local authorities;
- Swiss cantons;
- DenizBank Corporate, Small Companies and Retail (PD).

Most parameters described above will be used for regulatory purposes from 2010 onwards.

Models not yet Developed

The main internal rating models for which the PD and/or the LGD and/or the CCF parameters are currently in the phase of estimation:

- Real estate corporates;
- Other non-Belgian satellites;
- Other DenizBank models.

These models will be internally validated in 2010 and will consequently be used for regulatory purposes from 2013 onwards. In the meantime, Dexia maintains the corresponding exposures under the Basel II Standardized Approach.

3.6.3. Nominated External Credit Assessment Institutions (ECAI)

The Standardized Approach provides weighted risk figures based on external ratings. In order to apply the Standardized Approach for risk-weighted exposure, Dexia uses the external ratings assigned by the following rating agencies: Standard & Poor's, Moody's and Fitch.

Dexia also plans to use any other eligible ECAI as approved from time to time by the Banking, Finance and Insurance Commission and as far as Dexia has implemented these ECAI in its Basel II methodology and IT systems.

The rating used for the regulatory capital calculation is the lower of the two ratings, if two ratings are available, or the lower of the best two ratings, if three ratings are available. If no external rating is available, the Standardized Approach provides specific risk weights (usually 100% or 150% depending on the counterparty type).

Credit Rating Agencies and Credit Quality Step under Standardized Approach

Standard and Poor's	Moody's	Fitch	CBFA credit quality step
AAA to AA-	Aaa to Aa3	AAA to AA-	1
A+ to A-	A1 to A3	A+ to A-	2
BBB+ to BBB-	Baa1 to Baa3	BBB+ to BBB-	3
BB+ to BB-	Ba1 to Ba3	BB+ to BB-	4
B+ to B-	B1 to B3	B+ to B-	5
CCC+ and below	Caa and below	CCC+ and below	6

Risk weights are mainly determined in relation to the credit quality step and the exposure class.

3.6.4. Exposure at Default and Average Risk Weights

The following table shows the total exposure at default, undrawn commitments and exposure weighted-average risk weights broken down by exposure class and obligor grade at year-end 2009.

Exposure class	Obligor grade	EAD	Average RW	Undrawn commitment
Corporate	AAA to AA-	37	100%	6
	A+ to A-	221	83%	30
	BBB+ to BBB-	1,143	87%	229
	BB+ to B-	1,144	99%	317
	Below B-	426	124%	138
	No rating available	8,825	95%	3,079
	Total		11,796	95%
Financial institutions	AAA to AA-	527	56%	24
	A+ to A-	5,882	11%	747
	BBB+ to BBB-	3,687	7%	328
	BB+ to B-	313	78%	17
	Below B-	4	101%	0
	No rating available	1,153	83%	325
Total		11,565	20%	1,441
Public sector entities	AAA to AA-	38,881	5%	2,735
	A+ to A-	10,702	42%	1,537
	BBB+ to BBB-	8,739	57%	2,069
	BB+ to B-	2,144	69%	269
	Below B-	121	142%	1
	No rating available	16,761	29%	1,484
Total		77,349	23%	8,096
Sovereign	AAA to AA-	9,340	0%	38
	A+ to A-	808	0%	0
	BBB+ to BBB-	10	34%	0
	BB+ to B-	5,469	100%	0
	Below B-	0	-	0
	No rating available	0	-	0
Total		15,627	35%	38
Project finance	AAA to AA-	16	20%	0
	A+ to A-	516	100%	61
	BBB+ to BBB-	244	100%	63
	BB+ to B-	32	100%	32
	Below B-	0	-	0
	No rating available	105	100%	48
Total		912	99%	204
Retail	No rating available	8,367	60%	2,115
Equities	No rating available	756	138%	0
Others	No rating available	516	95%	71
TOTAL		126,888		15,766

Note: the counterparties are the final counterparties, i.e. after taking account of the Basel II eligible guarantee (substitution principle).

The bulk of the exposure treated under the Standardized Approach is in the public sector entities class (61%) and is rated in the AAA/AA/A range.

About 42% of this total standard exposure will be treated under advanced approaches in the coming years as part of the roll-out plan. Most of it (75%) is classified in public local authorities (mainly public satellites and also Japanese and United Kingdom local authorities, Swiss cantons, other non-Belgian satellites or *Groupements de communes sans fiscalité propre*).

German Länder counterparties, representing 17% of the portfolio, are permanently treated in Standardized approach (0% risk weight).

The Dexia entities calculating their capital requirement under the Standardized Approach focus their activity on corporates, retail and financial institutions. DenizBank¹ (Turkey where ECAI activity is not completely developed) represents the major contributor to the unrated counterparties. The Group's exposure to the sovereign non-investment grade category is mostly concentrated in Turkey through DenizBank exposure.

Regarding equity exposure, the grandfathering clause allows banking institutions to apply the Standardized Approach to calculate the risk weights of the equity portfolio (refer to part 3.8.1.). As of today, about half of the exposures are calculated with the Standardized Approach.

¹ Calculation of DenizBank regulatory capital requirements with AIRB approach is scheduled for the beginning of 2013.

3.7. Counterparty Risk on Derivatives

3.7.1. Management of the Risk

A counterparty risk on derivatives exists in all the Over-The-Counter (OTC) transactions such as interest rate swaps, foreign exchange swaps, inflation or commodity swaps and credit default swaps.

Counterparty risk is measured and monitored according to the general principles described in the Dexia credit risk policies. The credit risk equivalent for derivative transactions is based on the mark-to-market value of the derivatives plus the application of an add-on, which is function of the complexity, the maturity, and the underlying of the derivative.

To reduce the counterparty risk, Dexia OTC derivatives are in most cases concluded within the framework of a master agreement (i.e. the International Swap and Derivative Association – ISDA) taking account of the general rules and procedures set out in the Dexia credit risk policies. Collateral postings for derivative contracts are regulated by the terms and rules stipulated in the Credit Support Annex (CSA) negotiated with the counterparty.

These terms might depend on the credit rating of the counterparties. The impact of potential downgrades are analyzed and managed by the Dexia Group Collateral Management team.

All OTC transactions are monitored within the credit limits, set up for each individual counterparty and are subject to the general delegation rules. Sublimits may be put in place for each type of product.

On non-collateralized swaps (concluded with a very limited number of counterparties, such as local authorities, project SPVs, some corporates, monoline insurers), the counterparty risk is managed through a Credit Value Adjustment (CVA); this hold-back reserve is updated, on a regular basis, based on the evolution of the value of the derivatives and the credit quality of the counterparty.

During the year 2009, major efforts have been made to streamline the valuation process of derivatives from the point of view of appropriate collateral management and subsequently reducing credit risk.

3.7.2. Basel II Treatment

For swap and derivative products, the mark-to-market method is used.

The following table shows the gross EAD, net EAD (after taking the impact of netting agreements and collateral posting into account) and capital requirements broken down by type of derivative product at year-end 2009. The Financial Products portfolio is not included in these figures.

Type of derivatives	Gross EAD	Net EAD	Capital requirement
Credit derivatives	8,066	6,702	274
<i>Trading book</i>	3,716	2,351	70
CDS back to back	2,479	1,876	65
Other CDS	1,237	475	6
Total return swap	455	455	23
Banking book	4,350	4,350	203
CDS bought	0	0	0
CDS sold	4,350	4,350	203
Other derivatives	55,076	13,093	309
Commodities	25	14	1
Equity derivatives	2,400	786	21
Exchange derivatives	6,982	2,081	48
Rate derivatives	45,670	10,212	239
TOTAL	63,142	19,795	582

Note: sold CDS positions in the banking books are taken into account as off-balance-sheet items (sold guarantees) and EAD is calculated as notional value multiplied by credit conversion factor. Bought CDS positions in the banking books are treated as bought guarantees applying the substitution principles.

Credit Derivatives

Credit Default Swaps are used in the context of intermediation and the mitigation of risk concentrations.

Dexia's CDS Back-to-Back strategies consist of selling credit protection to a bank (collateralized via ISDA/CSA agreements) and simultaneously buying protection from a Monoline insurer.

"Other CDS" positions are mostly related to negative basis trade positions.

On credit derivatives, the decrease in EAD between 2009 and 2008 is due to several factors:

- the natural amortization of the CDS portfolio;
- the unwind of Negative Basis Trades (NBT) for a large account;
- the improvement of market conditions – i.e. a tightening in credit spreads – leading to better market values, particularly for non-collateralized CDS with monoliners.

The decrease of capital requirements as compared to year-end 2008 is due to restructuring of deals and limited positive rating migrations.

Other Derivatives

Derivatives are mainly used as hedging instruments for Dexia's banking books. As far as Interest Rate Swaps (IRS), Currency Interest Rate Swaps (CIRS) and Asset Swaps are concerned, both the bond and loan portfolios and the structures sold to customers are hedged in terms of interest and currency risk. Long-term funding issues are also hedged against interest and currency risk and involve the use of IRS and CIRS. ALM, short-term funding and treasury activities also use derivatives for hedging purposes.

3.8. Focus on Equity Exposure

3.8.1. Basel II Treatment and Accounting Rules

3.8.1.1 Basel II Treatment

For the calculation of the capital requirement for equity exposure, Dexia has decided to treat them as follows:

- For exposures booked before 31 December 2007, Dexia applies the grandfathering clause;
- For exposures booked after 1 January 2008, Dexia applies the PD/LGD method.

The grandfathering clause allows banking institutions to apply the Standardized Approach to calculate the risk weights of the equity portfolio held as at 31 December 2007 and this for a maximum period of ten years (CRD 267). Traded securities therefore receive a risk weight of 100% and non-traded securities receive a risk weight of 150%.

3.8.1.2 Accounting Rules

Available-for-sale financial assets are subsequently remeasured at fair value based on quoted bid prices and/or bid prices derived from available market spreads or amounts derived from internal valuation models in the case of inactive markets. Unrealized gains and losses arising from changes in the fair value of financial assets classified as available-for-sale are recognized within equity.

Available-for-sale quoted equities are measured at fair value through "Gains and losses on securities not recognized in the statement of income" or within the statement of income in the case of impairment. Dexia analyzes all equities that have declined by more than 25% compared to the acquisition price or when a risk is identified by Management and takes the decision to assess and impair when there is an objective evidence of impairment according to IAS 39. A significant or prolonged decline in the fair value below its cost is also objective evidence of impairment. Impairments on equity securities cannot be reversed in the statement of income in the case of later recovery of quoted prices.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's-length transaction. Quoted prices on an active market (such as a recognized stock exchange) are used as fair value, as it is the best evidence of the fair value of a financial instrument. Quoted prices are not, however, available for a significant number of financial assets and liabilities held or issued by Dexia. Therefore, for financial instruments where no such quoted prices are available, the fair values have been estimated using the bank's proper valuation model and market assumptions, i.e. present value or other estimation and valuation models or techniques (hereafter called models) based on market conditions existing at balance-sheet date.

3.8.2. Equity Exposure

3.8.2.1. Equity Exposure by Type of Asset and Calculation Process

The following table shows the amount of exposure to equities not included in the trading book broken down by type of asset and by calculation process at year-end 2009.

Type of assets	Accounting value	Fair value	Level 1 ⁽¹⁾	Level 2 ⁽²⁾	Level 3 ⁽³⁾
Financial assets designated at fair value	31	31	0	31	0
Available-for-sale financial assets	1,811	1,811	888	135	789
Non-current assets held for sale	0	0	0	0	0
TOTAL	1,843	1,843	888	166	789

(1) Level 1 = Fair value based on market prices quoted in an active market.

(2) Level 2 = Fair value based on observable market data.

(3) Level 3 = Fair value based on pricing models for which some key market data are unobservable.

The major proportion of equity exposure is Available for Sale assets and is assessed via a quoted market price.

3.8.2.2. Equity Exposure by Type of Market and Basel II Approach

The following tables show the exposure at default in equities not included in the trading book broken down by type of market and by Basel II treatment at year-end 2009. Equity for which Dexia share exceeds 10%, are not included in these figures as they are deducted from own funds for the calculation of the regulatory solvency ratio.

Type of market	EAD	RWA
Private equity	746	1,028
Recognized market	541	588
Unrecognized market	195	238
TOTAL	1,482	1,854

The majority of equity exposures are private equity or equities from a recognized market.

Basel II Treatment	EAD	RWA
Grandfathering	756	896
PD/LGD	726	958
Simple risk weight	-	-
TOTAL	1,482	1,854

In 2009, the balance between equity exposures treated with PD/LGD approach and Grandfathered exposures has been equilibrated.

3.8.3. Gains or Losses

3.8.3.1. Realized Gains or Losses Arising from Sales and Liquidations in 2009

The following table shows the cumulative realized gains or losses arising from sales and liquidations in 2009.

Gains on available-for-sale financial assets	222
Gains on assets and liabilities held for sale	0
Total gains	222
Losses on available-for-sale financial assets	(169)
Losses on assets and liabilities held for sale	0
Total losses	(169)
TOTAL	53

3.8.3.2. Unrealized Gains or Losses Included in Own Funds

The total unrealized gains or losses related to equity instruments amounted to EUR 435 million as at 31 December 2009. This amount is net of tax.

3.9. Focus on Securitization Activities

3.9.1. Objectives and Roles of Dexia

Objectives Pursued

Depending on the role played by Dexia regarding a securitization transaction, the objectives pursued can vary from reduction of the economic capital requirement, to improvement of the risk-return ratio, to funding or more sophisticated portfolio management.

During 2009 and previous years, Dexia entities were able to pledge eligible asset-backed securities as collateral for repurchase agreements with major central banks, which allows banks temporarily to swap high quality asset backed securities for cash, among other things. This process has contributed to the sources of funding of Dexia during 2009 taking into consideration constraints still existing in the interbank market and the relative lack of investor base for securitizations.

Roles

Dexia as Originator

Dexia, as originator, carries out securitization transactions related to various asset classes: commercial mortgage loans, residential mortgage loans, and other types of financial assets. These securitizations may take the form of sale of the related asset or

transfer of credit risk through the use of credit derivatives with special purpose vehicles. These transactions are carried out with a view to diminishing risk concentration, lowering economic capital held, fundraising or seizing an arbitrage opportunity.

Dexia as Investor

Dexia invests in securitization transactions backed by various asset classes originated by various SPE/third parties or structured for its own balance sheet. Dexia may also resecuritize part of its exposure to securitized assets it has purchased.

Dexia as Servicer

In transactions where Dexia is the originator, Dexia often continues to service the assets being securitized, but depending upon the transaction this role may be outsourced to other specialized parties.

Dexia as Arranger of Securitization Transactions for Customers

Dexia acts as arranger of securitization transactions for customers. In these instances, Dexia will structure the securitization transaction, place the corresponding notes with investors and may act as swap counterparty or liquidity provider at arm's length market rates. Dexia receives market-rate fees for structuring and placing the notes. Dexia may act as an investor or market maker and may hold limited positions in this capacity.

Dexia in Another Role

Depending upon the specific details of a transaction, Dexia may undertake various roles in securitization transactions ranging from cash collateral bank to swap provider or liquidity facility provider. Dexia may also act as calculation agent, paying agent, corporate service provider and underwriter. Nevertheless, Dexia is not acting as a sponsor when providing liquidity facilities potentially in Dexia securitization transactions or third parties as it is not in the framework of conduits or other programmes such as ABCP.

Involvement of Dexia in each Securitization Transaction

Depending upon the role Dexia plays in the securitization transactions, the involvement can vary. When Dexia acts solely as an investor, the extent of the involvement in the transaction is limited. However when Dexia is acting as an originator or where several roles are played by Dexia, the extent of this involvement can become significantly more important.

3.9.2. Management of the Risk

3.9.2.1. Originations

Where securitizations are put in place for Dexia's own balance sheet, a strong framework of guidelines and policies ensures compliance with various requirements (refer to part 6.9 – Securitization Risk). These policies aim not only at identifying the regulatory requirements/procedures for new transactions, but also at defining the decision tree and actions for deal follow-up (investments in Dexia transactions, redemptions of transactions etc). Overall supervision of the correct implementation of these policies is in the hands of a dedicated Risk Management team within Dexia, with a global coverage of all entities in the Group. In relation to securitization activities, Risk Management is also responsible for maintaining contacts with relevant banking regulators. In addition to specific point-in-time analysis of files submitted, there is regular follow-up of all projects.

In practice, the steering of the set-up for securitization transactions is performed by the Market Solutions department with the support of the dedicated organization/project management departments. As such, both prior and after the closing of a transaction, transversal taskforces are set up including all relevant departments, such as accounting, balance sheet management, credit risk, market risk, back-office, transaction processing, etc. For instance, for the exposures that have been resecuritized, processes are in place to monitor changes in the credit and market risk of these securitization exposures.

Post closing, the transaction follow-up concerns the efficiency and effectiveness of the servicing (where retained by a Dexia entity), the appropriate monitoring of the transaction from a credit, market and liquidity risk perspective as well as the reliability of the reportings being produced.

3.9.2.2. Investments

Generally speaking the risk policies and procedures for investment activities related to Asset Backed Securities (ABS) and Collateralized Debt Obligations (CDO) are to a large extent based on the existing framework for granting credit and making investments, but additionally take into account specific risks and features related to these products.

In practice, prior to purchase, each investment proposal is analyzed by the Central Risk Analysis Center (CRAC) ABS and decided upon by a credit committee. Once the investment is booked and during the course of its life, both the structure and the underlying risk are assessed through a system of internal ratings (IRBA approach), and constantly monitored by the same Central Risk Analysis Center (CRAC) ABS through annual reviews, sector reviews, Early Warning indicators, daily monitoring

of rating changes, and if necessary by means of a watch list for those investments showing a deteriorating risk profile. On a quarterly basis, a portfolio report is produced on the status of the ABS/CDO portfolio and distributed to management.

3.9.3. Basel II Treatment and Accounting Rules

3.9.3.1. Basel II Treatment

In the Advanced Approach, Dexia applies the Rating-Based Approach (RBA) in order to calculate the weighted risks corresponding to its securitization exposures. This method determines the Risk Weight percentage applicable as a function of the external rating of the securitization exposure (or the inferred rating if no external rating is available), their seniority and the granularity of the underlying pool of exposure. When no external or inferred rating is available, the amount of the securitization position is deducted from capital.

Dexia has not yet implemented the Supervisory Formula Method (SFM). This method allows the calculation of weighted risks for unrated exposure based on the securitized pool composition and underlying Risk Weight according to the AIRB Approach. For both securitization originations and calculating weighted risks in relation to its investments in securitization positions, Dexia uses the services of the following rating agencies: Standard & Poor's, Moody's and Fitch. Dexia is also studying the possibility of using external ratings assigned by other rating agencies.

3.9.3.2. Accounting Rules

The recognition and derecognition of financial assets and liabilities relating to securitization transactions, their valuation and accounting treatment are pursuant to IAS 39 relating to Financial Instrument Recognition and Measurement

For consolidation purposes, a Securitization Special Purpose Entity (SPE) is consolidated, in accordance with IAS 27 and SIC 12 relating to consolidation, at Dexia's level if the majority of the benefits of the SPE are retained, or the majority of the residual or ownership risks related to the SPE or its assets are retained.

3.9.4. Securitization Activity as Originator

Only two operations have been performed including some risk transfer and regulatory capital relief so far (WISE 2006-1 and Dublin Oak).

The other originations except the DRECM ones, were carried out with a view of long term funding. The risk was not therefore transferred out of the Group. DRECM securitization transactions were made following a standardized and recurrent format (all loans are sold, no securitization position is retained, no credit risk is retained) with no risk transfer and regulatory capital relief.

Consequently, the major part of the exposure provided in the following table is intragroup exposure.

The following table shows the securitization activity (Dexia as originator): amount of exposure securitized, and gains and losses on sales during the period, the amount of underlying assets (amount of defaulted assets disclosed separately) originated by Dexia by nature of securitization and type of underlying assets.

Refer to appendix 3 for more details regarding Dexia originations.

	Payment rights	Residential mortgage loans	Commercial mortgage loans	Public sector	Corporate exposures	ABS	Other	Total
Traditional securitizations								
Underlying assets ⁽¹⁾	302	10,394	-	12,755	155	-	255	23,861
Defaulted assets ⁽²⁾	-	11	-	-	-	-	-	11
Exposure securitized in 2009 ⁽³⁾	-	-	-	5,818	-	-	255	6,073
Gains & losses on sales in 200 ⁽⁴⁾	-	-	-	-	-	-	-	0
Synthetic securitizations								
Underlying assets ⁽¹⁾	-	-	-	-	1,308	1,766	300	3,374
Defaulted assets ⁽²⁾	-	-	-	-	-	-	-	0
Exposure securitized in 2009 ⁽³⁾	-	-	-	-	-	-	-	0
Dexia as originator/ contributor								
Underlying assets ⁽¹⁾			5,666					5,666
Defaulted assets ⁽²⁾			561					561
Exposure securitized in 2009 ⁽³⁾			-					0
	DenizBank	Penates MBS4	DRECM	DSFB DCC Tevere s1	Atrium 1, 2 Wise	Dublin Oak	Tevere s2 Wise	

(1) Outstanding amount at the end of the year of reference obligations in the pool securitized.

(2) Amount of defaulted assets (as of the date of default) using the definitions used in the securitization transaction.

(3) Gross amount of exposure.

(4) Applicable only to cash transactions where assets are sold to a vehicle and the sale is done at market value.

Dexia has not yet securitized any revolving exposure. The main changes impacting 2009 in comparison to 2008 relate to:

- Closing of the DSFB-4 transaction and issuance of Tevere Finance securitizations;
- Early redemption of the DSFB-3 transaction;
- Amortization in the underlying portfolios of assets securitized;
- Performance of the assets in the transactions securitized (resulting in the amount of defaulted assets).

3.9.5. Securitization Activity as Investor

3.9.5.1. Dexia Portfolios

The following table shows the outstanding amount of securitization positions retained or purchased broken down by type of securitization and risk-weight class at year-end 2009.

The Financial Products portfolio (which primarily comprises the guaranteed investment contract business and Global Funding portfolio) is not included in the figures and is presented separately in a table below.

Type of securitization	[0-8%]	[8%-16%]	[16%-106%]	[106%-1,250%]	1,250%	Total
ABS	7,960	562	175	67	24	8,787
CDO	1,187	1,217	9	26	66	2,505
Consumer asset securitization	897	0	0	0	0	897
MBS	11,596	1,693	496	31	42	13,857
Other ABS	0	0	0	1	26	28
TOTAL	21,639	3,472	680	125	158	26,074

Dexia invested almost exclusively in originally AAA externally rated transactions explaining the current low weighted risks associated to this portfolio. The bulk of the portfolio is concentrated on European Residential MBS (EUR 11.1 billion), US government guaranteed student loans (EUR 6.8 billion – ABS) and CDOs supported by corporate or SME loans (EUR 2.5 billion). Dexia is little exposed in its banking portfolio to US RMBS (EUR 0.05 billion qualified as Subprime or Alt-A).

No new investments were made (purchased) in 2009. Issues retained during the period are detailed in appendix 3 (DSFB 4 and Tevere Finance).

The following table presents the exposures related to each bucket of weighted risks for both Global Funding and the excluded assets of the Financial Products Portfolio (e.g. the assets not covered by the State guarantee and for which Dexia is supporting the entire risk).

Type of securitization	[0-8%]	[8%-16%]	[16%-106%]	[106%-1,250%]	1,250%	Total
ABS	-	-	738	-	-	738
CDO	-	-	-	-	-	0
Consumer asset securitization	-	-	-	-	-	0
MBS	239	341	674	8	0	1,262
TOTAL	239	341	1,412	8	0	2,000

The ABS Category mainly relates to Cypress Point Notes wrapped by FSA and related to underlying assets like Perps and Zero Coupon.

The MBS Category relates to:

- MBS benefiting from the guarantee of US Federal Agencies like Freddy Mac and Fannie Mae;
- US RMBS (Alt-A and Subprime) which still have a good rating (in the AAA or AA range) except one small position rated BB by Fitch (but AA+ by S&P and with no expected loss considering Dexia projections).

The rating of these exposures has been globally stable in 2009 especially in the last 6 months for the excluded assets following the State guarantee put in place on the Financial Products portfolio in July 2009.

3.9.5.2. Investor Activity in 2009

The following table shows the amount of securitization positions retained or purchased in 2009 broken down by type of securitization. Note that the Financial Products portfolio of FSA (which primarily comprises the guaranteed investment contract business and the Global Funding portfolio) is not included in the figures.

Type of securitization	[0-8%]	[8%-16%]	[16%-106%]	[106%-1,250%]	1,250%	Total
ABS	-	3,022	-	-	-	3,022
CDO	-	-	-	-	-	0
Consumer asset securitization	-	-	-	-	-	0
MBS	-	-	-	-	0	0
TOTAL	0	3,022	0	0	0	3,022

No new investments were made (purchased) in 2009. Two issues were retained: DSFB 1 and DSFB 2 for EUR 3 billion (Public Sector ABS).

3.9.5.3. Gains or Losses on Sales

The table below shows the recognized gains or losses by type of exposure in 2009 arising from sales of securitization positions. The total losses arising from securitization sales for the year 2009 amounted to EUR 60 million before reversal of collective provision.

Payment rights	Residential mortgage loans	Commercial mortgage loans	Public sector	Corporate exposures	ABS	ABS
-	(51)	-	-	-	(8)	(59)

4. Market and Balance Sheet Management Risks

4.1. Market Risk

4.1.1. Market Risk Definition

Market risk comprises the Group's exposure to adverse movements in markets prices as a result of interest rate risk, equity price risk, foreign exchange risk and other risks (inflation and CO₂ risks).

Interest rate risk is composed of general interest rate risk capturing value changes due to general market movements, while specific interest rate risk (credit spread) captures individual issuer-related causes. This risk results from spread movements within a ratings class.

Equity price risk is the risk arising from the potential reduction in value of equity, whereas foreign exchange risk represents the potential decrease of the value due to currency exchange rate movements.

Other market risks reflect a potential decrease in value due to changes in organized or OTC markets not taken into account in previous definitions, such as inflation, carbon (CO₂) and commodity risks.

4.1.2. Market Risk Governance

The Financial Markets Risk Management (FMRM) teams act as expertise centres covering all Treasury and Financial Markets activities on a Group-wide basis.

FMRM is an integrated support line within the Group organization in charge of the identification, analysis, monitoring and reporting of risks and results (including valuation) with a holistic view of risk management.

A set of policies, guidelines and procedures document and govern all activities in detail and FMRM oversees their effective application. Risk Management is also in charge of defining the statement of income and Risk Measurement methods and of assuring a consolidated measurement, reporting and follow-up of Risk and statement of income figures at Dexia Group level. Local FMRM are situated at the level of the operational entities and are in charge of the day-to-day activity i.e. local risk assessment, local risk monitoring (computation of the risk indicators, control of the limits and triggers and so on), local reporting, reconciliation with local strategic planning and accounting and reconciliation with local information systems. Each operational entity is also responsible for the monitoring and reporting to local supervisory and regulatory bodies.

Committees

The Market Risk and Guidelines Committee (MRGC) meets on a monthly basis and is responsible for a wide range of topics such as: risk and statement of income trigger reporting analysis and related decisions, limit definition and review, new product approval proposals, guideline discussions, risk governance and standards as well as risk concepts and measurement methodology.

Ad-hoc MRGC are organized to decide on specific issues when required from a business and/or a risk management perspective.

In addition to the monthly MRGC, a dedicated quarterly MRGC is organized to discuss risk and business reports for the Treasury and Financial Markets line.

Dexia Market Risk Committee (DMRC) meets bimonthly and acts as supervisory committee of the MRGC.

The Risk Policy Committee and Risk Management Executive Committee validate all major changes in the risk profile or risk governance.

4.1.3. Market Risk Management

The Dexia Group adopted the VaR (Value at Risk) measurement methodology as one of the leading risk indicators. The VaR is a measure of the potential loss that can be experienced with a 99% confidence level and for a holding period of 10 days. Dexia applies multiple VaR approaches based on their ability to measure market risk accurately in different market activities and portfolios.

- General interest rate and forex risks are measured through a parametric VaR approach.
- Specific interest rate risk, equity risk and other risks (inflation and CO₂) in trading books are moreover measured by means of a historical VaR approach.
- Non-linear and particular risks are measured through specific and historical VaR methodologies with a view to a more appropriate measurement of the sensitivity to market volatilities.

Dexia exposure to market risk as measured in Value at Risk (VaR) terms stems mainly from general interest rate risk and specific interest rate (spread) risk reflecting today's volatility in credit markets, while its market exposure arising from trading positions in equity, exchange and other risk factors remains much lower.

Dexia applies the internal VaR model for the regulatory capital requirement calculus on foreign exchange risk and general interest rate risk within the trading scope.

The VaR methodologies are improved on an ongoing basis. No backtesting exceptions for interest rate and forex risks, for equity risk and for credit spread risk were observed during 2009, clearly demonstrating that the backtesting results by major risk factor remain appropriate (refer to part 4.1.3.2.).

As a complement to VaR risk measures and statement of income triggers, Dexia applies a wide range of other risk measures in order to assess the risks related to the different activities and portfolios (nominal limits, maturity and authorized market limits, sensitivity limits and Greeks and scenario analysis).

Stress-testing is becoming increasingly important for sound risk management as it explores a range of low-probability events outside the predictive capacity of VaR measurement techniques. As such, VaR measures assess market risk in a daily market environment, whereas stress-testing measures market risk in an abnormal market environment (refer to part 4.1.3.1.).

In this context, the range of scenario assumptions was constantly revised and updated during the financial year 2009.

Outside the trading activities, Dexia supports a bond portfolio on its banking books. This portfolio is not subject to 99% 10-day VaR limits, given its different investment horizon. Its volume and sensitivity is however measured. Following the Dexia transformation plan, this portfolio is in run-off.

Basel II Treatment

Dexia applies the internal VaR model for the regulatory capital requirement calculus on foreign exchange risk and general interest rate risk within the trading scope.

The other market risks are treated under the Basel II standardized approach.

4.1.3.1. Market Risk Measures

The main characteristics of the VaR calculation models used for each subportfolio are the following:

- **General interest rate and Forex risk:** the parametric methodology is implemented for the computation of VaR on general interest rate risks (excluding vega risk) and Forex (FX) risk (excluding FX derivative books). This methodology consists of computing variances and correlations for all risk factors and the entire framework is broadly based on the RiskMetrics methodology. The main assumption is that returns of those risk factors follow a normal distribution. Dexia calculates delta VaR and also uses delta gamma parametrical VaR for assets where the convexity is significant and must be taken into consideration. This VaR parametric is completed by a historical full valuation VaR to measure the FX derivatives and IR volatility risks.
- **Equity risk:** the general and specific equity risk is measured through the historical VaR with full valuation based on the use of 250 scenarios.
- **Credit spread risk:** the specific interest rate risk (spread risk) is measured through the historical VaR using sensitivities. On every position, 250 historical scenarios are applied: observed spread variations of the exposure itself, observed spread variations of bonds of the same issuer or observed spread variations of bonds with similar characteristics.
- **Other risks:** the commodities and inflation VaR are calculated via an historical approach with either full valuation (carbon) or based on sensitivities (inflation).

Dexia aims on a continuous basis to improve its VaR methodology:

- Implementation of VaR vega in full valuation (instead of a sensitivity based historical VaR);
- Introduction of cross gammas for parametrical VaR calculation;
- Non-overlapping 10-day historical VaR;
- Introduction of decay factor in order to improve the reactivity of our parametric VaR and in order to reduce backtesting exceptions.

These evolutions respond to recommendations both from the Dexia validation department and from its regulators and also deal with the increased volatility caused by the financial crisis.

4.1.3.2. Market Risk Exposure

The detailed VaR use of Treasury and Financial Markets (TFM) – bond portfolio in banking book not included – is disclosed in the table below. Average global Value at Risk amounted to EUR 78.4 million in 2009 (as compared to EUR 126.6 million in 2008). Substantial limit reductions have been implemented, in line with the risk appetite reduction as included in the overall Dexia transformation plan. The global TFM limit has been reduced from EUR 178 million in the third quarter of 2008 to EUR 130 million in the fourth quarter of 2008 and to EUR 100 million since the first quarter of 2009.

		2008															
		Interest rate and foreign exchange - trading and banking ⁽¹⁾				Equity - Trading				Spread - Trading				Other risks			
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
By risk factor	Average	30.0	43.6	38.4	62.7	6.5	7.7	7.5	7.7	60.0	79.4	78.0	75.9	1.8	1.3	2.4	3.7
	Max	37.1	52.1	48.0	90.6	14.4	12.2	11.3	11.9	78.4	91.1	116.0	112.7	3.5	2.4	3.0	5.9
Global	Average															126.6	
	Maximum															179.1	
	End period															127.5	
	Limit															3Q: 178 4Q: 130	

(1) IR & FX: without BSM.

		2009															
		Interest rate and Foreign exchange - trading and banking ⁽¹⁾				Equity - Trading				Spread - Trading				Other risks			
		1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
By risk factor	Average	58.9	24.0	17.2	20.3	6.3	5.6	4.2	2.4	43.4	43.4	42.0	28.6	4.9	4.4	4.6	4.4
	Max	86.5	32.3	23.1	26.3	7.6	9.7	8.6	4.5	59.2	51.2	47.3	37.7	7.8	5.3	5.1	4.7
Global	Average															78.4	
	Maximum ⁽²⁾															137.8	
	End period															45.7	
	Limit															1Q: 130 2Q, 3Q & 4Q: 100	

(1) IR & FX: without BSM.

(2) Temporary limit overdraft in January due to high volatility in BMA spread on TOB.

Bond Portfolio

Dexia manages bond portfolios in its banking book, largely in run-off, amounting to EUR 165.5 billion² as at 31 December 2009 (as compared to EUR 181.2 billion as at 31 December 2008).

The interest rate risk of these credit spread portfolios is very limited, as interest rate risk is hedged.

As at 31 December 2009 the sensitivity in fair value after a basis point credit spread increase amounted to EUR -115.7 million for the (banking) bond portfolio (against EUR -129.7 million/basis point as at 31 December 2008).

Given the illiquidity of markets and the reduced possibility of having “observable” prices/spreads in the valuation process, a mark-to-model valuation development was performed on the illiquid part of the available-for-sale bond perimeter as from year-end 2008.

The credit spreads provided by the model are based on the credit component plus a liquidity premium. Methodological and operational improvements were made during 2009 on the advanced mark-to-model for the illiquid available-for-sale perimeter. The advanced mark-to-model has also been applied on the reclassified loans and receivables bond perimeter as at 31 December 2009 for IFRS disclosures.

4.1.3.3. Stress-Testing

The scenario framework (stress-testing) is of particular importance at Dexia and has gained further importance since the 2008 financial crisis. The range of possible scenarios has been constantly revised and updated. Stress tests are intended to explore a range of low probability events that lie outside the predictive capacity of VaR measurement techniques. VaR measures market risk in a daily market environment, while stress-testing measures market risk in an abnormal market environment.

The numerous stress tests carried out by Dexia can be grouped in three categories:

² Excluding bond portfolios managed by BSM department. These portfolios are detailed in part 4.2. – Balance Sheet Management Risk.

- sensitivity stress tests (on interest rate rates, foreign exchange risks, volatilities and on credit spreads);
- historical stress tests on a wide range of risk factors (equity crash of 1987, monetary crisis of 1992, terrorist attack of 2001 and the last one capturing the turmoil triggered by the Lehman default and called “2008 financial crisis scenario”);
- specific stress tests (which are oriented towards the risks specific to certain activity lines of TFM, e.g. the specific stress test on emerging currencies on exchange rates and volatilities).

A global overview of the stress test framework at Dexia is presented in the table below:

Type	Stress test description
Sensitivity stress tests	Spreads (increase/decrease of the spreads in relative)
	Interest rate (parallel shifts, flattening, steepening of the curve)
	Equity (relative move)
	Volatility (increase/decrease of volatility in relative)
	Forex (relative shift of EUR against all currencies)
Historical stress scenarios	Equity crash 1987 (impacting interest rates, equity prices, volatilities and spreads)
	Monetary crisis 1992 (impacting interest rates and FX risks)
	Terrorist attack 2001 (impacting interest rates, equity prices, volatility, forex and credit spreads)
	Financial crisis 2008' (historical stress test on interest rates, FX, equity, inflation commodities and credit spreads) – to be implemented from 4Q 2009
Specific stress tests	Stock Market Crash (specific stress tests on exchange rates and volatility)
	Emerging Market Crisis (specific stress test on emerging currencies on exchange rates and volatilities)
	Asian Crisis 1997 (specific Asian currency stress on exchange rates and volatilities)
	East European crisis (specific Eastern European currency stress on exchange rates and volatilities)
	Nordic European crisis (specific Nordic currency stress on exchange rates and volatilities)
	Financial crisis 2008 (stress test on credit spreads)
Specific stress tests for ALM	Stress tests on spreads – applying 50% of the last 12 month spread evolution by asset class to existing portfolio
	Stress tests on value and income on interest rates (applied to banking books)
	Stress tests outlier on sensitivities at 200 bp which are compared with 20% of the regulatory capital

The stress tests containing banking and trading books are presented at least on a quarterly basis to the Market Risk Guidelines Committee.

4.1.3.4. Regulatory Internal Model and Backtesting

The Dexia Group uses its internal VaR model for the regulatory capital requirement calculation on foreign exchange risk and general interest rate risk within the trading scope (refer to part 2.2. for figures on market risk capital requirements).

On the risks for which capital requirements are calculated according to the standardized approach (spread, equity) a backtesting is nevertheless performed daily on the trading scope.

The result of the backtest is the number of losses exceeding their corresponding VaR figures (i.e. “the number of exceptions”). According to this number, the regulators will decide on the multiplier used for determining the regulatory capital base applied on the internal model scope.

For backtesting purposes, the VaR amounts need to be recalculated using a 1-day holding period. For VaR figures calculated under a parametric approach, rescaling is achieved through the application of a square root of 10 conversion. For any other VaR approach, a 1-day VaR figure is calculated.

Risk reports are based on end-of-day positions meaning that risk figures refer to the maximum loss at the chosen confidence interval over the holding period for the portfolio that is held at the end of the business day. With a 1-day holding period, this figure is compared with the variation of the statement of income of the following business day.

Intraday trading tends to increase the volatility of trading results and consequently might result in rejecting a theoretically sound model although this volatility falls outside the purpose of VaR measurement. For this reason, Dexia considers hypothetical backtesting as the main indicator. The hypothetical statement of income is calculated under the assumption that the portfolio breakdown remains stable and is only impacted by the change of the corresponding risk factors.

Hypothetical backtesting runs under the following scenarios: change in all market data, change in interest rate alone, change in exchange rate alone, change in equity price, or change in credit spread.

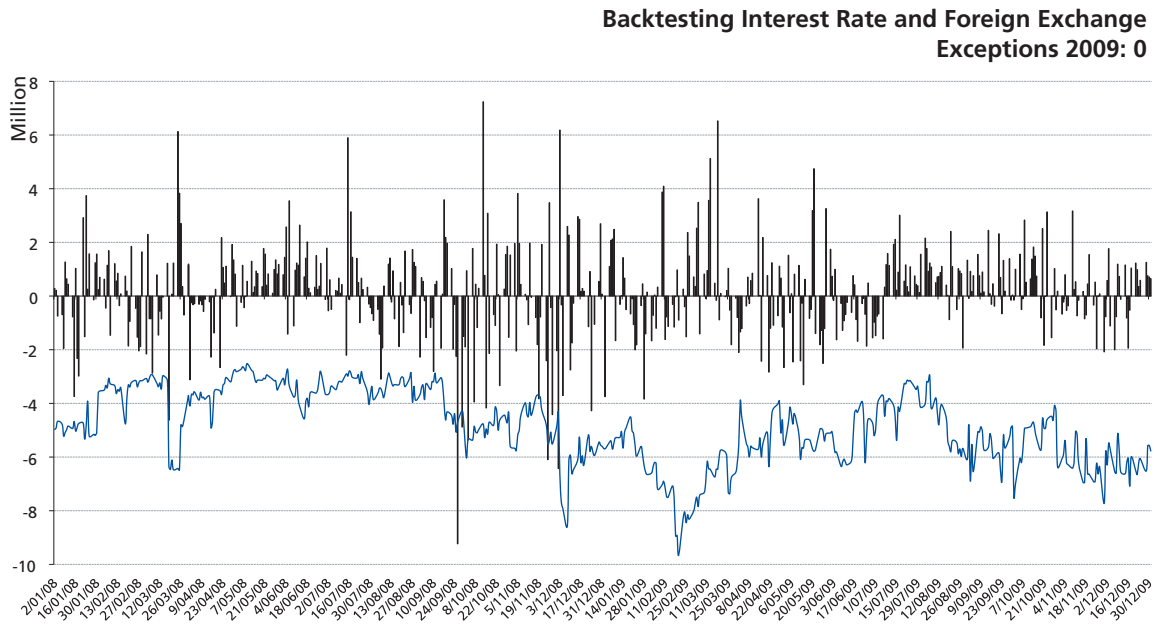
The backtesting process provides the Market Risk Management department with a view of the number of exceptions. This number is taken to adjust the multiplier used for calculating the bank's risk capital requirements for market risk under the internal model approved by the regulator. The multiplier has a minimum value of 4 but in the event that backtesting proves the risk measurement models to be inappropriate or some recommendations on uniform application of the methodology are outstanding, the multiplier can be increased up to 5.

In 2009, Dexia noticed on internal models:

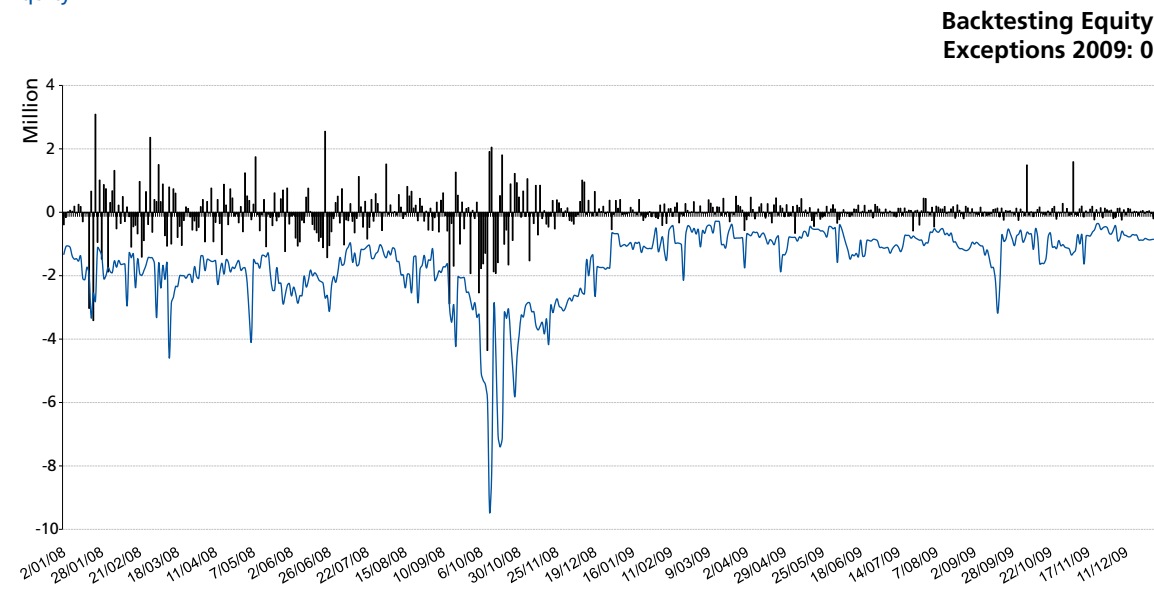
- no “downward” exception on its IR and FX perimeter (as compared with 6 exceptions in 2008);
- no “downward” exception on its equity perimeters (as compared with 4 exceptions in 2008);
- no “downward” exception on its spread perimeter (as compared with 5 exceptions in 2008).

The following charts are showing backtesting in 2009 and 2008 on each perimeter:

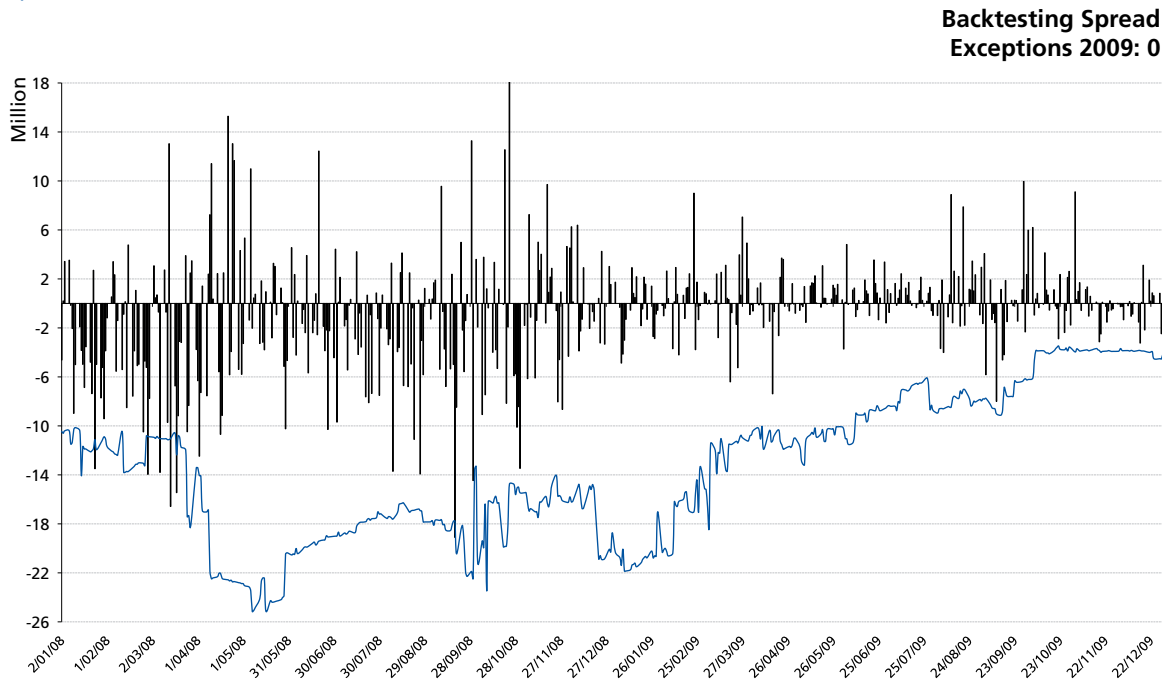
Interest Rate and Foreign Exchange



Equity



Spread



4.1.3.5. Validation

Validation is responsible for the overall assessment of the market risk models. The process set up to endorse the validation of models deployed within Dexia Group is multi-layered, ensuring total compliance with regulations and local regulatory requirements through the work-out of proposals by the Validation Department, an approval of these proposals by the Markets VAC and a final endorsement by the Risk Policy Committee, composed of members of the Dexia Management Board.

4.2. Balance Sheet Management Risk

4.2.1. BSM Risk Definition

Balance Sheet Management (BSM) risks include both structural market risk (structural interest rate risk, specific interest rate risk – credit spread –, foreign exchange risk, equity risk generated off and on-balance sheet by the commercial business lines) and liquidity risk.

We refer to the part on market risk (4.1.) for detailed definitions of structural and specific interest rate risk, foreign exchange risk and equity risk.

The liquidity risk is defined as the probability of the bank being unable to cover its expected and unexpected current and future liquidity requirements.

4.2.2. BSM Risk Governance

The Management Board of Dexia decided, as part of the Dexia transformation plan:

- to extract ALM out of Treasury and Financial Market activities and to place it under the responsibility of the Finance Department, combined with an adequate risk monitoring thereof performed by Risk Management;
- to restructure and reorganize ALM – renamed BSM – in order inter alia to reflect its unique mission as hedging centre for Dexia's commercial activities, without any proprietary P&L objective.

Committees

Overall BSM risks are managed by the Dexia Group Assets & Liabilities Committee (Group ALCo) meeting on a monthly basis. The Group ALCo decides on limits, ensures the consistency of the global BSM risk framework and strategy, decides on hedges to be implemented (or global investment/divestments to be made in the insurance activities) and validates internal transfer pricing mechanisms at Group level. Local ALCo committees are in place at entity level managing local specific risks within the framework and under the guidance of the Group ALCo.

The Funding and Liquidity Committee (FLC), under the delegation of Group ALCo, centralizes and coordinates the decision process on liquidity-related issues. The FLC is responsible for monitoring the evolution of short-term and long-term funding needs, elaborating the global funding strategy of Dexia, reviewing and updating liquidity-related stresses to be considered, putting contingency plans in place, proposing corrective actions to improve the liquidity situation, coordinating global liquidity reporting to the Boards, rating agencies, regulators, central banks, and governments. The FLC meets on a weekly and monthly (extended) basis.

4.2.3. BSM Risk Management

4.2.3.1. BSM Risk Measures

Interest Rate

BSM aims to minimize statement of income volatility, thus ensuring an immunization of the commercial margin generated by the business lines and to preserve the overall value creation of the Group.

Measurement of balance-sheet risks is harmonized among the Group's various entities. A calculation of the sensitivity of the net present value of the BSM positions is currently used as the main indicator. In 2010 Dexia will improve the EaR calculations under stress scenarios among the Group's entities to integrate this indicator in the decision process.

Risk exposure as measured in both economic and accounting terms is primarily on long-term European interest rates and results from the structural imbalance between Dexia's assets and liabilities. Sensitivity risk measures reflect the balance-sheet exposure to first and second order sensitivity and behavioural risk. VaR calculations are performed as an additional measurement.

Credit Spread

The credit spread is defined as being the specific interest rate risk capturing individual issuer related causes. This risk results from spread movements within a rating class and is measured with sensibility measures (/basis point).

Equity

The Value at Risk measurement approach is applied to assess the portfolio's vulnerability to adverse changes in equity prices, volatility or correlation. Inter alia, the market risk management framework includes Earnings-at-Risk and Stress-Test measures representing the maximum accounting loss under different scenario assumptions. The equity portfolios of the banking entities are in run-off mode. In the insurance perimeter an "early warning" system has been developed to re-allocate assets in case of stress scenarios in order to preserve the solvency ratios.

(Structural) Foreign Exchange

Although Dexia's reporting currency is the euro, assets, liabilities, income and expenses are also denominated in other currencies. The Group ALCo decides on the hedges to be implemented in order to reduce both earnings volatility resulting from the structural foreign exchange risk and the volatility of the solvency ratio related to exposures (credit, participations) in foreign currencies.

Insurance Companies and Pension Funds

Specific reports on insurance companies and pension funds are presented to the Group ALCo, covering interest rate, inflation and equity risk factors. Risk indicators are calculated on the basis of a Group harmonized risk methodology complemented by specific risk management factors.

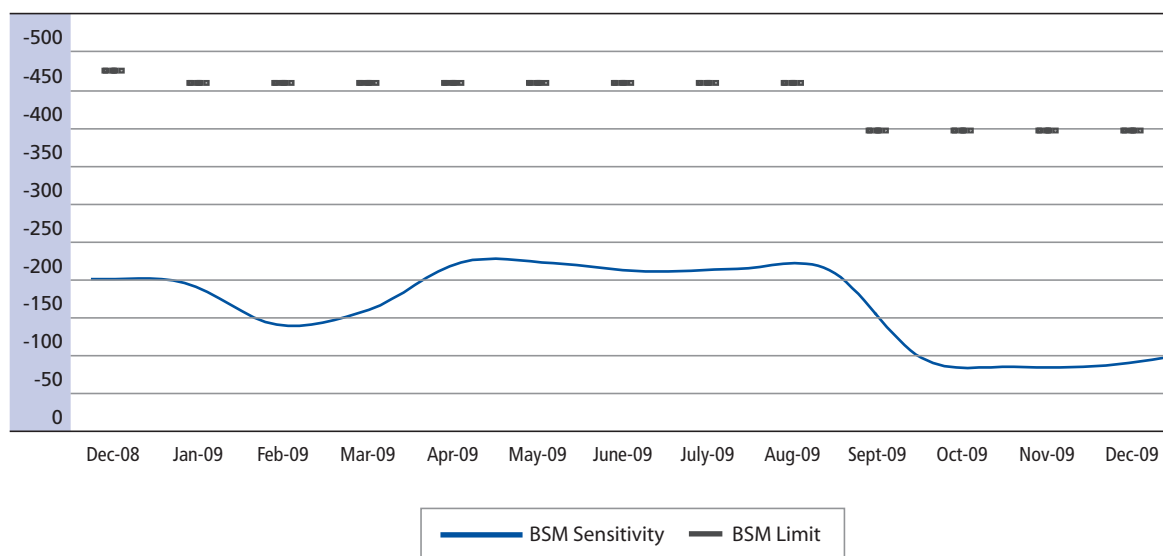
4.2.3.2. BSM Risk Exposure

BSM Interest Rate Risk Exposure (Sensitivity)

Interest rate sensitivity measures the change in the balance-sheet net economic value if interest rates move by 1% across the entire curve. ALM long-term sensitivity amounted to EUR -104 million as at 31 December 2009 (against EUR -198 million as at 31 December 2008), excluding insurance companies and pension funds. The interest rate sensitivity limit amounted to EUR -400 million/% at year-end 2009 (against EUR -486 million/% at year-end 2008).

This evolution is fully in line with the renewed BSM strategy focusing on minimizing statement of income volatility while preserving overall value creation.

BSM Sensibility vs Limit



The Dexia Financial Products portfolio amounted to USD 15.5 billion (EUR 10.7 billion) as at 31 December 2009. The interest rate risk of this portfolio amounted to EUR -6.2 million/% (against a limit of EUR -42 million/%).

BSM Credit Spread Risk Exposure

BSM manages bond portfolios in banking, amounting to EUR 17.5 billion (banking entities) respectively EUR 15.8 billion (insurance) as at 31 December 2009. The interest rate risk of these bond portfolios is integrated in the interest rate risk management of BSM.

As at 31 December 2009 the sensitivity in fair value after a basis point credit spread increase amounted to EUR -15.7 million/bp (banking entities) and to EUR -12.9 million/bp (insurance).

The spread sensitivity of the Financial Products portfolio stood at EUR -4.4 million/bp as at 31 December 2009.

BSM Equity Exposure (Quoted Shares)

The equity Value at Risk (VaR with a 99% confidence level and a 10-day holding period) expresses the potential change in market value, while equity Earnings at Risk (EaR) measures the impact on the statement of income. The VaR use at year-end 2009 amounted to EUR 16 million (not including Assured Guaranty participation) for a EUR 70 million VaR limit. Please note that the banking equity portfolio is currently in run-off mode.

On the insurance and pension funds side, the equity portfolio amounted to EUR 1,435 million (market value). As at year-end 2009, the VaR limit was EUR 160 million and the VaR use was EUR 119 million.

4.2.4. Liquidity Risk

Strong Improvement of the Liquidity Profile

Significant progress was made in 2009 in terms of liquidity consolidation.

To recall, a guarantee on a major proportion of Dexia's short and long-term funding, granted in October 2008 by the Belgian, French and Luxembourg States, was extended until 31 October 2010. With an endorsement signed on 14 October 2009, this guarantee was extended until 31 October 2010 and the following changes were made to the mechanism:

- The cap on guaranteed outstandings was lowered from EUR 150 billion to EUR 100 billion;
- The maturity of new long-term debts issued was extended to a maximum of four years.

In addition, since 16 October 2009, Dexia has waived the benefit of the guarantee for all new contracts with a maturity below one month and for all new contracts with no fixed maturity. Dexia could easily replace guaranteed with non-guaranteed funding.

On 30 October 2009, the European Commission provisionally authorized the extension of this funding guarantee until the end of February 2010. Then, within the context of the agreement with the European Commission on 5 February 2010, an early exit from the guarantee mechanism was announced, the details of which are given in the chapter "2009 and early 2010 highlights" of the Dexia annual report 2008.

In 2009, the Group issued a total of EUR 45.7 billion of medium and long-term funds (with an average maturity of 5 years). The portion of debt not covered by the State guarantee was 51%, rising constantly over the year.

This good performance was made possible by:

- The reopening of the covered bond market in the second quarter 2009, which allowed a total of EUR 13.0 billion in covered bonds to be issued in 2009 via its three issuers Dexia Municipal Agency, Dexia Kommunalbank Deutschland and Dexia Lettres de Gage Banque;
- The renewed access to unsecured non-guaranteed funding, particularly from the third quarter 2009, reflected by a volume of medium and long-term unsecured non-guaranteed issues of EUR 10.3 billion in 2009.

The short-term liquidity profile was also improved considerably in the second half of the year with the gradual increase of funding raised on the bilateral and triparty repo market and the improved access to non-guaranteed short-term liquidity.

Globally, the Group's short-term funding needs fell sharply in 2009 by virtue of the active deleveraging policy initiated by the Group since the fourth quarter 2008 (sale of bonds within the portfolio in run-off for an amount of EUR 16.5 billion in 2009, with a maturity of 4.5 years) and the strong momentum of the long-term issue programme.

The result of all these elements combined was a sharp reduction of guaranteed short and long-term debts. They amounted to EUR 50.4 billion as at 31 December 2009, compared to a maximum of EUR 95.8 billion in May 2009.

In 2010, liquidity consolidation efforts will continue with the principal aim of fully exiting the guarantee mechanism at the latest on 30 June 2010, which means that no new government guaranteed debt will be issued by the Group after this date.

Liquidity Risk Management

Dexia's approach to liquidity risk management was reviewed in the light of the financial and liquidity crisis. It is based on the general principle that Dexia's future funding needs should never exceed its proven covered funding capacity. In other words, Dexia ensures that its short-term funding needs can always be covered by the use of liquid assets in the interbank market.

Dexia ensures that it maintains a liquidity buffer which is sufficient to face cash exits under different scenarios. That liquidity buffer is formed of freely available securities accepted as underlying by the central banks to which Dexia has access.

Future funding needs are assessed dynamically and comprehensively, taking into account liquidity needs arising from current and programmed on and off-balance-sheet transactions. Its covered funding capacity is determined conservatively, taking the lessons from the current crisis into consideration. The adequacy of Dexia's future liquidity needs with its covered funding capacity is tested under an ongoing scenario as well as under a variety of severe stress scenarios including bank-specific and market stresses and even a combination of both.

Short-term funding needs are monitored on a daily basis. Longer-term funding needs (up to three years) are monitored on a monthly basis. More generally, liquidity risk management is at the very heart of the definition of Dexia's triennial financial plan. The result of that monitoring is presented weekly to the Funding and Liquidity Committee, which determines the major orientations of the liquidity management. This framework is backtested and updated regularly in accordance with best risk management practices and integrating all the local regulatory constraints.

The diversity of Dexia's funding sources is a key-mitigant of its liquidity risk. Dexia's principal funding sources are:

- Retail bank deposits (essentially in Belgium, Luxembourg and Turkey);
- Long-term funding:
 - covered bonds;
 - unsecured bonds, benefiting from the State guarantee or not (notably bonds distributed via the Dexia networks);
- short-term funding:
 - bilateral and triparty repo transactions;
 - central bank tender operations;
 - a wide variety of wholesale short-term unsecured funding sources, some of which benefit from the State guarantee.

Dexia's liquidity risk is managed using a centralized approach. Although liquidity positions are managed by the different entities of the Group, the Dexia funding strategy is managed on a centralized and integrated basis.

Dexia also makes use of securitization operations within the framework of liquidity management both by means of the external sale of assets and by applying "internal securitization" techniques enhancing liquidity/eligibility of illiquid asset classes.

Since June 2009, the CBFA has applied a monthly observation ratio stress test on liquidity. This ratio measures the bank's liquidity position in exceptional circumstances by comparing the liquidity potentially required with its available liquidity on and off-balance sheet. This approach combines the impact of a so-called "idiosyncratic" shock (shock associated with the establishment) with the consequences of a general liquidity crisis.

The hypotheses of this stress are principally based on the impossibility of obtaining unsecured funding, the impossibility of securitizing or selling illiquid assets, and limited or impossible recourse to certain funding sources.

5. Operational Risk

5.1. Definition

Dexia defines operational risk as follows: operational risk is the risk of financial or non-financial impact resulting from inadequate or failed internal processes, people and systems, or from external events. The definition includes IT, legal and compliance risk but excludes strategic risk.

Dexia's definition of operational risk is based on, but not restricted to, the one used by the Basel Committee, which focuses on losses (negative financial impacts). Dexia's policy also requires the collection of events which lead to financial gains.

5.2. Governance

The Operational Risk Management framework relies on strong governance with clearly defined roles and responsibilities.

The Management Board, organized on a weekly basis, regularly reviews the evolution of the risk profile of the different Group activities and takes the required decisions.

The Risk Policy Committee, a strategic committee with representatives of the Management Board, approves Group-wide policies. This committee is organized on a quarterly basis.

The Operational Risk Guidelines Committee, chaired quarterly by the Group Chief Risk Officer, details the approved policies in guidelines adapted to business activities, and transversally reviews the operational risk events and related analysis.

The Operational Risk Management Committee, chaired monthly by the Head of Group Operational Risk, ensures the development of a consistent Group-wide operational risk framework integrating Business Continuity and Crisis Management, Information Security and Insurance.

The Line Management function is primarily responsible for operational risk management. For their activity field they appoint Operational Risk Correspondents whose role is to coordinate the collection of risk event data and the Risk and Control Self-Assessment, with the support of the local Operational Risk Management function.

5.3. Management of the Risk

5.3.1. Operational Risk Framework

The operational risk framework relies on the following elements:

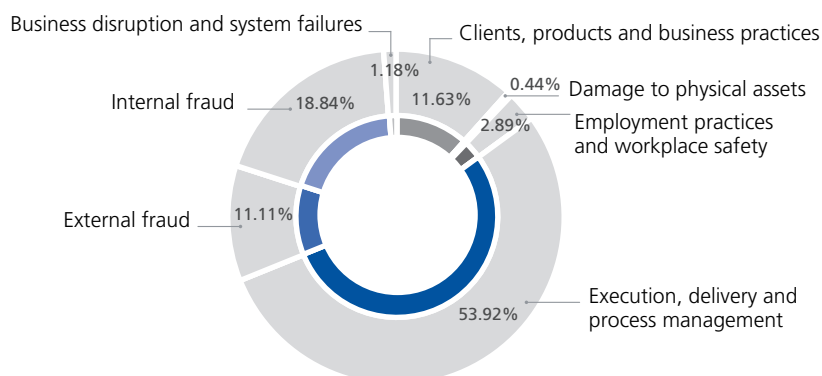
Operational Risk Event Data Collection

The systematic capture and monitoring of risk events is one of the most important requirements stated by the Basel Committee, whatever the approach chosen for the capital calculation (Standardized or Advanced Measurement Approach): "data on a bank's historical loss experience could provide meaningful information for assessing the bank's exposure to operational risk and developing a policy to mitigate/control the risk".

As a consequence, the continuous collection of risk event data enables Dexia both to be compliant with regulatory requirements, and to obtain very valuable information in order to improve the quality of the internal control system. Strict guidelines have been defined and deployed at Group level in terms of reporting, in order to ensure that the most important information is escalated in due time to Senior Management (in particular, the compulsory declaration threshold has been set at EUR 2,500). The most significant events including a risk mitigation action plan defined by the Line Management are reported to the Management Board by the Operational Risk function.

Over the last 3 years, the split of the total amount of losses among standard event types is the following:

Loss Distribution by Type of Events as at 31/12/2009



The largest proportion of the losses is due to execution, delivery and process management events, which also represent the majority of all events, present in all businesses and support functions. These events and the related action plans are reviewed on a quarterly basis with the key stakeholders (in particular the Operations & IT line). As a matter of fact, most important events of this type observed in 2008 did not occur again in 2009.

The proportion of frauds increased in 2009 in the retail banking activities. Global mitigating plans have been approved by the Management Board, so that existing processes can be adapted to all threats.

Other categories remain limited in number and amount. Major events when they occur are of course subject to the definition of corrective actions approved by the Senior Management.

Risk and Control Self-Assessment

In addition to building a history of losses, it is also necessary to determine the exposure of Dexia to main risks through risk mapping of all significant activities. This objective is achieved on the basis of bottom-up risk and control self-assessment exercises, carried out in all entities of the Dexia Group. These exercises focus on the identification and assessment of the main risks and controls, and can lead to the definition of mitigating actions. They provide a good view of the most important risk areas in the different entities and activities, with the objective of reporting the results to Management across the organization.

These risk and control self-assessments are updated on a regular basis.

Information Security and Business Continuity Management

The information security policy and the related information security guidelines, standards and practices aim to secure Dexia information assets.

Security programmes and well-defined responsibilities ensure that all business activities are organized in a secure environment.

As required by the Group business continuity policy, business lines are required to make business impact analyses of critical business activities, define and document recovery plans, and ensure that business continuity plans are tested and updated at least once a year. On the basis of regular reporting, the Management Board validates recovery strategies, residual risks, and action plans for continuous improvement.

Management of Insurance Policies

Mitigation of the operational risks to which Dexia is exposed is also ensured through the purchase of Group insurance policies, principally covering professional liability, fraud and theft, and business interruption. On the basis of the Group insurance policy, the objective is also to develop insurance guidelines regarding the different risks within the Group, for application at Group level, and at entity level, and centrally to manage the negotiations with brokers and insurance companies.

Definition and Follow-up of Action Plans

Line Management defines corrective actions related to major events or to key risks identified. A regular follow-up and a quarterly reporting for all activities have been set up by operational risk management.

By virtue of this process, the internal control system is continuously improved and the main risks appropriately mitigated over time.

Increased Coordination with Other Functions Involved in the Internal Control System

A new software tool was developed in 2009 aimed at covering most of the building blocks of the operational risk management framework, and also offering some key functions for other central functions such as Internal Audit, Compliance, Permanent

Control or Quality Control. The implementation of this software solution at the beginning of 2010 will allow the use of common language and systems of reference among these functions, as well as the production of consolidated information for Line Management, especially regarding any kind of action plans or recommendation to be followed up over time.

5.3.2. Calculation of Regulatory Capital Requirements

Dexia has decided to apply the Basel II Standardized Approach for the calculation of the capital requirement for operational risk management.

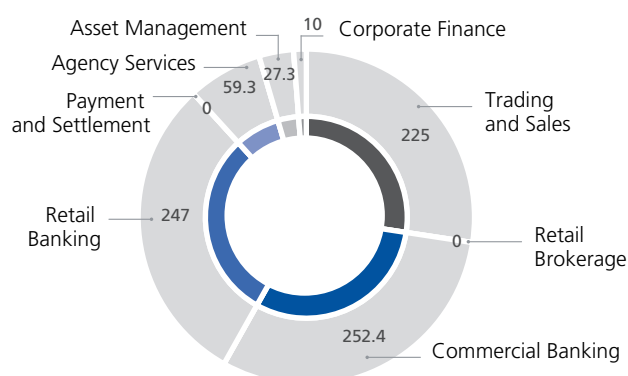
This approach mainly consists of applying a percentage (called "Beta" factor, in a range between 12% and 18%) to a relevant indicator calculated for each of the eight business lines defined by the Basel Committee (Corporate Finance, Commercial Banking, Retail Banking, Trading and Sales, Asset Management, Agency Services, Retail Brokerage, Payment and Settlement).

The relevant indicator is principally made of the operating income of the underlying activities (i.e. mainly excluding non-recurring items and the impact of the financial crisis) which comprises net interest and net commission income. Income from insurance activities is not taken into consideration, as they are not subject to Basel II regulation.

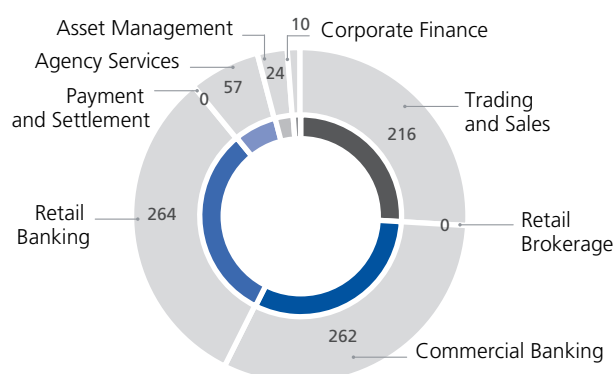
The sum of capital requirements for each business line is used to calculate the total capital requirement of the operational risk, as an average over the last three years. The calculation is updated on a yearly basis, for the regulatory reporting as at 31 December each year.

The capital requirement for the last calculation periods is the following: EUR 833 million at year-end 2009 and EUR 821 million at year-end 2008.

Capital Requirement (in millions of EUR)
by Basel Business Line as at 31/12/2008



Capital Requirement (in millions of EUR)
by Basel Business Line as at 31/12/2009



An increase of the capital requirements of 1.5% can be observed between 2008 and 2009. This is linked to a change in the calculation figures i.e. the 2006 Gross income has been replaced in the calculation by the 2009 Gross income, which is slightly higher, as the development of DenizBank activities more than offset the reduction in other businesses.

The split among the 8 Basel II business lines reflects the main activities of the Group:

- Retail Banking (which refers to the retail and private banking activities of Dexia) and Commercial Banking (which mainly corresponds to Public and Wholesale Banking) are the most important ones.
- Trading & Sales is also significant because it not only includes the Treasury and Financial Market activities, but also the ALM and the Long-Term Funding activities within Dexia to a large extent re-allocated to business lines.
- Agency Services corresponds to the share of Dexia in the joint venture RBC Dexia Investor Services (custody and fund administration activities).
- Corporate Finance activities as defined by regulators are very limited at Dexia, and mainly consist of advice provided to clients within the context of project finance or other investment operations.
- Retail Brokerage activities have not been identified separately, but are included in "Retail Banking", as they are completely supportive of this activity, and not handled as a separate business (for instance with dedicated subsidiaries).
- Payment and Settlement activities, as services provided to third parties, are very limited at Dexia and not identified on a stand-alone basis.

6. Pillar 2 Risks

Credit risk, market risk and operational risk described in the previous parts of this report and subject to Pillar 1 framework are also included in Pillar 2 framework.

The Pillar 1 and Pillar 2 approaches of the same risks might differ at four levels:

- the perimeter;
- the methodology;
- the risk parameters used;
- the level of severity.

The perimeter of Pillar 2 risks is larger as Pillar 2 aims at exhaustiveness. Other risks than those included in the Pillar 1 framework are then specifically included in the Dexia Pillar 2 framework: behavioural risk, business risk, strategic risk, reputation risk, model risk, pension risk, insurance risk, concentration risk, settlement risk and securitization risk.

Methodologies and risk parameters used by Dexia lead to the calculation of economic capital. It is defined as the potential deviation of the Group's economic value in relation to the value expected at a determined interval of confidence and time horizon. The choice made by Dexia is to estimate its risks at a severity level of (99.97%, 1 year) instead of (99.9%, 1 year) as required by the Pillar 1; (99.97%, 1 year) being more in line with the AA rating aimed at by Dexia.

6.1. Behavioural Risk

Definition

Behavioural risk is defined as the potential change of exposure to interest rate and funding risks due to the uncertain behaviour of retail type customers.

It includes the uncertain amortization of non-maturing liabilities, such as certain type of deposits, and mortgage prepayment schedules.

For example, customers may decide to reduce their savings or their sight accounts impacting the bank's interest rate position.

Organization and Management of the Risk

Behavioural risk is managed through sensitivity and convexity measures in reporting to the members of the Dexia ALM Committee. In addition, this risk is included in the Dexia economic capital reporting.

Capitalization

Behavioural risk is capitalized as follows:

- Prepayment risk capital is calculated through a statistical model;
- Outflow risk capital is defined as the potential depreciation of the value of the stock of non-maturing liabilities with a severity level of 99.97% (interval of confidence at a one-year time horizon).

6.2. Business Risk

Definition

Business risk reflects the unexpected decrease of profitability from the expected (or budgeted) one, resulting from other risks than those for which economic capital is calculated separately.

Organization and Management of the Risk

The business risk is at the heart of the daily management of the bank.

Indeed, management control as an independent department is responsible for the consolidation of data necessary to calculate income, expenses and profitability, as well as related reporting.

The steering of future profitability is operated through the various business line committees and ultimately by the Board of Directors: the latter defines any strategic decisions to achieve the levels of expected profitability as announced to the market and ensures the survival of the Group and its business lines.

Capitalization

The methodology to compute business risk capital aims at analyzing the volatility of the revenues/expenses ratio in order to estimate its potential reduction, given a fixed severity level (i.e. 99.97%, one year).

6.3. Strategic Risk

Definition

Strategic risk is defined as the current or prospective loss of value arising from adverse business decisions, improper implementation of decisions or lack of responsiveness to changes in the business environment.

Organization and Management of the Risk

The principles underlying the mitigation of the strategic risk are the following:

- To ensure the adequacy of the Group strategic plan to the business environment;
- To react efficiently to changes in the business environment or to development opportunities;
- To ensure the correct implementation of decisions taken by Group top management in the business lines/entities.

Capitalization

This risk is managed through an appropriate governance process.

6.4. Reputation Risk

Definition

Reputation risk is the potential decrease in the value of Dexia arising from adverse perception of the image of the financial institution on the part of customers, counterparties, shareholders, investors, regulators and other stakeholders.

Organization and Management of the Risk

Due to its very broad definition, reputation risk is managed by different departments such as:

- Compliance;
- Operational Risk Management;
- Secretary General, Tax & Legal;
- Communication.

These key internal control actors have set up appropriate risk management frameworks and policies to prevent, detect and monitor potential reputation impacts of the risks of which they are primarily in charge.

They each assess risks relating to their areas of expertise on a regular basis, in order to identify areas that might not yet be sufficiently covered and accordingly to define corrective actions. This exercise is performed on a consolidated basis within the Group using harmonized methodologies and tools.

Meetings between the different departments are organized on a regular basis in order to share information and to ensure a consistent and exhaustive risk management approach within the Group.

Capitalization

The risk is managed through strong corporate governance and compliance rules within the Group as described above.

6.5. Model Risk

Definition

Model risk is defined as the potential risk assessment errors resulting from inadequate methodology and model, and/or data uncertainty or inappropriate use of models.

The major issues that should be addressed by model risk are the following:

- Risk of poor model development;
- Risk of incorrect model calibration;
- Wrong data use and/or data problems;
- Inadequate model usage;
- Risk of population and/or performance non-stationarity.

Organization and Management of the Risk

The risk of each issue described above is reduced by a set of actions systematically undertaken.

In addition, current practices have a positive effect for containing model risk. These practices include:

- Allocating experienced professionals to the development of risk models;
- Providing a systematic “four eyes approach” via model validation;
- Monitoring and capitalizing model risk within the Dexia economic capital framework.

Capitalization

For each type of risk and each risk capital calculation methodology, the potential increase (not decrease) of risk capital resulting from model risk is assessed by expert judgment. This judgment results into an “uncertainty coefficient” depending on the perceived comfort with which the model has been developed and implemented, and is being fed and used.

6.6. Pension Risk

Definition

Pension risk is the risk stemming from commitments on employee pensions and benefits.

The risk for an employee benefits plan is the risk that the actual value of future commitments (liabilities of the plan) will change on the basis of changing market parameters (interest rates and inflation risk). A pension fund is created to meet the future commitments. The contributions paid to the plan are invested in assets (the pension fund).

The risk for a pension fund is the risk that the net present value of its liabilities (future commitments) is greater than the net present value of its assets (existing investments plus future contribution investments).

As a result, pension risk is not one risk but a set of risks. Pension risk includes market risk (interest rate risk, equity risk, and inflation risk), credit risk (solventy risk) and behavioural risk (turnover, mortality).

Organization and Management of the Risk

A three-level structure constituting the governing body of the pension plan, ranging from strategic through tactical to the operational management level, establishes a rigorous process by which investment activities are carried out.

A dedicated committee approves the investment mandates and grants them to the pension fund asset manager. These investment mandates establish clear investment objectives for the pension fund consistent with the characteristics of the pension fund and the acceptable degree of risk for the pension fund.

The approach for achieving these objectives takes account of the need for proper risk management, diversification needs, liquidity requirements and asset allocation limitations.

Capitalization

Pension risk is capitalized. Risk capital is the sum of different calculations by type of risk.

6.7. Insurance Risk

Definition

Insurance risk is defined as the potential losses resulting from unexpected changes in mortality, morbidity or casualty rates and/or from natural catastrophe.

Organization and Management of the Risk

Insurance risk is only faced by Dexia Insurance Services (DIS) which consolidates the various insurance subsidiaries of the Dexia Group (the reference market being Belgium).

The risks within the specific insurance risk category are associated with both the perils covered by the specific line of insurance (life, non life, health) and with the specific processes associated with conducting insurance business (claims processing, premium collection, pricing, selection, etc).

To manage them, DIS issues various risk reports (daily, weekly, monthly and quarterly reports). In addition, Dexia Group risk objectives apply – *mutatis mutandis* – to Dexia insurance risk management organization.

Capitalization

A global risk capital is statistically calculated on the four following insurance risks:

- Underwriting risks in life activities (mortality);
- Non-life reserve risks;
- Non-life premium risks;
- Natural catastrophe risks.

6.8. Settlement Risk

Definition

Settlement risk is defined as the risk that the credit institution will deliver the sold asset or cash to the counterparty, and will not receive the purchased asset or cash as expected.

This risk is not to be confused with the operational risk classified under "Execution, delivery and process management risk". Settlement risk only refers to the situation where the delivery process fails because of a solvency issue.

Organization and Management of the Risk

The most general way to reduce settlement risk is to proceed via an intermediary performing DVP (Delivery Versus Payment). For Forex in particular, there is one main agent: CLS (Continuous Linked Settlement). With DVP one can say that the risk becomes negligible. Dexia intends then to generalize the recourse to DVP.

Historically, there has been no instance of any loss related to this risk at Dexia and very few externally (the best known example is the one that resulted from the failure of a small German bank, Herstatt, in 1974). In fact, losses would only occur if Dexia

simultaneously faces a mismatch in the delivery against settlement process and the default of the counterparty bearing the resulting temporary exposure. Of course the two events can be strongly correlated: a bank close to bankruptcy is much more likely to fail in its settlement duties.

To complement the safety offered by the current processes, it is considered to include the potential credit risk exposure resulting from a settlement event in the credit limits and control systems.

Settlement risk capital is not computed via a statistical model but rather results from the occurrence of a single settlement problem (a presumably very rare event).

6.9. Securitization Risk

Definition

Securitization risk refers to uncertainty on the economic substance of a transaction and its risk transfer level.

Organization and Management of the Risk

The key elements of the prudential review process of the securitization activity are the following (and are monitored by specific committees):

Risk Transfer

The significance of credit risk transfer will be assessed on the basis of a formal threshold of at least 50%. If a securitization transaction does not respect the 50% risk transfer threshold at inception, then the issue can be submitted to the Banking, Finance and Insurance Commission (CBFA) for regulatory clearance. If the bank only retains exposure risk weighted at 1,250% (such as "first loss" tranches for instance), the achievement of a "significant" risk transfer is to be considered as fulfilled, i.e. the securitization will be automatically considered as satisfying this risk transfer requirement.

Dexia currently calculates the risk transferred at inception on the basis of a regulatory weighted risk calculation and will calculate the risk transferred on the basis of an economic capital tool as a second step.

Maturity Mismatches in Synthetic Securitization

There is a maturity mismatch when the residual maturity of the credit protection is less than the residual maturity of the underlying credit exposure. Maturity mismatches impact the calculation of the risk weight of the transaction (after the origination) used to assess the risk transfer.

When the residual maturity of the credit protection is less than three months and less than the residual maturity of the underlying exposure, the credit protection is not recognized. When the initial maturity of the credit protection is less than one year, the credit protection is not taken into account.

Implicit Support

At origination Dexia will pay attention to the absence of any clause or practice that could be qualified as implicit support.

During the life of the transaction, an additional prudential review is carried out in the event of a modification of the structure validated at inception or in case of buy-backs by Dexia.

The securitization risk is currently managed through appropriate procedures. So far, only two operations have been performed including some risk transfer and regulatory capital relief. These were partially funded synthetic operations, fully documented and compliant with Basel II rules. In addition, the danger of not fulfilling the conditions for regulatory capital relief is documented in Dexia securitization guidelines.

Appendix 1

Glossary

ABS	Asset-Backed Security	Securities issued by a vehicle created for the purpose of buying assets from a bank, a company or a state, like trade receivables or inventories, and to provide the seller with cash and the buyer with a financial product characterized by a certain risk profile and a rate of return.
ABCP	Asset-Backed Commercial Paper	A programme of securitizations the securities issued by which predominantly take the form of commercial paper with an original maturity of one year or less.
AFS	Available For Sale	Non-derivative financial assets designated on initial recognition as available for sale or any other instruments that are not classified as (a) loans and receivables, (b) held-to-maturity investments or (c) financial assets at fair value through profit or loss.
AIRBA	Advanced Internal Rating-Based Approach	Institutions using the IRB approach are allowed to determine borrowers' probabilities of default and to rely on own estimates of loss given default and exposure at default on an exposure-by-exposure basis. These risk measures are converted into risk weights and regulatory capital requirements by means of risk weight formulas specified by the Basel Committee.
ALM (BSM)	Asset and Liability Management	Action – for instance in a financial institution or a corporate – of managing the net risk position between assets and liabilities, particularly with respect to imbalances generated by the evolutions of interest rates, currencies and inflation, but also maturity mismatch, liquidity mismatch, market risk and credit risk.
ALT-A	ALternative A-paper	Type of US mortgage that, for various reasons, is considered riskier than A-paper, or "prime", and less risky than "subprime", the riskiest category. Alt-A interest rates, which are determined by credit risk, therefore tend to be between those of prime and subprime home loans. Typically Alt-A mortgages are characterized by borrowers with less than full documentation, lower credit scores, higher loan-to-values, and more investment properties.
BIS	Bank for International Settlements	"Bank for International Settlements" ("BIS") designates the international financial institution which acts as the central bank of the national central banks and of some supranational organizations, such as the European Central Bank (ECB). BIS receives deposits from, and makes loans to, these entities. BIS is also a forum to discuss co-ordination of macroeconomic policies in general, with a focus on monetary policies, such as the evolution of interest rates and currency exchange rates. The organization's prime objective is the overall stability of the world's financial system. In that context, capital adequacy ratios applicable to banks are set up by the Basel Committee which is part of BIS.
CBFA	Commission bancaire, financière et des assurances	The Belgian Banking, Finance and Insurance Commission is the Belgian Financial Institutions regulator.
CCF	Credit Conversion Factor	The ratio of the currently undrawn amount of a commitment that will be drawn and outstanding at default to the currently undrawn amount of the commitment. The extent of the commitment will be determined by the advised limit, unless the unadvised limit is higher.
CDO	Collateralized Debt Obligation	Type of structured asset-backed security (ABS) the value of and payments for which are derived from a portfolio of fixed-income underlying assets. CDO securities are split into different risk classes, or tranches, whereby "senior" tranches are considered the safest securities. Interest and principal payments are made in order of seniority, so that junior tranches offer higher coupon payments (and interest rates) or lower prices to compensate for additional default risk.
CDS	Credit Default Swap	Swap contract in which the buyer of the CDS makes a series of payments to the seller and, in exchange, receives a pay-off if a credit instrument (typically a bond or loan) undergoes a defined "Credit Event", often described as a default (fails to pay).

CLN	Credit Linked Note	A credit linked note (CLN) is a form of funded credit derivative. It is structured as a security with an embedded credit default swap allowing the issuer to transfer a specific credit risk to credit investors. The issuer is not obligated to repay the debt if a specified event occurs. This eliminates a third-party insurance provider.
CRD	Capital Requirements Directive	The Capital Requirements Directive (CRD) for the financial services industry introduce a supervisory framework in the EU which reflects the Basel II rules on capital measurement and capital standards.
CRM	Credit Risk Mitigant	Range of techniques whereby a bank can, partially, protect itself against counterparty default (for example by taking guarantees or collateral, or buying a hedging instrument).
EAD	Exposure At Default	Estimate of the amount outstanding (drawn amounts plus likely future draw-downs of yet undrawn lines) in case the borrower defaults.
ECAI	External Credit Assessment Institutions	Under the Basel II agreement of the Basel Committee on Banking Supervision, banking regulators can allow banks to use credit ratings from certain approved Credit Rating Agencies when calculating the risk weight of an exposure. Competent authorities will recognize an ECAI as eligible only if they are satisfied that its assessment methodology complies with the requirements of objectivity, independence, ongoing review and transparency, and that the resulting credit assessments meet the requirements of credibility and transparency.
EL	Expected Loss	The amount expected to be lost on an exposure from a potential default of a counterparty or dilution over a one-year period.
FX	Foreign eXchange	Transaction of international monetary business, as between governments or businesses of different countries.
HELOC	Home Equity Line Of Credit	It is a loan in which the lender agrees to lend a maximum amount within an agreed period (called a term), where the collateral is the borrower's equity in his/her house.
HTM	Held To Maturity	Non-derivative financial assets with fixed or determinable payments that an entity intends and is able to hold to maturity and that do not meet the definition of loans and receivables and are not designated on initial recognition as assets at fair value through profit or loss or as available for sale.
IAS	International Accounting Standards	IAS stands for International Accounting Standards. IAS are used outside the US, predominantly in continental Europe.
ICAAP	Internal Capital Adequacy Assessment Process	The main objective of the Pillar 2 requirements is to implement procedures which will be more sensitive to an institution's individual risk profile. This is to be achieved by introducing implementation of internal processes (ICAAP).
IFRS	International Financial Reporting Standards	International Financial Reporting Standards published by the IASB and adopted by most countries but the USA. They have been designed to ensure globally transparent and comparable accounting and disclosure.
IR	Interest Rate	Interest expressed as an annual percentage rate.
ISDA	International Swap and Derivative Association	Trade organization of participants in the market for over-the-counter derivatives. Its headquarters are in New York, and it has created a standardized contract (the ISDA Master Agreement) to enter into derivatives transactions.
ISIN	International Securities Identification Numbers	An International Securities Identification Number (ISIN) uniquely identifies a security. Its structure is defined in ISO 6166. Securities for which ISINs are issued include bonds, commercial paper, equities and warrants. The ISIN code is a 12-character alpha-numerical code that does not contain information characterizing financial instruments but serves for uniform identification of a security at trading and settlement.
IT	Information Technology	Study, design, development, implementation, support or management of computer-based information systems, particularly software applications and computer hardware IT deals with the use of electronic computers and computer software to convert, store, protect, process, transmit, and securely retrieve information.
LGD	Loss Given Default	The ratio of the loss on an exposure due to the default of a counterparty to the amount outstanding at default.

L&R	Loans & Receivables	Non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than held for trading or designated on initial recognition as assets at fair value through profit or loss or as available-for-sale.
MBS	Mortgage-Backed Securities	Asset-backed security or debt obligation that representing a claim on the cash flows from mortgage loans.
NBT	Negative Basis Trade	A basis trade involves an investor buying a bond and simultaneously buying credit protection on the same credit to maturity. Such structures are typically purchased when the CDS is offered at a tighter spread than the offer on the bond asset swap spread. The combination is referred to as a negative basis trade.
PD	Probability of Default	The probability of default of a counterparty over a one-year period.
P/L	Profit and Loss	The statement of income is a document showing all wealth-creating revenues and wealth-destroying charges. There are two major statement of income formats: the by-nature statement of income format and the by-function statement of income format. Also called profit and loss account (or P&L).
RAROC	Risk Adjusted Return On Capital	Risk-based profitability measurement framework for analysing risk-adjusted financial performance and providing a consistent view of profitability across businesses.
RMBS	Residential Mortgage-Backed Securities	RMBS are securities where the primary source of payments is a mortgage loan or a pool of mortgage loans secured mostly on residential real property. Investors receive payments of interest and principal that are derived from payments received on the underlying mortgage loans.
RWA	Risk Weighted Assets	Used in the calculation of risk-based capital ratios. They are the total assets calculated by applying risk-weights to the amount of exposure.
SPV	Special Purpose Vehicle	Separate legal entity created specially to handle a venture on behalf of a company. In many cases, the SPV belongs from a legal standpoint to banks or to investors rather than to the company. The IASB has however stipulated that the company should consolidate the SPV if it enjoys the majority of the benefits or if it incurs the residual risks arising from the SPV even if it does not own a single share of the SPV.
UCITS	Undertakings for Collective Investment in Transferable Securities	Set of European Union directives that aim to allow collective investment schemes to operate freely throughout the EU on the basis of a single authorization from one member state. In practice many EU member nations have imposed additional regulatory requirements that have impeded free operation with the effect of protecting local asset managers.
VaR	Value at Risk	Value at risk (VaR) represents an investor's maximum potential loss on the value of an asset or a portfolio of financial assets and liabilities, based on the investment timeframe and a confidence interval. This potential loss is calculated on the basis of historical data or deduced from normal statistical laws.

Appendix 2

Internal Rating Systems

1. Structure of Internal Rating Systems

The internal rating systems developed by Dexia are set up to evaluate the three Basel II parameters: Probability of Default (PD), Loss Given Default (LGD) and Credit Conversion Factor (CCF). For each counterparty type in the advanced method, a set of three models, one for each parameter, has been or will be developed as part of the roll-out plan validated by the regulator.

The PD models estimate the one-year probability of default. Each model has its own rating scale and each rating on the scale corresponds to a probability of default used for regulatory and reporting purposes. The correspondence between rating and PD for each scale is set during the calibration process, as part of the model development, and is reviewed and adjusted during the yearly backtesting when applicable. The number of ratings on each scale depends on the characteristics of the underlying portfolio (the number of counterparties, their homogeneity, whether it is a low default portfolio or not) and varies between 6 and 17 non-default classes. In addition each scale has been attributed two default classes (named D1 and D2).

For reporting purposes, a “masterscale” has been set up. This masterscale is structured in grades ranging from AAA to CCC and the modifiers plus, flat and minus (except for both extremes of the scale). The two default classes D1 and D2 are also reported. Each rating corresponds to a bucket of PD set up according to the one-year average default rate of rating agencies. This rating is obtained by mapping its probability of default as estimated by the relevant IRS (Internal Rating System) into the masterscale bucket. Rating classes provided in the present document stem from the masterscale.

LGD models estimate the ultimate loss incurred on a defaulting counterparty before taking the credit risk mitigants into account. The unsecured LGD depends on different factors such as the product type, the level of subordination or the rating of the counterpart. The granularity of the estimate is a function of the quantity and quality of data available.

CCF models estimate the part of off-balance-sheet commitments that would be drawn should a counterparty go into default. The regulation authorizes the use of CCF models only when CCF under the Foundation Approach is not equal to 100% (as it is for credit substitutes for instance). CCF granularity also depends on the availability of data.

The relation between the outcome of internal rating systems and external agency ratings is at two levels.

- While designing the models: some internal rating systems have been designed and calibrated on the basis of external ratings. This is typically the case when internal default data are scarce.
- While establishing reporting: information on the portfolio is reported using the masterscale which is representative for the external agency probability of default.

2. Description of the Internal Rating Process

General Organization of the Internal Rating Process

The internal rating process is organized in three stages: the model development, the maintenance and the control of the internal rating.

The model manager is responsible for the entire process of developing and maintaining a model whereas the control of the internal rating is dispatched through several control functions within the Dexia Group (validation, audit, quality control...).

Development of the Models

The model management process is coordinated by Risk Management Group. Model managers are physically situated close to the business and the credit analysts and perform the model management activities with a Group-wide focus enhancing both consistency and efficiency.

The different steps are:

- Defining the scope of the counterparties concerned;
- Identifying and gathering the most relevant available data (financial data, data on defaults of the segment concerned, institutional framework);
- Building a database if needed;

- Defining a broad list of financial ratios and qualitative criteria;
- Testing these ratios (repetitive processes between statisticians and analysts);
- Building the score function. A score function is the mathematical function that allows determination of the counterparty (or exposure) PD, LGD or CCF based on its characteristics. Score function is established by the modeling team on the basis of statistical analysis and modeling techniques;
- Testing the score function;
- Developing IT tools;
- Validating and implementing the model;
- Adjusting risk policies to take internal risk systems into account;
- Documentation (user guide, documentation for the regulator, notes concerning the building of the model).

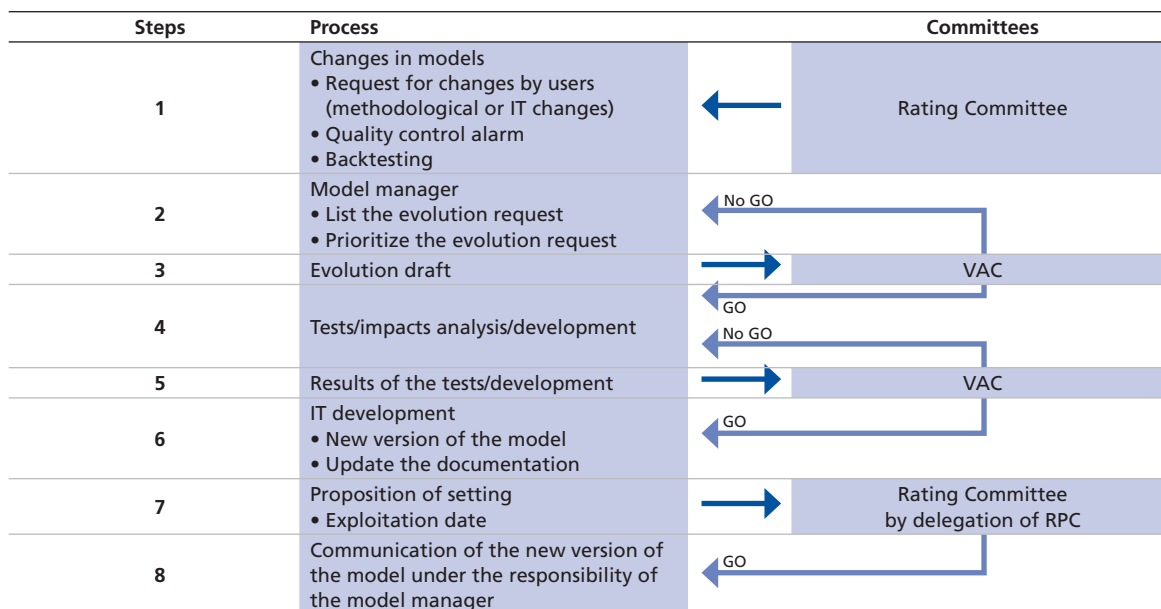
Nevertheless, some steps in the development process detailed above (such as building the score function, testing the function, etc.) are not applied for some specific models:

- Models based on an expert approach (such as the model used for US municipalities) do not include a score function. They are based on internal experience and qualitative knowledge and not on statistical data (which may not be available due to very low number of defaults for instance).
- Models based on a derivation approach are derived from an existing model.
- Models based on an assimilation approach are not *stricto sensu* models due to the fact that counterparties treated by assimilation simply inherit the rating of their “master” counterpart.
- Assimilations and derivations are applied when it is neither financially intuitive nor statistically relevant to develop, adapt or use an existing model. Such cases occur typically for low default portfolios with a low number of observations, limited data availability (both for design and for model use) and for portfolios where strong relations exist between the “master” counterparty and the “assimilated” or “derived” counterpart. These relations can be legally bound or based upon long-term past experience and practice.

Maintenance of the Models

As mentioned above, the model manager is responsible for the entire process linked to the model developed, including the maintenance of the model.

The model maintenance process is detailed in the diagram hereafter.



Legend: Validation Advisory Committee (VAC), Risk Policy Committee (RPC).

Internal Rating Process by Broad Exposure Class

Type of Exposure Included in Each Exposure Class

Dexia has developed a wide range of models to estimate PD, LGD and CCF of the following types of counterparties. These models are validated and are currently used for regulatory purposes.

Sovereigns

Sovereigns

The scope of the model encompasses sovereign counterparties, defined as central governments, central banks and embassies (which are an offshoot of the central state), and all debtors of which liabilities are guaranteed irrevocably and unconditionally by central governments or central banks.

Assimilations to Sovereigns

The in-depth analysis of some public sector counterparties (such as public hospitals in France or communities in Germany) shows that they share the same credit risk as the “master” counterparties to whom they are assimilated (usually local authorities or sovereigns). They are consequently assimilated to these “master” counterparties and benefit from the same PD and LGD as their “master” counterparties.

Project Finance (Specialist Lending)

This model encompasses the project financing activity of Dexia on all segments of activity in which Dexia intervenes (which are actually mainly Energy and Infrastructure). The specialist lending portfolio is a subgroup of the corporate portfolio which has the following characteristics: the economic objective is to finance or acquire an asset; the flows generated by this asset are the sole or practically the sole source of repayment; this financing represents a significant debt in respect of the liabilities of the borrower; the main distinguishing criterion of risk is essentially the variability in flows generated by the financed asset, much more than the borrower's ability to repay.

Insurance Companies (Including Monolines)

The scope of the model encompasses worldwide insurance companies. An insurance company is restricted by the terms of its status, to write financial guarantees or insurance policies related to a single type of risk.

Financial Institutions

Banks

The scope of the model encompasses worldwide bank counterparties, defined as legal entities which have banking activities as their usual profession. Banking activities consist of the receipt of funds from the public, credit operations and putting these funds at customers' disposal, or managing means of payment. Bank status is gained by the delivery of a banking license given by the supervisory authority.

Undertakings for Collective Investment in Transferable Securities (or UCITS)

This model is used to score direct risk exposure to UCITS counterparties such as loans or facilities (this model is not aimed at rating investments made by Dexia in UCITS).

The sole object of a UCITS is the collective investment in transferable securities and/or other liquid financial assets of capital raised from the public and which operate on the principle of risk spreading.

In order to be treated by the UCITS internal rating system, the considered fund must satisfy these criteria: being an open-ended fund, being quoted, having a prospectus and presenting sufficient information.

Corporates

Two models have been designed for corporate counterparties: corporate and mid-corporate models.

Corporates

The scope of the model encompasses worldwide corporate counterparties. Dexia defines a corporate as a private or a publicly-quoted company with total annual sales higher than EUR 50 million or belonging to a group with total annual sales higher than EUR 50 million which is not a bank, a financial institution, an insurer or a satellite. For Belgium, companies with total annual sales exceeding EUR 250 million are integrated in the model.

Mid-corporates

This model encompasses mid-corporates from Belgium and Luxembourg. Dexia defines a mid-corporate as a private company with total turnover lower than EUR 50 million and belonging to a group with consolidated total turnover lower than EUR 50 million and with total assets higher than EUR 2 million. This company is not a bank, a financial institution, an insurer or a satellite.

Public Sector Entities

Public sector entities represent a large part of the Dexia portfolio. Some differences between counterparties have been noticed inside this portfolio, and this explains the number of models.

West European Local Authorities

This model encompasses local authorities from France, Belgium, Spain, Italy and Portugal. From this model, the models applicable for German *Länder*, French *Groupements à fiscalité propre*, French *Groupements sans fiscalité propre* and Swiss Cantons have been inferred. These last two models are currently in a use-test period and will be used for regulatory purposes at the end of 2010.

Dexia defines local authorities as subsovereign governmental elected bodies empowered by the legislation of the country in which they are located with specific responsibilities in providing public services and with certain resources and capacity to decide their own practical organization in terms of administrative procedures, personnel, buildings, equipment, etc.

US States

The scope of application of the US State model encompasses the 50 States of the United States of America and the Commonwealth of Puerto Rico. The model only rates US State general funds or general obligations.

Every US State or local government has a general fund and generally issues general obligation or general fund debt. The general fund of a public entity is the main revenue coming from direct or indirect taxes and is used for common and general purposes. For instance, a general fund usually backs general obligation bonds, lease or certificate of participation bonds.

US Local Governments

The scope of the US local government model encompasses cities, counties and school districts. The internal rating system only rates US local government general funds or general obligations.

Other Counterparties from the US Municipal Sector (Expert Model)

The scope of application of these expert models covers only the counterparties related to the special revenue funds, i.e. the following categories for Dexia: Special Tax, Utilities (including water and sewer, gas and electricity), Higher Education, General Airport, Toll Facilities, Mass Transportation, Housing, Healthcare, Public Facility Lease.

Every local government or public authority generally has one or several special revenue funds, the financial characteristics of which differ from one sector to another. The special revenue funds of a public entity are usually used for a special purpose and they receive either utility revenues (water, public power, toll...) or special taxes (sales tax, allocation tax, excise tax...).

Other Satellites

The initial model encompassed the Belgian non-public satellites. The scope has been recently extended to all non-public satellites (including non-Belgian). Nevertheless, this second part is currently in a use-test period and will be used for regulatory purposes in 2010. Dexia defines "non-public satellites" as counterparties which are considered as "satellites" but not as "public satellites" as defined below:

- The "satellites" are entities, the main activity of which is a public authority's responsibility which has been delegated to the satellite concerned and of which the majority of stakeholders are not-for-profit entities.
- Among all the "satellites", the "public satellites" are those of which the business cannot be closed down (in particular the entity cannot be declared bankrupt), or if so, either a public authority gets assets and liabilities back, or an equivalent entity does so, and those of which strategic (including financial) decisions are made (or approved) by the public authority. The public satellite model is currently in a use-test period and will be used for regulatory purposes in 2010.

Social Housing

This model encompasses social housing companies in France and the United Kingdom. The social housing sector encompasses dedicated entities with public, private or non-profit entity status which have a social lessor's mission within the regulated field of social housing activity in France and in the United Kingdom. This field is notably strongly regulated by the *Code de la Construction et de l'Habitat* in France and by the Housing Corporation in the United Kingdom.

Belgian Regions and Communities

An expert methodology has been developed to rate the five Belgian regions and communities which are the French community, German community, Flemish community (including Flemish Region), Walloon Region and Brussels Capital Region.

Assimilations to Public Sector Entities

The in-depth analysis of some public sector counterparties (such as public hospitals in France or communities in Germany) shows that they share the same credit risk as the "master" counterparties to which they are assimilated (usually local authori-

ties or sovereigns). They are consequently assimilated to these “master” counterparties and benefit from the same PD and LGD as their “master” counterparties.

Retail

Retail – Individuals

These models encompass retail customers (individuals) from Dexia Bank Belgium or Dexia Banque Internationale à Luxembourg. Individuals are defined as retail counterparties without a self-employed activity or a liberal profession and are not linked to the activity of a legal entity.

Retail – Small Professionals

These models encompass small professional retail customers from Dexia Bank Belgium or Dexia Banque Internationale à Luxembourg defined as individuals with a self-employed activity or a liberal profession (i.e. doctors, lawyers, etc) or small companies generating a turnover lower than a certain threshold.

Retail – Small Companies

The models encompass small companies which are defined as companies generating a turnover higher than a certain threshold but that are still considered as retail counterparties based on distinctive criteria (i.e. not considered as mid-corporate or corporate counterparties).

Retail – Lombard Products

The “Lombard” model encompasses clients with “margin account” loans. Such loans are defined as loans (named “Lombard”) made available to customers as a current account or a term advance, subject to the deposit with the bank of collateral taking the form of securities or cash.

Equity and Securitization Transactions

No internal models have been developed specifically for equity or securitization transactions which follow a different regulatory approach under Basel II: securitization risk weighting is based on external and not internal ratings (Rating-Based Approach – refer to part 7); equities do not require the development of specific models (Simple Risk Weight Approach – refer to part 8).

Default Definition Used in the Models

The “default” notion is uniform throughout the entire Dexia Group covering all business segments with some minor exceptions due to special characteristics.

The notion of default has been harmonized from the beginning of the Basel II project with the impairment notion used in IFRS. All credits in default and only those flagged as in default give rise to an impairment test (that can or cannot eventually lead to a provision).

The notion of default is not automatically related to the notion of potential loss (for instance, a loan may present unpaid terms but may be totally collateralized and consequently present a nil expected loss) or to the notion of denunciation (which is decided on the basis of the interest Dexia may have to do so).

Definition, Methods and Data for Estimating PD, LGD and CCF

Main Principles Used for Estimating the PD

Types of counterparties	Through the cycle models	Default definition	Time series used	Internal/ external data
Sovereigns	Models are forward looking and through the cycle. They are designated to be optimally discriminative over the long term. The through the cycle aspect of the rating is also addressed in a conservative calibration of the PD.	Default at first day	> 10 years	External
Banks		Default at first day	> 10 years	External
Insurance companies		Transverse	> 10 years	External
Local public sector		Default at 180th day		Cf. following table
Corporates		Transverse	> 10 years	Internal + External
Specialist lending		Transverse	6 years	Internal
Mid-corporates		Transverse	6 years	External + internal
Other satellites		Transverse	5 years	Internal
Retail		Transverse	2 years	Internal
UCITS		Default at first day, if the net asset value is lower than the equity value.	N/A	
Equity	Specific approach: PD/LGD approach.	N/A	N/A	N/A
Securitization	Specific approach: Rating-Based approach.	Default if related ABS is classified as impairment 1 (loss probability >50%) or impairment 2 (loss probability =100%).	N/A	N/A

Overview of the Local Public Sector

Types of counterparties	Time series used	Internal/external data
Western Europe local authorities	From 5 years (e.g. Italy) to over 10 years (e.g. French municipalities, Belgian provinces and municipalities)	Internal + External
US municipalities	> 10 years	Internal + External
Groupements à fiscalité propre	4 years	Internal
Social housing	France: 9 years United Kingdom: 5 years	Internal

Main Principles Used for Estimating CCF

Types of counterparties	Main hypotheses	Time series used	Internal/external data
Sovereigns	Expert score function based upon Fitch country loss risk methodology and internal expert knowledge to discriminate between high and low loss risk.	> 10 years	Internal + External
Banks	Statistical model derived from LGD corporate model and integrating additional risk factors adapted to banking counterparty (country of residence, business profile, etc).	> 10 years	Internal + External
Insurance companies Corporates	Statistical model based on external rating agencies loss data. The LGD depends on counterparty rating, exposure seniority level, geographic region and macro-economic factors.	> 10 years	Internal + External
Local public sector	Cf. next table.		
Specialist lending	This model belongs to the "Workout LGD" type: the LGD computation was developed according to the workout of the bank during a 10-year period concerning internal project finance default facilities. Cash flows are estimated on the basis of the observed historical recovery process, and LGD is computed by means of discounted cash flows.	10 years	Internal
Mid-corporates	The LGD model is a white box model with explanatory variables: number of workout years. The LGD is calculated as the multiplication of the LGD unsecured (LGD when the loans are not collateralized) and of the haircut factor taking into account the collateralization of the loan.	7 years	Internal
Other satellites	Based on internal observation.	5 years	internal
Retail Dexia Bank Belgium	Statistical model based on cash flow observation and segmentation by type of product for the concerned segments of retail customers (individuals, small businesses and professionals, medium enterprises treated as retail).	Available data differ depending on product types but minimum 7 years	Internal
Retail Dexia Banque Internationale à Luxembourg	The retail LGD model is based on statistical estimates of prior LGD and haircuts to compute LGD in line with the comprehensive CRM technique as part of the AIRB Approach and the Dexia Group guidelines.	5 years	Internal
UCITS	Merton-like model when expected losses and implicit LGD are also estimated by this model.	N/A	Internal + External
Equity	Specific approach: PD/LGD approach.	N/A	N/A
Securitization	Specific approach: Rating-Based approach.	N/A	N/A
Western Europe local authorities	Statistical model based on the internal existing default cases observed which were related to French municipalities. Final LGD are segmented on the basis of the number of inhabitants and on an economic parameter.	>10 years	Internal
Municipalities US	The Muni US LGD model is an expert model guided by external recovery rate factors and estimates. The final segmentation is based on business sectors.	N/A	External
Groupements à fiscalité propre	A mixed analytical - expert model was chosen and constructed based on the indicative available observations to determine indicative LGD and quantify potential loss related to a default in this sector.	4 years	Internal
Social housing	Expert model based on a global evaluation of security/credit risk mitigant. Segmentation is based on the number of houses and on a performance ratio.	9 years	Internal + External

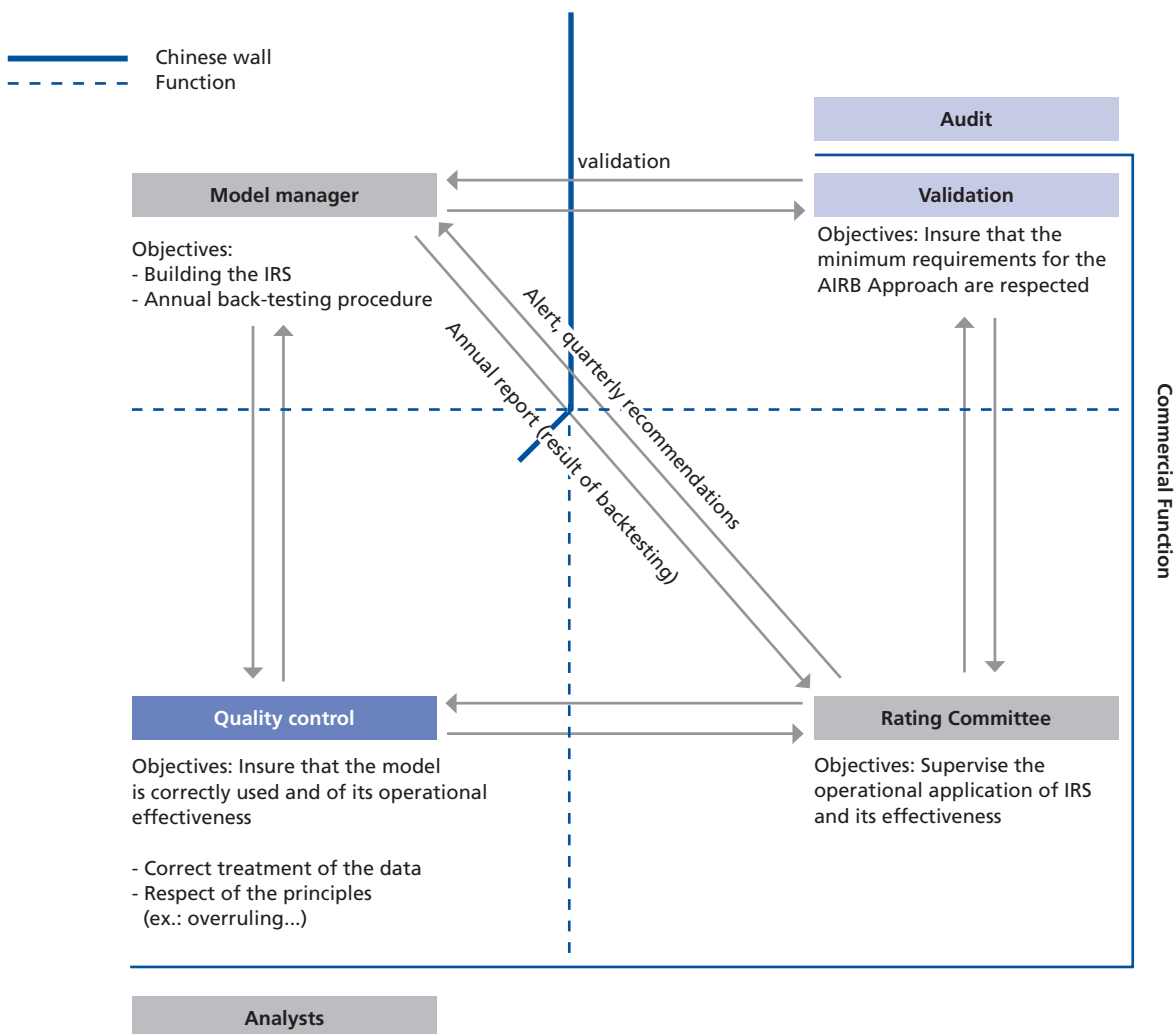
Main Principles Used for Estimating CCF

At present Dexia does not use CCF models for regulatory purposes except for Specialist Lending and US Municipalities CCF models. Otherwise, Foundation Approach is applied.

Most of the CCF models were calibrated and internally validated in 2008 (these models will then be used for regulatory purposes in 2010) based on a statistical approach using the data of the internal loss database or based on expert approaches when such approaches are not available.

3. Control Mechanisms for Rating Systems

The Basel II regulation requires internal control of the internal rating systems and processes. The following graph provides an overview of the different control functions.



The control mechanisms for Internal Rating Systems (IRS) are organized in 3 levels:

- Quality Control is responsible for the permanent control of IRS;
- Validation is responsible for the overall assessment of the IRS;
- Audit is responsible for auditing the general consistency and compliance with the regulation of the IRS, operational validation being carried out by the Validation Department.

Chinese walls between Model manager and Validation, Model manager and Rating Committee and Validation and Audit ensure control system independence.

Quality Control

Quality Control Purpose

Quality control is defined, in accordance with the regulatory directives, as an internal and independent audit to ensure that the IRS is being used properly, that it is operationally effective and that the audit trail in the rating process remains clear.

In practice, the controls and organization established meet a number of requirements:

- Ensuring that the assumptions on which the model is founded are respected;
- Facilitating the adaptability of the general IRS containment procedure. When malfunctions or anomalies in the use of or results produced by the model are evidenced, swift and effective remedial action should follow. To this end, control should not only concentrate on anomalies but it should also explain their cause. A regular and constructive relationship with the backtesting function has been put in place which has the authority to modify the model with the approval of the Validation Advisory Committee (VAC), and the Rating Committee.
- Ensuring the establishment of IRS containment procedures and the maintenance of the audit trail in the rating process.

Quality Control Scope

The scope of the quality control process within Dexia Group applies as following to:

- All Basel II models;
- All entities within the Dexia Group (with the exception of Dexia Insurance and Dexia Asset Management); and
- All geographical locations.

Each entity is responsible for setting up a quality control unit for the IRS that applies to:

- The counterparties within its scope on the PD IRS, i.e. the IRS used by the credit risk team of that entity, its subsidiaries and its branches.
- The transactions within its scope on the LGD IRS.

Quality Control Process: Parties Involved

Key Stakeholders and Functions

The quality control process is decentralized for local portfolios with coordination and steering at the level of the Risk Management team at Dexia Group level.

Quality Control Steering Committee

A quality control steering committee has been set up in order to ensure a uniform approach throughout the Group.

Rating Committee

The key role of the Rating Committee is to monitor the appropriate application of internal rating systems within the Group as a whole and to ensure that these IRS are effective.

For these reasons, the Rating Committee:

- Validates overrides proposed by analysts on counterparties of its own competence;
- Reviews quality control reports about the utilization and performance of IRS;
- Monitors the homogeneous application within the Group of the rating and derogation principles;
- Validates operational establishment of the models once they are validated by the VAC.

Quality Control Processes and Guarantee of Independence

Fully aware of the importance of preserving the neutrality of the quality control process, a Chinese wall has been set between development departments, model managers, sales function, analysis functions and the quality control function. This Chinese wall ensures a high credibility of the final quality control outcomes. This way any potential conflict of interest is fully avoided:

- The quality control function is independent;
- The quality control function submits its proposal to the Rating Committee which can deliberate on any subject concerning IRS or modes of applying the IRS within the Group.

Validation

The Validation Department

All Dexia Group models, either market risk models, pricing models, Basel II Pillar 1 credit rating models, ALM models, economic capital models (Basel II Pillar 2) & Solvency II insurance models must obtain an independent validation.

The main objectives of the Validation department are:

- To define the procedures and guidelines of model validation;
- To identify all models waiting for validation;
- On this basis to elaborate a validation schedule, taking account of a firewall between Validation and Modeling;

- To exercise the validation work on the models;
- To bring and defend their works before the Validation Advisory Committee (VAC) in order to obtain a pre-approval;
- To present these pre-approvals for final approval to the Risk Policy Committee (RPC³).

Validation Approval Process

The process set up to endorse the validation of models deployed within Dexia Group is multi-layered, ensuring total compliance with regulations and local regulation requirements through the work-out of proposals by the Validation department, an approval of these proposals by the VAC and a final endorsement by the RPC, composed of members of the Dexia Management Board.

The validation approval process is formalized in a set of policies and guidelines. The output of the validation is formalized in a validation report also including an executive summary, strengths and weaknesses and a list of recommendations. These reports together with a set of slides are presented to the VAC, the RPC and are sent to the Regulators upon request.

The Validation Advisory Committee

As mentioned above, in order to develop an efficient and transparent validation process, the Validation Advisory Committee (VAC) has been set up. The VAC is responsible for:

- Establishing and following up the overall validation framework including procedures and subcommittees terms of reference;
- Defining priorities in the validation of the various risk models;
- Reviewing each validation step of the guidelines and model life cycle validations;
- Preparing proposals for decisional committees to facilitate the decision-making process.

In practice, four Validation Advisory Committees exist:

- The Markets VAC covering market risk and pricing models;
- The Basel II VAC covering Basel II Pillar 1 credit rating models and operational risk models;
- The Insurance VAC covering Solvency II insurance models;
- The Transversal VAC covering transversal models such as economic capital models and ALM models.

The VACs are composed of the representatives from the Validation departments, Risk Management Group, Risk Management entities and representatives of the business lines and/or Modeling teams for the validation of their respective business lines/models, this in line with the type of models they cover. Internal Audit is also present as it constitutes an additional level of control on the validation process.

Validation Scope

The global scope of the generic validation process within Dexia Group applies to:

- All models requested by regulators (e.g. Basel II, Solvency II, IFRS II) or for business purposes;
- All risks deployed in the company, such as insurance, credit, market, operational and ALM related risk...;
- All Dexia Group entities (cross-entity dimensions);
- All geographical locations (cross-border dimensions).

Audit

According to the CRD minimal requirement 131, Annex VII Part 4, "Internal Audit has to include in its plan, at least once a year, a review of the IRS and its functioning, including credit scoring and estimation of PD, LGD, EL and CCF. Also compliance with all the minimal requirements has to be verified".

At Dexia, this annual verification has been delegated to the Validation department. Audit acts as an additional level of control, included in its audit plan.

Nevertheless for the smallest entities, the Validation department relies on the work carried out by the local auditors. To support this, the Validation department dispatches its methodology/key controls.

³ The RPC can delegate application modalities for their decisions to other specialized Risk Committees (within the limits and rules defined by the RPC), e.g. RPCi (insurance) in case of insurance models, ...

4. Business Integration of Internal Estimates

Internal estimates of Basel II parameters are increasingly used within Dexia, at present covering a large number of applications in addition to the calculation of the regulatory risk-weighted exposure amounts. They are notably used in the following fields:

- Decision-making process;
- Credit risk management and monitoring;
- Internal limit determination;
- Provisioning methodology;
- Capital allocation;
- Pricing.

Decision-Making Process

Basel II parameters are key elements considered by the Credit Committee in assessing the opportunity to accept or reject a transaction. Credit guidelines have been updated in order to integrate Basel II parameters while assessing credit proposals.

Credit Risk Management and Monitoring

Basel II parameters are actively used in periodic credit risk reporting and also for the individual follow-up of distressed transactions and counterparties within Watch List Committees.

Dexia integrates the Basel II parameters to define a new internal reporting based on a unique and common reporting credit risk data warehouse and Group-wide uniform concepts. The counterparty internal ratings, the LGD, the level of EL and the regulatory weighted risks are the key Basel II parameters used within the new internal reporting and the credit risk portfolio review. A central database registers internal ratings and keeps them available for all relevant needs.

Internal Limit Determination

Basel II parameters have been integrated for fine-tuning the Dexia credit limit system and determining delegation levels for credit acceptance.

Provisioning Methodology

The implementation of Basel II parameters has made it possible to develop more synergies between accounting and prudential issues (IFRS/Basel II), while relying on the processes, data and tools of the Basel II project.

The Basel II notion of default and the accounting notion of impairment have converged in relation to specific impairments.

As a consequence, only defaulted assets identified as such in the Basel II compliant risk management systems are identified as impaired assets for both accounting and risk management purposes. However, some exceptions to this general principle exist in relation to some specific segments such as equity, Undertaking for Collective Investment in Transferable Securities (UCITS) or Asset-Backed Securities (ABS). For these types of products, the notion of default cannot be applied due to their characteristics; hence the sole notion of impairment prevails.

Capital Allocation

The capital allocation process is managed through reporting, budgeting and cost control procedures within the Dexia Group. This capital allocation relates to both regulatory and economic capital.

All credit files submitted to the Dexia Credit Committees include a weighted risk calculation based either on the regulatory Basel II parameters (PD, LGD, CCF) or on economic parameters.

Pricing

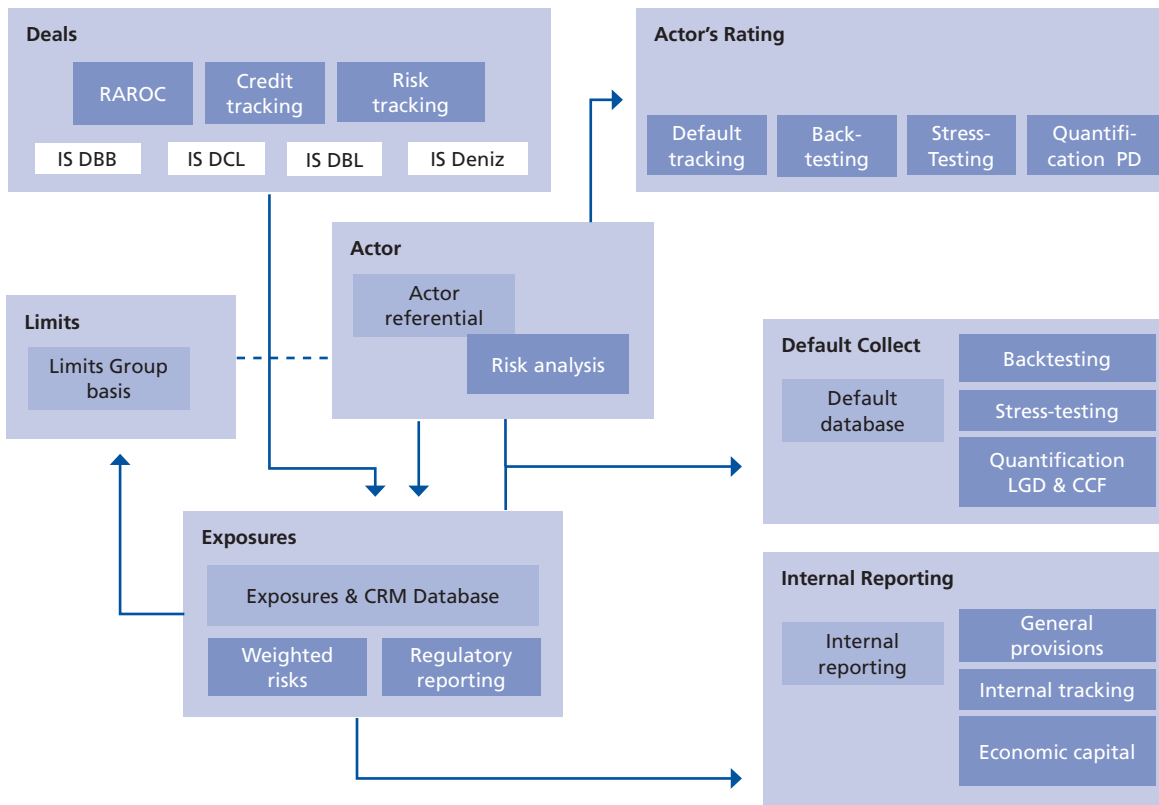
Basel II parameters are integrated in the RAROC calculation tool. As a consequence, the Basel II parameters are integrated in the pricing. RAROC is the risk adjusted return on capital generated on a transaction or a portfolio.

5. Credit Risk IT Systems

Basel II has been an outstanding opportunity for Dexia to reinforce the integration of its risk management IT systems and promote close cooperation between Dexia entities.

In order to foster best practices in its IT systems and to ensure state-of-the-art solutions to Basel II requirements, Dexia completely redesigned its Credit Risk IT Systems.

The following chart provides a global view of the functional architecture of the credit risk information system within Dexia Group.



Note: DDB=Dexia Bank Belgium; DCL=Dexia Crédit Local; DBL=Dexia Banque Internationale à Luxembourg; Deniz=DeniaBank

The core of credit risk IT systems is the "actor" database which gathers information on all Dexia credit counterparties (identified by a unique internal identification number) such as:

- Type of counterparty (bank, corporate, retail, etc);
- Descriptive data;
- External ratings from rating agencies (S&P, Moody's and Fitch);
- The internal rating before and after the Sovereign ceiling impact;
- The internal rating system;
- Available internal credit analyses;
- Relations between different counterparties such as capital or commercial ties.

The "actor" database is linked to other databases that allow:

- Attribution of an external and/or internal rating to credit counterparties (actor rating database).
- A precise view on the exposure related to one given counterparty (exposure database) with all their characteristics such as type of product (facility, loan, bond, equity, etc), significant amounts (nominal, outstanding, mark-to-market, accrued interests, etc), identification of the counterparty to which this exposure is linked (bank, counterpart, etc), seniority level, RAROC, and so on.
- A comparison to be made of current exposure with current limits on any credit counterparty (limit database) and appropriate actions to be taken when needed.
- Production of credit risk internal reports based on the information gathered in Dexia's centralized IT systems (internal reporting database).
- Feeding Dexia default databases which are then used to calibrate, backtest and stress-test Dexia internal rating systems.

Process Used to Transfer the Issuers and Issue Credit Assessments onto Items not Included in the Trading Book

Issuers and issue credit assessments onto items not included in the trading book are automatically collected by Dexia credit risk IT systems and then attributed to the relevant issuers or issues on the basis of a unique identification number for issuers (Dexia internal "ID" numbers) and for issues (ISIN codes).

Appendix 3

Dexia Originations

Traditional Securitizations of Dexia as Originator

Dexia Bank Belgium, Dexia Crediop and DenizBank have securitization vehicles:

- Five for Dexia Bank Belgium (Atrium-1, Atrium-2, MBS, Dexia Secured Funding Belgium – DSFB – and Penates);
- Two for Dexia Crediop (DCC and Tevere Finance);
- One for DenizBank (DFS Funding Corporation Cayman).

Atrium-1 and Atrium-2 (Type of Underlying Assets: Corporate)

Atrium-1 is a securitization transaction for social housing loans pursuant to a long term credit facility between Dexia Bank Belgium and Domus Flandria NV (the borrower) and guaranteed by the Flemish Region. The guarantee of the Flemish Region was transferred to the special purpose vehicle (SPV). The original size of the transaction was EUR 188 million. Two classes of fixed-rate notes were issued on 30 April 1996, both carrying a Moody's rating equal to that of the Flemish government (initially Aa2, currently Aaa). As at 31 December 2009 EUR 88.5 million were still outstanding under class A2 while class A1 has been repaid.

Atrium-2 is a securitization transaction for social housing loans pursuant to a long term credit facility between Dexia Bank Belgium and Domus Flandria NV (the borrower) and guaranteed by the Flemish Region. The guarantee of the Flemish Region was transferred to the SPV. The original size of the transaction was EUR 129.3 million. Two classes of fixed-rate notes were issued on 19 June 1997, both carrying a Moody's rating equal to that of the Flemish government (initially Aa2, currently Aaa). As at 31 December 2009 EUR 66.7 million were still outstanding under class A2.

MBS-4 (Type of Underlying Assets: Residential Mortgage)

MBS has six compartments, of which one with activity.

MBS-4 is a securitization transaction for Belgian residential mortgage loans. The transaction, which had an original outstanding amount of EUR 272.7 million, was launched on 25 November 1998. Four floating-rate tranches of bonds were issued, three senior classes (called class A1 through A3 and rated Aaa/AAA by Moody's and Fitch) and one junior class (called class B and rated A3/A by Moody's and Fitch). As at 31 December 2009 there were still EUR 26.9 million outstanding. There are EUR 23.8 million outstanding under class A3 (still rated Aaa/AAA by Moody's and Fitch) and EUR 3.1 million under class B (currently rated Aa1/AA by Moody's and Fitch). MBS-4 has been called on 25 January 2010 meaning that all bonds are redeemed in full. Dexia Bank Belgium has bought the remaining portfolio of residential mortgage loans. After the call, none of the compartments of MBS NV will be active any more. Therefore MBS NV will be liquidated after the call of MBS-4.

DSFB-1, DSFB-2, DSFB-3 and DSFB-4 (Type of Underlying Assets: Public Sector)

Dexia Secured Funding Belgium N.V./S.A. (DSFB) is a Belgian securitization vehicle (*institutionele VBS naar Belgisch recht/SIC institutionnelle de droit belge*) incorporated in June 2007.

DSFB, acting through its ring-fenced compartments DSFB-1, DSFB-2, DSFB-3 and DSFB-4, securitized loans granted to Belgian public sector entities or 100% guaranteed by such public sector entities.

The original size of the transactions was EUR 1.7 billion (DSFB-1 launched on 28 June 2007), EUR 1.62 billion (DSFB-2 launched on 28 April 2008), EUR 928 million (DSFB-3 launched on 9 October 2008) and EUR 5.06 billion (DSFB-4 launched on 14 December 2009).

At closing date, the floating rate notes issued were rated AA/Aa1/AA+ (DSFB-1), AA/Aa1/AA+ (DSFB-2) by respectively S&P, Moody's and Fitch, A+ (DSFB-3) by S&P and AA (DSFB-4) by Fitch for the Class A notes only.

For DSFB-1, DSFB-2 and DSFB-3, Dexia Bank Belgium has guaranteed the payment of principal and interest on the notes.

As at 31 December 2009, EUR 1.53 billion (DSFB-1) and EUR 1.54 billion (DSFB-2) were still outstanding with notes having a rating of A/A1/A+. EUR 4.7 billion Class A notes, EUR 300 million non-rated Class B floating rate notes, EUR 60 non-rated Class C floating rate notes (DSFB-4) were still outstanding with the Class A notes having a rating of AA. The DSFB-3 transaction was redeemed in full on 25 August 2009.

The DSFB transactions have been fully subscribed by Dexia Group's entities and for a minor part by Dexia Bank Belgium.

Penates-1 and Penates-2 (Type of Underlying Assets: Mortgage Loans)

Penates Funding NV is a Belgian securitization vehicle (SIC) currently with three compartments, two of which have been activated.

On 27 October 2008, Dexia Bank Belgium closed a EUR 8,080 million RMBS securitization transaction. The SPV, Penates Funding acting through its compartment Penates-1, securitized Belgian residential mortgage loans originated by Dexia Bank Belgium and issued five classes of notes: EUR 7,600 million Class A mortgage-backed floating rate notes due 2041 (Fitch AAA/ S&P AAA); EUR 160 million Class B mortgage-backed floating rate notes due 2041 (Fitch AA); EUR 120 million Class C mortgage-backed floating rate notes due 2041 (Fitch A); EUR 120 million Class D mortgage-backed floating rate notes due 2041 (Fitch BBB) and EUR 80 million Subordinated Class E floating rate note due 2041 (not rated). As of 31 December 2009 all the notes still have their initial rating and the outstanding amounts for all classes of notes are still at their initial amount except for the Class A notes where the balance decreased to EUR 6,865.5 million. There was therefore EUR 7,345.5 million outstanding on notes under Penates-1 as at 31 December 2009.

On 15 December 2008, Dexia Bank Belgium closed a EUR 3,636 million RMBS securitization transaction. The SPV, Penates Funding acting through its compartment Penates-2, securitized Belgian residential mortgage loans originated by Dexia Bank Belgium and issued five classes of notes: EUR 3,384 million Class A mortgage-backed floating rate notes due 2041 (Fitch AAA/ S&P AAA); EUR 72 million Class B mortgage-backed floating rate notes due 2041 (Fitch AA); EUR 72 million Class C mortgage-backed floating rate notes due 2041 (Fitch A); EUR 72 million Class D mortgage-backed floating rate notes due 2041 (Fitch BBB) and EUR 36 million Subordinated Class E floating rate note due 2041 (not rated). As at 31 December 2009 the outstanding balance of Penates-2 notes decreased to EUR 3,342.7 million. The decrease is fully due to the amortization under the Class A notes. The outstanding amount under the Class A notes dropped to EUR 3,090.7 million as at 31 December 2009. All classes of notes still have their initial rating.

The Penates transactions have been fully subscribed by Dexia Bank Belgium (95%) and by other Dexia Group's entities. The notes can be used as collateral in repurchase agreements with the European Central Bank.

DenizBank – Diversified Payment Rights

In June 2005, DenizBank completed its first securitization transaction: the "DPR (Diversified Payment Rights) Securitization". The bank securitizes its SWIFT MT 100 category payment orders received primarily through foreign depository banks in EUR, USD and GBP currencies.

The SPC "DFS Funding Corporation Cayman" issued three tranches of series and bought the diversified payment rights.

The original size of the three tranches was respectively USD 150 million/EUR 108 million (Series 2005-A floating-rate notes due 2010 – which were disposed on 3 July 2007), USD 80 million/EUR 57 million (Series 2005-B fixed-rate notes due 2012, has been reimbursed partially every three months and amounted to USD 45 million as at 31 December 2009), USD 70 million/EUR 50 million (Series 2005-C fixed-rate notes due 2010, has been reimbursed partially every three months and amounted to USD 5.8 million as at 31 December 2009) .

In June 2007, Dexia arranged another two tranches under the same programme: USD 200 million/EUR 144 million (Series 2007-B floating-rate notes due 2015) and USD 150 million/EUR 108 million (Series 2007-C floating-rate notes due 2015).

As at 31 December 2009, USD 400.8 million were outstanding (EUR 285.5 million).

Dexia Crediop per la Cartolarizzazione (DCC) – Series 2004-1, Series 2005-1 and Series 2008-1 (Type of Underlying Assets: Public Sector)

Dexia Crediop arranged an issuance programme composed of three transactions in order to securitize first business line assets. The underlying assets are bonds issued by local authorities and held by Dexia Crediop. The original size of the transactions was EUR 1,131.85 million, EUR 1,008.97 million and 2,346.19 million respectively. Two classes of notes were issued on 24 May 2004 (Series 2004-1), two on 10 November 2005 (Series 2005-1) and two on 26 March 2008 (Series 2008-1), class A were rated Aa2/AA-/AA by Moody's, S&P and Fitch (today: A2/A/A) (on the basis of the unconditional guarantee of Dexia Crediop, and class B is not rated).

As at 31 December 2009, the outstanding commitments amounted to EUR 836.9 million and EUR 3 million respectively (Series 2004-1) for class A and class B; the outstanding commitments amounted to EUR 779.5 million and EUR 3 million respectively (Series 2005-1) for class A and class B and the outstanding commitments amounted to EUR 2,219.5 million and EUR 46.2 million respectively (Series 2008-1) for class A and class B.

An amount of EUR 3.8 billion was subscribed by entities of the Dexia Group.

Tevere Finance Series 2009 I, Series 2009 II (Type of Underlying Assets: Public Sector and Other)

On 27 February 2009, Dexia Crediop issued two securitizations with the intention of providing funding with the use of senior ABS (previously re-purchased) in Repo transaction with the European Central Bank (the underlying assets are not ECB eligible).

The underlying assets of Tevere Finance series I are bonds issued by Italian local authorities (4.67% Italian Regions; 42.78% Italian Provinces; 52.54% Italian municipalities). Two classes of notes were issued: Class A (senior tranche rated A by S&P) and Class B (junior/subordinated tranche unrated). The original size of these classes was EUR 715.7 million (Class A) and EUR 109.1 million (Class B). Both classes were purchased by Dexia Crediop at inception.

The underlying assets of Tevere Finance series II are loans granted to an Italian financial institution. Two classes of notes were issued: Class A (original size: EUR 253.9 million) and Class B (original size: EUR 1.1 million). Both classes are unrated.

As at 31 December 2009 the outstanding amount was the same as the original size.

Synthetic Securitizations of Dexia as Originator

WISE 2006-1 (Type of Underlying Assets: Corporate and Other)

WISE 2006-1 is a partially funded synthetic securitization pursuant to which Dexia Crédit Local Dublin Branch bought credit protection on a portfolio of GBP 1.5 billion wrapped bonds related to PPP/PFI or regulated utilities in the water, electricity or gas sectors. The transaction was closed on 21 December 2006.

Dexia is transferring the credit risk related to the wrapped infrastructure portfolio to external parties by means of two credit default swaps: a non-funded super senior credit default swap with an OECD Bank and a junior credit default swap with WISE 2006-1 Plc, a special purpose company registered in Ireland. WISE 2006-1 has issued 3 tranches of credit linked notes (CLNs) to transfer the risk to the market, ranging from AAA/Aaa to AA-/Aa3 (S&P and Moody's respectively) at inception. As at 31 December 2009 the rating of the class A notes was B+/Ba3, the rating of class B notes was CCC+/B3 and the rating of the class C notes was CCC/Caa2 (S&P and Moody's respectively). The tranches have been placed with several investors. The bonds (underlying assets) will remain on the Dexia Crédit Local Dublin Branch balance sheet and will continue to be administered by the company.

Dublin Oak Ltd (Type of Underlying Assets: ABS)

Dublin Oak is a partially funded balance-sheet CDO transaction on a USD 3 billion portfolio of Asset-Backed Securities (ABS) entered into by Dexia Bank Belgium Dublin Branch on 15 May 2007. The securitized portfolio consisted of 127 different ABS, all rated AAA by one or more rating agencies. The portfolio is diversified among a number of ABS asset classes including: student loans, RMBS and CMBS.

Dexia was selling the credit risk related to the AAA ABS portfolio to external parties by means of two credit default swaps: a non-funded super senior credit default swap with an OECD bank and a junior credit default swap with Dublin Oak Ltd, a special purpose company registered in Ireland. Dublin Oak has issued 3 tranches of CLNs to transfer the credit risk to the market. As at 31 December 2009 the rating of class A notes was Caa2 and for the class B notes was Ca from Moody's. The ABS portfolio remains on the Dexia Bank Belgium Dublin Branch balance sheet and continues to be managed by the ABS portfolio management team based in Dublin.

Dexia as Originator/Contributor

DRECM Securitization Activity (Type of Underlying assets: Commercial Mortgage Loans)

Dexia Real Estate Capital Markets (DRECM) originates fixed rate commercial real estate loans with the intent of packaging the loans into CMBS bonds and selling them through a securitization process. Its first securitization was completed in 1998. Subsequent transactions were always concluded with deal partners in order to create larger deals which would be more liquid in the secondary markets. DRECM is mainly a loan originator/contributor and relies on the large brokers/dealers it works with to underwrite the deal with the marketing, finalize the actual sale of the bonds and maintain a secondary market in all the bonds.

As a loan contributor, DRECM does not have any ongoing interest in the securitizations in which it participates. Credit enhancement in these CMBS bonds is achieved through subordination. As such, bonds are created with different ratings whereby the total nominal amount of all bonds equals the total pool loan amount. All bonds of all rating categories (including the BB, B, non-rated portions and IO strips) are sold to outside investors. The servicing rights are also sold to an outside entity and they take on the task of monitoring the loans on an ongoing basis on behalf of the trust.

In 2009, DRECM made no securitization. As at 31 December 2009, the outstanding amount of all securitizations originated by DRECM in the previous years amounted to USD 8,158 billion (EUR 5,666 billion).