

# Risk report 2010

Pillar 3 of Basel II

# Contents

Introduction.....	3
<b>1. Risk Management Objectives and Policies .....</b>	<b>6</b>
1.1 Mission and Objectives .....	6
1.2 Risk Governance and Organization .....	6
1.3 Dexia Risk Cartography.....	10
<b>2. Own Funds and Capital Adequacy.....</b>	<b>11</b>
2.1. Own Funds.....	11
2.2. Capital Requirements by Type of Risk .....	14
2.3. Capital Adequacy .....	15
2.4. Significant Banking Subsidiaries .....	17
<b>3. Credit Risk .....</b>	<b>18</b>
3.1. Credit Risk Management and Governance .....	18
3.2. Credit Risk Exposure .....	21
3.3. Impairment, Past-Due and Related Provisions .....	26
3.4. Credit Risk Mitigation Techniques .....	30
3.5. AIRB Approaches .....	33
3.6. Standardized Approaches .....	38
3.7. Counterparty Risk on Derivatives.....	42
3.8. Focus on Equity Exposure.....	43
3.9. Focus on Securitization Activities.....	45
<b>4. Market and Balance-Sheet Management Risks .....</b>	<b>51</b>
4.1. Market Risk .....	51
4.2. Balance-Sheet Management Risk .....	56
<b>5. Operational Risk .....</b>	<b>59</b>
5.1. Definition .....	59
5.2. Governance.....	59
5.3. Management of the Risk.....	59
<b>6. Pillar 2 Risks.....</b>	<b>62</b>
6.1. Behavioural Risk .....	62
6.2. Business Risk .....	62
6.3. Strategic Risk.....	63
6.4. Reputation Risk .....	63
6.5. Model Risk .....	64
6.6. Pension Risk .....	64
6.7. Insurance Risk.....	65
6.8. Settlement Risk.....	65
6.9. Securitization Risk.....	66
<b>Appendix 1 – Glossary.....</b>	<b>67</b>
<b>Appendix 2 – Internal Rating Systems .....</b>	<b>70</b>
<b>Appendix 3 – Basics on Securitization.....</b>	<b>82</b>
<b>Appendix 4 – Dexia Originations .....</b>	<b>84</b>
<b>Appendix 5 – List of Dexia main subsidiaries and branches .....</b>	<b>88</b>

# Introduction

In 2010, the Risk Management activities were severely impacted by a disrupted economic environment, marked by significant interest and exchange rates volatility as well as considerable investor distrust for some sovereign issuers in the euro zone. Despite this difficult context, Dexia continued to implement its transformation plan successfully, further reducing its short-term funding requirement and thus its risk profile. An update on the transformation plan of Dexia is available in its annual report.

This reduction of the Group's risk profile continued thanks to the bond portfolio in run-off mode since the end of 2008. In line with the agreement with the European Commission, the Group also disposed of various holdings in 2010 which, combined with the reduction of the portfolio in run-off, is reflected by a fall of EUR 38.5 billion in the Group's credit risk exposure compared to the end of 2009. Weighted risks naturally followed the same trend and decreased by EUR 2.3 billion over the year, despite the unfavourable impact of the price of the euro against the US dollar, whilst the Tier 1 ratio improved from 12.3% at year-end 2009 to 13.1% at year-end 2010. We can also notice a significant reduction of the cost of risk which amounted to EUR 641 million in 2010 against EUR 1,096 million in 2009. The decrease would be higher by excluding the Financial Products portfolio.

Over the year, the Group considerably reduced its short-term liquidity gap and continued to improve the mix of its short-term funding sources. This improvement of its liquidity situation enabled Dexia to exit the State guarantee on its financing four months before the formal end date of 30 October 2010. In fact, on 30 June 2010, the Group stopped issuing guaranteed debt, in line with its undertakings to the European Commission.

Dexia was subject to the 2010 European Union-wide stress testing exercise, coordinated by the Committee of European Banking Supervisors (CEBS). The conclusion of that stress test, based on various scenarios of credit-quality deterioration<sup>1</sup>, is that Dexia does not require additional capital to withstand the CEBS two-year adverse scenario, including the additional sovereign shock (for more detailed information on stress test, refer to the part dedicated to stress tests in part 2.3.2. – Internal Capital Adequacy).

Market activity monitoring was improved with the launch in 2010 of the "Market Risk Engine" project aimed at having an integrated system for the calculation of historical VaR over all risk factors. Considerable progress was also made in valuing structured instruments and back-to-back derivatives.

Dexia continued the development and implementation of various transversal projects:

- new credit models were developed and will be gradually used for the calculation of regulatory capital;
- Dexia put in place an action plan related to stress-testing: the development of new governance enhancing and optimizing the organization in place was made a priority in 2010;
- a formal framework of risk appetite indicators was put in place at Dexia SA level and will be gradually introduced in the main entities during 2011;
- an action plan was put in place to answer the recommendations made by the Dexia regulators within the context of the Pillar 2 mission;
- potential impacts of the regulatory developments proposed by the BIS (Bank for International Settlements) were quantified, particularly regarding the definition of capital, leverage ratio and liquidity ratios;
- Dexia took part in international consideration of the evolution of IFRS regulations on classification and provisioning, with presentation of the exposure draft in June 2010, as well as on the hedging of financial instruments.

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<sup>1</sup> The test was conducted using the scenarios, methodology and key assumptions provided by the CEBS, detailed in the aggregate report published on the CEBS website: <http://www.c-eps.org/EU-wide-stress-testing.aspx>

## 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) to further 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<sup>2</sup> 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 roll-out 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, equity risk and commodity risk (refer to part 4 – Market and balance-sheet management risks).

#### 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).

<sup>2</sup> As from 1 April 2011, the competences of the Banking, Finance and Insurance Commission have been split between the Belgian National Bank, in charge of prudential control, and the Financial Services and Markets Authority (FSMA), in charge of supervising financial markets and listed companies.

## 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

Pillar 2 was further consolidated in 2010 following inspections by the college of regulators. This process, applicable since end of 2008, requires banks to demonstrate to the regulators the adequacy of their risk profile and their capital (Internal Capital Adequacy Assessment Process – ICAAP). In this context, appropriate internal systems should be in place for the calculation and management of the risks and the assessment of the economic capital needs.

The Board of Directors and the Management Board of Dexia SA have been kept closely informed of developments on Pillar 2. In May 2010 these two governance bodies approved Dexia's global risk appetite policy.

## Pillar 3 – Disclosure Policy

### Frequency of Disclosure

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

Pillar 3 disclosure is organized on an annual basis together with the 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](http://www.dexia.com)).

### Currency

The figures in the following tables are provided in millions of euros (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.).

The list of main subsidiaries and branches included in the perimeter is provided in Appendix 5.

### 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.

Dexia SA is authorized as 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

2010 was marked by the streamlining of the Risk Management organization fully aligned on the general organization of the Dexia Group and based on a directive model in which the local CRO (Chief Risk Officer) reports directly to the Group CRO. In this context, the mission of the Risk Management support line has been redefined. Main challenges are to define the Dexia risk appetite, putting in place independent and integrated risk measures for all types of risks, to manage all risks and proactively identify and address all emerging risk.

The support line is now organized transversally by business line: Retail and Commercial Banking credit risks, Public and Wholesale Banking credit risks and risks related to financial market activities. This organization is based on expertise centres on which local risk management can rely, in accordance with the Service Level Agreements concluded in 2010.

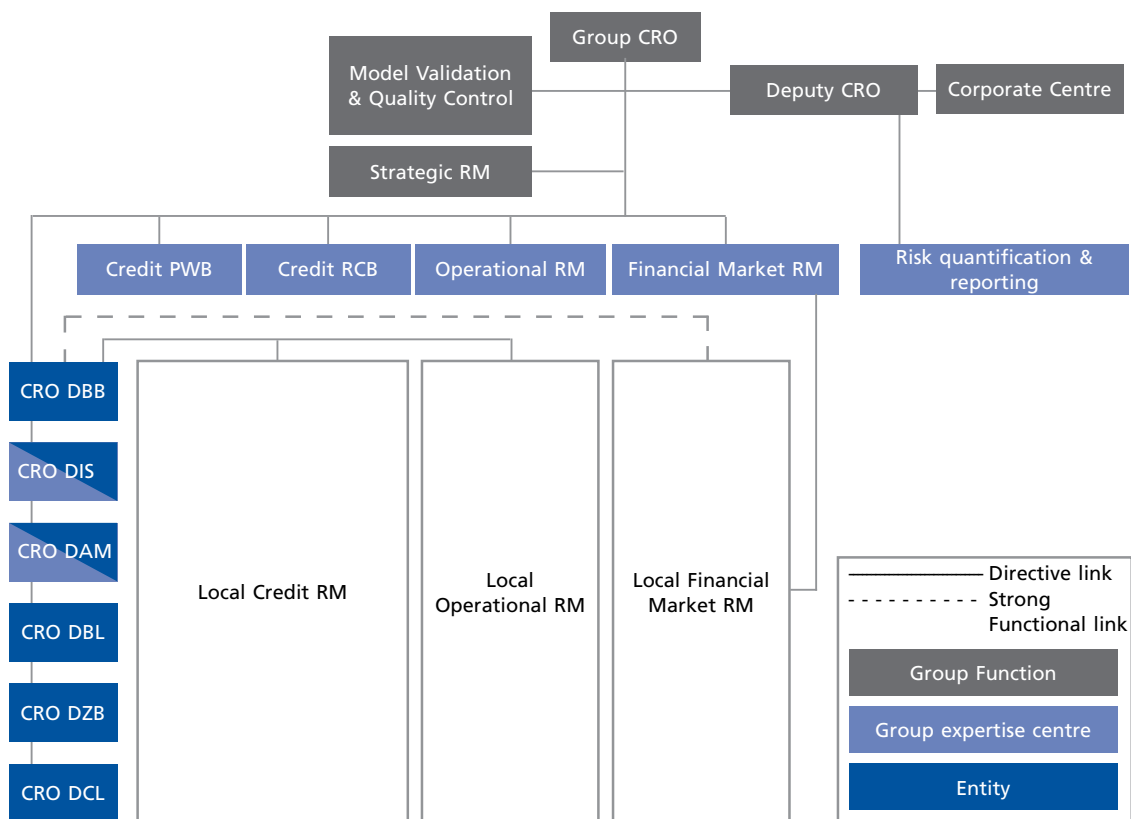
## 1.2. Risk Governance and Organization

### 1.2.1. Organization

The new Risk Management organization is aligned on the overall Dexia Group organization as evidenced above. 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 in line 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 in charge of 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 & real estate counterparties and international local authority counterparties. The Credit Risk Analysis Centres are responsible for assigning internal ratings to Dexia counterparties but also monitoring and reporting on the portfolio. In addition, they play a key role in the qualitative part of the back testing and stress testing process.
- PWB model management responsible for developing and maintaining Internal Rating Systems (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, country 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, analyzing, monitoring (including valuation, model management) and reporting on risks and results with a holistic view.

The other Dexia expertise centres are:

### **Operational Risk Management**

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 in charge of defining and developing the risk quantification approaches (quantitative risk modelling 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 reportings.

### **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.

#### ***Dexia Asset Management (DAM)***

Front Office of DAM performs the first-level controls whereas DAM Risk Management department performs the monitoring of the risks related to the funds managed and carries out second-level controls. Management intervenes to control the following risk types: credit, market, counterparty, model, liquidity, regulatory and operational. Within this framework, the management is performed "ex ante" (regulatory and contractual risk) as well as "ex post" (monitoring of the market risks indicators).

#### ***Dexia Insurance Services (DIS)***

DIS Risk Management is in charge of:

- Developing a risk management methodology and define procedures, policies and guidelines taking into account the Dexia risk appetite;
- Developing internal models to monitor DIS activities and monitoring the main steps of the life cycle of the models;
- Defining asset allocation.

DIS has adopted a risk management framework covering all material risks DIS is exposed to. An "a posteriori" control is added to the use of the model. The model takes into account the following risk factors: general market risk, specific risk, insurance risk and BSM link.

## **Group Functions**

### **Strategic Risk Management**

Strategic Risk Management has a holistic and consolidated view on credit risks, to proactively anticipate emerging risks, defines the stress testing framework and scenarios and runs the different stress tests.

In addition, Strategic Risk Management is in charge of closely monitoring 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. The Corporate Centre plays a key role in the overall governance of the Risk Management support line (including the overall organization, budgets and Human Resources issues).

### **Local Risk Management**

Local Risk Management is focused on local risk management activities and is organized through 3 main functions:

- Local credit risk is responsible for analyzing and monitoring local counterparties including developing and maintaining the local Internal Rating Systems (IRS) and for producing local reportings;
- Local operational risk is responsible for the local risk assessment/monitoring and producing local reportings;



- Local financial market risk management is 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. Besides, each entity steers its subsidiaries.

Local Chief Risk Officers put in place a local governance in line with the Dexia Group practices and policies:

- local committees organization;
- delegation rules;
- local reportings production;
- defaults and watchlist files detection and monitoring;
- credit risk provisions computation and following;
- local operational risks cartography;
- local management of the data and information security, continuity plans and resumption activity plan.

## 1.2.2. Governance

The Dexia risk committees are organized under the same governance as to 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 Management 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, Dexia Head of PWB Credit Risk Management and Dexia Head of Strategic Risk Management.

### Credit Risk Committees

The decision-making process applies to transactions and is organized via a series of credit committees organized per entity and/or expertise centre. All of these committees operate under the delegation of the Management Credit Committee. A transaction delegation framework 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 <sup>(1)</sup>		x
Market and balance-sheet management risk	Interest-rate risk	x	x
	Price risk <sup>(2)</sup>	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

Dexia monitors its solvency using rules and ratios established by the Basel Committee on Banking Supervision and the European Capital Requirements Directive.

These ratios, the capital adequacy ratio and the Tier 1 ratio, compare the amount of regulatory capital (in total and Tier 1) with total weighted risks. From a regulatory point of view, they should amount to a minimum 4% for the Tier 1 ratio and 8% for the capital adequacy ratio.

Another indicator used by Dexia to monitor its solvency is the Core Tier 1 ratio, which compares the amount of regulatory capital excluding hybrid capital, with total weighted risks.

The Belgian National Bank (BNB) requires Dexia to submit the calculation of capital necessary in performance of its activity in accordance with the prudential banking regulations on the one hand and in accordance with the prudential regulations on financial conglomerates on the other.

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

### 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 SA 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.
- 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.

	31/12/2009		31/12/2010	
	Financial statements	Regulatory purposes	Financial statements	Regulatory purposes
Total shareholders' equity	10,182	10,182	8,945	8,945
of which Core equity	18,498	18,498	19,214	19,214
of which Gains and Losses not recognized in the statement of income	(8,316)	(8,316)	(10,269)	(10,269)
Non-controlling interests	1,805	1,796	1,783	1,773
of which Core equity	1,813	1,805	1,858	1,849
of which Gains and Losses not recognized in the statement of income	(8)	(9)	(75)	(76)
Discretionary participation features of insurance contracts	1	0	0	0
<b>TOTAL</b>	<b>11,988</b>	<b>11,978</b>	<b>10,728</b>	<b>10,718</b>

Notes:

- Comments on regulatory requirements are described in note 4.5 of the accounting principles and rules of consolidated financial statements published in the Annual Report 2010.

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

At EUR 19.2 billion, Dexia's core shareholders' equity increased by 3.9% on December 2009 supported by the robust organic capital generation of the Group.

The Group's total shareholders' equity amounted to EUR 8.9 billion, down 12.1% (EUR 1.2 billion) compared to the end of 2009. This decline is due to an increase of the negative Other Comprehensive Income (EUR -2.0 billion), and in particular of the available-for-sale reserve on securities (AFS), from EUR -1.5 billion at the end of December 2009 to EUR -3.9 billion at the end of December 2010.

The negative evolution on the AFS reserve on bonds is mainly explained by the spread widening on sovereign debt (Greece, Portugal and Italy). The frozen fair value of assets reclassified in Loans and Receivables improved by EUR 0.3 billion to EUR -5.3 billion by the end of 2010. If the reclassification had not been made, an additional EUR -0.6 billion fair-value adjustment would have been recognized.

## 2.1.2. Regulatory Capital

Regulatory capital consists of:

- Tier 1 capital: share capital, share premiums, retained earnings including current year profit, hybrid capital, foreign currency translation and non-controlling interests, less intangible assets, accrued dividends, net long positions in own shares and goodwill;
- Tier 2 capital including the eligible part of subordinated long-term debt, less subordinated debt from and equities in financial institutions.

According to regulatory requirements:

- AFS reserves on bonds and cash flow hedge reserves are not part of equity;
- AFS reserves on shares are added to Tier 2 equity if positive, with a haircut, or deducted from Tier 1 equity if negative;
- certain IFRS adjustments on subordinated debts, non-controlling interests and debts must be reversed to reflect the characteristics of absorption of loss of those instruments;
- other elements (SPV, deferred taxes, etc.) are also adjusted based on CBFA requirements.

Moreover, since 1 January 2007, according to the CRD regulation (Capital Requirement Directive), the FSMA adapted its definition of the regulatory capital. The most important point impacting Dexia, is that the elements which were deducted from the total regulatory capital (banks accounted for by the equity method, participations in financial companies or subordinated loans issued by such a financial company) will be deducted for 50% from Tier 1 capital and for 50% from total regulatory capital. For these elements dealing with insurance companies, the new deduction rule will be implemented as from 1 January 2013.

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

	31/12/2009	31/12/2010
<b>TOTAL REGULATORY CAPITAL (AFTER PROFIT APPROPRIATION)</b>	<b>20,251</b>	<b>20,636</b>
<b>Tier 1 capital</b>	<b>17,573</b>	<b>18,425</b>
Core shareholders' equity	18,498	19,214
Cumulative translation adjustments (group share)	(531)	(361)
Prudential filters	(111)	(104)
Non-controlling interests eligible in Tier 1	613	660
Dividend payout (non-controlling interests)	(9)	(6)
Items to be deducted:	(2,308)	(2,401)
Intangible and Goodwill	(2,163)	(2,262)
Holdings > 10% in other credit and financial institutions (50%)	(57)	(54)
Subordinated claims and other instruments held by insurance in which holdings >10% (50%)	(88)	(85)
Innovative hybrid tier-1 instruments	1,421	1,423
<b>Tier 2 capital</b>	<b>2,678</b>	<b>2,211</b>
Perpetuals	755	839
Subordinated debts	2,630	2,541
Available for sale reserve on equities (+)	435	308
IRB provision excess (+); IRB provision shortfall 50% (-)	157	0
<b>Items to be deducted:</b>	<b>(1,298)</b>	<b>(1,477)</b>
Holdings > 10% in other credit and financial institutions (50%)	(187)	(186)
Subordinated claims and other instruments held by insurance in which holdings >10% (50%)	(88)	(85)
Participations in insurance undertakings	(1,023)	(1,206)

Note: For regulatory purposes, insurance companies are accounted for by the equity method. Therefore, non-controlling interests differ from those published in the financial statements. Discretionary participation features only relate to insurance companies.

At year-end 2010, Tier 1 capital amounted to EUR 18,425 million, up 5%. Excluding hybrid Tier 1 instruments in an amount of EUR 1,423 million, core Tier 1 capital amounted to EUR 17,002 million at year-end 2010.

Innovative hybrid Tier 1 instruments include:

- a) the hybrid capital instrument perpetual of EUR 225 million issued by Dexia Banque Internationale à Luxembourg;
- b) the undated deeply subordinated non-cumulative notes for EUR 700 million, issued by Dexia Crédit Local;
- c) the undated subordinated non-cumulative notes for EUR 498 million, issued by Dexia Funding Luxembourg.

<b>Issuer</b>	<b>Booked Amount (millions of EUR)</b>	<b>Rate</b>	<b>Call date</b>	<b>Rate applicable after the call</b>
Dexia Banque Internationale à Luxembourg SA	225	6.821%	06/07/11	Euribor 3 m + 230 bp
Dexia Crédit Local SA	700	4.30%	18/11/15	Euribor 3 m + 173 bp
Dexia Funding Luxembourg SA	498	4.892%	02/11/16	Euribor 3 m + 178 bp

The agreement with the European Commission provides certain restrictions in relation to the payment of coupons and calls on Dexia hybrid capital instruments.

Dexia may only pay coupons on its subordinated debt instruments and hybrid capital if there is a contractual obligation and will make no call until the end of 2011.

On the other hand, and until 31 December 2014, Dexia will limit any form of dividend on its ordinary shares and any call or discretionary payment of a coupon on subordinated debt instruments and hybrid capital so that, after the payment, the Group's core Tier 1 ratio remains above or equal to:

- 10.6% as at 31 December 2010 and then decreasing each year to 10.2% as at 31 December 2014;
- the sum 12.5% of the weighted risks of the Legacy Division and 9.5% of the weighted risks of the other business lines.

These restrictions apply in particular to Tier 1 hybrid capital instruments issued by Dexia Banque Internationale a Luxembourg, Dexia Credit Local and Dexia Funding Luxembourg.

Considering the undertakings described above:

- the coupon linked to the Dexia Banque Internationale a Luxembourg 6.821% Tier 1 issue was paid on 6 July 2010;
- the coupon linked to the Dexia Credit Local 4.30% Tier 1 issue was not paid;
- the coupon linked to the Dexia Funding Luxembourg 4.892% Tier 1 issue was paid on 6 November 2010 as a consequence of the resolution of the Extraordinary Shareholders' Meeting of Dexia SA to increase the capital by incorporation of available reserves and with the issue of bonus shares which were attributed to shareholders.

## 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 2010 and 2009. The minimum capital requirements correspond to 8% of the weighted risks.

Regarding credit risk, the breakdown by exposure class presented in the following table is more detailed than the advanced regulatory approach, reflecting the presence of Dexia in financing public sector entities and project finance. Details on exposure classes are provided in Appendix 2.

Type of risk	Basel II treatment	Exposure class	31/12/2009		31/12/2010		
			Weighted risks	Capital requirements	Weighted risks	Capital requirements	
Credit risk	Advanced	Corporate	26,336	2,107	24,395	1,952	
		Equities	958	77	420	34	
		Financial institutions	11,453	916	10,170	814	
		Monolines	2,230	178	2,360	189	
		Project Finance	5,563	445	6,304	504	
		Public sector entities	4,733	379	5,682	455	
		Retail	Mortgage loans	1,220	98	1,723	138
			Revolving loans	105	8	104	8
			Other loans	2,285	183	2,560	205
		Securitization	27,445	2,196	23,458	1,877	
		Sovereign	3,335	267	3,960	317	
		Others	136	11	5	0	
		<b>Total</b>		<b>85,800</b>	<b>6,864</b>	<b>81,141</b>	<b>6,491</b>
		Standard	Corporate	10,954	876	13,156	1,053
			Equities	896	72	772	62
			Financial institutions	2,362	189	3,748	300
			Monolines	0	0	0	0
	Project finance		899	72	662	53	
	Public sector entities		18,101	1,448	18,429	1,474	
	Retail		Mortgage loans	0	0	2	0
			Revolving loans	9	1	9	1
			Other loans	4,767	381	4,322	346
	Securitization		0	0	0	0	
	Sovereign	5,480	438	5,812	465		
	Others	489	39	186	15		
	<b>Total</b>		<b>43,958</b>	<b>3,517</b>	<b>47,098</b>	<b>3,768</b>	
	Market risk	Internal model	Interest-rate & foreign-exchange risk	841	67	669	54
Position risk on equities			0	0	0	0	
Other market risks			0	0	0	0	
<b>Total</b>			<b>841</b>	<b>67</b>	<b>669</b>	<b>54</b>	
Standard		Interest-rate risk	1,646	132	1,829	146	
		Foreign-exchange risk	354	28	235	19	
		Position risk on equities	152	12	143	11	
		Other market risks	0	0	69	6	
		<b>Total</b>	<b>2,152</b>	<b>172</b>	<b>2,276</b>	<b>182</b>	
Operational risk	Standard		10,419	834	9,650	772	
<b>TOTAL</b>			<b>143,170</b>	<b>11,454</b>	<b>140,835</b>	<b>11,267</b>	

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

At year-end 2010, Dexia's total weighted risks amounted to EUR 140.8 billion against EUR 143.2 billion at year-end 2009 thanks to the deleveraging efforts and the mitigating impact of additional impairments on the Financial Products portfolio. This reduction of weighted risks was partly offset by FX effects and the increased commercial activity.

## 2.3. Capital Adequacy

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

### 2.3.1. Regulatory Solvency Ratios

The following table shows Dexia Group weighted risks and solvency ratios at 2010 and 2009 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.

		31/12/2009	31/12/10
<b>Tier 1 capital</b>		<b>17,573</b>	<b>18,425</b>
<b>Total regulatory capital</b>		<b>20,251</b>	<b>20,636</b>
<b>Total weighted risks</b>		<b>143,170</b>	<b>140,835</b>
Credit risk	Advanced	85,799	81,141
	Standard	43,960	47,098
Market risk	Advanced	841	669
	Standard	2,152	2,276
Operational risk	Basic	10,419	9,650
<b>Tier 1 ratio</b>		<b>12.3%</b>	<b>13.1%</b>
<b>Capital adequacy ratio</b>		<b>14.1%</b>	<b>14.7%</b>

In 2010, Tier 1 ratio further improved by 81 bps to 13.1% supported by organic generation of Tier 1 capital of EUR 852 billion (equivalent to 60 bps) and by a decrease of total weighted risks by EUR 2.3 billion (equivalent to 21 bps).

The core Tier 1 ratio reached 12.1%, up by 79 bps compared to the end of 2009, illustrating the Group's solid solvency situation.

The capital adequacy ratio was 14.7% at the end of 2010, up 51 bps on the end of 2009.

Dexia was subject to the 2010 European Union-wide stress testing exercise, coordinated by the Committee of European Banking Supervisors (CEBS). The conclusion of that stress test, based on various scenarios of credit quality deterioration<sup>3</sup>, was that Dexia does not require any additional capital to withstand the CEBS two-year adverse scenario, including the additional sovereign shock (for more detailed information on stress tests, refer to the part dedicated to stress tests in part 2.3.2 – Internal Capital Adequacy).

### 2.3.2. Internal Capital Adequacy

In 2010, the Management Board and the Board of Directors validated the internal capital adequacy mechanism addressing the requirements of Pillar 2 of Basel II. The Pillar 2 process is at the heart of management of the bank as this so called "own process" should demonstrate that the available financial resources are at any time appropriate to cover the economic risks incurred by the bank.

#### Risk Appetite

Risk appetite expresses the level of risk an institution is ready to take, given the expectations of the main stakeholders (shareholders, creditors, regulators, rating agencies, clients and other stakeholders), in order to achieve its strategic and financial objectives. Dexia continued the integration of the risk appetite approach in various strategic analyses in 2010, and also started implementation in the main subsidiaries.

Risk appetite is the reference point:

- to guide strategy and planning;
- to frame performance in terms of growth and value creation;
- to facilitate daily investment decisions.

<sup>3</sup>The test was performed according to the scenarios, methodology and hypotheses provided by the CEBS, detailed in the global report published on the CEBS website: <http://www.c-eps.org/EU-wide-stress-testing.aspx>

A formalized framework integrates a series of ratios constituting a key element in defining limits for major financial balances. The framework is based on a set of accounting ratios (gearing), regulatory ratios (Tier 1, weighted risks), economic ratios (economic capital, earnings at risk), liquidity and funding structure ratios and credit concentration limits.

Limits are defined for each of these ratios, and annually validated by the Board of Directors. As such, the risk appetite framework is a key element in setting up the Group financial plan. The Risk Management and Finance support lines are in charge of monitoring these ratios and to propose appropriate measures to the Management Board to align to the limits.

## 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 given interval of confidence and time horizon. The economic capital quantification process is organized in three phases: risk identification (definition and cartography updated on an annual basis up to the level of the local entities), their assessment (essentially on the basis of statistical methodologies) and aggregation based on an inter-risks diversification matrix.

The majority of risks are capitalized based on expected loss measurements; certain risks are not capitalized as alternative management modes (limits, scenarios, governance and so on) are considered more appropriate to cover them.

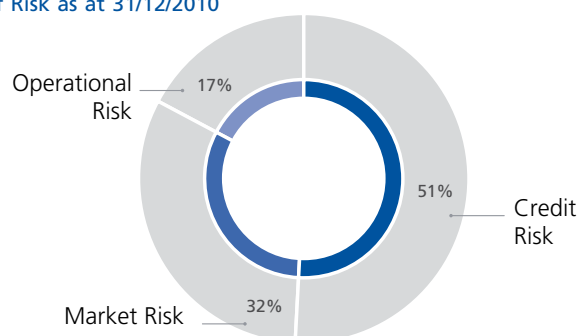
Capitalized risks are assessed at a high level of severity (99.97% at one year).

Economic capital reporting is performed at the level of Dexia SA for all Group entities. A series of methodological changes has been applied to address both internal and external recommendations and some lessons from the crisis.

### Economic Capital by Type of Risk

Dexia's economic capital amounted to EUR 14,022 million at year-end 2010.

#### Economic Capital by Type of Risk as at 31/12/2010



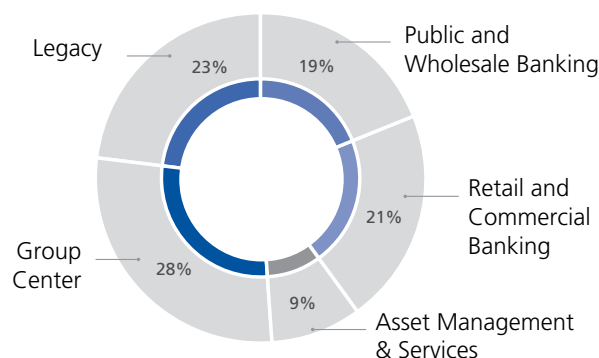
Credit risk represents approximately half of the economic capital use. Market risk, which includes interest-rate risks, foreign-exchange risks and the equity-price risk, is the second risk factor. Operational risk (including commercial risk) is the third risk factor.

This distribution is very stable between 2009 and 2010.

### Economic Capital by Business Line

The economic capital use by business line is evidenced below.

#### Economic Capital by Business Line as at 31/12/2010



The Legacy division consumes almost one quarter of the economic capital. It includes the bond portfolio in run-off (comprising the former credit spread portfolio, the public bond portfolio and the Financial Products portfolio and some non-core public



loans as well as off-balance sheet commitments, mainly liquidity lines in the United States. Public and Wholesale Banking and Retail and Commercial Banking both consume 20% of economic capital. Asset Management & Services consumes almost 10% of economic capital and the rest is allocated to the Group Center (ALM, minority interests...).

### Economic Capital Adequacy

The joined Risk-Finance Economic Performance Analysis Committee (EPAC) manages the capital adequacy process. The EPAC examines (regulatory and economic) ratios, limits and triggers defined in the risk appetite policy and the budget framework, and potential gaps with forecasts.

### Stress Tests

The Pillar 2 stress tests (global stress tests) are performed on the basis of expert scenarios of economic recession. In addition to the "traditional" stress tests for market and liquidity risks, Dexia has put in place a wide range of stress tests (sensitivity analyses, the implementation of stress scenarios and potential vulnerability assessments) to assess the potential impact of a stressed event or a combination of events on its financial structure, capital ratios and income statement. These kinds of stress scenarios have been performed in 2010 for ABS, wrapped by Assured Guaranty Ltd (as FSA was sold to Assured) and local authorities.

In 2010 Dexia was among 91 European establishments subjected by the Committee of European Banking Supervisors (CEBS) to a common stress test, built on different scenarios of credit quality deterioration. The conclusion of the stress tests is that Dexia does not require additional capital to withstand the CEBS two-year adverse scenario, including the additional sovereign shock. Dexia's strong capital base would enable it to resist to the conservative set of assumptions of the stress tests over the next two years, while still maintaining strong capital ratios. More specifically, as a result of the assumed shock under the adverse scenario, the estimated consolidated Tier 1 ratio of the Group would change to 11.2% in 2011 compared to 12.3% by the end of December 2009. An additional sovereign risk scenario would have a further impact of 0.29 percentage point on the estimated Tier 1 ratio, bringing it to 10.9% at the end of 2011, compared with the regulatory minimum of 4%.

## 2.4. Significant Banking Subsidiaries

Significant subsidiaries of the Dexia Group are Dexia Bank Belgium (DBB), Dexia Crédit Local (DCL), DenizBank and Dexia Banque Internationale à Luxembourg (DBL), based on:

- their contribution to the Group (in terms of earnings and balance sheet) and/or
- 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. DenizBank is a growing contributor to the earnings of the Group. Dexia Crédit Local represents a significant share of the balance sheet of the Group because of the public finance business.

Regulatory capital and solvency ratios under Basel II at year-end 2010 and 2009 for significant subsidiaries are disclosed in the following table.

	DBL		DBB		DCL		DenizBank <sup>(1)</sup>	
	31/12/2009	31/12/2010	31/12/2009	31/12/2010	31/12/2009	31/12/2010	31/12/2009	31/12/2010
Tier 1 capital	2,288	2,468	6,887	7,258	6,668	6,547	1,431	1,800
Total regulatory capital	2,759	2,908	7,748	7,780	11,123	10,418	1,794	2,255
Total weighted risks	13,167	11,026	49,929	49,551	74,890	69,582	10,730	14,367
Tier 1 ratio	17.38%	22.38%	13.79%	14.65%	8.90%	9.41%	13.34%	12.53%
Capital adequacy ratio	20.96%	26.37%	15.52%	15.70%	14.85%	14.97%	16.72%	15.70%

(1) Figures are presented under Basel I rules as regulatory local calculation is performed with Basel I rules. Basel II Standardized calculation will be requested by the BRSA – Turkish regulator – by the end of 2011. For Dexia SA regulatory calculation purposes, DenizBank is treated with Standardized approach and AIRB models are currently being developed to switch to AIRB approach in the future (refer to part 3.6.2.).

The reported figures are calculated according to IFRS figures and to the guidelines issued by the local supervisory authorities. The minimum capital adequacy ratio required by the local supervisory authorities to open new branches is 12% in Turkey. The detailed data are presented in the annual report of the subsidiaries.

## 3. Credit Risk

### 3.1. Credit Risk Management and Governance

#### 3.1.1. Definition

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.

#### 3.1.2. Governance

The Dexia risk management oversees Dexia credit risk, under the supervision of the Management Board and specialist committees. It is in charge of defining the Group policy on credit risk, particularly the decision-making process for granting loans, and supervising the processes for rating counterparties, analyzing credit files and monitoring exposure.

In 2010, in order to increase its efficiency and to fully exploit Group synergies, the Risk support line evolved towards an organization by specialist expertise centres, in relation to the various Dexia business lines (Retail and Commercial Banking, Public and Wholesale Banking) and financial market activities. Specialist risk committees were also set up per expertise centre, while coordination is provided by transversal teams and committees.

##### Transversal Committees

The Risk Policy Committee defines risk policies including the credit-assignment rules for different sectors and types of counterparty.

The Executive Risk Committee meets weekly to decide on the risk management strategy and the organization of the support line. The Management Credit Committee, organized on a weekly basis, is in charge of undertaking decisions.

##### Committees Specializing per Expertise Centre

The Management Credit Committee delegates its decision-making power to Credit Committees organized per entity and/or expertise centre. This delegation is based on specific rules, in relation to the type of counterparty, the counterparty rating and level of credit risk exposure. The Management Credit Committee remains the decision-making body of last resort for larger credit files or those presenting a risk level considered sensitive. For each file presented to the credit committee, an independent analysis is performed, presenting the main risk indicators, as well as a qualitative analysis of the transaction. Dexia updated credit granting procedures in accordance with the requirement of the European Commission to ensure a minimum RAROC of 10% for transactions of the Public and Wholesale Banking business line.

While monitoring the credit process, the different committees are responsible for the supervision of specific risks. These committees are organized per expertise centre and per entity and meet quarterly.

**Watchlist committees** supervise assets deemed to be "sensitive" and placed on watchlist.

**Default committees** qualify and monitor counterparties in default in accordance with Basel II regulations, applying rules prevailing at Dexia.

**Provision committees** define and propose the appropriate amount of provisions to be allocated and monitor the cost of risk.

**Rating committees** ensure the correct application of internal rating systems and the appropriateness of rating processes in relation to established principles and the consistency of those processes within the different entities.

#### 3.1.3. Management of the Risk

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

Credit risk measures rely principally on internal rating systems put in place by Dexia under Basel II. Each counterparty is rated by analysts in charge of credit risk or by dedicated scoring systems. This rating corresponds to an assessment of the counterparty's level of default risk, expressed on an internal rating scale, and is a key element in the loan granting process. Ratings are reviewed at least annually allowing a proactive identification of counterparties requiring regular monitoring by the "watchlist" committee.

In order to control the Group's general credit risk profile and to limit risk concentrations, credit risk limits are defined for each counterparty, fixing the maximum exposure to credit risk deemed acceptable for a given counterparty. Limits may also be imposed per economic sector and per product. The risk department proactively monitors these limits, in relation to the evolution of the perception of risks run by the Group. In order to take more recent events into consideration, specific limits may be frozen at any time by the Risk Management department.

As to risk management of derivatives, Dexia closely monitors the conclusion of appropriate legal documentation relating to netting agreements and the exchange of collateral.

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

### **Fundamentals of Dexia Credit Risk in 2010**

At a macroeconomic level, the year 2010 saw a gradual improvement of the economic environment in the majority of countries in Europe. However, the year was also marked by a crisis of confidence as to the ability of some European States to fulfil their financial obligations, resulting in tensions on the financial markets and difficulties for those countries to obtain financing. The crisis led all European countries to adopt financial austerity measures aimed at reducing their public debt.

Within Dexia, a clear slowdown was observed in the deterioration of the average rating of portfolios, reflecting the improvement of the economic situation. That more general trend is particularly visible on a certain number of sectors weakened by the financial crisis and on which collective impairments were booked in 2008 and 2009, in particular the harbour, textiles, motorway sectors, and subsequently reversals in collective impairments.

With regard to Retail and Commercial Banking activities, an improvement is also to be noted. In Belgium, the persistence of mitigated macroeconomic indicators is reflected by new defaults which, although down compared to 2009, are still beyond pre-crisis levels. The mortgage loan portfolio has proved particularly resilient. Also the professional loans presented a cost of risk down compared to 2009. In Turkey, the sharp economic rebound is reflected in sustained production volumes, a return of defaults to a pre-crisis level and significant recoveries. As a consequence, the cost of risk improved considerably compared to 2009.

In order to cope with the crisis affecting the sovereign debt of some European States, principally Greece, Ireland, Portugal and Spain, Dexia not only blocked the granting of credit to the sovereigns concerned but also reduced those exposures via its asset cession programme. Dexia continues to monitor this issue, particularly the impact of interventions by the European Support Fund and the IMF to sustain those States experiencing difficulties.

It is important not to extrapolate the sovereign default risk to that of local authorities. A certain number of elements enable relativization of the risk of systemic contagion:

- The prudential framework to the management of local authorities is constraining. In the majority of countries in which Dexia is active, local authorities are obliged to present balanced budgets. The contracting of debt is reserved for investment and not for operating expenditure, which is 80% guaranteed by grants and subsidies. The debt level is generally limited. As a consequence, although local authorities have seen their debt grow over the recent period, it remains at reasonable levels (8% deficit and 9% public debt in the European Union).
- Numerous mechanisms protect local authority debt holders (in France and Belgium, they are obliged to reserve the amounts necessary to service the debt; in Italy, creditors of public debt benefit from a priority right to tax revenues, and so on).

Local authorities have nonetheless been globally hit by the deterioration of the world economy, rather heterogeneously depending upon the country concerned. Indeed, Japan was somewhat sheltered from the crisis, local authorities not appearing to be significantly impacted. Turkey was not affected by the recession and most major metropolitan cities retain good savings capacity. The reactions and measures taken by governments play a significant role. Some authorities receive a major proportion of their receipts from central government. The increase of transfers, either ad hoc as in Poland or through the introduction of recovery plans as in the United States, offset the fall of tax receipts. In Spain, a clear increase of the level of debt and a pronounced deterioration of gross savings levels are to be noted for some regions, whilst in view of land registry revisions the communes have posted an increase of receipts. In Italy, debt is likely to stabilize but pressures on health expenditure remain severe. In Eastern Europe, the impact of the crisis is rather marked in Bulgaria, the Czech Republic and Hungary through a fall in tax receipts but this is offset by increased government subsidies. No pronounced effect is observed at this stage in Romania. In Poland, the crisis is hardly visible on current authority receipts but savings are falling and investment remains sustained. In France, the sharp increase in transfer duty products has helped in coping with the slowdown of other operational resources. 2010 was a year of transition for direct local taxation, marked by the abolition of local business tax. Government grants hardly evolved at all and are likely to remain frozen for three years. Investment fell slightly but remains at a high level. There is a risk that the impact of these different measures will particularly affect Départements which on the one hand are deprived of the momentum of their fiscal resources and on the other hand must deal with a sustained increase in social action expenditure, particularly by virtue of Active Solidarity Income (Revenu de solidarité active – RSA), which will have a potential impact on their internal rating, although it will nonetheless remain sound. In Belgium, affected by the economic and financial crisis, budgets revealed a weakening in 2009 of the financial situation of numerous Belgian municipalities. Results demonstrate a relative stabilization in 2010 compared to the situation in 2009. The rate of growth of receipts for the financial year (2.2%) is well above the forecast expenditure rate (1.6%). In general, local administrations have a funding structure which is relatively less

directly sensitive to the evolution of the economic situation. In the USA, the federal States have budgets which are difficult to conclude but are more frequently obliged by the law to be balanced. Authorities have therefore made significant reductions to their expenditure.

Dexia pursued its bond cession programme in 2010, in line with the undertakings made to the European Commission, resulting mechanically in a reduction of the Group's credit risk. On that portfolio, the impact of the crisis continued to weigh on the average rating level, although no clear deterioration was observed in terms of performance or expected loss. The deterioration is more pronounced in Residential Mortgage-Backed Securities (RMBS) segments in the United States and in Europe, predominantly in Greece, Ireland and Spain. The bond debt securities portfolio remains nonetheless characterized by very good credit quality, with 91.5% at Investment Grade level.

In general, the good resistance demonstrated to the economic crisis confirms the low risk profile of the Group's business lines.

### Financial Products portfolio<sup>4</sup>

In 2010, the Financial Products portfolio was reduced by USD 1.6 billion, to USD 13.8 billion (nominal value), due to USD 0.4 billion asset sales and to the amortization of the portfolio. As at 31 December 2010, the expected average life of the portfolio is 9.2 years.

In a context characterized by a volatile economic environment and large stocks of homes which will continue to weigh heavily on the real estate market, at least in 2011, Dexia adapted its US RMBS scenario to take the following considerations into account.

- During 2010, a high percentage of delinquent loans, in particular subprime loans, have been restructured by the servicers, and this has contributed to an improvement of the default rate on such assets. However, Dexia estimates that a proportion of these defaults could just be postponed in time.
- Visibility on housing price recovery remains low due to the existing large stock of homes for sale and to other negative factors such as the impact of a potential foreclosure freeze.

Dexia therefore proceeded to make some adjustments to its assumptions for US RMBS. In particular, to reflect the assessed impact of loan modifications, Dexia assumes that the current default rates will not improve within the next 3 years and might need 4 additional years to return to the levels observed before the crisis arose. Moreover, Dexia assumes that current severity rates<sup>5</sup> will not show any improvement until the end of the transactions.

Based on these elements, projected economic losses would increase to USD 1.796 billion under Dexia's "base case". Such an estimate is made to the best of Dexia's knowledge on the basis of market conditions as at the end of December 2010.

As at 31 December 2010, total impairments amounted to USD 2.252 billion.

The modelling of the US RMBS portfolios is very sensitive to parameters such as the timing of defaults, loan modifications, the evolution of house prices and the length of the crisis. Therefore any changes of the parameters could lead to significant modifications to the projected economic results compared to the "base case".

- As an example, under a scenario based on deteriorated default rates against the "base case" (higher level of default during the whole period) coupled with a higher (5%) severity, expected losses would increase to USD 2.3 billion;
- as another example, under a scenario based on a flat default rate curve until maturity of the last asset in the portfolio, expected economic losses would increase to USD 2.8 billion;
- in contrast, a faster recovery in the US economy by 18 months compared to the "base case" would decrease the expected economic losses to USD 1.3 billion.

Assuming the materialization of one of those scenarios, Dexia's regulatory solvency ratio is immune from provisions and losses on the Financial Products portfolio in line with the State guarantee mechanism<sup>6</sup>.

Lastly, Dexia launched an active work-out process to optimize recoveries on the US RMBS portfolio in 2011, with a dedicated and experienced team in New York, and filed lawsuits against different stakeholders involved in the US RMBS market. However, at this stage no potential positive impact of such litigation has been taken into account in the Group's financial statements.

<sup>4</sup> Refer also to part 3.9 – Securitization Activities.

<sup>5</sup> "Severity" refers to the loss expected on a property that would have been sold following a foreclosure process.

<sup>6</sup> Refer also to note 12.2.A.3. to the consolidated financial statements in the Annual Report 2010 (page 211).

## 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 derivative 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 2010. The Group's total exposure amounted to EUR 531.6 billion as at 31 December 2010, 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 2010 and 2009.

Exposure at year-end 2009					
Type of product	Eurozone <sup>(1)</sup>	Rest of Europe <sup>(2)</sup>	US & Canada	Rest of the world	Total
Debt securities	92,081	19,231	26,631	16,513	154,456
Retail loans	39,963	2,574	475	3,799	46,812
Loans and advances	174,989	25,227	6,738	10,647	217,601
ABS	11,481	2,137	20,402	3,221	37,241
Derivatives	4,914	1,615	1,546	219	8,294
Given guarantees	54,699	7,700	26,622	5,294	94,316
Repo	4,299	5,866	2,768	1,406	14,339
Other assets	256	49	71	1,226	1,601
<b>TOTAL</b>	<b>382,682</b>	<b>64,400</b>	<b>85,252</b>	<b>42,326</b>	<b>574,659</b>

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

(2) Including Turkey.

Exposure at year-end 2010					
Type of product	Eurozone <sup>(1)</sup>	Rest of Europe <sup>(2)</sup>	US & Canada	Rest of the world	Total
Debt securities	76,098	17,659	25,919	12,567	132,242
Retail loans	41,641	3,252	197	4,542	49,632
Loans and advances	175,637	26,094	4,943	7,252	213,926
ABS	7,892	1,319	13,419	2,537	25,168
Derivatives	4,936	2,073	1,920	114	9,043
Given guarantees	49,473	8,629	22,684	5,212	85,998
Repo	4,997	2,467	4,881	1,337	13,682
Other assets	171	100	102	1,529	1,903
<b>TOTAL</b>	<b>360,846</b>	<b>61,593</b>	<b>74,064</b>	<b>35,089</b>	<b>531,592</b>

(1) Countries using the Euro currency as of 31 December, 2010.

(2) Including Turkey.

As at 31 December 2010, loans and advances represented 40% 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. Compared to 2009, the ABS portfolio was down 32.4% mainly due to maturity and the sale of assets and the USD exchange rate impact as US & Canada assets are predominant in the portfolio. Debt securities equally decreased (-14.3%) in line with the deleveraging efforts of the Dexia Group.

The Group's exposure was predominantly concentrated in the Eurozone (68% or EUR 360.8 billion at year-end 2010), particularly in France (18%) and Belgium (20%). The relative weight of Dexia's exposure on Eurozone and Rest of Europe increases in line with Dexia's strategy to refocus on its core markets and its business development in Turkey.

### 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 2010 and 2009.

For reporting purposes, a rating "masterscale" has been applied. 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 year-end 2009						
Type of product	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
<b>TOTAL</b>	<b>277,270</b>	<b>207,267</b>	<b>49,974</b>	<b>2,056</b>	<b>38,092</b>	<b>574,659</b>

Exposure at year-end 2010						
Type of product	AAA+ to AA-	A+ to BBB-	Non investment grade	Default	Non rated	Total
Debt securities	59,483	61,561	9,398	161	1,639	132,242
Retail loans	12,463	14,746	12,479	885	9,059	49,632
Loans and advances	96,534	86,847	18,848	805	10,892	213,926
ABS	18,025	2,651	4,221	97	174	25,168
Derivatives	3,549	4,507	822	82	84	9,043
Given guarantees	43,425	26,666	7,828	334	7,745	85,998
Repo	4,478	8,518	625	0	60	13,682
Other assets	14	69	40	0	1,780	1,903
<b>TOTAL</b>	<b>237,971</b>	<b>205,564</b>	<b>54,259</b>	<b>2,364</b>	<b>31,434</b>	<b>531,592</b>

As at 31 December 2010, 45% of Dexia's exposure was rated AAA or AA, reflecting Dexia activity on highly-rated municipal and government-related credits. The relative weight of this portfolio decreased while the relative weight of the A+ to BBB exposure increased. This shift is a consequence of the European sovereign debt crisis, reduction of exposure on AA rated sovereigns (Italy) and sales and maturity of Public Sector and ABS exposure.

The debt securities portfolio was still investment grade (91.5%).

Only 10% of Dexia's exposure was classified as non-investment grade and the bulk was situated in the BB range. Corporate and retail counterparties represented 50% of these exposures. Unrated exposures mainly related to exposures under Standardized approach with no rating available (refer to part 3.6.). For a large part of these positions, rating attribution according to Dexia methodology will start in 2011.

## 2009 average exposure

Type of product	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
<b>TOTAL</b>	<b>295,290</b>	<b>211,259</b>	<b>47,885</b>	<b>1,724</b>	<b>46,665</b>	<b>602,823</b>

Note: average exposure is the quarterly average figure.

## 2010 average exposure

Type of product	AAA+ to AA-	A+ to BBB-	Non investment grade	Default	Non rated	Total
Debt securities	63,927	66,110	9,251	156	2,325	141,769
Retail loans	12,480	14,311	11,914	868	9,009	48,582
Loans and advances	100,699	83,172	17,969	997	13,715	216,551
ABS	21,193	2,831	5,346	48	122	29,540
Derivatives	4,210	4,584	917	94	463	10,269
Given guarantees	48,445	27,920	7,796	417	8,042	92,620
Repo	5,597	8,363	340	0	450	14,750
Other assets	23	151	38	1	1,884	2,097
<b>TOTAL</b>	<b>256,573</b>	<b>207,443</b>	<b>53,571</b>	<b>2,581</b>	<b>36,010</b>	<b>556,177</b>

Note: average exposure is the quarterly average figure.

Total 2010 average exposure is higher than exposure at year-end 2010 due to Dexia current deleveraging efforts.

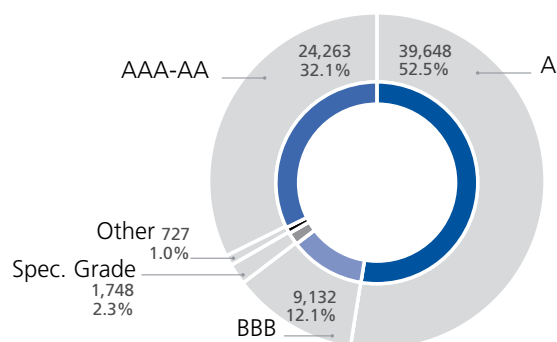
### 3.2.3. Exposure per Exposure Class and Economic Sector

The following table shows the total exposure with a breakdown by economic sector and exposure class at year-end 2010 and 2009.

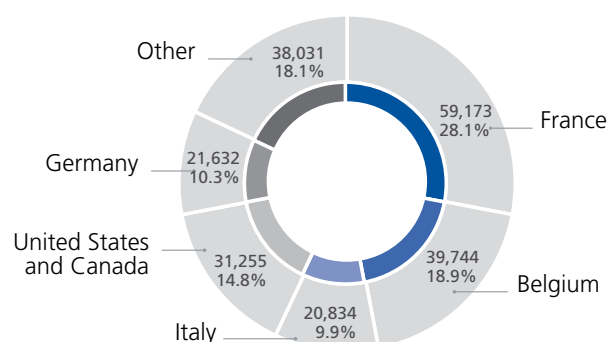
Exposure at year-end 2009										
Economic sector	Corporate	Financial institutions	Monolines	Project finance	Public sector entities	Retail	Securitization	Sovereign	Other	Total
Industry	12,336	238	-	4,840	6,870	357	-	5	-	24,647
Construction	4,121	-	-	5,455	308	496	-	-	-	10,380
Trade-Tourism	4,868	-	-	147	309	1,279	-	-	-	6,604
Services										
Transport, storage and communication	9,556	22	-	6,371	5,863	131	-	-	-	21,943
Financial intermediation	3,792	75,518	11,055	-	3,843	178	9,715	9,041	12	113,154
Real estate, renting and business activities	9,016	11	-	382	14,443	1,887	-	-	7	25,747
Public administration, compulsory social security	119	4	-	43	210,669	2	652	55,264	26	266,779
Health and social work	474	-	-	-	15,145	585	-	-	-	16,203
Other community, social and personal service activities	921	-	-	561	5,357	178	-	8	-	7,025
Other	220	-	-	-	1,013	15	-	1,496	-	2,745
Other	2,594	7,096	-	129	1,052	39,621	26,874	1,469	596	79,432
<b>TOTAL</b>	<b>48,017</b>	<b>82,888</b>	<b>11,055</b>	<b>17,928</b>	<b>264,874</b>	<b>44,731</b>	<b>37,241</b>	<b>67,283</b>	<b>642</b>	<b>574,659</b>

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

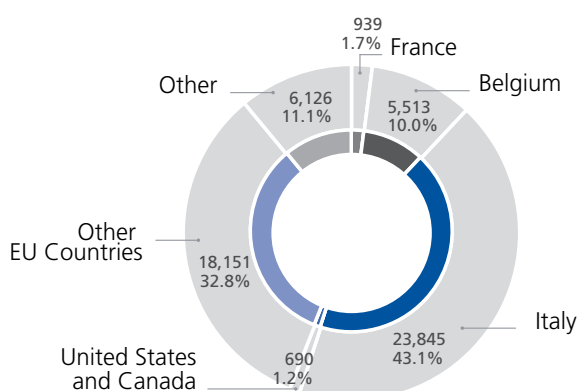
Financial Intermediation:  
split by Rating Class



PSE: Public Administration,  
Social Security: split by Country



Sovereign: Public Administration,  
Social Security: split by Country



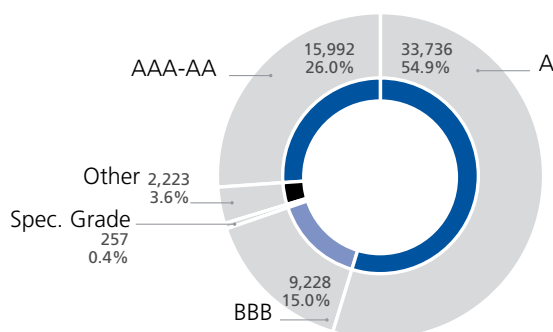


## Exposure at year-end 2010

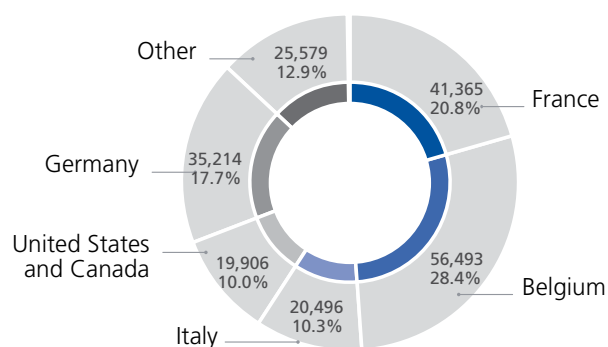
Economic sector	Corporate	Financial Institutions	Monolines	Project Finance	Public Sector Entities	Retail	Securitization	Sovereign	Other	Total
Industry	13,416	419	0	5,138	6,886	729	0	5	0	26,592
Construction	4,876	0	0	6,142	387	556	0	0	0	11,960
Trade-Tourism	5,199	0	0	171	333	1,273	0	0	0	6,976
Services										
Transport, storage and communication	9,384	219	0	6,719	6,319	131	0	89	0	22,862
Financial intermediation	2,209	61,437	11,544	1	2,524	216	392	5,832	0	84,154
Real estate, renting and business activities	9,340	1,288	0	229	15,056	1,951	0	9	0	27,873
Public administration, compulsory social security	155	65	0	43	199,053	3	811	47,374	0	247,504
Health and social work	510	0	0	0	15,020	642	0	0	0	16,171
Other community, social and personal service activities	1,023	0	0	575	5,339	185	0	6	0	7,127
Other	38	0	0	0	1,175	12	9	1,059	0	2,293
Other	3,144	6,561	0	109	353	42,209	23,956	1,488	258	78,078
<b>TOTAL</b>	<b>49,294</b>	<b>69,989</b>	<b>11,544</b>	<b>19,127</b>	<b>252,445</b>	<b>47,905</b>	<b>25,168</b>	<b>55,862</b>	<b>258</b>	<b>531,592</b>

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

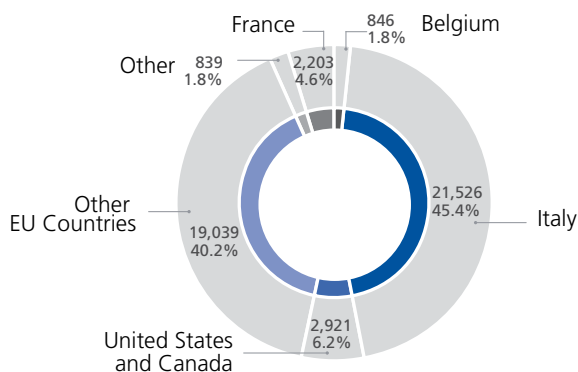
Financial Intermediation:  
split by Rating Class



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 stable. More than 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 (47.5%), financial institutions (13.2%) and sovereigns (10.5%).

### 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 2010 and 2009.

Exposure 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	6,472	4,437	6,324	6,050	22,566	2,176	48,025
Financial institutions	14,598	8,201	14,069	11,646	29,452	4,936	82,901
Monolines	0	107	2,096	2,016	6,834	1	11,055
Project finance	466	961	1,233	1,235	13,844	191	17,928
Public sector entities	5,033	11,166	23,772	17,789	204,990	2,150	264,901
Retail	1,880	4,806	3,471	2,712	30,758	1,104	44,731
Securitization	33	240	797	1,086	27,072	8,012	37,240
Sovereign	7,855	4,220	4,220	3,062	44,814	3,111	67,283
Other	91	41	57	75	140	192	596
<b>TOTAL</b>	<b>36,419</b>	<b>34,179</b>	<b>56,038</b>	<b>45,679</b>	<b>380,470</b>	<b>21,874</b>	<b>574,659</b>

Exposure at year-end 2010							
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	6,937	5,446	7,607	5,625	20,964	2,716	49,294
Financial institutions	13,419	3,788	10,651	11,584	27,369	3,178	69,989
Monolines	365	1,123	1,621	1,385	7,050	0	11,544
Project finance	342	896	1,618	1,124	15,134	14	19,127
Public sector entities	6,307	15,160	19,096	15,247	194,515	2,120	252,445
Retail	1,820	4,740	3,673	3,041	33,425	1,205	47,905
Securitization	16	80	389	830	23,227	625	25,168
Sovereign	4,255	1,030	3,717	3,273	40,213	3,375	55,862
Other	3	12	100	50	92	2	258
<b>TOTAL</b>	<b>33,465</b>	<b>32,274</b>	<b>48,472</b>	<b>42,158</b>	<b>361,989</b>	<b>13,235</b>	<b>531,592</b>

As at 31 December 2010, 12% of the credit risk exposure will mature in less than one year, 17% of the exposure will mature between one year and five years and 68% beyond five years.

No significant evolution between 2009 and 2010 is to be pointed out.

## 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 exceeds 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 considered 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

Collective impairments cover losses in segments of portfolios or lending-related commitments of Dexia. 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 or lending-related commitments, the credit ratings allocated to the borrowers and reflecting the current economic environment in which the borrowers operate.

### 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 2010 and 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 <sup>(1)</sup>	1	0		
Loans and advances (at amortized cost) <sup>(2)</sup>	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
<b>TOTAL</b>	<b>1,070</b>	<b>395</b>	<b>766</b>	<b>5,814</b>	<b>1,667</b>

(1) Excluding variable income securities.

(2) Debt instruments – in the category "Loans and advances" – accounted for an amount of EUR 2,028 million in 2010.

Exposure at year-end 2010					
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 <sup>(1)</sup>	0	0	0	679	0
Loans and advances (at amortized cost) <sup>(2)</sup>	875	174	413	5,587	1,281
Held to maturity financial assets	0	0	0	0	0
Other financial instruments - at cost	0	1	2	287	
<b>TOTAL</b>	<b>875</b>	<b>175</b>	<b>415</b>	<b>6,552</b>	<b>1,281</b>

(1) Excluding variable income securities.

(2) Debt instruments – in the category “Loans and advances” – accounted for an amount of EUR 2,861 million in 2010.

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 5,587 million on loans and advances as at 31 December 2010 includes an amount of EUR 2,237 million for Dexia Financial Products (versus EUR 1,780 million as at 31 December 2009). No collaterals are declared in this disclosure regarding the Financial Products portfolio (EUR 559 million in 2010 versus EUR 231 million in 2009) as it benefits from the guarantee mechanism of the Belgian and French States. 2010 was marked by higher impairments on the Financial Products portfolio (up EUR 328 million on FY 2009), particularly during the last quarter of the year in line with tougher assumptions on the US RMBS market. These impairments have not however impacted Dexia's regulatory solvency ratios which have been immune from losses and provisioning on the Financial Products portfolio following the Financial Products State Guarantee mechanism. Refer also to note 12.2.A.3. to the consolidated financial statements in the Annual Report 2010 (page 211).

### 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 2010.

Exposure at year-end 2010		
Geographical entity	Past due	Impaired
Dexia Banque Internationale à Luxembourg	217	422
Dexia Crédit Local	498	3,844
Dexia Bank Belgium	493	1,417
DenizBank	256	795
Dexia Nederland	0	73
<b>TOTAL</b>	<b>1,465</b>	<b>6,552</b>

Past-due exposure was down in 2010 mainly due to the improving credit environment in Turkey and an overall improvement in Belgium and Luxembourg.

### 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 2010 and 2009.

Exposure 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	(507)	(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>Investments held to maturity</i>	0	0	0	0	0	0	-	-
Available-for-sale financial assets	998	(169)	31	(146)	(2)	713	-	-
<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	-	-
<i>Loans and advances due from banks</i>	65	0	45	(53)	(1)	56	-	-
<i>Loans and advances to customers</i>	1,441	(16)	297	(303)	(15)	1,404	-	-
<i>Investments held to maturity</i>	0	0	0	0	0	0	-	-
<b>TOTAL</b>	<b>4,683</b>	<b>(269)</b>	<b>1,409</b>	<b>(862)</b>	<b>(123)</b>	<b>4,838</b>	<b>9</b>	<b>(97)</b>
Provision for off-balance-sheet credit commitment and guarantees	121	(6)	58	(6)	(15)	152	0	0

## Exposure at year-end 2010

Type of Asset	As at 1 Jan. 2010	Utilization	Amounts set aside for estimated probable loan losses	Amounts reversed for estimated probable loan losses	Other adjustments	As at Dec. 31 2010	Recoveries directly recognized in profit or loss	Charge- offs directly recognized in profit or loss
Specific allowances for individually assessed financial assets	3,377	(231)	1,083	(359)	(21)	3,850	-	-
<i>Loans and advances due from banks</i>	8	0	15	0	2	25	0	0
<i>Loans and advances to customers</i>	2,656	(181)	1,054	(286)	(30)	3,213	13	(80)
<i>Investments held to maturity</i>	0	0	0	0	0	0	-	-
Available-for-sale financial assets	713	(50)	14	(74)	8	611	-	-
<i>Of which fixed income instruments</i>	582	0	11	(73)	5	525	-	-
<i>Of which equity instruments</i>	131	(50)	3	0	3	87	-	-
Allowances for incurred but not reported losses on financial assets	1,460	(40)	322	(499)	40	1,283	-	-
<i>Loans and advances due from banks</i>	56	0	5	(43)	0	18	-	-
<i>Loans and advances to customers</i>	1,404	(40)	317	(456)	40	1,265	-	-
<i>Investments held to maturity</i>	0	0	0	0	0	0	-	-
<b>TOTAL</b>	<b>4,838</b>	<b>(271)</b>	<b>1,405</b>	<b>(858)</b>	<b>19</b>	<b>5,133</b>	<b>13</b>	<b>(80)</b>
Provision for off-balance-sheet credit commitments and guarantees	152	(10)	8	(10)	2	142	0	0

In 2010, specific allowances increased by 14% to EUR 3.9 billion mainly because of the Financial Products portfolio for which more conservative assumptions on the US RMBS were taken, as well as specific allowances on some commitments in the Public and Wholesale Banking business and at DenizBank (shipping). This explains the rise in the "Loans and advances to customers" portfolio impairments which were impacted by the specific impairments (EUR 473 million) of the newly-identified impaired loans.

Collective impairments (or allowances for incurred but not reported losses on financial assets) were down 12% versus 2009 as there were reversals of collective impairments in Public and Wholesale Banking, reflecting an improvement of the environment (more particularly in sectors like textile, shipping, ports, highways and projects). A collective provision related to project finance was also reversed mainly reflecting a change in methodology due to a now mature project finance activity having reached critical mass.

## 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.).

### 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 exist:

- 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.

### 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.).

### Main Types of Netting Agreements

Netting agreements consist in a technique for mitigating credit risk. Banks have legally enforceable netting arrangements for loans and deposits by which they may calculate capital requirements on the basis of net credit exposures subject to specific regulatory conditions.

Types of netting are payment netting, novation netting, close-out netting or multilateral netting.

## 3.4.2. Policies and Processes

### Collaterals and Guarantees/Credit Derivatives

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.

### 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 the minimum requirements that netting agreements need to fulfil 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.

### 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 lower 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 2010. The amounts shown in the table below take netting agreements into account and include collateral values for repo transactions.

2010				
Exposure class	Financial and physical collaterals	Guarantee and Credit derivatives	Repo	Total
Sovereigns	0	155	4,181	4,336
Financial institutions	47,091	6,448	73,081	126,620
Corporates	3,970	9,525	192	13,687
<b>TOTAL</b>	<b>51,061</b>	<b>16,128</b>	<b>77,454</b>	<b>144,643</b>

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) included in Corporate exposure class are mainly covered by financial or physical collateral.

The table does not take account of exposure classes with CRM incorporated in the preliminary LGD as project finance, public sector entities 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 about 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.

#### 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: 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: 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 counterparty.

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

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 (now named Financial Services and Markets Authority), 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.

### 3.5.2. Internal Rating Systems<sup>7</sup>

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.

### 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 2010 and 2009. The Financial Products portfolio is not included in the exposure figures.

<sup>7</sup> Refer to Appendix 2 for details regarding Internal Rating Systems.

2009

Exposure class	Obligor grade	EAD	Average EAD	Average PD	Average LGD	Average RW	Average EL	Undrawn commitment
Corporate	AAA to AA-	973	1,238	0.03%	39%	22%	0.01%	181
	A+ to A-	6,890	7,352	0.07%	38%	26%	0.03%	2,877
	BBB+ to BBB-	12,333	13,785	0.45%	50%	79%	0.23%	6,126
	Others	10,478	10,473	3.32%	55%	138%	1.58%	3,290
	<b>Total</b>	<b>30,674</b>	<b>32,849</b>	<b>1.33%</b>	<b>48%</b>	<b>85%</b>	<b>0.64%</b>	<b>12,473</b>
Financial institutions	AAA to AA-	25,735	29,271	0.04%	25%	8%	0.01%	1,845
	A+ to A-	36,856	39,845	0.06%	28%	16%	0.02%	1,654
	BBB+ to BBB-	7,106	7,714	0.30%	27%	29%	0.07%	260
	Others	5,992	5,598	2.19%	11%	24%	0.30%	301
	<b>Total</b>	<b>75,690</b>	<b>82,429</b>	<b>0.24%</b>	<b>26%</b>	<b>15%</b>	<b>0.04%</b>	<b>4,060</b>
Monolines	AAA to AA-	6,997	7,471	0.04%	34%	20%	0.01%	5,704
	A+ to BBB-	125	154	0.41%	47%	99%	0.21%	0
	Others	173	272	22.80%	66%	393%	14.76%	0
	<b>Total</b>	<b>7,295</b>	<b>7,896</b>	<b>0.59%</b>	<b>35%</b>	<b>31%</b>	<b>0.36%</b>	<b>5,704</b>
Project finance	AAA to AA-	26	34	0.03%	19%	12%	0.01%	0
	A+ to A-	1,378	1,880	0.06%	13%	12%	0.01%	157
	BBB+ to BBB-	9,481	8,935	0.40%	16%	31%	0.07%	1,992
	Others	4,047	3,747	3.15%	19%	59%	0.64%	876
	<b>Total</b>	<b>14,932</b>	<b>14,597</b>	<b>1.12%</b>	<b>16%</b>	<b>37%</b>	<b>0.22%</b>	<b>3,025</b>
Public sector entities	AAA	55,627	61,921	0.01%	4%	1%	0.00%	19,417
	AA+ to AA-	34,842	34,999	0.03%	7%	3%	0.00%	15,874
	A+ to A-	37,857	38,099	0.08%	5%	4%	0.00%	3,522
	BBB+ to BBB-	30,376	30,739	0.35%	2%	4%	0.01%	3,226
	Others	5,231	4,873	1.70%	2%	7%	0.06%	229
	<b>Total</b>	<b>163,933</b>	<b>170,631</b>	<b>0.15%</b>	<b>4%</b>	<b>3%</b>	<b>0.01%</b>	<b>42,267</b>
Retail	AAA to AA-	14,295	14,087	0.03%	16%	1%	0.00%	2,181
	A+ to A-	2,251	2,134	0.08%	18%	4%	0.01%	382
	BBB+ to BBB-	9,295	9,137	0.34%	16%	8%	0.05%	1,336
	Others	8,669	8,891	5.87%	17%	29%	0.96%	1,343
	<b>Total</b>	<b>34,509</b>	<b>34,249</b>	<b>1.58%</b>	<b>16%</b>	<b>10%</b>	<b>0.03%</b>	<b>5,242</b>
Sovereign	AAA	42,726	47,690	0.00%	9%	0%	0.00%	2,289
	AA+ to A-	6,319	6,996	0.06%	13%	10%	0.01%	2
	BBB+ to BBB-	6,104	6,196	0.23%	22%	33%	0.06%	5
	Others	1,322	995	12.09%	40%	40%	7.03%	49
	<b>Total</b>	<b>56,471</b>	<b>61,877</b>	<b>0.31%</b>	<b>12%</b>	<b>6%</b>	<b>0.17%</b>	<b>2,346</b>
Equities	AAA to AA-	338	417	0.09%	90%	96%	0.08%	0
	A+ to A-	44	127	0.11%	90%	104%	0.10%	0
	BBB+ to BBB-	298	178	0.19%	90%	137%	0.17%	0
	Others	42	40	11.89%	87%	426%	9.29%	0
	<b>Total</b>	<b>721</b>	<b>762</b>	<b>0.82%</b>	<b>90%</b>	<b>133%</b>	<b>0.66%</b>	<b>0</b>
Default		<b>3,029</b>	<b>2,900</b>					<b>241</b>
<b>TOTAL</b>		<b>387,255</b>						<b>75,358</b>

## Notes:

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

- Average EAD is the quarterly average figure.

2010								
Exposure class	Obligor grade	EAD	Average EAD	Average PD	Average LGD	Average RW	Average EL	Undrawn commitment
Corporate	AAA to AA-	972	1,008	0.03%	35%	20%	0.01%	192
	A+ to A-	5,318	5,883	0.07%	35%	23%	0.03%	1,967
	BBB+ to BBB-	12,566	12,537	0.44%	48%	75%	0.22%	6,485
	Others	10,910	11,033	3.18%	51%	123%	1.33%	3,153
	<b>Total</b>	<b>29,766</b>	<b>30,460</b>	<b>1.36%</b>	<b>47%</b>	<b>82%</b>	<b>0.58%</b>	<b>11,797</b>
Financial institutions	AAA to AA-	16,355	20,394	0.04%	25%	9%	0.01%	973
	A+ to A-	31,683	32,518	0.06%	28%	15%	0.02%	2,034
	BBB+ to BBB-	8,172	9,140	0.30%	26%	28%	0.07%	80
	Others	5,802	6,482	2.12%	11%	23%	0.28%	188
	<b>Total</b>	<b>62,012</b>	<b>68,534</b>	<b>0.28%</b>	<b>25%</b>	<b>16%</b>	<b>0.05%</b>	<b>3,275</b>
Monolines	AAA to AA-	7,495	7,593	0.04%	34%	20%	0.01%	5,343
	A+ to BBB-	75	110	0.18%	41%	62%	0.07%	0
	Others	208	192	16.95%	66%	348%	10.84%	0
	<b>Total</b>	<b>7,779</b>	<b>7,895</b>	<b>0.49%</b>	<b>35%</b>	<b>29%</b>	<b>0.30%</b>	<b>5,343</b>
Project finance	AAA to AA-	29	28	0.03%	19%	10%	0.01%	0
	A+ to A-	1,064	1,190	0.07%	13%	12%	0.01%	93
	BBB+ to BBB-	10,770	10,440	0.39%	16%	30%	0.06%	1,851
	Others	5,140	5,090	1.46%	19%	52%	0.27%	1,014
	<b>Total</b>	<b>17,003</b>	<b>16,748</b>	<b>0.69%</b>	<b>16%</b>	<b>36%</b>	<b>0.12%</b>	<b>2,959</b>
Public sector entities	AAA	53,337	56,537	0.01%	5%	1%	0.00%	17,751
	AA+ to AA-	32,251	33,029	0.03%	6%	3%	0.00%	11,798
	A+ to A-	34,754	35,018	0.08%	5%	4%	0.00%	3,405
	BBB+ to BBB-	36,003	34,400	0.33%	3%	5%	0.01%	2,573
	Others	6,286	5,871	1.54%	2%	6%	0.04%	197
	<b>Total</b>	<b>162,631</b>	<b>164,855</b>	<b>0.16%</b>	<b>4%</b>	<b>3%</b>	<b>0.00%</b>	<b>35,723</b>
Retail	AAA to AA-	14,658	14,702	0.03%	16%	1%	0.00%	2,248
	A+ to A-	3,699	3,358	0.09%	15%	4%	0.01%	586
	BBB+ to BBB-	10,823	10,675	0.34%	16%	9%	0.05%	1,443
	Others	10,133	9,675	7.77%	16%	30%	1.14%	1,703
	<b>Total</b>	<b>39,313</b>	<b>38,410</b>	<b>2.12%</b>	<b>16%</b>	<b>11%</b>	<b>0.31%</b>	<b>5,979</b>
Sovereign	AAA	35,938	40,041	0.00%	9%	0%	0.00%	1,985
	AA+ to A-	3,955	4,441	0.05%	9%	7%	0.00%	38
	BBB+ to BBB-	9,914	8,994	0.31%	19%	33%	0.06%	0
	Others	469	614	1.78%	33%	83%	0.49%	13
	<b>Total</b>	<b>50,275</b>	<b>54,090</b>	<b>0.08%</b>	<b>11%</b>	<b>8%</b>	<b>0.02%</b>	<b>2,036</b>
Equities	AAA to AA-	0	1	0.95%	58%	133%	0.46%	0
	A+ to A-	30	30	0.12%	90%	105%	0.10%	0
	BBB+ to BBB-	162	223	0.20%	90%	140%	0.18%	0
	Others	49	41	7.54%	53%	332%	2.41%	0
	<b>Total</b>	<b>241</b>	<b>295</b>	<b>1.70%</b>	<b>82%</b>	<b>175%</b>	<b>0.63%</b>	<b>0</b>
Default		<b>3,349</b>	<b>3,552</b>					<b>265</b>
<b>TOTAL</b>		<b>372,368</b>						<b>67,379</b>

## Notes:

- The counterparties are the final counterparties, i.e. after taking into account the Basel II eligible guarantee (substitution principle). Monolines 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 (60% – mainly midcorporate loans and facilities) and in other Western European countries (28%).
- Project finance: non-investment grade exposures are concentrated in Western European countries (39%), in America (35%) and in Australia (14%).
- Retail: non-investment grade exposures are mainly related to mortgage loans and to other retail products originated in Belgium mainly and in Luxembourg. 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 LGD) whereas the rating of the issuer of the bond is the non-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 2010 and 2009.

2009								
Retail product	Obligor grade	EAD	Average EAD	Average PD	Average LGD	Average RW	Average EL	Undrawn commitment
Retail mortgage loans	AAA to AA-	10,859	10,708	0.03%	10%	1%	0.00%	0
	A+ to A-	901	871	0.08%	10%	2%	0.01%	0
	BBB+ to BBB-	4,869	4,756	0.31%	10%	6%	0.03%	0
	Others	2,790	2,893	6.08%	10%	29%	0.61%	0
	<b>Total</b>	<b>19,419</b>	<b>19,229</b>	<b>0.97%</b>	<b>10%</b>	<b>6%</b>	<b>0.10%</b>	<b>0</b>
Revolving retail consumer loans	AAA to AA-	584	153	0.03%	50%	1%	0.02%	573
	A+ to A-	29	8	0.08%	55%	3%	0.04%	28
	BBB+ to BBB-	253	84	0.30%	51%	8%	0.15%	226
	Others	179	93	3.40%	51%	44%	1.76%	117
	<b>Total</b>	<b>1,046</b>	<b>338</b>	<b>0.67%</b>	<b>51%</b>	<b>10%</b>	<b>0.35%</b>	<b>944</b>
Other retail	AAA to AA-	2,851	3,225	0.03%	33%	3%	0.01%	1,608
	A+ to A-	1,321	1,255	0.08%	23%	5%	0.02%	354
	BBB+ to BBB-	4,173	4,298	0.38%	20%	11%	0.07%	1,110
	Others	5,699	5,905	5.85%	19%	29%	1.11%	1,226
	<b>Total</b>	<b>14,044</b>	<b>14,682</b>	<b>2.50%</b>	<b>23%</b>	<b>16%</b>	<b>0.47%</b>	<b>4,298</b>
Default	<b>Total</b>	<b>796</b>	<b>760</b>					<b>32</b>
<b>TOTAL</b>		<b>35,305</b>	<b>35,009</b>					<b>5,275</b>

Notes:

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

- Average EAD is the quarterly average figure.

2010								
Retail product	Obligor grade	EAD	Average EAD	Average PD	Average LGD	Average RW	Average EL	Undrawn commitment
Retail mortgage loans	AAA to AA-	11,124	11,129	0.03%	10%	1%	0.00%	0
	A+ to A-	2,005	1,781	0.09%	10%	2%	0.01%	0
	BBB+ to BBB-	6,324	6,189	0.31%	10%	6%	0.03%	0
	Others	3,670	3,542	9.38%	10%	33%	0.96%	253
	<b>Total</b>	<b>23,124</b>	<b>22,641</b>	<b>1.60%</b>	<b>10%</b>	<b>7%</b>	<b>0.16%</b>	<b>253</b>
Revolving retail consumer loans	AAA to AA-	580	588	0.03%	50%	1%	0.02%	569
	A+ to A-	32	31	0.10%	54%	3%	0.05%	30
	BBB+ to BBB-	240	245	0.29%	51%	8%	0.15%	216
	Others	182	179	3.26%	51%	43%	1.69%	124
	<b>Total</b>	<b>1,034</b>	<b>1,043</b>	<b>0.66%</b>	<b>51%</b>	<b>10%</b>	<b>0.34%</b>	<b>939</b>
Other retail	AAA to AA-	2,954	2,985	0.03%	32%	3%	0.01%	1,679
	A+ to A-	1,662	1,547	0.10%	20%	5%	0.02%	556
	BBB+ to BBB-	4,258	4,240	0.40%	22%	13%	0.08%	1,227
	Others	6,281	5,954	6.96%	19%	29%	1.23%	1,326
	<b>Total</b>	<b>15,155</b>	<b>14,726</b>	<b>3.01%</b>	<b>22%</b>	<b>17%</b>	<b>0.54%</b>	<b>4,787</b>
Default	<b>Total</b>	<b>957</b>						<b>46</b>
<b>TOTAL</b>		<b>40,270</b>						<b>6,026</b>

## Notes:

- The counterparties are the final counterparties, i.e. after taking into account the Basel II eligible guarantee (substitution principle).
- Average EAD is the quarterly average figure.

The increase of EAD on the mortgage loans part in 2010 is due to the integration of the Elantis portfolio in AIRB Approach during the first quarter of 2010 (with a higher average PD).

Average PD distribution follows the rating distribution and 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.

### 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 Policy Committee.

In terms of Pillar 1 stress tests (individual stress tests on Basel II internal rating models), Dexia maintains its target of covering 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 years on business segments and Basel II parameters.

The majority of models have been validated internally and some CCF homologation files have already been sent to regulators. In the meantime, Dexia maintains the corresponding exposures under the Basel II Standardized Approach.

DenizBank is currently treated in Standardized approach<sup>8</sup>. Dexia is in a process of integrating DenizBank within the advanced method and models are being developed and validated internally. Target is to use them from 2012 onwards and test them until the effective implementation by the end of 2014.

<sup>8</sup>DenizBank regulatory local calculation is currently performed with Basel I rules. Basel II Standardized calculation will be requested by the BRSA – the Turkish regulator – by the end of 2011.

### 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 Belgian National Bank (BNB) 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 & Poor's	Moody's	Fitch	BNB 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 2010 and 2009.

2009				
Exposure class	Obligor grade	EAD	Average RW	Undrawn commitment
Corporate	AAA to AA-	257	20%	1
	A+ to A-	49	50%	22
	BBB+ to BBB-	58	75%	13
	BB+ to B-	63	80%	14
	Below B-	0	-	0
	No rating available	11,368	97%	3,749
	<b>Total</b>		<b>11,796</b>	<b>95%</b>
Financial institutions	AAA to AA-	8,776	4%	622
	A+ to A-	976	50%	356
	BBB+ to BBB-	49	41%	6
	BB+ to B-	260	101%	44
	Below B-	54	147%	0
	No rating available	1,450	80%	412
<b>Total</b>		<b>11,565</b>	<b>20%</b>	<b>1,440</b>
Public sector entities	AAA to AA-	63,026	9%	3,556
	A+ to A-	3,468	48%	348
	BBB+ to BBB-	1,572	100%	413
	BB+ to B-	448	91%	70
	Below B-	0	0%	0
	No rating available	8,835	99%	3,710
<b>Total</b>		<b>77,349</b>	<b>23%</b>	<b>8,096</b>
Sovereign	AAA to AA-	9,095	0%	38
	A+ to A-	598	1%	0
	BBB+ to BBB-	4	50%	0
	BB+ to B-	5,930	92%	0
	Below B-	0	-	0
	No rating available	0	-	0
<b>Total</b>		<b>15,627</b>	<b>35%</b>	<b>38</b>
Project finance	No rating available	912	100%	204
Retail	No rating available	8,367	60%	2,115
Equities	No rating available	756	138%	0
Others	No rating available	516	95%	71
<b>TOTAL</b>		<b>126,888</b>		<b>15,763</b>

Note:

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



2010

Exposure class	Obligor grade	EAD	Average RW	Undrawn commitment
Corporate	AAA to AA-	266	20%	21
	A+ to A-	3	50%	6
	BBB+ to BBB-	4	100%	2
	BB+ to B-	91	52%	2
	Below B-	70	83%	19
	No rating available	13,873	96%	5,199
	<b>Total</b>		<b>14,307</b>	<b>94%</b>
Financial institutions	AAA to AA-	6,929	4%	676
	A+ to A-	942	42%	397
	BBB+ to BBB-	388	94%	8
	BB+ to B-	599	95%	27
	Below B-	421	56%	22
	No rating available	3,997	40%	344
	<b>Total</b>		<b>13,276</b>	<b>28%</b>
Public sector entities	AAA to AA-	55,550	10%	1,661
	A+ to A-	3,173	49%	316
	BBB+ to BBB-	1,600	100%	378
	BB+ to B-	533	100%	43
	Below B-	0	-	0
	No rating available	9,593	100%	2,970
	<b>Total</b>		<b>70,449</b>	<b>27%</b>
Sovereign	AAA to AA-	4,755	0%	76
	A+ to A-	374	3%	0
	BBB+ to BBB-	43	50%	0
	BB+ to B-	6,138	94%	0
	Below B-	0	-	0
	No rating available	0	-	0
	<b>Total</b>		<b>11,310</b>	<b>51%</b>
Project finance	No rating available	<b>664</b>	<b>100%</b>	<b>97</b>
Retail	No rating available	<b>6,550</b>	<b>71%</b>	<b>2,301</b>
Equities	No rating available	<b>642</b>	<b>143%</b>	<b>0</b>
Others	No rating available	<b>188</b>	<b>99%</b>	<b>30</b>
<b>TOTAL</b>		<b>117,387</b>		<b>14,598</b>

Note:

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

The bulk of the exposure treated under the Standardized Approach is in the public sector entities class (60% – EUR 55 billion) and is rated in the AAA/AAVA range.

About 33% 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 (66%) is classified in public local authorities (mainly public satellites, other non-Belgian satellites or *Groupements de communes sans fiscalité propre*).

German Länder counterparties, representing 18% of the portfolio, are permanently treated in Standardized Approach (0% risk weight – partial use).

The Dexia entities calculating their capital requirement under the Standardized Approach focus their activity on corporates, retail and financial institutions. DenizBank (Turkey where ECAI activity is not completely developed) represents the major contributor to the unrated corporate counterparties. The Group's exposure to the sovereign non-investment grade category (EUR 6,138 billion) is mostly concentrated in Turkey through DenizBank exposure.

## 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 (CDS).

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 holdback reserve is updated, on a regular basis, based on the evolution of the value of the derivatives and the credit quality of the counterparty.

### 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 2010 and 2009. The Financial Products portfolio is not included in these figures.

Exposure at year-end 2009			
Type of derivatives	Gross EAD	Net EAD	Capital requirement
<b>Credit derivatives</b>	<b>8,066</b>	<b>6,702</b>	<b>274</b>
<i>Trading book</i>	<b>3,716</b>	<b>2,351</b>	<b>70</b>
CDS back to back	2,479	1,876	65
Other CDS	1,237	475	6
Total return swap	455	455	23
<b>Banking book</b>	<b>4,350</b>	<b>4,350</b>	<b>203</b>
CDS bought	0	0	0
CDS sold	4,350	4,350	203
<b>Other derivatives</b>	<b>55,076</b>	<b>13,093</b>	<b>309</b>
Commodities	25	14	1
Equity derivatives	2,400	786	21
Exchange derivatives	6,982	2,081	48
Rate derivatives	45,670	10,212	239
<b>TOTAL</b>	<b>63,142</b>	<b>19,795</b>	<b>582</b>

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.

Exposure at year-end 2010			
Type of derivatives	Gross EAD	Net EAD	Capital requirement
<b>Credit derivatives</b>	<b>8,174</b>	<b>6,702</b>	<b>284</b>
<b>Trading book</b>	<b>4,035</b>	<b>2,563</b>	<b>96</b>
CDS back to back	2,234	1,790	67
Other CDS	1,375	346	6
Total return swap	426	426	23
<b>Banking book</b>	<b>4,566</b>	<b>4,566</b>	<b>211</b>
CDS bought	0	0	0
CDS sold	4,566	4,566	211
<b>Other derivatives</b>	<b>56,017</b>	<b>12,948</b>	<b>319</b>
Commodities	1	0	0
Equity derivatives	1,955	575	16
Exchange derivatives	6,966	2,088	52
Rate derivatives	47,096	10,284	251
<b>TOTAL</b>	<b>64,618</b>	<b>20,076</b>	<b>626</b>

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 (CDS) 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.

### 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 included in the banking book broken down by type of asset and by calculation process at year-end 2010 and 2009.

2009					
Type of assets	Accounting value	Fair value	Level 1 <sup>(1)</sup>	Level 2 <sup>(2)</sup>	Level 3 <sup>(3)</sup>
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
<b>TOTAL</b>	<b>1,843</b>	<b>1,843</b>	<b>888</b>	<b>166</b>	<b>789</b>

(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.

2010					
Type of assets	Accounting value	Fair value	Level 1 <sup>(1)</sup>	Level 2 <sup>(2)</sup>	Level 3 <sup>(3)</sup>
Financial assets designated at fair value	34	34	0	34	0
Available-for-sale financial assets	1,223	1,223	281	145	796
Non-current assets held for sale	0	0	0	0	0
<b>TOTAL</b>	<b>1,257</b>	<b>1,257</b>	<b>281</b>	<b>179</b>	<b>796</b>

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

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

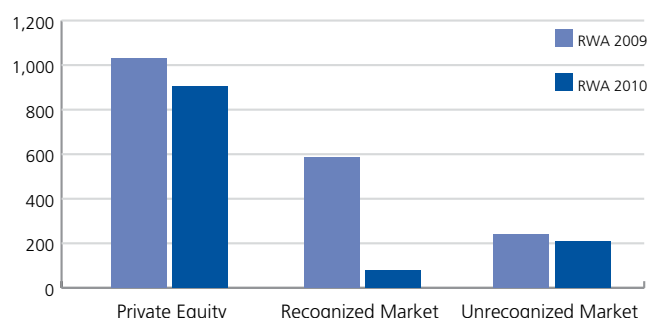
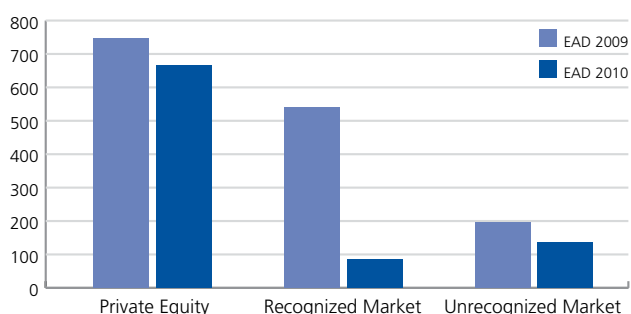
(3) Level 3 = Fair value based on pricing models for which some key market data are unobservable.

The equity portfolio has significantly decreased (-32%) between 2009 and 2010 due to strategic cessions in line with the Dexia transformation plan.

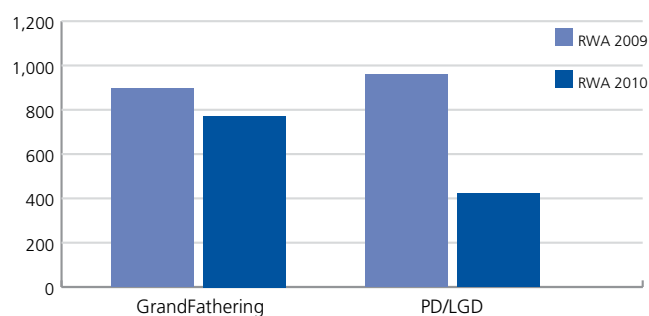
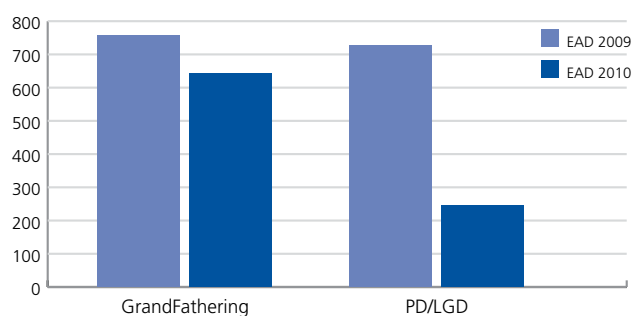
The major proportion of equity exposure in 2010 (as in 2009) is available-for-sale assets and is assessed via a pricing models as some key market data are unobservable.

### 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 2010 and 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.



As at 31 December 2010, the majority of equity exposures are private equities. Most equities held by Dexia on a recognized market in 2009 have been sold in 2010 due to current deleveraging programme.



As at 31 December 2010, the majority of equity exposures are grandfathered exposures and are subsequently treated with the Standardized Approach. The decrease of equity exposures treated with the PD/LGD Approach is due to the current deleveraging programme.

### 3.8.3. Gains or Losses

#### 3.8.3.1. Realized Gains or Losses Arising from Sales and Liquidations in 2009 and 2010

The following table shows the cumulative realized gains or losses arising from sales and liquidations in 2010 and 2009.

Gains or Losses – 2009	
Gains on available-for-sale financial assets	222
Gains on assets and liabilities held for sale	0
<b>Total gains</b>	<b>222</b>
Losses on available-for-sale financial assets	(169)
Losses on assets and liabilities held for sale	0
<b>Total losses</b>	<b>(169)</b>
<b>TOTAL</b>	<b>53</b>

Gains or Losses – 2010	
Gains on available-for-sale financial assets	276
Gains on assets and liabilities held for sale	0
<b>Total gains</b>	<b>276</b>
Losses on available-for-sale financial assets	(46)
Losses on assets and liabilities held for sale	0
<b>Total losses</b>	<b>(46)</b>
<b>TOTAL</b>	<b>230</b>

#### 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 308 million as at 31 December 2010 (compared 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<sup>9</sup>

#### 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 2010 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,

<sup>9</sup> For more detailed information on basic explanations on securitization concepts, please refer to Appendix 4 – Basics on Securitization.

among other things. This process has contributed to the sources of funding of Dexia during 2010 taking into consideration constraints still existing in the interbank market and the relative reduced 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, public finance 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 no longer invests in securitization transactions. In addition and in line with the strategy for the bond portfolio, Dexia has implemented a de-risking/de-leveraging strategy.

### 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, may 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 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.

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

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

The portfolio has been in a run-off mode since two years. The ABS positions are reviewed by the Risk Management ABS Expertise Centre (EC) on a regular basis from quarterly to annual basis depending on the risk of the underlying assets. Each position benefits from an internal rating by the ABS EC.

Specific analyses are also performed by the ABS EC within the de-risking/de-leveraging process in order to identify the opportunity to sell a position. Early Warning indicators and daily monitoring of external rating changes have also been put in place in order to identify or anticipate any deterioration of the portfolio. At last, 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

Dexia applies the Rating-Based Approach (RBA – advanced approach) 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.

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<sup>10</sup>

Dexia performed only two operations 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 obtaining long-term funding or establishing a liquidity buffer. The risk was not therefore transferred out of the Group. In 2010, one operation has been closed (Penates 3). 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.

<sup>10</sup> Refer to Appendix 4 for more details regarding Dexia originations.

## Exposure at year-end 2009

	Payment rights	Residential mortgage loans	Commercial mortgage loans	Public sector	Corporate exposures	ABS	Other	Total
<b>Traditional securitizations</b>								
Underlying assets <sup>(1)</sup>	302	10,394	-	12,755	155	-	255	23,861
Defaulted assets <sup>(2)</sup>	-	11	-	-	-	-	-	11
Exposure securitized in 2009 <sup>(3)</sup>	-	-	-	5,818	-	-	255	6,073
Gains and losses on sales in 2009 <sup>(4)</sup>	-	-	-	-	-	-	-	-
<b>Synthetic securitizations</b>								
Underlying assets <sup>(1)</sup>	-	-	-	-	1,308	1,766	300	3,374
Defaulted assets <sup>(2)</sup>	-	-	-	-	-	-	-	-
Exposure securitized in 2009 <sup>(3)</sup>	-	-	-	-	-	-	-	-
<b>Dexia as originator/ contributor</b>								
Underlying assets <sup>(1)</sup>			5,666					5,666
Defaulted assets <sup>(2)</sup>			561					561
Exposure securitized in 2009 <sup>(3)</sup>			-					-
	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 (as of year-end based on reference obligations).

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

## Exposure at year-end 2010

	Payment rights	Residential mortgage loans	Commercial mortgage loans	Public sector	Corporate exposures	ABS	Other	Total
<b>Traditional securitizations</b>								
Underlying assets <sup>(1)</sup>	241	12,219	-	12,056	566	-	255	25,336
Defaulted assets <sup>(2)</sup>	-	14	-	-	-	-	-	14
Exposure securitized in 2010 <sup>(3)</sup>	-	5,760	-	475	430	-	-	6,665
Gains and losses on sales in 2010 <sup>(4)</sup>	-	-	-	-	-	-	-	-
<b>Synthetic securitizations</b>								
Underlying assets <sup>(1)</sup>	-	-	-	-	1,355	1,754	389	3,498
Defaulted assets <sup>(2)</sup>	-	-	-	-	-	-	-	-
Exposure securitized in 2010 <sup>(3)</sup>	-	-	-	-	-	-	-	-
<b>Dexia as originator/ contributor</b>								
Underlying assets <sup>(1)</sup>	-	-	5,092	-	-	-	-	5,092
Defaulted assets <sup>(2)</sup>	-	-	693	-	-	-	-	693
Exposure securitized in 2010 <sup>(3)</sup>	-	-	0	-	-	-	-	0
	DenizBank	Penates MBS4	DRECM	DSFB DCC Tevere s1	Atrium 1, 2 Wise Tevere s3	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 (as of year-end based on reference obligations).

(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 2010 in comparison to 2009 relate to:

- closing of the Penates-3 transaction;
- early redemption of the MBS-4 and Penates-2 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 2010 and 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.

Exposure at year-end 2009						
Type of securitization	[0-8%]	]8%-16%]	]16%-106%]	]106%-1250%]	1250%	Total
ABS	7,960	562	175	67	24	<b>8,787</b>
CDO	1,187	1,217	9	26	66	<b>2,505</b>
Consumer asset securitization	897	0	0	0	0	<b>897</b>
MBS	11,596	1,693	496	31	42	<b>13,857</b>
Other ABS	0	0	0	1	26	<b>28</b>
<b>TOTAL</b>	<b>21,639</b>	<b>3,472</b>	<b>680</b>	<b>125</b>	<b>158</b>	<b>26,074</b>

Exposure at year-end 2010						
Type of securitization	[0-8%]	]8%-16%]	]16%-106%]	]106%-1250%]	1250%	Total
ABS	6,261	443	174	80	74	<b>7,032</b>
CDO	703	958		0	69	<b>1,730</b>
Consumer asset securitization	-	-	-	-	-	<b>-</b>
MBS	6,268	2,504	719	77	41	<b>9,609</b>
Other ABS	-	-	-	-	27	<b>27</b>
<b>TOTAL</b>	<b>13,232</b>	<b>3,905</b>	<b>893</b>	<b>157</b>	<b>211</b>	<b>18,398</b>

Dexia invested almost exclusively in originally AAA externally-rated transactions explaining the current low weighted risks associated to this portfolio.

The bulk of the Dexia portfolio (excluding Financial Products) is concentrated on European Residential MBS (EUR 7.6 billion), Collateralized Debt Obligations (EUR 1.7 billion), US government guaranteed student loans (EUR 5.2 billion – ABS). US RMBS represent EUR 0.7 billion in the portfolio.

No new investments were made (purchased) in 2010 as the portfolio is in a run-off mode. And, in line with the Dexia deleveraging/de-risking strategy, about EUR 7 billion of ABS assets were sold on the market in 2010.

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).

Exposure at year-end 2009						
Type of securitization	[0-8%]	]8%-16%]	]16%-106%]	]106%-1250%]	1250%	Total
ABS	0	0	738	0	-	<b>738</b>
CDO	-	-	-	-	-	<b>-</b>
Consumer asset securitization	-	-	-	-	-	<b>-</b>
MBS	239	341	674	7	0	<b>1,262</b>
<b>TOTAL</b>	<b>239</b>	<b>341</b>	<b>1,412</b>	<b>7</b>	<b>0</b>	<b>2,000</b>

Exposure at year-end 2010						
Type of securitization	[0-8%]	]8%-16%]	]16%-106%]	]106%-1250%]	1250%	Total
ABS	0	0	719	0	0	<b>719</b>
CDO	0	0	0	0	0	<b>0</b>
Consumer asset securitization	0	0	0	0	0	<b>0</b>
MBS	340	142	42	13	0	<b>538</b>
<b>TOTAL</b>	<b>340</b>	<b>142</b>	<b>762</b>	<b>13</b>	<b>0</b>	<b>1,257</b>

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 within the excluded assets mainly 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+. The rating of these exposures have been downgraded for some of them by few notches but remain sound in terms of credit (Investment grade categories).

### 3.9.5.2. Gains or Losses on Sales

The table below shows the recognized gains or losses by type of exposure in 2010 and 2009 arising from sales of securitization positions. The total losses arising from securitization sales for the year 2010 and 2009 amounted respectively to EUR 32 million and to EUR 59 million before reversal of collective impairments.

Gains or losses 2009						
Payment rights	Residential mortgage loans	Commercial mortgage loans	Public sector	Corporate exposures	ABS	Total
-	(51)	-	-	-	(8)	(59)

Gains or losses 2010						
Payment rights	Residential mortgage loans	Commercial mortgage loans	Public sector	Corporate exposures	ABS	Total
-	(25)	-	-	-	(7)	(32)

# 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 market prices as a result of interest-rate risk, equity-price risk, foreign-exchange risk and other risks (inflation and CO<sub>2</sub> risks).

The interest-rate risk consists of a general interest-rate risk resulting from market evolution and a specific interest-rate risk (credit spread) linked to the issuer. The latter arises from variations in the spread of a specific signature within a rating class.

The risk associated with the equity price represents the risk arising from the reduction in value of equity. As for foreign-exchange risk, this 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 (CO<sub>2</sub>) and commodity risks.

### 4.1.2. Market Risk Governance

Risk management and more particularly Financial Markets Risk Management (FMRM) oversees market risk under the supervision of the Management Board and specialist risk committees. FMRM is a support line integrated into the Risk support line. On the basis of its global risk management approach, it is responsible for identifying, analyzing, monitoring and reporting on risks and results (including the valuation aspect) associated with financial market activities.

The policies, guidelines and procedures documenting and governing each of the activities are defined within Dexia SA and applied to all entities of the Dexia Group. Central teams within expertise centres or transversal teams also have the responsibility to define methods of income statement calculation and risk measurement, as well as to guarantee consolidated measurement, reporting and monitoring of the risks and results of each of the activities for which they are responsible.

Established in the operational entities, local FMRM teams are responsible for day-to-day activity, namely and inter alia the implementation of policies and directives defined at Dexia SA level, but also local risk assessment and monitoring of risks at a local level (computation of risk indicators, control of the limits and triggers and so on), as well as reporting, reconciliation with local strategic planning, accounting and IT systems. Each operational entity is also responsible for 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<sup>11</sup> and related decisions, definition and revision of limits, proposals for the approval of new products, discussion of guidelines, risk governance and standards, risk concepts and measurement methodology and the quality of valuation processes.

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 specific MRGC meets each quarter to discuss risk and business reports associated with market activities. 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 risk profile or risk governance.

<sup>11</sup> Statement of income triggers warn of a deterioration of results and are expressed as a percentage of VaR limits: typically at 50%, 75% and 100% for triggers 1, 2 and 3 and stop the activity at 300% of VaR.

### 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 foreign-exchange risks are measured through a parametric VaR approach.
- Specific interest-rate risk, equity risk and other risks (inflation and CO<sub>2</sub>) 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.

The "Market Risk Engine" project was launched in 2010. It aims at an historical VaR over all risk factors (with a complete revaluation on non-linear risk factors). A complete historical VaR as the standard in many banks will provide a consistent and more precise measure. In addition to VaR, the new tool will facilitate stress testing and the analysis of extreme values.

In addition to VaR measures and statement of income triggers, Dexia applies a wide range of other risk measures in order to assess risks related to the different business lines and portfolios (nominal limits, maturity limits, market limits and limits on authorized products, 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 a distorted market environment (refer to part 4.1.3.1.).

In this context, the range of scenario assumptions is regularly revised and updated. The results of consolidated stress tests and the corresponding analyses are presented quarterly to the MRGC and the DMRC.

The bond portfolio on the banking books is not subject to VaR limits, given its different investment horizon. 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 foreign-exchange risk

The parametric methodology is implemented for the computation of VaR on general interest-rate (IR) risks (excluding vega risk) and foreign-exchange (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).

#### 4.1.3.2. Market Risk Exposure

The detailed VaR use of market activities (bond portfolio in banking book not included) is disclosed in the table below. Average global Value at Risk amounted to EUR 44.6 million in 2010 (as compared to EUR 78.4 million in 2009).

Substantial limit reductions have been implemented, in line with the risk appetite reduction as included in the overall Dexia transformation plan. The global 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.

		2009				2010			
VaR (10 days, 99%)		IR <sup>(1)</sup> & FX <sup>(2)</sup> (Trading and Banking) <sup>(3)</sup>	EQT <sup>(4)</sup> Trading	Spread Trading	Other risks <sup>(5)</sup>	IR <sup>(1)</sup> & FX <sup>(2)</sup> (Trading and Banking) <sup>(3)</sup>	EQT <sup>(4)</sup> Trading	Spread Trading	Other risks <sup>(5)</sup>
By activity	Average	30.1	4.6	39.3	4.6	16.6	2.1	22.4	3.5
	Maximum	86.5	9.7	59.2	7.8	28	4.7	30	5.8
Global		Core <sup>(6)</sup>		Legacy <sup>(6)</sup>		Core		Legacy	
	Average	45.7		41.9		30.4		23.5	
	Maximum	103.6		58.5		44.1		32.7	
	End period	37		29.4		27.8		15	
		Total 2009				Total 2010			
	Average	78.4				44.6			
	Maximum	137.8				55.5			
	End period	45.7				39.1			
	Limit	100				100			

(1) IR: interest-rate.

(2) FX: forex.

(3) IR & Forex: without BSM.

(4) EQT: equities.

(5) Other risks: inflation, commodities (CO<sub>2</sub>).

(6) "Core" refers to assets considered by Dexia as being part of its core businesses while the Legacy portfolio contains the run-off assets, in line with the Agreement with the European Commission. More detailed information on the Legacy Division is provided in the Annual Report 2010 (page 13).

#### Bond Portfolio

Dexia (excluded BSM portfolio and Financial Products, see below) manages bond portfolios, largely in run-off, amounting to EUR 138.5 billion as at 31 December 2010 (against EUR 165.5 billion as at 31 December 2009). The sensitivity in economic value of these bond portfolios is very limited, as interest-rate risk is hedged.

An important part of the bond portfolios is classified in Loans & Receivables. The AFS reserve of these securities is insensitive to the market spread evolutions. Regarding the other bond portfolios classified in AFS, the sensitivity of the AFS reserve value after a basis point credit-spread increase amounted to EUR -35.46 million (against EUR -36.18 million/basis point as at 31 December 2009).

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 (AFS).

#### 4.1.3.3. Stress-Testing

The scenario framework (stress testing) is of particular importance at Dexia. 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 a distorted market environment.

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

- sensitivity stress tests (on interest-rate risks, 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 market activities, 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)
	Foreign-exchange (FX) (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, FX and credit spreads)
	Financial crisis 2008 (historical stress test on interest-rates, FX, equity, inflation commodities and credit spreads) – to be implemented from Q4 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)
	Stress tests on spreads – applying 50% of the last 12 month spread evolution by asset class to existing portfolio
Specific stress tests for ALM	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 reglementary 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.

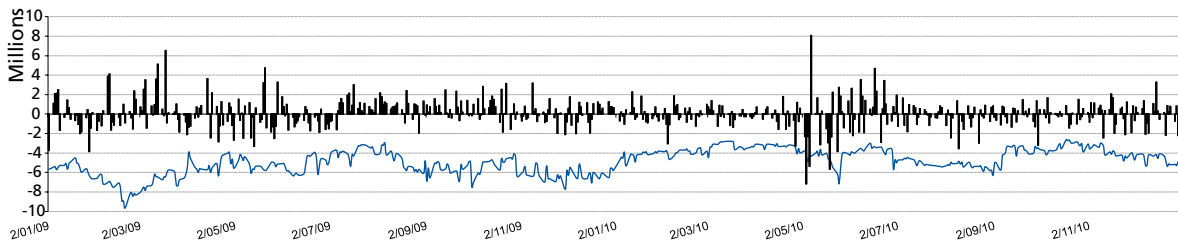
In 2010, Dexia noticed on internal models:

- 3 “downward” exceptions on its IR and FX perimeter (as compared with 0 exception in 2009);
- 3 “downward” exceptions on its equity perimeters (as compared with 0 exception in 2009);
- no “downward” exception on its spread perimeter (as compared with 0 exception in 2009).

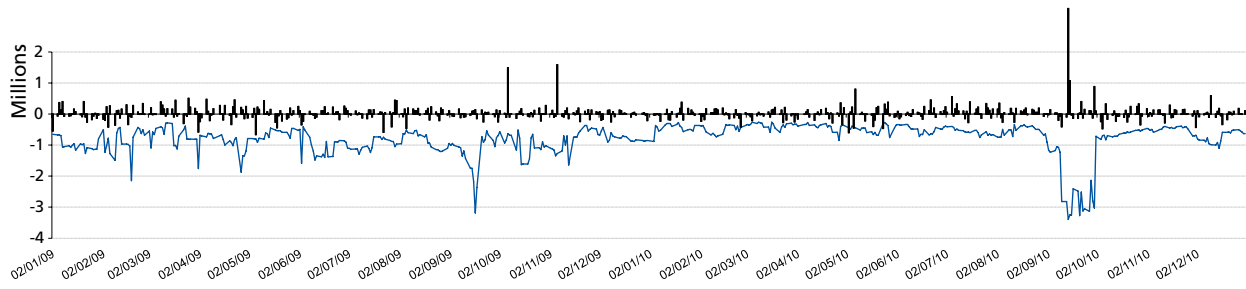
These exceptions have been observed in May and June 2010 due to the high market volatility consequently to the Greek sovereign crisis. This amount of exceptions is in line with the expectations of the model.

The following charts are showing backtesting in 2010 and 2009 on each perimeter:

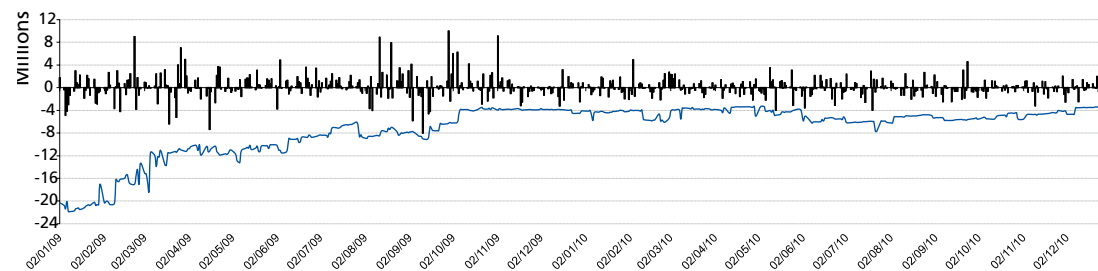
Interest-rate and foreign-exchange



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

The objective of Balance-Sheet Management is to minimize volatility of the statement of income (immunizing the commercial margin generated by the business lines) while preserving value creation. Interest-rate sensitivity is the main risk indicator (full revaluation expressed in sensitivity terms). Although a parametric VaR (indicative) is calculated at Group level based on interest-rate sensitivities.

### 4.2.1. Definition

Balance Sheet Management (BSM) covers all the structural risks of the banking book, namely, interest-rate risk, foreign-exchange risk, equity risk and liquidity risk.

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

Liquidity risk measures the ability of the Group to meet its current and future liquidity requirements, both expected and unexpected.

### 4.2.2. Governance

Balance Sheet Management (BSM) is a support line and involves the management of the structural risks of the entire Group. The role of BSM Risk is to define the risk framework in which balance-sheet management may be undertaken by BSM Finance (risk factors, limits, investment universe, guidelines), to validate models used in the effective management of that risk, to monitor exposure and to check compliance in relation to Group standards, to define the stress to be applied to different risk factors, to challenge the management of the risk performed by the Finance support line and to ensure compliance of the framework with external regulations in force throughout the Dexia Group. All BSM risks are managed via the Dexia SA Assets & Liabilities Committee (ALCo) which meets monthly. ALCo decides on the global risk framework, fixes limits, ensures consistency of strategy and delegates its implementation to local ALCo. ALCo decides globally on the level of exposure in line with the risk appetite defined by the Management Board, and validates internal transfer price mechanisms within the Dexia Group. Local ALCo manage risks specific to their balance sheet within the framework defined by and under the responsibility of the Dexia SA ALCo.

The Funding and Liquidity Committee (FLC), under the delegation of the Group ALCo, centralizes and coordinates the decision process related to liquidity associated issues. The FLC is responsible for monitoring the Group's liquidity position, its evolution and its cover by short, medium and long-term resources. It monitors the achievement of liquidity targets fixed by the Management Board and elaborates funding, disinvestment and structuring strategies which will enable the Group to overcome regulatory and internal stresses. Meeting bi-monthly, the FLC deals with the improvement of the Group's liquidity profile.

### 4.2.3. Risk Management

#### 4.2.3.1. Risk Measures

##### Interest-rate

The role of BSM in the management of interest-rate risk consists on the one hand of reducing the volatility of the statement of income, thus immunizing the commercial margin generated by the business lines, and on the other hand of preserving the overall value creation of the Group.

Measurement of balance-sheet risks is harmonized among the Group's various entities. Sensitivity of the net present value of BSM positions to an interest-rate trend is currently the main indicator for fixing limits and monitoring risks.

The structural rate risk of the Dexia Group is concentrated principally on European long-term interest-rates and results from the structural imbalance between Dexia's assets and liabilities.

Risk sensitivity measures reflect the balance-sheet exposure to first and second order sensitivity and to behavioural risk. VaR calculations are additional indicative measures.

In 2011, Dexia will continue to implement new indicators more earnings management oriented to complement current management mainly based on the sensitivity of the balance-sheet economic value. Dynamic gap and earning-at-risk indicators which takes into account run-off activities, financial plans and commercial margins within the interest-rate environment, will be of great importance in the management of the balance sheet.



### Credit Spread

The credit spread is defined as being the specific interest-rate risk capturing individual issuer-related causes. This is due to variations in the spread of one specific signature within a rating class and is measured with sensitivity 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. Within the insurance perimeter, a warning system has been introduced from the perspective of reallocating assets for the potential occurrence of a stress and in order to preserve 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 hedging the risk associated with the evolution of these results in foreign currencies. In 2010, a systematic and ongoing hedge was made of these exposures.

The structural risks associated with the financing of participations (equity) in foreign currencies as well as the volatility of the Group's solvency ratio are also monitored regularly.

### Insurance Companies and Pension Funds

Specific reports on insurance companies and pension funds are presented to the Group ALCo. They cover risk factors associated with interest-rates, inflation and equities. Risk indicators are calculated on the basis of a Group harmonized risk methodology complemented with specific risk management factors.

#### 4.2.3.2. 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 -148 million as at 31 December 2010 (against EUR -104 million as at 31 December 2009), excluding insurance companies and pension funds. Interest-rate sensitivity limit was EUR -400 million/% as at 31 December 2010. The limit is unchanged compared to the limit at year-end 2009.

The Dexia Financial Products portfolio amounted to USD 13.8 billion (EUR 10.4 billion) as at 31 December 2010 against USD 15.5 billion (EUR 10.7 billion) as at 31 December 2009. The interest-rate risk of this portfolio amounted to EUR -8.5 million/% (against a limit of EUR -42 million/%) as at 31 December 2010 against a risk of EUR -6.2 millions/% (against a limit of EUR -42 million/%) as at 31 December 2009.

##### BSM Credit-Spread Risk Exposure

BSM manages bond portfolios amounting to EUR 14.6 billion (banking entities) and EUR 14.9 billion (insurance) as at 31 December 2010 against an exposure of EUR 17.5 billion (banking entities) and EUR 15.8 billion (insurance) as at 31 December 2009.

Part of the bond portfolios was classified in Loans & Receivables. As a result, the AFS reserve of these securities is insensitive to the market spread evolutions. Regarding the other bond portfolios managed by BSM and classified in AFS, the sensitivity (in AFS reserve) after a basis point credit-spread increase amounted to EUR -12.85 million (banking entities) against EUR -15.62 million/basis point as at 31 December 2009 and to EUR -10.18 million (insurance) against EUR -11.09 million/basis point as at 31 December 2009.

The spread sensitivity of the Financial Products portfolio still classified in AFS (small part of the portfolio which was mainly reclassified in Loans & Receivables) stood at EUR -1.31 million/basis point as at 31 December 2010 against EUR -1.12 million/basis point as at 31 December 2009.

##### BSM Equity Exposure (Quoted Shares)

Equity Value at Risk (VaR with a 99% confidence level and a 10-day holding period) expresses the potential change in market value. Please note the banking equity portfolio is currently in run-off mode. As for insurance companies and pension funds, the equity portfolio amounted to EUR 1,359 million as at 31 December 2010.

VaR (10 days, 99%)	2009		2010	
	Banking	Insurance/ Pension funds	Banking	Insurance/ Pension funds
Average	37.8	98.5	11	102
Maximum	53	142	14	116
End period	16	119	14	116
Limit	70	160	15	150

## 4.2.4. Liquidity Risk

### Dexia Policy

In 2010, Dexia completely revised its internal process for managing liquidity risk, including its contingency funding plan. The new framework aims at providing more effective and coordinated liquidity management. The cornerstone of this new framework is the Funding and Liquidity Committee (FLC), a central committee of all those parties concerned by liquidity and funding, coordinating their actions.

Dexia ensures that it maintains liquidity reserves proportional to its future funding requirement under several scenarios, in a normal situation and in a stress situation. These liquidity reserves consist of assets eligible to refinancing with central banks to which Dexia has access (ECB, Fed and Central Bank of Turkey). Dexia's expected funding requirements are assessed prudently, dynamically and fully, taking existing and planned on and off-balance-sheet transactions into consideration. The monitoring of short-term liquidity risk is organized on a daily basis whilst the supervision of long-term liquidity risk is on a quarterly basis. Furthermore, liquidity is at the centre of the definition of Dexia's annual business plan.

Globally, Dexia's internal framework allows a monitoring of short-term liquidity on a daily basis and a prospective view of long-term liquidity.

The updated contingency funding plan modifies the governance structure to make it more reactive in the case of liquidity stress requiring rapid measures to be taken.

### Risk Measures

It also defines a certain number of liquidity indicators which, alongside regulatory liquidity indicators, guarantee Dexia's resistance to liquidity risk. These indicators include but are not limited to normal "liquidity ratios" comparing liquidity reserves to liquidity deficits. They also include limits on the absolute size of liquidity deficits. All of these indicators are assessed according to different scenarios, in the principal currencies and at all relevant consolidation levels. They are part of the Dexia Risk Appetite framework and are communicated to the Management Board and to the Audit Committee on a regular basis.

Dexia liquidity risk is also monitored by regulatory liquidity ratios. These ratios are communicated to the BNB on a monthly basis.

### Exposure to Liquidity Risk

In 2010, the Group raised EUR 44.4 billion of medium and long-term wholesale funding. The funds raised consisted of EUR 23.2 billion in State guaranteed debt, EUR 13.6 billion in covered bonds, EUR 4.4 billion in long-term secured funding other than covered bonds and EUR 3.2 billion senior unsecured funding.

The Group made considerable progress in reducing its short-term liquidity gap. Short-term funding requirements fell by EUR 48 billion in 2010, to EUR 119 billion as at the end of December 2010.

This good performance was achieved by virtue of:

- the sustained pace of deleveraging programme. EUR 22.4 billion of bonds and EUR 4.8 billion of Public and Wholesale Banking run-off loans were sold in 2010.;
- the swift execution of the long-term funding programme;
- the reduction of the Public and Wholesale Banking lending activity, this being aligned to the Group's long-term funding capacity;
- the increase of retail deposits, particularly in Belgium and Turkey. These were EUR 87.7 billion at the end of 2010, against EUR 81.5 billion at the end of 2009.

Dexia also considerably improved its short-term funding mix. Indeed, Dexia accelerated the decrease of central bank borrowings (EUR -32 billion compared with the end of December 2009) and since June 2010 was no longer funded by short-term guaranteed debt, in view of the repayment of short-term guaranteed loans. The shift towards longer-term funding bilateral and tri-party repos was confirmed in 2010.

As at 31 December 2010, the total amount of central bank eligible securities amounted to EUR 108 billion, of which EUR 42 billion were unencumbered allowing for a major liquidity buffer despite the Group's active deleverage policy. With the reserves available within one month, EUR 66 billion are available to cover the one month liquidity gap.

This significant reduction of the short-term funding requirement was under unfavourable interest-rate conditions resulting in an increase of the amount of cash collateral of EUR 8 billion in 2010 despite a very disrupted macroeconomic environment, marked by the sovereign crisis which weighed heavily on the funding of many European banks.

In 2010, Dexia also ended transactions guaranteed by the Belgian, French and Luxembourg governments. In fact, on 30 June 2010, considering the improvement of its liquidity situation and in line with its undertakings to the European Commission, the Group ceased to issue guaranteed debt four months before its formal end date of 30 October 2010. Total outstanding long-term guaranteed debt amounted to EUR 44 billion as at 31 December 2010 (against EUR 50 billion at the end of December 2009). This guaranteed outstanding will be totally written down in 2014 of which about 40% in 2011.

## 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 on a quarterly basis by the Group Chief Risk Officer, reflects in detail the policy approved on recommendations suited to commercial activities. It transversally reviews operational risk events as well as analyses performed.

The Operational Risk Management Committee, chaired on a monthly basis by the Group head of operational risks, develops a consistent mechanism for the entire Group, including business continuity, crisis management, information security and insurance policy.

Dexia Group Middle Management is principally responsible for operational risk management. In its field of activity, it appoints a correspondent for operational risks whose main role is to coordinate the gathering of data and the self-assessment of risks, with the support of the local operational risk management function.

### 5.3. Management of the Risk

#### 5.3.1. Operational Risk Framework

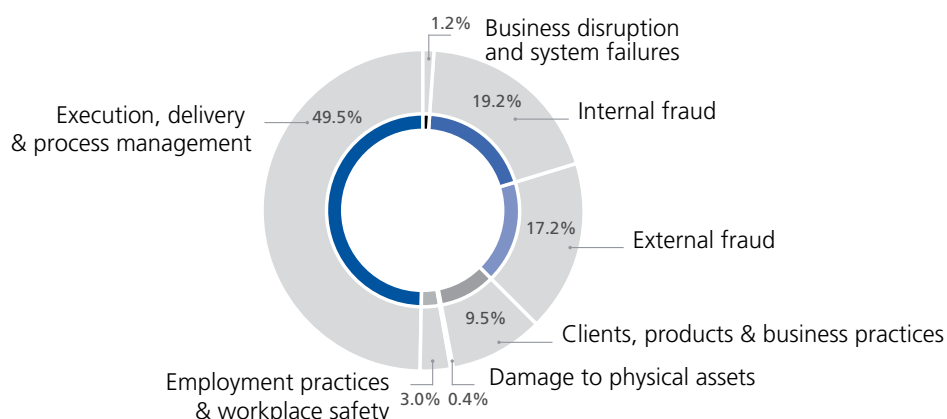
The operational risk framework relies on the following elements:

##### **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 Management Board receives a report on the main events, including an action plan enabling risks to be reduced, defined by the bank's Middle Management.

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



49% of the losses are generated by events related to execution, delivery and process management. These types of events are the most common type and are distributed over all business lines 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).

17% of the losses are generated by events related to external fraud. Dexia set up a series of global mitigating plans for swift and adequate reaction to these types of threats.

Other categories remain limited in number and amount.

### Risk and Control Self-Assessment

In addition to building a history of losses, it is also necessary to proactively identify and mitigate Dexia's exposure to main operational risks. To do this, all the entities of the Dexia Group perform bottom-up self-assessments regarding their risks and associated controls. Risk control and self-assessment exercises are executed yearly.

### 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.

An assessment of the business continuity mechanisms took place in 2010 for all Dexia subsidiaries.

### Management of Insurance Policies

The mitigation of the operational risks to which Dexia is exposed is also guaranteed by subscription to Group insurance policies, covering professional liability, fraud, theft and business interruption. Through an insurance policy elaborated for the whole Group, the aim is moreover to establish insurance guidelines regarding the different risks within the Group and to be implemented at Group and entity levels. It is also a matter of providing a centralized framework for the content and evolution of insurance contracts discussed with brokers and insurance companies. Against that background, a mapping of existing policies in each entity and subsidiary was realized in 2010, in order to improve effective cover.

### Definition and Follow-up of Action Plans

The bank's Middle Management defines the corrective actions required by major incidents or notable 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 installation of this software in 2010 allows the use of one language and reference systems common to those functions, as well as the generation of consolidated information for the bank's Middle Management, in particular regarding any type of action plan or recommendation to be followed up over time.

### 5.3.2. Calculation of Regulatory Capital Requirements

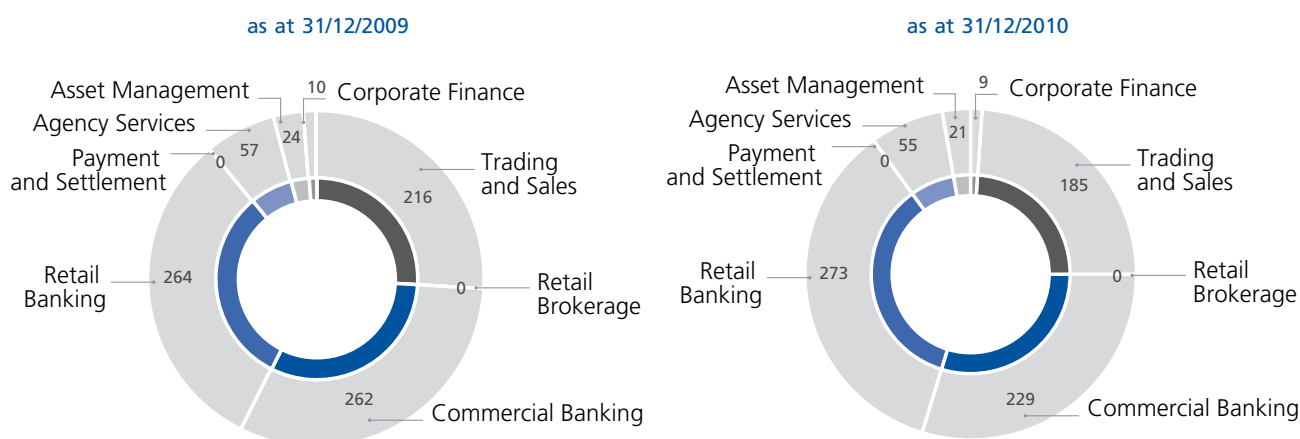
Dexia has decided to apply the Basel II Standardized Approach for the calculation of the capital requirement for operational risk management.

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 nonrecurring 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 of each year.

The capital requirement for the last calculation periods is the following: EUR 772 million at year-end 2010 and EUR 833 million at year-end 2009.

Capital Requirement (in millions of EUR) by Basel Business Line



2009 figures are based on the average of the years 2007 to 2009; 2010 figures are based on the average of the years 2008 to 2010.

Capital requirements decreased by 7% between 2009 and 2010. This is due to a change in the calculation (based on the average of the last 3 years): the 2007 gross income was replaced by the 2010 gross income, which is 19% lower, given the refocus of the businesses on the core activities in the frame of the transformation plan of Dexia.

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) remain the most important ones, but Retail Banking is increasing its weight, in line with the Group commercial orientations.
- Trading & Sales also decreases, in coherence with the evolution of the Group activities, where financial markets are considered as a support line to other business lines. As a reminder, it does not only include the market activities, but also other Group Center segments.
- 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 than Pillar 1 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.

### 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 BSM 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 ensure 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.

The Group's strategic orientation and its correct implementation within the entities are Board of Directors' responsibilities.

The Group's strategy is developed on the basis of the following principles:

- it is the responsibility of the Management Board to take the initiative to study and propose projects of a strategic nature to the Strategy Committee and to the Board of Directors;
- the Board of Directors and the Strategy Committee formed within it may ask the Management Board to study a strategic option;
- projects that meet at least one of the following criteria are considered to be of a strategic nature.

### Capitalization

This risk is managed through an appropriate governance process of the Dexia Group.

## 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:

- Operational Risk Management;
- Legal, Compliance and Tax;
- 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-rate 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 (solvency 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 foreign-exchange 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.

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 Belgian National Bank (BNB) 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

<b>ABS</b>	<b>Asset-Backed Security</b>	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.
<b>ABCP</b>	<b>Asset-Backed Commercial Paper</b>	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.
<b>AFS</b>	<b>Available For Sale</b>	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.
<b>AIRBA</b>	<b>Advanced Internal Rating-Based Approach</b>	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.
<b>ALT-A</b>	<b>ALternative A-paper</b>	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.
<b>BIS</b>	<b>Bank for International Settlements</b>	"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.
<b>BNB</b>	<b>Belgian National Bank</b>	As from 1 April 2011, the competences of the Banking, Finance and Insurance Commission, the Belgian financial institutions regulator, have been split between the Belgian National Bank, in charge of prudential control, and the Financial Services and Markets Authority (FSMA), in charge of supervising financial markets and listed companies.
<b>BSM</b>	<b>Balance-Sheet Management</b>	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.
<b>CCF</b>	<b>Credit Conversion Factor</b>	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.
<b>CDO</b>	<b>Collateralized Debt Obligation</b>	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.

<b>CDS</b>	<b>Credit Default Swap</b>	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).
<b>CLN</b>	<b>Credit-Linked Note</b>	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.
<b>CRD</b>	<b>Capital Requirements Directive</b>	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.
<b>CRM</b>	<b>Credit Risk Mitigant</b>	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).
<b>EAD</b>	<b>Exposure At Default</b>	Estimate of the amount outstanding (drawn amounts plus likely future draw-downs of yet undrawn lines) in case the borrower defaults.
<b>ECAI</b>	<b>External Credit Assessment Institutions</b>	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.
<b>EL</b>	<b>Expected Loss</b>	The amount expected to be lost on an exposure from a potential default of a counterparty or dilution over a one-year period.
<b>FX</b>	<b>Foreign-exchange</b>	Transaction of international monetary business, as between governments or businesses of different countries.
<b>HELOC</b>	<b>Home Equity Line Of Credit</b>	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.
<b>HTM</b>	<b>Held To Maturity</b>	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.
<b>IAS</b>	<b>International Accounting Standards</b>	IAS stands for International Accounting Standards. IAS are used outside the US, predominantly in continental Europe.
<b>ICAAP</b>	<b>Internal Capital Adequacy Assessment Process</b>	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).
<b>IFRS</b>	<b>International Financial Reporting Standards</b>	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.
<b>IR</b>	<b>Interest-rate</b>	Interest expressed as an annual percentage rate.
<b>ISDA</b>	<b>International Swap and Derivative Association</b>	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.
<b>ISIN</b>	<b>International Securities Identification Numbers</b>	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.
<b>IT</b>	<b>Information Technology</b>	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.

<b>LGD</b>	<b>Loss Given Default</b>	The ratio of the loss on an exposure due to the default of a counterparty to the amount outstanding at default.
<b>L&amp;R</b>	<b>Loans &amp; Receivables</b>	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.
<b>MBS</b>	<b>Mortgage-Backed Securities</b>	Asset-backed security or debt obligation representing a claim on the cash flows from mortgage loans.
<b>NBT</b>	<b>Negative Basis Trade</b>	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.
<b>PD</b>	<b>Probability of Default</b>	The probability of default of a counterparty over a one-year period.
<b>P/L</b>	<b>Profit and Loss</b>	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).
<b>RAROC</b>	<b>Risk Adjusted Return On Capital</b>	Risk-based profitability measurement framework for analyzing risk-adjusted financial performance and providing a consistent view of profitability across businesses.
<b>RMBS</b>	<b>Residential Mortgage-Backed Securities</b>	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.
<b>SPV</b>	<b>Special Purpose Vehicle</b>	Separate legal entity specially created 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.
<b>UCITS</b>	<b>Undertakings for Collective Investment in Transferable Securities</b>	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.
<b>VaR</b>	<b>Value at Risk</b>	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.
<b>WR</b>	<b>Weighted Risks</b>	Used in the calculation of risk-based capital ratios. They are the total assets calculated by applying risk-weights to the amount of exposure.

# 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 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 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 modelling 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).

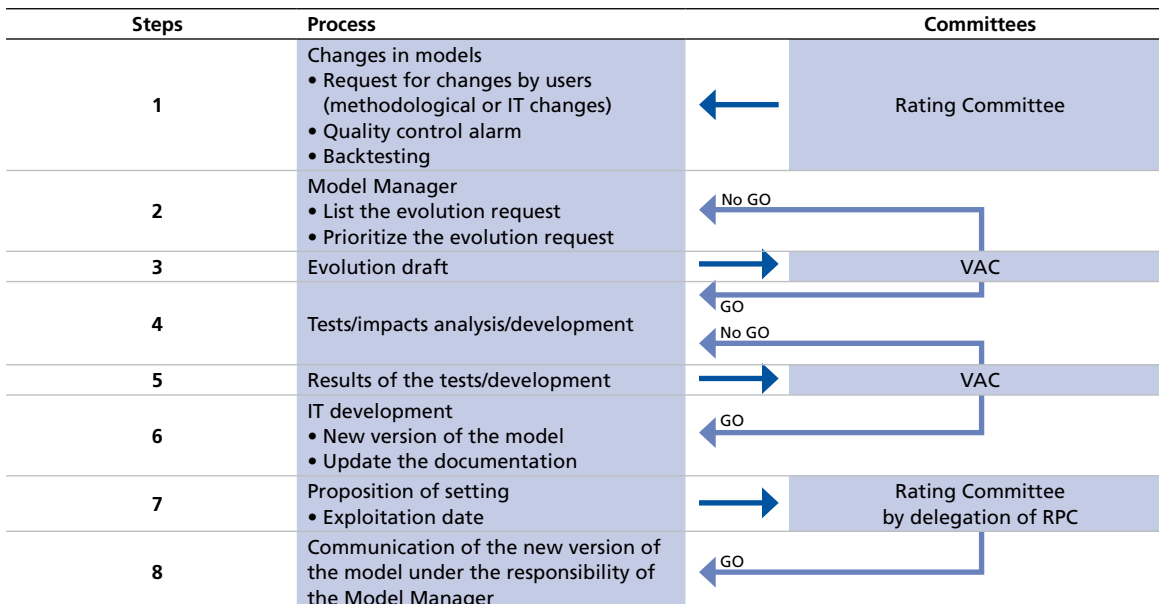
Nevertheless, some steps in the development process detailed above (such as building the score function, testing the function, etc.) are not applied for some specific models:

- 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” counterparty.
- 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” counterparty. 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* and French *Groupements sans fiscalité propre* have been inferred. This last model is currently in an experience-test period.

Dexia defines local authorities as sub-sovereign 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 model encompassed the Belgian non-public satellites. A specific model will be developed later on for the non-Belgian other satellites. 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.

### 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 authorities

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

These 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 3.9.); equities do not require the development of specific models (Simple Risk Weight Approach – refer to part 3.8).

### 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
<i>Groupements à fiscalité propre</i>	4 years	Internal
Social housing	France: 9 years United Kingdom: 5 years	Internal

### Main Principles Used for Estimating the LGD

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 counterparties (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 counterpart rating, exposure seniority level, geographic region and macroeconomic 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

Types of counterparties	Main hypotheses	Time series used	Internal/external data
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
<i>Groupements à fiscalité propre</i>	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

### Overview of the Local Public Sector

Types of counterparties	Main hypotheses	Time series used	Internal/external data
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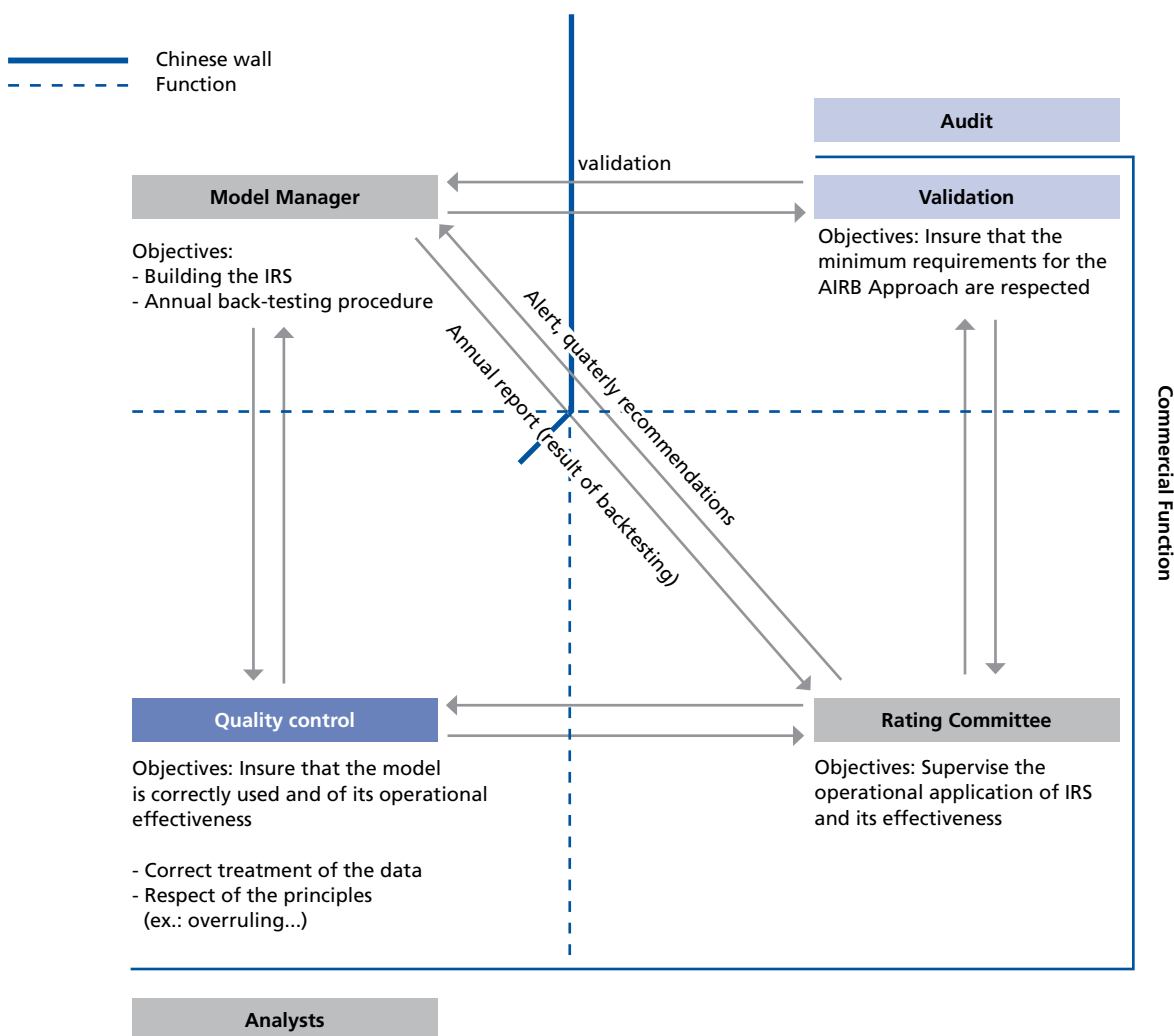
### Main Principles Used for Estimating CCF

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 or 2009 (these models will then be used for regulatory purposes from 2011 onwards) 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 control unit aimed at ensuring that the IRS are used properly and in an operationally effective manner and that an audit trail of the rating process is maintained.

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

- ensuring that the assumptions on which the models are founded are respected;
- ensuring the establishment of IRS containment procedures and the maintenance of the audit trail in the rating process;
- facilitating the IRS containment procedures. When malfunctions or anomalies in the use of or in the results produced by the model are evidenced, swift and effective remedial action should follow. To this end, controls should not only concentrate on anomalies but also help explaining their cause. Moreover, a regular and constructive relationship with the back-testing functions is put in place.

### Quality Control Scope

The scope of the quality control process covers:

- all Advanced Basel II models;
- all entities within Dexia (with the exception of Dexia Insurance Services and Dexia Asset Management which are not subject to Basel II); and
- all geographical locations.

### Quality Control Process: Parties Involved

#### Key Stakeholders and Functions

Quality control organization follows that of the Credit Risk teams: the principle is that IRS that are specific to an entity are used and controlled locally while “transversal” IRS are treated at Group level. Moreover, the Group Quality control also plays a role of coordination and steering of the global quality control process.

To enhance the efficiency and increase the uniformity of the control procedures, quality control monitoring tasks have been partially centralized in 2010.

#### Quality Control Steering Committee

A Quality Control Steering Committee has been set up in order to ensure a uniform approach throughout the Group. Meetings are held at least on a quarterly basis.

#### Rating Committee

The key role of the Rating Committee is to monitor the appropriate use 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, above tolerance threshold, proposed by analysts;
- 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.

Rating committees are held at local and group level and monitor the ratings of the counterparties of their own competence (local portfolios at entity level and transversal or not delegated counterparties at Group level).

#### Quality Control Processes and Guarantee of Independence

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

- the quality control functions are independent;
- the quality control functions submit their proposals to the Rating Committees that 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, BSM 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 Modelling;
- 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 (RPC 3).

### 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 BSM 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 Modelling 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 BSM-related risk...;
- all Dexia Group entities (cross-entity dimensions);
- all geographical locations (cross-border dimensions).

## Audit

According to the CRD minimal requirement 131, Appendix 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.

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.

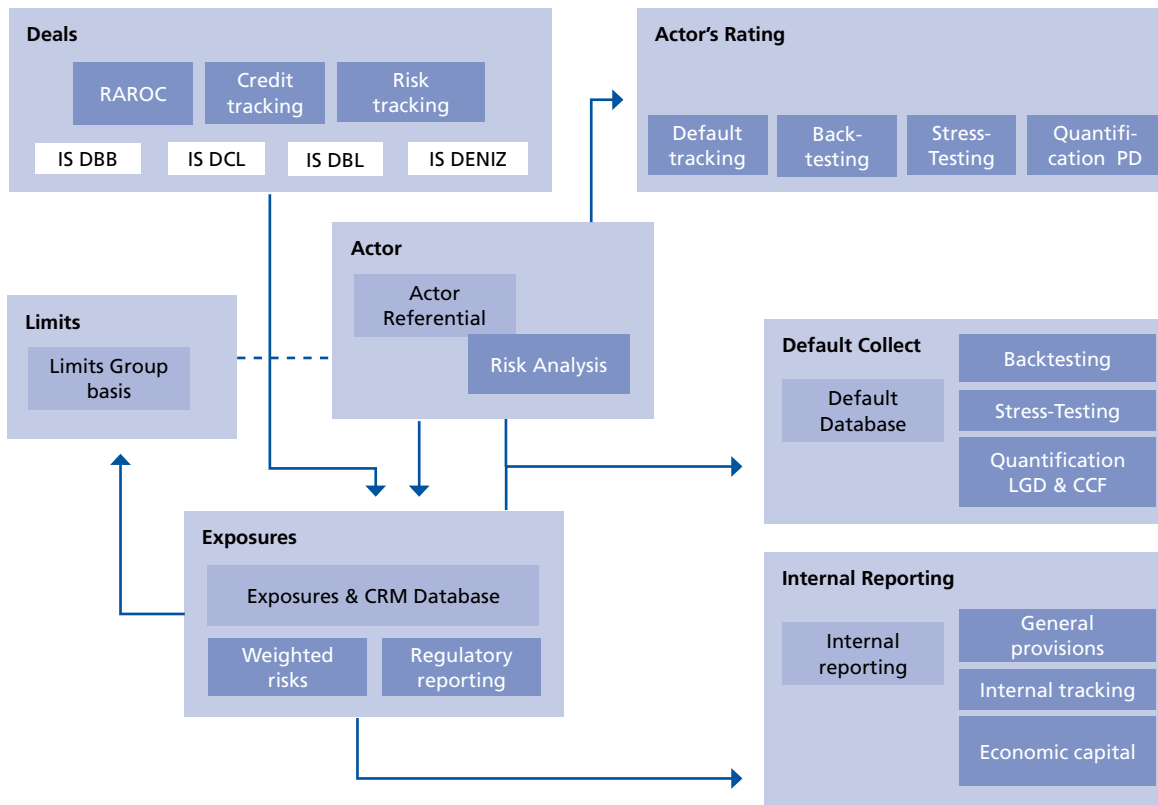


## 5. Credit Risk IT Systems

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.



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);
- internal rating before and after the Sovereign ceiling impact;
- 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

## Basics on Securitization

Securitization is the financial practice of pooling various types of contractual debt such as residential mortgages, commercial mortgages, auto loans or credit card debt obligations and selling said debt as bonds to various investors. The principal and interest on the debt, underlying the security, is paid to the various investors on a regular basis. Securities backed by mortgage receivables are called mortgage-backed securities, while those backed by other types of receivables are called asset-backed securities. A variant is the collateralized debt obligation, which uses the same structuring technology as an ABS but includes a wider and more diverse range of assets.

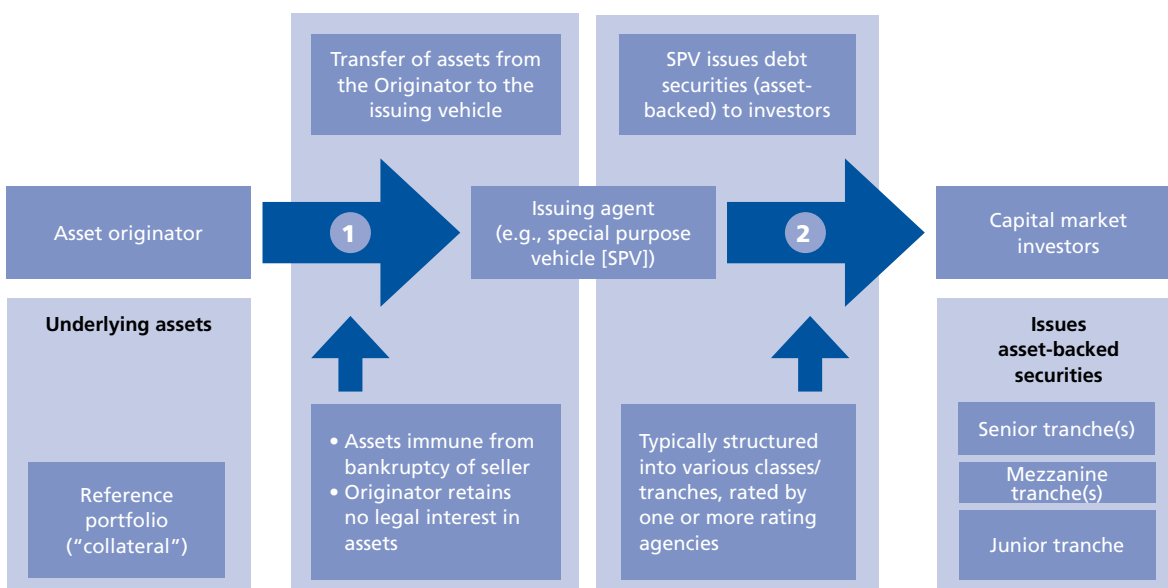
The originator initially owns the assets engaged in the deal. This is typically a company looking to seek financing or to raise capital.

A suitably large portfolio of assets is “pooled” and transferred to a “special purpose vehicle” or “SPV” (the issuer), a company or trust formed for the specific purpose of purchasing or funding the assets. Once the assets are transferred to the issuer, there is normally no recourse to the originator. The issuer is “bankruptcy remote”, meaning that the assets of the issuer are legally separated from the creditors of the originator. Additionally, the governing documents of the issuer will restrict its activities to only those necessary to complete the issuance of securities.

### Tranching

Securities issued are often split into tranches, or categorized into varying degrees of subordination. Each tranche has a different level of credit protection or risk exposure than another: there is generally a senior (“A”) class of securities and one or more junior subordinated (“B”, “C”, etc.) classes that function as protective layers for the “A” class. The senior classes have first claim on the cash or proceeds that the SPV receives, and the more junior classes generally only start receiving repayment after the more senior classes have repaid. Because of the cascading effect between classes, this arrangement is often referred to as a cash-flow waterfall. In the event that the underlying asset pool becomes insufficient to make payments on the securities (e.g. when loans default within a portfolio of loan receivables), the loss is absorbed first by the subordinated tranches, and the upper-level tranches remain unaffected until the losses exceed the entire amount of the subordinated tranches. The most junior class is often called the equity class and is the most exposed to re-payment or default risk.

The table below describes the way a securitization process is performed:



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## Credit Enhancement

Tranching in a securitization deal will create some securities which are “credit enhanced”, meaning the credit quality is increased above that of the originator’s unsecured debt or underlying asset pool. This increases the likelihood that the investors will receive cash flows to which they are entitled, and thus causes the securities to have a higher credit rating than the originator. Some securitizations use external credit enhancement provided by third parties, such as monolines or parental guarantees. Credit enhancements affect credit risk by providing more or less protection to promised cash flows for a security. Additional protection can help a security achieve a higher rating, lower protection can help create new securities with differently desired risks, and these differential protections can help place a security on more attractive terms.

## Servicing

Most collateral requires the performance of ongoing servicing activities. With credit card receivables, monthly bills must be sent out to credit card holders; payments must be deposited, and account balances must be updated. Similar servicing must be performed with auto loans, mortgages, accounts receivable, etc. Usually, the originator is already performing the servicing at the time of a securitization, and it continues to do so after the assets have been securitized. It receives a small, ongoing servicing fee for doing so... Whoever actually performs servicing is called the servicing agent.

# Appendix 4

## 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) of which MBS currently contains no active compartments;
- 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 Belgian securitization transaction of 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 2010 EUR 76.8 million was still outstanding under class A2 while class A1 has been repaid.

Atrium-2 is a Belgian securitization transaction of 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 2010 EUR 59.4 million was still outstanding under class A2.

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

The Belgian securitization vehicle MBS has six compartments. The last active compartment, MBS-4, has exercised its clean-up call in January 2010. As such there were no outstanding issues anymore under the MBS programme at the end of 2010.

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

Dexia Secured Funding Belgium (DSFB) is a Belgian securitization vehicle (*institutionele VBS naar Belgisch recht/SIC institutionnelle de droit belge*) with currently six compartments, of which three with activity.

DSFB-1 (using the first ringfenced compartment of DSFB) is a securitization transaction of loans granted to public entities in Belgium or 100% guaranteed by such public entities. This EUR 1.7 billion transaction was launched on 28 June 2007. One tranche of floating-rate notes, rated AA/Aa1/AA+ at closing by respectively S&P, Moody's and Fitch, was issued. Dexia Bank Belgium has guaranteed the full and timely payment of principal and interest on the notes. At 31 December 2010 there was EUR 1.49 billion outstanding and the notes have a rating of A/A1/A+.

DSFB-2 (using the second ringfenced compartment of DSFB) is a securitization transaction of loans granted to Belgian public entities. All the loans are 100% guaranteed by one of the 3 Belgian regions. This EUR 1.62 billion transaction was launched on 28 April 2008. One tranche of floating-rate notes, rated at closing AA/Aa1/AA+ by respectively S&P, Moody's and Fitch, was issued. Dexia Bank Belgium has guaranteed the full and timely payment of principal and interest on the notes. At 31 December 2010 EUR 1.48 billion were still outstanding and the notes have a rating of A/A1/A+.

DSFB-4 (using the fourth ringfenced compartment of DSFB) is a securitization transaction of loans granted to Belgian public entities. This EUR 5 billion transaction was launched on 14 December 2009. Three classes of floating-rate notes were issued: EUR 4.7 billion Class A notes (rated AA by Fitch Ratings), EUR 300 million non-rated Class B notes and EUR 60 million non-rated Class C notes. At the end of December 2010, EUR 4.63 billion were still outstanding.

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 is a Belgian securitization vehicle with currently six compartments. Two compartments, Penates-1 and Penates-3, had outstanding notes at the end of 2010. Penates-2 has been called in April 2010.

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 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 Notes due 2041 (not rated). As at 31 December 2010 all the notes still have their initial rating and the outstanding amounts for all classes of notes were still at their initial amount except for the Class A notes where the balance decreased to EUR 6,059.3 million. There was hence EUR 6,539.3 million outstanding under Penates-1 at 31 December 2010.

On 28 June 2010, Dexia Bank Belgium closed a EUR 6,060 billion RMBS securitization transaction. The SPV, Penates Funding acting through its compartment Penates-3, securitized Belgian residential mortgage loans originated by Dexia Bank and issued four classes of notes: EUR 2,250 million Class A1 Mortgage-Backed Floating-Rate Notes due 2044 (Fitch AAA/ S&P AAA); EUR 3,195 million Class A2 Mortgage-Backed Floating-Rate Notes due 2044 (Fitch AAA/ S&P AAA); EUR 555 million Class B Mortgage-Backed Floating-Rate Notes due 2044 (unrated) and EUR 60 million Subordinated Class C Floating-Rate Notes due 2044 (unrated). The Class A1 notes have amortized to EUR 2,009.8 million, meaning that EUR 5,819.8 million was still outstanding under Penates-3 at the end of 2010.

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 25 million as at 31 December 2010), USD 70 million/EUR 50 million (Series 2005-C fixed-rate notes due 2010, has been reimbursed partially every three months and fully repaid to investors on its scheduled repayment date on June 2010).

In June 2007, Dexia arranged two tranches under the same programme: USD 200 million/EUR 144 million (Series 2007-B Floating-Rate Notes due 2015, has been reimbursed partially every three months and amounted to USD 170 million as at 31 December 2010) and USD 150 million/EUR 108 million (Series 2007-C Floating-Rate Notes due 2015 has been reimbursed partially every three months and amounted to USD 127.5 million as at 31 December 2010).

In January 2009, Dexia arranged another tranche under the same programme: USD 650 million 2009-A Series which was early repaid to Dexia in two equal instalments on 16 March 2009 and 15 September 2009.

As at 31 December 2010, USD 322.5 million were outstanding (EUR 241.2 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 2010, the outstanding commitments amounted to EUR 787.1 million and EUR 3 million respectively (Series 2004-1) for class A and class B; the outstanding commitments amounted to EUR 728.8 million and EUR 3 million respectively (Series 2005-1) for class A and class B and the outstanding commitments amounted to EUR 2,165.2 million and EUR 46.2 million respectively (Series 2008-1) for class A and class B.

An amount of EUR 3.7 billion (as at 31 December 2010) was subscribed by entities of the Dexia Group.

## **Tevere Finance Series 2009 I, Series 2009 II and Series 2010 III (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 initially 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 million (Class B). Both classes were purchased by Dexia Crediop at inception. This series has been closed during the last quarter of 2010 and all the underlying bonds have been transferred part to Dexia Kommunalbank Deutschland and part to the Dexia Crediop portfolios.

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 million). Class A is rated A (S&P) while class B is unrated. As at 31 December 2010 the outstanding amount was the same as the original size.

During the first quarter of 2010 Dexia Crediop has issued a further series of Tevere Finance i.e. Tevere Finance Series III which underlying assets are Corporate Loans. As per the previous Series, two classes of notes have been issued: Class A (senior Tranche for an initial amount of EUR 472.7 million) and Class B (junior/subordinated tranche for an initial amount of EUR 2.6 million). As at 31 December 2010 the outstanding amount was the same as the original size. Both classes are unrated.

## **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 2010 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. The portfolio amortized slightly to GBP 1.49 billion (EUR 1.74 billion) at the end of 2010.

### **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. Moody's has withdrawn the ratings of the CLNs issued by Dublin Oak. Therefore, the CLNs currently have no rating anymore. 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. The total portfolio amortized to USD 2.35 billion (EUR 1.74 billion) at the end of 2010.

## 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.

Alike in 2009, DRECM made no securitization during 2010. As at 31 December 2010, the outstanding amount of all securitizations originated by DRECM in the previous years amounted to USD 6.749 billion (EUR 5.092 billion).

# Appendix 5

## List of Dexia main subsidiaries and branches

Below are the main subsidiaries and affiliated enterprises of the Dexia Group<sup>12</sup> (insurance companies excluded) which are included in the perimeter of the Dexia Pillar 3 risk report:

Name	Head Office	% of capital held	Consolidation method
<b>DIRECT PARTICIPATIONS OF DEXIA SA</b>			
Associated Dexia Technology Services SA (ADTS)	23, Atrium Business Park, z.a. Bourmicht, L-8070 Bertrange	100	fully
Dexia Funding Luxembourg SA	180, rue des Aubépines, L-1145 Luxembourg	100	fully
Dexia Participation Belgique SA	Place Rogier 11, B-1210 Brussels	100	fully
Dexia Participation Luxembourg SA	69, route d' Esch, L-2953 Luxembourg	100	fully
Group DenizBank AŞ	Büyükdere Cad. No: 106, T-34394 Esentepe/Istanbul	99.85	fully
Group Dexia Nederland BV	Piet Heinkade 55, NL-1019 GM Amsterdam	100	fully
<b>DEXIA BANQUE BELGIQUE SA : MAIN SUBSIDIARIES AND AFFILIATES</b>			
Dexia Auto Lease SA	Place Rogier 11, B-1210 Brussels	100	fully
Dexia Bank Belgium SA	Boulevard Pachéco 44, B-1000 Brussels	100	fully
Dexia Commercial Finance SA	Place Rogier 11, B-1210 Brussels	100	fully
Dexia Crédits Logement SA	Boulevard Pachéco 44, B-1000 Brussels	100	fully
Dexia Funding Netherlands NV	Strawinskylaan 3105, NL-1077 ZX Amsterdam	100	fully
Dexia Investment Company SA	Boulevard Pachéco 44, B-1000 Brussels	100	fully
Dexia Investments Ireland SA	6 George's Dock, IRL-IFSC Dublin 1	100	fully
Dexia Lease Belgium SA	Place Rogier 11, B-1210 Brussels	100	fully
Dexia Lease Services SA	Place Rogier 11, B-1210 Brussels	100	fully
<b>DEXIA BANQUE INTERNATIONALE À LUXEMBOURG SA : MAIN SUBSIDIARIES AND AFFILIATES</b>			
Dexia Asset Management Luxembourg SA <sup>13</sup>	136, route d'Arlon, L-1150 Luxembourg	100	fully
Dexia Banque Internationale à Luxembourg	69, route d'Esch, L-2953 Luxembourg	99.95	fully
Dexia LdG Banque SA	69, route d'Esch, L-1470 Luxembourg	100	fully
RBC Dexia Investor Services Ltd	77 Queen Victoria Street, UK-London EC4N 4AY	50	proportionally
RBC Dexia Investor Services Bank SA	14, rue Porte de France, L-4360 Esch-sur-Alzette	50	proportionally
RBC Dexia Investor Services Trust Ltd	77 King Street West - 35th floor, Royal Trust Tower, Toronto, ON, Canada M5W-1P9	50	proportionally
<b>DEXIA CRÉDIT LOCAL SA : MAIN SUBSIDIARIES AND AFFILIATES</b>			
Dexia banka Slovensko	Hodzova ul 11 010 11, Zilina - Slovakia	85.47	fully
Dexia CLF Banque	1, Passerelle des Reflets, Tour Dexia la Défense 2, TSA 92919 La Défense Cedex	100	fully
Dexia Crediop Spa	Via Venti Settembre 30, I-00187 Roma	70	fully
Dexia Crediop Ireland	6 George's Dock, IRL-IFSC Dublin 1	100	fully
Dexia Crédit Local SA	1, Passerelle des Reflets, Tour Dexia la Défense 2, TSA 12203, 92919 La Défense Cedex	100	fully
Dexia Delaware LLC	15 East North Street, Delaware, 19901 Dover – USA	100	fully
Dexia FP Holdings Inc.	445 Park Avenue, 5th floor New York, NY 10022 USA	100	fully
Dexia Holdings inc.	445 Park Avenue, 5th floor New York, NY 10022 USA	100	fully
Dexia Israel Bank	19 Ha'arbaha st., "Hatihon" building, Tel Aviv 61200, POB 7091	65.99	fully
Dexia Kommunalbank Deutschland AG	Charlottenstrasse 82, D-10969 Berlin	100	fully

<sup>12</sup> Complete list available on request.

<sup>13</sup> 49% owned by Dexia Bank Belgium, 51% owned by Dexia Banque Internationale à Luxembourg.



<b>Name</b>	<b>Head Office</b>	<b>% of capital held</b>	<b>Consolidation method</b>
Dexia Kommunalkredit Bank AG	Fischhof 3A-1010 Vienna - Austria	100	fully
Dexia Kommunalkredit Bank Polska	Ul. Sienna 39 - 00-121 Warschau - Pologne	100	fully
Dexia Municipal Agency SA	1, Passerelle des Reflets, Tour Dexia la Défense 2, TSA 12203, 92913 La Défense Cedex	100	fully
Dexia Sabadell Banco Local	Paseo de las 12 Estrellas 4, Campo de las Naciones, E-28042 Madrid	60	fully
Dexia Sofaxis	Route de Créton, 18110 Vasselay - France	100	fully
FSA Global Funding Ltd	PO Box 1093GT, Boundery Hall, Cricket Square, Grand Cayman, Cayman Islands	100	fully