# Risk report 2011

Pillar 3 of Basel II

DEXIA

# Contents

# Introduction

2011 was a year of two phases, demanding a great deal of reactivity on the part of the Risk support line in confronting the many events which punctuated the year.

Until the end of June, the implementation of the Group transformation plan, aimed at reducing its risk profile and adjusting its financial structure, progressed in line with set objectives. In May, against the background of a hardening economic environment, the Group announced its desire to accelerate its financial transformation by selling EUR 6.4 billion of guaranteed assets from the Financial Products portfolio, at a loss of EUR 1.9 billion and by booking a fair value adjustment on a significant reserve of non-strategic loans and bonds held for sale. Over the entire year, in addition to the guaranteed assets from the Financial Products portfolio, the Group disposed of EUR 18.2 billion in assets.

The aggravation of the sovereign debt crisis from the beginning of the year marked a breaking point. The worrying situation in Greece severely impacted the Group, with a write down of EUR 3.4 billion on its Greek sovereign and assimilated exposure. On the other hand, this aggravation of the sovereign debt crisis, combined with the deterioration of the macroeconomic environment, severely weakened the Group's liquidity position, despite the considerable reduction of its funding requirement and the clear improvement of its funding mix since the end of 2008. Investor risk aversion increased, leading to significant pressures on the short-term interbank market and to fewer long-term debt issues. Against this deteriorating background, the Group undertook in-depth changes to its structure from October 2011, notably including a funding guarantee scheme from the Belgian, French and Luxembourg States, the sale of Dexia Bank Belgium to the Belgian State (finalized on 20 October 2011) and a programme for the disposal of certain of the Group's operational subsidiaries.

For the Dexia Group and on the basis of the figures estimated as at 30 September 2011, the sale of Dexia Bank Belgium reduced the size of its balance sheet by EUR 150 billion, decreased weighted risks by EUR 45 billion, reduced the maximum credit risk exposure (MCRE) on government bonds from certain European countries and the bond portfolio in run-off by EUR 8.8 billion and EUR 19.8 billion respectively and decreased the short-term liquidity gap by EUR 16 billion.

Following the deconsolidation of Dexia Bank Belgium, a large number of the Dexia SA teams based in Brussels will move to Dexia Bank Belgium in 2012, requiring a reorganization of the Risk support line. Awaiting the introduction of this new organization, teams are guaranteeing a continuity of service on the basis of the Service Level Agreements in place.

Against that background, Dexia continued to be involved in national and international consultations, participating particularly in the impact study by the Bank for International Settlements (BIS) on the Basel III reforms with regard to the definition of equity capital, the leverage ratio and liquidity ratios. In particular, Dexia worked on the application of the so-called "CRD 3" European directive, applicable as from 31 December 2011.

# Basel II framework

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

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

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

- The first pillar – minimum capital requirements – defines the way banking institutions calculate their regulatory capital requirements in order to cover credit risk, market risk and operational risk. The 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 former Banking, Finance and Insurance Commission by 18 December 2007. Consequently, since 1 January 2008, Dexia has been authorized to use the Advanced Internal Rating-Based Approach (AIRB Approach) for the determination of its regulatory capital requirements under Basel II Pillar 1 for credit risk and for the calculation of its solvency ratios.
This acceptance is applicable to all entities and subsidiaries consolidated within the Dexia Group, which are established in a Member State of the European Union and subject to the Capital Requirement Directive.

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

### Market risk

In terms of market risk, Dexia calculates its capital requirements on the basis of the Internal Model Approach for general interest rate risk and foreign exchange risk and the Standardized Approach for specific interest rate risk (refer to part 4. Market and Balance-Sheet Management risks).
A formal request for approval to use a historical VaR instead of a parametric VaR has been submitted to the regulator.

### Operational risk

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

### COREP

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

## Pillar 2

Pillar 2 was further consolidated in 2010 and 2011 following inspections by the college of regulators. This process, applicable since the 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.

## 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 – Titre XIV (Belgian transposition of the Capital Adequacy Directive – Annex 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 releases the Pillar III/Risk Report on its website (*www.dexia.com*).

### Currency

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

### Scope of application

The Pillar 3 disclosure requirements under the new Basel II capital framework are applicable to the upper level of consolidation, the Dexia Group. This consolidation is realized at Dexia SA, based at Place Rogier 11, 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.).
Subsequent to the significant structural measures taken in October 2011 impacting the Group structure, the 2011 figures will be presented in consistency with the 2011 annual report:

- Dexia Bank Belgium was sold in October 2011 and left the scope of the Group.
- The assets and disposal groups held for sale will be identified separately. These are mainly Dexia Banque Internationale à Luxembourg (excluding its legacy portfolio, Dexia LdG Banque and other non-strategic participations), Dexia Asset Management, RBC Dexia Investor Services and Dexia Municipal Agency.

As a result, the 2011 data (tables and graphs) will be disclosed as follows:

- detailed tables and graphs for continuing operations;
- gross figures for disposal groups held for sale, otherwise further precisions will be made;
- average figures will be calculated including Dexia Bank Belgium for the first 3 quarters of 2011 and excluding Dexia Bank Belgium for the fourth quarter of 2011.

No pro forma has been produced on the 2010 figures.

### Pillar 3 contents

Part of the information provided within Pillar 3 is similar to the Annual Report. However, to facilitate reading 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.
Dexia SA is authorized like other financial institutions not to communicate information if it is considered to be non-significant or confidential.

# 1. Risk management objectives and policies

## 1.1. Mission and objectives

The mission of the Risk support line is to define the Group's risk appetite, to put in place independent and integrated risk measures for the different types of risks, to monitor and to manage them, as well as to identify and to address any emerging risks.

The general organization of the Risk support line, redesigned in 2010, is aligned to the general organization of the Dexia Group, with local risk management teams in each of the Group's subsidiaries, under the responsibility of the Group Chief Risk Officer. The support line is now organized transversally by type of risk: "Retail and Commercial Banking" credit risk, "Public and Wholesale Banking" credit risk, all risks related to financial market activities and operational risk. To fully exploit the competences available within the Group, the organization is based on expertise centres on which the local risk management function can rely, in accordance with the Service Level Agreements (SLA) concluded in 2010.

The worsening of the economic context and continuing pressure on liquidity led to the adoption of new structural measures in October 2011. The Group's in-depth restructuring was marked in particular by the disposal of Dexia Bank Belgium. The partial outflow of Brussels-based specialist teams will be phased over 2012 in line with the reorganization of the Risk support Line. Awaiting this reorganization, the current teams will ensure the continuity of services in line with the Service Level Agreements in place.

The organization and governance presented below correspond to the structure as at 31 December 2011. This structure will evolve in the near future in line with the aforementioned changes.

The principal operational responsibilities of the Risk support line at Dexia are as follows:
- to elaborate general risk policy under the supervision of the Management Board;
- to manage the function of risk monitoring and decision-making processes;
- to set credit limits and delegations for the different decision-makers.

From this point of view, risk management has therefore put methodologies in place to assess Dexia risks for each of the Group's activities and entities.

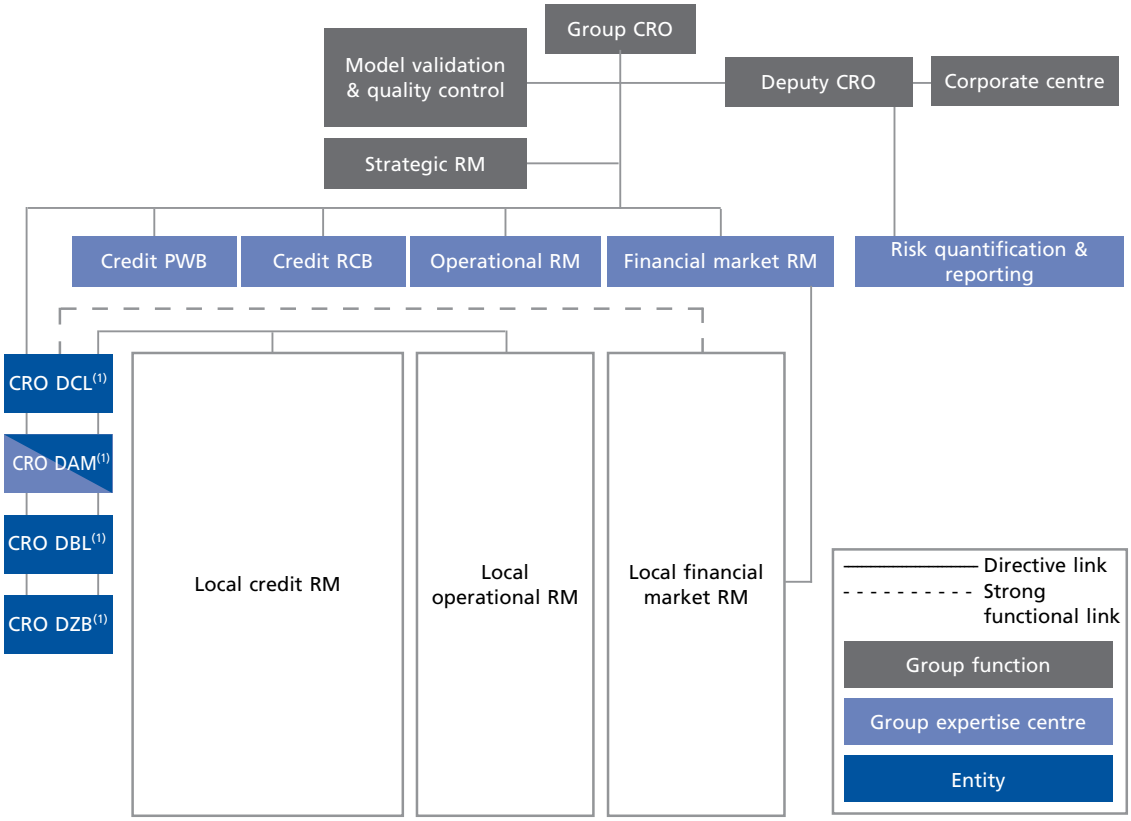
## 1.2. Risk organization and governance

### 1.2.1. Organization

The Risk Management organization is aligned to the overall Dexia Group organization. Dexia Risk management is composed of:

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

The following chart presents the Dexia Risk Management Organization.




*(1) DCL: Dexia Crédit Local – DAM: Dexia Asset Management – DBL: Dexia Banque Internationale à Luxembourg – DZB: DenizBank*

## Expertise Centre

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

### 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 and real estate counterparties and international local authority counterparties. The Credit Risk Analysis Centres are responsible for assigning internal ratings to Dexia counterparties but also for 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.

### 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.

### 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, analysing, monitoring (including valuation, model management) and reporting on risks and results from a holistic viewpoint.

The other Dexia expertise centres are:

### Operational risk

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

### Risk quantification and reporting

Risk quantification and reporting teams are 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 Asset Management (DAM)

Dexia Asset Management (DAM) is both an expertise centre and an entity as it is the only entity in the Group dealing with asset management business.

Front Office of DAM performs the first level controls whereas DAM Risk Management department monitors 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, management is performed "ex ante" (regulatory and contractual risk) as well as "ex post" (monitoring of the market risks indicators).

## Group functions

### Strategic Risk Management

Strategic Risk Management takes a holistic and consolidated view of credit risks, proactively to 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 anticipating any changes which might have an impact on 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 (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 reports;
- Local operational risk is responsible for the local risk assessment/monitoring and producing local reports;
- Local financial market risk management is responsible for 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. In addition, each entity steers its subsidiaries.

Local chief risk officers put local governance in place in line with the Dexia Group practices and policies:

- Local committees organization;
- Delegation rules;
- Local reporting production;
- Defaults and watchlist files detection and monitoring;
- Credit risk provisions computation and following;
- Local operational risk cartography;
- Local management of data and information security, continuity plans and resumption activity plans.

## 1.2.2. Governance

The Dexia risk committees are organized under the same governance as for chairmanship, decision rules and general delegations. This governance is fully in line with 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 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 Chief Risk Officer, Dexia Deputy Chief Risk Officer, Dexia Head of Financial Markets Risk Management (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 level 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 Watchlist 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 Acceptance 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. It represents the risk cartography of Dexia SA as at 31 December 2011, taking into account the sale of Dexia Bank Belgium and its subsidiary Dexia Insurance Belgium.

| | | | Pillar 1 | Pillar 2 |
|---|---|---|---|---|
| **Financial risks** | Credit risk | Solvency risk | x | x |
| | | Country risk | x | x |
| | | Settlement risk (1) | | x |
| | | Residual risk | | x |
| | Market and Balance-Sheet Management risk | Interest-rate risk | x | x |
| | | Price risk (2) | x | x |
| | | Currency risk | x | x |
| | | Spread risk | x | x |
| | | Basis risk | | x |
| | | Other market risks | x | x |
| **Operating risks** | Operational risk | | x | x |
| | Other risks | Funding risk | | x |
| | | Behavioural risk | | x |
| | | Business risk | | x |
| | | Model risk | | x |
| **Qualitative risks** | | Reputation risk | | x |
| | | Strategic risk | | x |
| | | Liquidity risk | | x |
| | | Securitization 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 RICAP (Risk Identification and Cartography Assessment Process) was implemented in 2011. All risk types are classified in Financial, Operating and Qualitative risks. Financial and Operating risks are capitalized as opposed to Qualitative risks.
Some methodology changes have been implemented, the most important being pension risk driven by obligations regarding pension funds and the integration of basis risk.

The risks listed above are described in more 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 National Bank of Belgium (NBB) 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 concerned.

## 2.1. Own funds

### 2.1.1. Accounting and regulatory equity figures

In line with regulatory capital, Dexia has chosen to limit the scope of Pillar 3 to banking institutions. Therefore, the scope of consolidation of Pillar 3 differs from the scope of consolidation of the financial statements (as released in the Dexia Group annual report).
Following the sale of Dexia Bank Belgium and its insurance subsidiary Dexia Insurance Belgium, the difference between the accounting methods and the prudential methods as at 31 December 2011 is limited to the insurance company of Dexia Banque Internationale à Luxembourg, BIL-Ré which is accounted for by the equity method for prudential purposes instead of full consolidation for accounting purposes. The difference is not material.
In 2010, the differences in consolidation between the accounting methods and the prudential methods were:

- Insurance companies consolidated using the equity method for prudential purposes instead of full consolidation for accounting purposes. Dexia Insurance Belgium was the main insurance company of Dexia and was part of the sale of Dexia Bank Belgium.
- Small securitization vehicles (Special Purpose Vehicles – SPV) consolidated using the equity method for prudential purposes instead of full consolidation for accounting purposes. This was due to the very specific accounting treatment of SPV and related to subsidiaries of Dexia Bank Belgium.

The 2010 exhaustive list of the insurance companies and SPV concerned is available on request.

| | 31/12/2010 | | 31/12/2011 | |
|---|---|---|---|---|
| | **Financial statements** | **Regulatory purposes** | **Financial statements** | **Regulatory purposes** |
| Total shareholders' equity | 8,945 | 8,945 | (2,018) | (2,018) |
| *of which core equity* | *19,214* | *19,214* | *7,589* | *7,589* |
| *of which gains and losses not recognized in the statement of income* | *(10,269)* | *(10,269)* | *(9,607)* | *(9,607)* |
| Non-controlling interests | 1,783 | 1,773 | 1,698 | 1,698 |
| *of which core equity* | *1,858* | *1,849* | *1,819* | *1,819* |
| *of which gains and losses not recognized in the statement of income* | *(75)* | *(76)* | *(121)* | *(121)* |
| **TOTAL** | **10,728** | **10,718** | **(320)** | **(320)** |

*Notes:*
*- Comments on regulatory requirements are made in note 4.5. of the accounting principles and rules of consolidated financial statements published in the Annual Report 2011.*
*- 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.*

The decrease of the core equity is due to the net loss of EUR -11.6 billion recorded by the Group as at 31 December 2011. This was the result of the loss related to the disposal of Dexia Bank Belgium (EUR -4.1 billion), the loss related to the disposal of Dexia Municipal Agency (EUR -1 billion), the 75% discount on the Greek sovereign and assimilated exposure (EUR -3.4 billion of impairments excluding the impairments on the related hedging derivatives) and the cost of the deleveraging (EUR -2.6 billion including the loss on the sale of the guaranteed assets from the Financial Products portfolio).
The other comprehensive income (OCI) which includes the gains and losses not recognized in the statement of income were EUR -9.6 billion at the end of 2011. Globally, OCI recorded an improvement of EUR 0.7 billion compared to 31 December 2010. Over the first half-year 2011, losses and fair value adjustments associated with the acceleration of asset disposals led to an improvement of EUR 2 billion in OCI. The trend then reversed in the second half-year under the effect of the reversal of deferred tax assets and of the spread widening of certain sovereign issuers impacting the AFS reserve and leading to a deterioration of EUR 1.3 billion in OCI.

## 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, minority 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 on the basis of requirements from the Belgian regulator, the National Bank of Belgium (NBB).

Moreover, since 1 January 2007, according to the CRD regulation (Capital Requirement Directive), the Belgian regulator has adjusted the regulatory capital definition. The most significant impact for Dexia is related to deductions from total regulatory capital (banks accounted for by the equity method, participations in financial companies or subordinated loans issued by such a financial company) and will be deducted 50% from Tier 1 capital and 50% from total regulatory capital.

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

| | 31/12/2010 | 31/12/2011 |
|---|---|---|
| **TOTAL REGULATORY CAPITAL (AFTER PROFIT APPROPRIATION)** | **20,636** | **8,589** |
| **Tier 1 capital** | **18,425** | **6,305** |
| Core shareholders' equity | 19,214 | 7,589 |
| Cumulative translation adjustements (Group share) | (361) | (803) |
| Prudential filters | (104) | (335) |
| Non-controlling interests eligible in Tier 1 | 660 | 627 |
| Dividend payout (minority interests) | (6) | 0 |
| Items to be deducted: | (2,401) | (1,772) |
| *Intangible and goodwill* | *(2,262)* | *(1,416)* |
| *Holdings > 10% in other credit and financial institutions (50%)* | *(54)* | *(45)* |
| *Excess on limit for holdings, subordinated claims and other items in credit and financial institutions in which holdings < 10% (50%)* | *0* | *(310)* |
| *Subordinated claims and other instruments held by insurance in which holdings >10% (50%)* | *(85)* | *0* |
| Innovative hybrid Tier-1 instruments | 1,423 | 999 |
| | | |
| **Tier 2 capital** | **2,211** | **2,284** |
| Perpetuals and excess on innovative hybrid Tier-1 instruments for recognition in Tier 1 capital | 839 | 424 |
| Subordinated debts | 2,541 | 2,104 |
| Available for sale reserve on equities (+) | 308 | 202 |
| IRB provision excess (+); IRB provision shortfall 50% (-) | 0 | 44 |
| Items to be deducted: | (1,477) | (490) |
| *Holdings > 10% in other credit and financial institutions (50%)* | *(186)* | *(138)* |
| *Subordinated claims and other instruments held by insurance in which holdings >10% (50%)* | *(85)* | *0* |
| *Excess on limit for holdings, subordinated claims and other items in credit and financial institutions in which holdings < 10% (50%)* | *0* | *(310)* |
| *Participations in insurance undertakings* | *(1,206)* | *(42)* |

*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 2011, Tier 1 capital amounted to EUR 6,305 million, a 66% decrease compared to last year driven by the loss booked in 2011.

This also generated a limited recognition of the innovative hybrid Tier-1 instruments (EUR 999 million) as the European Directive CRD 2 limits the recognition of hybrid capital to 15% of Tier 1 capital (considered before deduction of holdings). The excess on Tier 1 recognition (EUR 424 million) is recognized in Tier 2 capital.

Innovative hybrid Tier 1 instruments at Dexia (total amount of EUR 1,423 million) 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 and booked for EUR 700 million;
c) the undated subordinated non-cumulative Notes for EUR 500 million, issued by Dexia Funding Luxembourg and booked for EUR 498 million.

| Issuer | Booked amount (millions of EUR) | Rate | Call date | Rate applicable after the call |
|---|---|---|---|---|
| Dexia Banque Internationale à Luxembourg SA | 225 | 6.821% | 06/07/11 | Euribor 3 m + 230 bp |
| Dexia Crédit Local SA | 700 | 4.300% | 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 the exercise of calls on Dexia hybrid capital instruments. Dexia effectively undertook only to pay coupons on its subordinated debt and hybrid capital instruments if there is a contractual obligation and not to exercise any call until the end of 2011. In 2012, the Group intends to apply the same rule.

Following the sale of Dexia Bank Belgium in October 2011 and within the framework of the unwinding of existing links between Dexia SA and Dexia Bank Belgium, on 20 February 2012 Dexia Bank Belgium launched a public offer for the purchase of the EUR 500 million perpetual non-cumulative securities issued by Dexia Funding Luxembourg SA, at a purchase price amounting to 25% of the nominal value of the securities. As part of that transaction, the Dexia Group undertook to purchase from Dexia Bank Belgium the securities tendered in the offer. Dexia Bank Belgium will repay the subordinated loan of EUR 500 million granted by Dexia Funding Luxembourg SA and financed by the issue of those securities, up to the nominal amount of the securities tendered in the offer. This transaction was closed on 29 February 2012, with investor participation in an amount of EUR 459 million, a success rate of 91.84%.

Furthermore, from the perspective of strengthening Core Tier 1 Capital of Dexia and its subsidiary Dexia Crédit Local, on 2 March 2012 Dexia Crédit Local launched an offer to purchase its EUR 700 million of hybrid Tier 1 securities at a purchase price (expressed as a percentage of nominal amount) of 24%. This offer, closed on 14 March 2012, had a success rate of 91.96%, representing an amount of EUR 644 million in securities contributed by investors.

## 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 2011 and 2010. 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.

| | | | 31/12/2010 | | 31/12/2011 | | | |
|---|---|---|---|---|---|---|---|---|
| | | | | | Continuing operations | | Groups held for sale | |
| Type of risk | Basel II treatment | Exposure class | Weighted risks | Capital requirements | Weighted risks | Capital requirements | Weighted risks | Capital requirements |
| **Credit risk** | Advanced | Corporate | 24,395 | 1,952 | 6,865 | 549 | 868 | 69 |
| | | Equities | 420 | 34 | 286 | 23 | 110 | 9 |
| | | Financial institutions | 10,170 | 814 | 6,990 | 559 | 1,285 | 103 |
| | | Monolines | 2,360 | 189 | 1,629 | 130 | | |
| | | Project finance | 6,304 | 504 | 5,478 | 438 | 52 | 4 |
| | | Public sector entities | 5,682 | 455 | 2,836 | 227 | 855 | 68 |
| | | Retail – Mortgage loans | 1,723 | 138 | - | - | 265 | 21 |
| | | Retail – Revolving loans | 2,560 | 205 | - | - | | |
| | | Retail – Other loans | 104 | 8 | - | - | 386 | 31 |
| | | Securitization | 23,458 | 1,877 | 5,849 | 468 | 716 | 57 |
| | | Sovereign | 3,960 | 317 | 3,720 | 298 | 83 | 7 |
| | | Others | 5 | 0 | - | - | 0 | 0 |
| | | ***Total*** | ***81,141*** | ***6,491*** | ***33,654*** | ***2,692*** | ***4,619*** | ***370*** |
| | Standard | Corporate | 13,156 | 1,053 | 10,466 | 837 | 638 | 51 |
| | | Equities | 772 | 62 | 384 | 31 | 411 | 33 |
| | | Financial institutions | 3,748 | 300 | 1,474 | 118 | 402 | 32 |
| | | Monolines | - | - | | - | | |
| | | Project finance | 662 | 53 | 664 | 53 | | |
| | | Public sector entities | 18,429 | 1,474 | 10,049 | 804 | 2,352 | 188 |
| | | Retail – Mortgage loans | 2 | 0 | - | - | | |
| | | Retail – Revolving loans | 9 | 1 | 4,020 | 322 | | |
| | | Retail – Other loans | 4,322 | 346 | 0 | 0 | 55 | 4 |
| | | Securitization | - | - | - | - | | |
| | | Sovereign | 5,812 | 465 | 3,684 | 295 | 398 | 32 |
| | | Others | 186 | 15 | 219 | 18 | 16 | 1 |
| | | ***Total*** | ***47,098*** | ***3,768*** | ***30,961*** | ***2,477*** | ***4,272*** | ***342*** |
| **Market risk** | Internal model | Interest rate & foreign exchange risk | 669 | 54 | 84 | 7 | 65 | 5 |
| | | Position risk on equities | - | - | - | - | - | - |
| | | Other market risks | - | - | - | - | - | - |
| | | ***Total*** | ***669*** | ***54*** | ***84*** | ***7*** | ***65*** | ***5*** |
| | Standard | Interest rate risk | 1,829 | 146 | 878 | 70 | 155 | 12 |
| | | Foreign exchange risk | 235 | 19 | 785 | 63 | 4 | 0 |
| | | Position risk on equities | 143 | 11 | 10 | 1 | 67 | 5 |
| | | Other market risks | 69 | 6 | - | - | - | - |
| | | ***Total*** | ***2,276*** | ***182*** | ***1 673*** | ***134*** | ***225*** | ***18*** |
| **Operational risk** | Basic | | 9,650 | 772 | 7 821 | 626 | - | - |
| **TOTAL** | | | **140,834** | **11,267** | **74,192** | **5,935** | **9,182** | **735** |

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

At year-end 2011, the weighted risks of the continuing operations of the Dexia Group[1] amounted to EUR 74.2 billion and the weighted risks of the groups held for sale amounted to 9.2 billion. The weighted risks per type of risk are detailed in the related chapters (credit, market and operational risks).

# 2.3. Capital adequacy

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

## 2.3.1. Regulatory solvency ratios

The adequacy of Dexia's capital is monitored using, among other measures, the rules and ratios established by the Circular PPB-2007-15-CPB-CPA and revised by the Circular NBB_2011_04 of 23 august 2011. The solvency ratios compare the amount of eligible capital (in Total and Tier 1) with the total of weighted risks. Dexia monitors and reports its capital ratios and the capital requirements underpinning Dexia's business following the banking prudential rules and the prudential rules of conglomerates of the National Bank of Belgium (NBB).
Dexia has complied with all regulatory capital rules for all periods concerned.

The following table shows Dexia Group weighted risks and solvency ratios at 2011 and 2010 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 2014.

| | | 31/12/2010 | 31/12/2011 |
|---|---|---|---|
| **Tier 1 capital** | | **18,425** | **6,305** |
| **Total regulatory capital** | | **20,636** | **8,589** |
| | | | |
| **Total weighted risks** | | **140,834** | **83,374** |
| Credit risk | Advanced | 81,141 | 38,273 |
| | Standard | 47,098 | 35,233 |
| Market risk | Advanced | 669 | 149 |
| | Standard | 2,276 | 1,898 |
| Operational risk | Basic | 9,650 | 7,821 |
| | | | |
| **Tier 1 ratio** | | **13.1%** | **7.6%** |
| **Capital adequacy ratio** | | **14.7%** | **10.3%** |

| | 31/12/2010 | 31/12/2011 | | |
|---|---|---|---|---|
| | | Total | Continuing operations | Activities held for sale |
| Weighted credit risks | 128,240 | 73,507 | 64,615 | 8,892 |
| Weighted market risks | 2,945 | 2,047 | 1,756 | 291 |
| Weighted operational risks | 9,650 | 7,821 | 7,821 | - |
| **TOTAL** | **140,834** | **83,374** | **74,192** | **9,182** |

At EUR 83 billion as at 31 December 2011, weighted risks were down EUR 57 billion compared to year-end 2010 in view of the sale of the guaranteed assets from the Financial Products portfolio during the first half-year and the sale of Dexia Bank Belgium (impact of EUR 46 billion without recognition of the risk represented by the Dexia Group's exposure to Dexia Bank Belgium).
At 7.6% and 6.4% respectively, the Tier 1 and the Core Tier 1 ratio were impacted by losses booked in 2011. The reduction of core shareholders' equity is reflected by an 861 basis point fall of the Tier 1 ratio whilst the reduction of weighted risks enabled the ratio to be improved by 309 basis points. Excluding the weighted risks of entities which are likely to be sold in 2012, the Group's pro forma Tier 1 and Core Tier 1 ratios should be 8.6% and 7.3% respectively.
Following the sale of Dexia Bank Belgium in October 2011 and within the framework of the unwinding of existing links between Dexia SA and Dexia Bank Belgium, Dexia Bank Belgium launched on 20 February 2012 a public offer for the purchase of the EUR 500 million perpetual non-cumulative securities issued by Dexia Funding Luxembourg SA, at a purchase price amounting to 25% of the nominal value of the securities. As part of that transaction, the Dexia Group undertook to

[1] See "Scope of application", page 5.

purchase from Dexia Bank Belgium the securities tendered in the offer. Dexia Bank Belgium will repay the subordinated loan of EUR 500 million granted by Dexia Funding Luxembourg SA and financed by the issue of those securities, up to the nominal amount of the securities tendered in the offer. This transaction was closed on 29 February 2012, with investor participation in an amount of EUR 459 million, a success rate of 91.84%.
Furthermore, from the perspective of strengthening the Core Tier 1 of Dexia and its subsidiary Dexia Crédit Local, on 2 March 2012 Dexia Crédit Local launched an offer to purchase its EUR 700 million of hybrid Tier 1 securities at a purchase price (expressed as a percentage of nominal amount) of 24%. This offer, closed on 14 March 2012, had a success rate of 91.96%, representing an amount of EUR 644 million in securities contributed by investors. Compared to 31 December 2011, these two operations will be reflected by an improvement of the Group's Core Tier 1 ratio by 83 basis points and are neutral regarding its Tier 1 ratio.

## 2.3.2. Internal capital adequacy

Dexia continued deploying its risk appetite and capital adequacy process in the Group's main subsidiaries including the dialogue with the regulators on the analysis of Pillar 2. The impact of the profound Group restructuring will be closely analysed and adjustments to methodology and processes will be made accordingly.

### Risk appetite

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

Based on a global approach, risk appetite is a reference point to:
- guide strategy and planning;
- frame performance in terms of value creation;
- facilitate daily investment or disposal decisions.

Dexia's risk appetite is marked by a series of ratios which constitute a key element in defining limits for major financial balances. This framework is based on a mix of accounting ratios (gearing), regulatory ratios (Tier 1, weighted risks), economic ratios (economic capital, earnings at risk) and integrates liquidity and funding structure ratios as well as credit concentration limits.
Limits have been defined on each of these ratios and are validated by the Board of Directors each year. The Risk and Finance support lines are responsible for monitoring these ratios, and if necessary propose measures to the Management Board to ensure limits are observed.
After deployment at Group level in 2010, the risk appetite approach was integrated in 2011 in the main Group subsidiaries and validated by their governance bodies.

### Economic capital

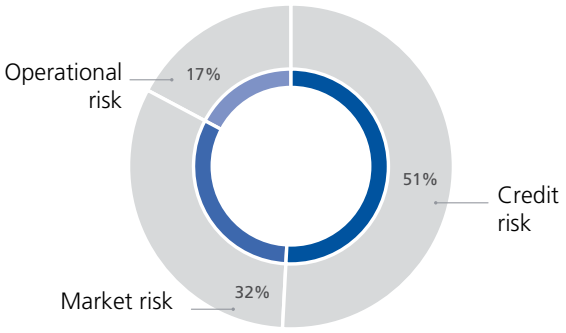
#### Definition

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 mapping updated annually up to a local level), their assessment (essentially on the basis of statistical methodologies) and their aggregation on the basis of an inter-risks diversification matrix. The majority of risks are capitalized in relation to a measure of expected loss; certain risks are not however capitalized if other 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).

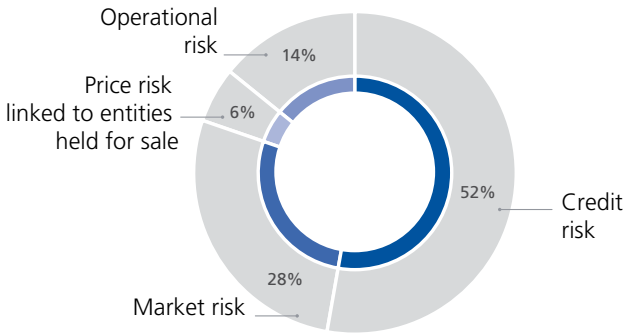
### Economic capital by type of risk

The economic capital for the continuing activities of the Dexia Group amounted to EUR 8,090 million at year-end 2011.

Economic capital by type of risk as at 31/12/2010




Economic capital by type of risk at 31/12/2011

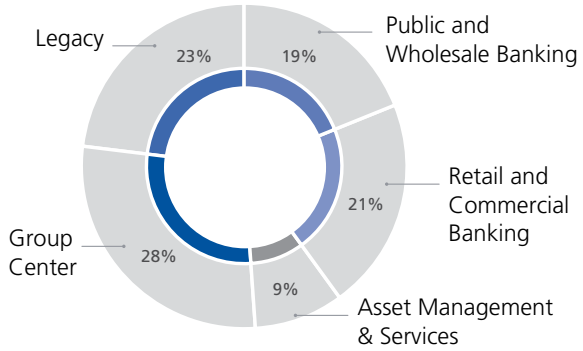



The distribution between different categories remains stable despite the focus of the scope of the Group on the continuing activities: credit risk represents approximately 52% of economic capital, market risk (which includes interest rate risks, exchange risks and equity risk) 28% and operational risk 14%. The price risk, which for the most part corresponds to economic capital carried by the entities held for sale represents 6% of economic capital.

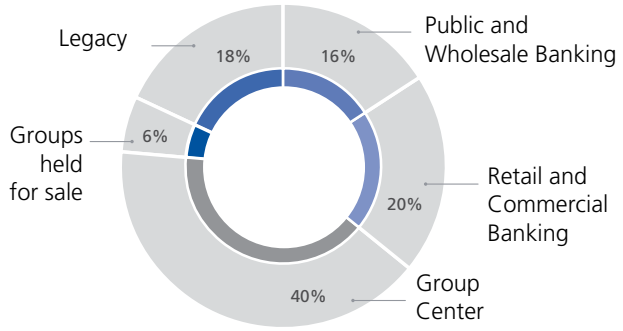
### Economic capital by business line

The economic capital use by business line as at 31 December 2011 is evidenced below.

Economic capital by business line as at 31/12/2010




Economic capital by business line as at 31/12/2011




The Legacy Division, which includes the bond portfolio in run-off, the Financial Products portfolio as well as certain non-strategic public sector loans and off-balance-sheet commitments (mainly liquidity lines in the United States), consumes 18% of the Group's economic capital. The Public and Wholesale Banking and Retail and Commercial Banking business lines (essentially in Turkey) represent 16% and 20% respectively. The balance consists of 40% allocated to Group Center (ALM, holdings…) and 6% for the activities held for sale.

## Economic capital adequacy

Created in 2009, the Economic Performance Analysis Committee (EPAC) manages the capital adequacy process and in this context has to propose solutions suited to Dexia strategy. On a quarterly basis, the EPAC examines (regulatory and economic) ratios, limits and triggers defined in the risk appetite policy and the budget framework, and possible divergences in relation to forecasts. It assesses the Group's capacity to absorb them and studies action proposals. The information in the EPAC report is established jointly by the Risk and Finance support lines.

## Stress tests

At the end of 2010, Dexia introduced reinforced governance for the performance of stress tests based on a transversal and integrated approach to the Group risk management process.

Stress tests aim to measure the bank's sensitivity in the event of an adverse occurrence in terms of expected losses, weighted risks, liquidity and capital requirements.

In 2011, Dexia performed a series of stress tests (sensitivity analyses, scenario analyses, potential vulnerability assessments) enabling it to assess the potential impact on its financial balances of an event or of a combination of events. To do this, macroeconomic scenarios were defined with the economists to simulate crisis situations common to the entire Group.
In addition to the stress tests on market and liquidity risks, performed regularly and responding to regulatory requirements, Dexia implemented stress tests covering the majority of its credit portfolios in 2011. Under Pillar 1 of Basel II, the exposures covered by internal rating systems were subject to tests for sensitivity and scenarios involving the unfavourable evolution of macroeconomic variables.

Dexia also took part in 2011 in stress tests performed by the European Banking Authority (EBA) and the national regulators. These stress tests[2] were intended to measure the solvency of European banks in the case of a deterioration of credit quality, market risk parameters and funding costs.

After publication of the results of these stress tests on 15 July 2011, a new exercise,[3] integrating a stress on sovereign exposures, was performed on 71 banks, on the basis of data as at 30 September 2011, in order to respond to investor concerns on sovereign risk. The aim was to establish a temporary and exceptional capital reserve so as to reach a Core Tier 1 ratio of 9% as at 30 June 2012 (against 5% in the test published in July) and to cover potential value reductions on sovereign exposures. According to the EBA methodology, a capital deficit of EUR 6.3 billion was identified for Dexia, on a scope nonetheless including Dexia Bank Belgium (sold on 20 October 2011). According to that EBA methodology, the capital deficit in relation to the threshold ratio would be EUR 4.2 billion at the end of September on a pro forma basis excluding Dexia Bank Belgium.
Since 30 September 2011, the Group has announced a huge restructuring plan including the planned disposals of Dexia Banque Internationale à Luxembourg, RBC Dexia Investor Services, Dexia Asset Management, Dexia Municipal Agency and DenizBank. In line with that restructuring programme, the Group will no longer carry on any significant cross-border activity and its size will be considerably reduced. In order to implement the plan, the Group will have the support of a guarantee from the Belgian, French and Luxembourg States on its new issues, approved provisionally by the European Commission on 21 December 2011.
Considering these elements, Dexia is not subject to the recapitalization requirements of this exercise of building a capital reserve and will no longer be included in the EBA sample.

## 2.4. Significant banking subsidiaries

In the 2010 Risk Report, Dexia Crédit Local (DCL), Dexia Bank Belgium (DBB), Dexia Banque Internationale à Luxembourg (DBL) and DenizBank were considered as significant subsidiaries on the basis of Group contributions (in terms of balance sheet and results) and/or of local market share.
For the 2011 publication, Dexia Banque Internationale à Luxembourg (DBL) will not be reported as a significant subsidiary considering its disposal process. Dexia Bank Belgium is also not reported as it has exited the scope of the Group.
As a consequence, regulatory capital and solvency ratios under Basel II at year-end 2011 and information about weighted risks and capital requirements for each type of risk will only be disclosed for Dexia Crédit Local and DenizBank.
Regulatory capital and solvency ratios under Basel II at year-end 2011 and 2010 for significant subsidiaries are disclosed in the following tables.

| | DBL | DBB | DCL (2) | | DenizBank (1) | |
|---|---|---|---|---|---|---|
| | 31/12/2010 | 31/12/2010 | 31/12/2010 | 31/12/2011 | 31/12/2010 | 31/12/2011 |
| Tier 1 capital | 2,468 | 7,258 | 6,547 | 8,355 | 1,800 | 1,944 |
| Total regulatory capital | 2,908 | 7,780 | 10,418 | 9,885 | 2,255 | 2,415 |
| Total weighted risks | 11,026 | 49,551 | 69,582 | 50,961 | 14,367 | 16,399 |
| Tier 1 ratio | 22.38% | 14.65% | 9.41% | 16.40% | 12.53% | 11.86% |
| Capital adequacy ratio | 26.37% | 15.70% | 14.97% | 19.40% | 15.70% | 14.72% |

*(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.).*

*(2) DCL figures include Dexia Municipal Agency (entity expected to be sold in 2012).*

[2] The exercise was performed according to the scenarios, methodology and hypotheses provided by the EBA, detailed in the global report published on the EBA internet site on 15/07/11: *http://www.eba.europa.eu/EU-wide-stress-testing/2011/2011-EU-wide-stress-test-results.aspx*

[3] The exercise was performed according to the scenarios, methodology and hypotheses provided by the EBA, detailed in the global report published on the EBA internet site on 08/12/11:
*http://www.eba.europa.eu/News--Communications/Year/2011/The-EBA-publishes-Recommendation-and-final-results.aspx*

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.
The following tables show the weighted risks and capital requirements for each type of risk (and exposure class for credit risk) for Dexia Crédit Local (including Dexia Municipal Agency) and DenizBank at year-end 2011 and 2010. The minimum capital requirements correspond to 8% of the weighted risks.

## Dexia Crédit Local

| | | | | 31/12/2010 | | 31/12/2011 | |
|---|---|---|---|---|---|---|---|
| **Type of risk** | **Basel II treatment** | **Exposure class** | | **Weighted risks** | **Capital requirements** | **Weighted risks** | **Capital requirements** |
| **Credit risk** | Advanced | Corporate | | 8,035 | 643 | 6,649 | 532 |
| | | Equities | | 9 | 1 | 16 | 1 |
| | | Financial institutions | | 7,014 | 561 | 8,108 | 649 |
| | | Monolines | | 998 | 80 | 1,079 | 86 |
| | | Project finance | | 5,769 | 462 | 5,364 | 429 |
| | | Public sector entities | | 4,376 | 350 | 3,595 | 288 |
| | | Retail | Mortgage loans | - | - | - | - |
| | | | Revolving loans | - | - | - | - |
| | | | Other loans | - | - | - | - |
| | | Securitization | | 19,553 | 1,564 | 3,231 | 258 |
| | | Sovereign | | 2,796 | 224 | 3,377 | 270 |
| | | Others | | - | - | - | - |
| | | ***Total*** | | ***48,550*** | ***3,884*** | ***31,419*** | ***2,514*** |
| | Standard | Corporate | | 1,411 | 113 | 1,432 | 115 |
| | | Equities | | 683 | 55 | 967 | 77 |
| | | Financial institutions | | 948 | 76 | 483 | 39 |
| | | Monolines | | - | - | - | - |
| | | Project finance | | 585 | 47 | 584 | 47 |
| | | Public sector entities | | 12,522 | 1,002 | 11,204 | 896 |
| | | Retail | Mortgage loans | 2 | 0 | - | - |
| | | | Revolving loans | 8 | 1 | - | - |
| | | | Other loans | 281 | 22 | 0 | 0 |
| | | Securitization | | 713 | 57 | 1,801 | 144 |
| | | Sovereign | | 661 | 53 | 143 | 11 |
| | | Others | | - | - | - | - |
| | | ***Total*** | | ***17,813*** | ***1,425*** | ***16,615*** | ***1,329*** |
| **Market risk** | Internal model | Interest rate & foreign exchange risk | | 35 | 3 | 83 | 7 |
| | | Position risk on equities | | | | | |
| | | Other market risks | | | | | |
| | | ***Total*** | | ***35*** | ***3*** | ***83*** | ***7*** |
| | Standard | Interest rate risk | | 798 | 64 | 815 | 65 |
| | | Foreign exchange risk | | 145 | 12 | 636 | 51 |
| | | Position risk on equities | | | | | |
| | | Other market risks | | | | | |
| | | ***Total*** | | ***943*** | ***75*** | ***1,451*** | ***116*** |
| **Operational risk** | Standard | | | ***2,241*** | ***179*** | ***1,392*** | ***111*** |
| **TOTAL** | | | | **69,582** | **5,567** | **50,960** | **4,077** |

## DenizBank

| | | | | 31/12/2010 | | 31/12/2011 | |
|---|---|---|---|---|---|---|---|
| **Type of risk** | **Basel II treatment** | **Exposure class** | | **Weighted risks** | **Capital requirements** | **Weighted risks** | **Capital requirements** |
| **Credit risk** | Advanced | Corporate | | - | - | - | - |
| | | Equities | | - | - | - | - |
| | | Financial institutions | | - | - | - | - |
| | | Monolines | | - | - | - | - |
| | | Project finance | | - | - | - | - |
| | | Public sector entities | | - | - | - | - |
| | | Retail | Mortgage loans | - | - | - | - |
| | | | Revolving loans | - | - | - | - |
| | | | Other loans | - | - | - | - |
| | | Securitization | | - | - | - | - |
| | | Sovereign | | - | - | - | - |
| | | Others | | - | - | - | - |
| | | ***Total*** | | **-** | **-** | **-** | **-** |
| | Standard | Corporate | | 7,269 | 581 | 8,643 | 691 |
| | | Equities | | - | - | - | - |
| | | Financial institutions | | 418 | 33 | 191 | 15 |
| | | Monolines | | - | - | - | - |
| | | Project finance | | - | - | - | - |
| | | Public sector entities | | - | - | - | - |
| | | Retail | Mortgage loans | 417 | 33 | 474 | 38 |
| | | | Revolving loans | - | - | - | - |
| | | | Other loans | 3,816 | 305 | 4,543 | 363 |
| | | Securitization | | - | - | - | - |
| | | Sovereign | | - | - | - | - |
| | | Others | | 679 | 54 | 668 | 53 |
| | | ***Total*** | | ***12,599*** | ***1,008*** | ***14,519*** | ***1,162*** |
| **Market risk** | Internal model | Interest rate & foreign exchange risk | | 0 | 0 | 0 | 0 |
| | | Position risk on equities | | 0 | 0 | 0 | 0 |
| | | Other market risks | | 0 | 0 | 0 | 0 |
| | | ***Total*** | | ***0*** | ***0*** | ***0*** | ***0*** |
| | Standard | Interest rate risk | | 190 | 15 | 243 | 19 |
| | | Foreign exchange risk | | 86 | 7 | 149 | 12 |
| | | Position risk on equities | | 16 | 1 | 10 | 1 |
| | | Other market risks | | 0 | 0 | 0 | 0 |
| | | ***Total*** | | ***292*** | ***23*** | ***402*** | ***32*** |
| **Operational risk** | Standard | | | ***1,477*** | ***118*** | ***1,478*** | ***118*** |
| **TOTAL** | | | | **14,367** | **1,149** | **16,399** | **1,312** |

# 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

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

Since 2010, in order to increase its efficiency and to make the most of Group competences, the Risk support line has evolved towards an organization by specialist competence centres, such as project finance, local public sector finance and corporate finance, in relation to the various Dexia business lines (Retail and Commercial Banking, Public and Wholesale Banking and market activities). Specialist risk committees have also been set up per competence centre, while coordination is provided by transversal teams and committees.

#### Transversal committees

The Risk Policy Committee defines risk policies including the rules for granting loans, for different sectors and types of counterparty.
The Executive Risk Committee meets weekly to decide risk management strategy and the organization of the support line.
The Management Credit Committee is in charge of undertaking decisions.

#### Specialist committees per expertise centre

In order to ease the decision-making process, the Management Credit Committee delegates its decision-making power to Credit Committees organized per entity and/or expertise centre. This delegation is on the basis of specific rules, in relation to the type of counterparty, the level of counterparty rating and 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 deemed to be 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.
At the same time as 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** settle the amount of provisions 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.
Credit risk management in each entity of the Dexia Group is focussed on management of the credit risk specific to its domestic market and is in charge of analysing and monitoring local counterparties. This activity also includes the development and maintenance of internal rating systems in relation to these counterparties and local reporting.

## 3.1.3. Management of the risk

### Dexia credit risk policy

Dexia Credit Risk Management (CRM) has established a global framework of policies and procedures consistent with the Bank's risk appetite. This framework guides CRM in its functions of risk analysis, decisions and surveillance.
CRM manages the credit granting process by giving delegations to different committees and support lines, within the limits set by the Bank's top management and by chairing credit committees. As part of its credit risk surveillance function, risk management and more particularly the different teams in charge of credit risk, monitor the credit risk evolution of its portfolios by regularly performing credit reviews and by updating ratings. It also defines and implements impairment policy. As such it qualifies defaults and decides on specific impairments.

### Risk measures

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 relying on dedicated scoring systems. This internal rating corresponds to a valuation 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, and this permits the 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 acceptable for a given counterparty. Limits may also be imposed per economic sector and per product by the risk department, which proactively monitors these limits, and may be reduced at any time depending on the evolution of associated risks.
Credit risk management on equities, derivatives and securitization activities is further detailed in parts 3.7., 3.8. and 3.9. respectively.

### Fundamentals of Dexia credit risk in 2011

#### Macroeconomic environment

The International Monetary Fund (IMF) reports a slowdown of global economic growth since the second quarter 2011, as a consequence of various factors: natural disaster in Japan, rising oil prices, uncertainty on public finances in the euro-zone. As a result, growth of global activity will be 3.8% in 2011.

In 2012, persistence of the brakes observed in 2011, but also the possible occurrence of additional shocks, could weaken growth. Susceptible to significant revisions, the IMF growth forecast is nonetheless set at 3.3%.
Euro-zone growth slowed sharply in the second quarter, taking the IMF growth estimate for 2011 to 1.6%. Weakened by deficits and high debt levels placing severe pressures on the markets, any improvement of the situation remains dependent on finding a political response to the sovereign debt crisis. Considerable disparities are to be observed in terms of growth: Germany will record one of the highest growth rates at +3%, whilst the majority of other economies will trend lower (+1.6% in France, +0.4% in Italy, +0.7% in Spain), or negative (-5.0% in Greece, -2.2% in Portugal). In general, this crisis has forced all European countries to adopt financial austerity measures aimed at reducing public debt. For 2012, the IMF anticipates a slowdown of euro-zone growth of about -0.5%.

In 2011, within the euro-zone, market uncertainty was primarily related to the so-called "PIIGS", namely Portugal, Italy, Ireland, Greece and Spain.
The situation in Greece appears to be the most disconcerting, because in 2011 the country experienced a fourth consecutive year of recession, posting a debt level close to 160% of GDP.
The first rescue plan for EUR 110 billion put in place in May 2010 proved insufficient for a return to budget equilibrium. Difficulties in the implementation of the reforms demanded by the Troika (International Monetary Fund, European Commission and European Central Bank) against a tense social background and a chronic deficit in government receipts on expenditure due particularly to structural weaknesses in the collection of taxes made any budget stabilization difficult, despite the establishment of a national unity government under the aegis of Prime Minister Lucas Papademos in October 2011.
This situation led to the introduction of a second rescue plan for EUR 130 billion, including EUR 40 billion intended to recapitalize the banks. The release of this aid was dependent on the conclusion of an exchange agreement with private lenders, represented by the International Institute of Finance (IIF), involving a large discount on Greek sovereign securities held by the latter. This second plan was successfully implemented during March 2012.
In Spain, the general elections in November 2011 gave a strong majority to the conservative government of Prime Minister Mariano Rajoy who confirmed his intention to introduce additional austerity measures enabling Spain to maintain sustainable financing costs at the end of 2011. Spain is still seeking a new growth model and, facing massive unemployment (20%) and a huge fiscal deficit (8% against an expected rate of 6%), the country could enter a phase of recession in 2012, a consequence in particular of the austerity measures implemented.

In Italy, the absence of a parliamentary majority resulted in the resignation of Prime Minister Silvio Berlusconi, replaced by Mario Monti at the head of a government charged with implementing austerity measures and the reforms demanded by the European Commission.
The risk of political paralysis has still not disappeared, the parliamentary majority being far from guaranteed and a major proportion of the population remaining opposed to reforms. In addition, there are difficulties in the Italian banking sector which requires major recapitalization. Finally, the austerity measures announced are likely to weigh on economic growth, and this explains the distrust shown by the markets in a country with a public debt greater than EUR 1,900 billion and refinancing requirements in 2012 of EUR 20 billion a month.
In Portugal, the reform government of Prime Minister Pedro Passos Coelho gained power at the beginning of 2011 and continued to implement a programme in line with the requirements of the IMF and the European Union. Nevertheless, the country's financing conditions are still extremely unfavourable (with a 10-year bond yield above 12.5%).
For its part Ireland seems to have succeeded in implementing an internal devaluation policy and returned to positive growth from 2011. The government remains firmly in favour of continuing the programme agreed with the IMF and the European Union, so far with the support of the population. The cost of recapitalizing the banks seems now to have stabilized. Nevertheless, as Ireland has an open economy, it remains severely exposed to an economic slowdown in the euro-zone and/or the United Kingdom.
In general, all the so-called "PIIGS" sovereigns were subject to specific and regular monitoring by the Country Analysis competence centre and the Special Mention and Watchlist Committee.
In the United States, growth slowed more sharply than forecast in 2011. Beyond the strong rise in oil prices, confidence among households and business leaders declined, unemployment remained at high levels and the financial markets were still extremely volatile. GDP growth should be 1.8% in 2011 and 2012, according to the IMF.

It should also be noted that uncertainties arising from troubles in the Middle East and North Africa led the Group temporarily to freeze its activities in those areas.

### Commitments to the local sector

Against the background of the sovereign debt crisis it is important not to extrapolate the default risk of a sovereign with that of its local authorities.
Nevertheless, the financial data available on local authorities shows a change of performances in the majority of European countries and in the United States, as a consequence of the tense economic environment leading to a fall in tax receipts; savings capacities are restricted and pressures are weighing on cash flows. This general deterioration, in response to which Dexia booked collective impairments in 2011 in particular with regard to the local public sector in Spain, Italy and North America, has proved to be contained and does not at this stage reflect any increase in defaults. This observation is corroborated by the evolution of files monitored quarterly by the Special Mention and Watchlist Committee. This is due in particular to the institutional framework governing local authorities, which are extremely restrictive in almost all of the countries in which Dexia has clients, and to its recent reinforcement against a background of global economic crisis. Situations differ from one country to another.
In France, despite a difficult environment and after the sharp fall observed last year, local investment rose (+2.9% in 2011, against a marked fall of 5% in 2010), particularly in the communal sector. This investment effort was made with limited recourse to fiscal levers, as local authorities have made the choice of a modest increase of taxation rates (+0.7% on council taxes, local and business rates).
2011 was marked by the introduction of a new structure to replace the local tax on professional activity. Tax receipts rose but at a less sustained pace than the previous year (+4.5% in 2011 after +6.2%), and despite a further rise of the proceeds from remunerated transfer duties (+15%). At the same time, government allocations remain stable (EUR 48.1 billion, +0.5%).
Local budgets for 2011 reflect an effort to control management expenditure (EUR 160 billion, +2.4%, after +2.7% in 2010), particularly marked for personnel costs (+2.0%, after +2.9% in 2010 and +4.5% in 2009).
After two years falling (-13.5% in 2009 and -5.3% in 2010), financial costs increased again in 2011 (+8.2%) with the impact of the past increase in debt stock and the rise in the cost of credit. Their weighting in operating expenditure remains limited however at 3%.
In total, gross savings, representing the difference between receipts and operating expenditure, rose by 5.3% and reached EUR 39.4 billion.
Local authorities limited their recourse to debt against a background in which it is in short supply. The variation of debt in 2011 can be estimated at EUR 2.7 billion, against EUR 6 billion on average since 2003. The outstanding debt of local authorities is thus at EUR 154.7 billion at the end of 2011, or 7.7% of GDP.
For several months the financial crisis has been a source of concern for local authorities. The liquidity and refinancing constraints currently weighing on banks have in fact led to the majority of them reducing their local public sector funding capacities, or even withdrawing totally from the market. For some months the result has been an insufficiency of finance to cover the requirements of all authorities, an increase of the rates on offer, linked to the increased cost of access to liquidity and a shortening of maturities on new loans. The prospect of introduction of the new so-called "Basel III" norms further restricts the ability of banks to finance a sector asking for significant loan volumes, traditionally amortized over long terms.
This situation has led, as in 2008, to public authorities introducing an emergency package provided by the Caisse des dépôts

et consignations to cover some of the requirements at the end of 2011.
The year 2011 was marked everywhere therefore by a consolidation of financial balances in the local public sector, this observation resting in part on economic effects, notably the momentum of proceeds from transfer taxes, which are likely to be less favourable in the future. It also masks severe disparities in the situation from one territory to another.
In Spain, where the local sector seems to be more affected than French, Italian and US local authorities, there is a gradual reform of regional financing, which should be fully effective in 2013 and result in more tax receipts being allocated to the regions.
The constraints aimed at limiting debt are strengthened:

- a deficit target has been set for the regions at -1.3% for 2011 and 2012. If the target is not met, the regions have to submit an Economic and Financial Plan (EFP) to central government. If the EFP is not ratified by the State then the regions cannot borrow over the long term;
- borrowing has been forbidden to municipalities and provinces where debt exceeds 75% of current receipts.

Of the three segments (regions, provinces, municipalities) a fall is observed in savings levels whilst debt is increasing. The first elements of 2010 (latest available data) show a significant fall of receipts in the regions (expected savings rate -6%; debt 91%).
As at the third quarter of 2011, the consolidated regional deficit reached 1.19% of GDP and six regions present deficits lower than 1.3% of regional GDP.
Regional satellites suffer from reductions of transfers/subsidies and are therefore forced to review their budgets and their long-term plans. Some regions are launching programmes to rationalize the public sector.
In Italy, the Internal Stability Pact still applies, aimed at regulating expenditure and public debt. Transfers from the State to local authorities are likely to fall by 10% in 2012.
Debt servicing is set a ceiling of 8% of the current receipts of local authorities. In the latest accounts available to date (2009), the current receipts of cities increased on average by 3%, at the same pace as management expenditure: management savings are therefore relatively stable. However, average debt per inhabitant has increased sharply and room for fiscal manoeuvre has been reduced.
As for the Italian regions, the State continues to intervene to limit health sector deficits (this item represents 80% of current regional expenditure).
Current regional receipts remained stable in 2009 and expenditure was down slightly, generating a slight fall in savings. The average debt level remains measured.
In the United States, two authorities applied to be placed under Chapter 9 protection, events sufficiently rare to warrant mention: the County of Jefferson[4] and the City of Harrisburg[5]. Although this reveals an increase in pressures on the US public sector, it should be stressed that such cases are still extremely uncommon.
Globally, the latest available accounts show a slight deterioration of Local Government indicators explained by the following factors:

- their receipts depend in part on transfers made by the Federal States, and these tend to restrict their aid;
- local governments are financed by property taxes (70% of city receipts) and sale taxes (for the counties) and these are affected by the economic slowdown. It should nonetheless be stressed that debt servicing (less than 8% of receipts) and debt rates remain stable overall.

### Retail banking activity

The improvement of risk indicators noted in 2010 continued in 2011. In Turkey, the strong economic rebound and the strength of domestic demand are reflected by sustained production volumes, a return of defaults to pre-crisis levels and significant recoveries. The improvement of risk management tools and the tightening of credit policies also continued in 2011. As a consequence, the cost of risk of all credit portfolios fell sharply compared to 2010.
It is nonetheless to be noted that retail and commercial banking activities are globally concentrated in subsidiaries transferred or sold by the Dexia Group in 2011.

### Bond portfolios in run-off

Dexia manages two bond portfolios in run-off:

- the bond portfolio in run-off, amounting to EUR 75.2 billion as at 31 December 2011;
- the Financial Products portfolio, amounting to EUR 5.5 billion as at 31 December 2011.

The programme to dispose of Dexia's non-strategic assets continued in 2011, in line with the undertakings made to the European Commission, resulting mechanically in a reduction of the Group's credit risk.
In 2011 Dexia sold EUR 14.8 million assets from the bond portfolio in run-off. The bond disposals principally related to banking exposures, ABS/MBS and sovereign or public exposures. The Group endeavoured to reduce its risk profile notably by selling EUR 4.5 billion in assets with the aim of de-risking. The average rating for assets sold was "A". The Group concentrated its sale efforts on bonds in non-euro currencies, sales of assets denominated in USD representing 37% of sales volume. Sales did not significantly reduce the average quality of the portfolio, which remains 88% investment grade, or its diversification profile

[4] Not a client of Dexia.
[5] Not a client of Dexia which is only committed to a satellite with the benefit of guarantee from Assured Guaranty.

by asset class, sector, country or currency. Over the year, rating migrations are explained by the impact of the sale of Dexia Bank Belgium and asset sales, the Group having sold EUR 4.5 billion in assets with the aim of de-risking. The deterioration of European sovereign ratings particularly in Italy and Greece, and related downgrades, also resulted in significant rating migrations. Despite the reduction of the total amount of the portfolio and the sale of riskier assets, the level of portfolio provisioning rose to EUR 2.6 billion, in view of impairments recorded on Greek sovereign and assimilated exposure.
In May 2011, the Group announced its desire to accelerate its financial transformation by selling EUR 6.4 billion in guaranteed assets from the Financial Products portfolio. The portfolio now remains 99% investment grade, as lower quality assets have been sold. It is funded around EUR 3.7 billion by guaranteed investment contracts (GIC) collateralized by USD 5.0 billion of US Treasury bonds and similar notes.

# 3.2. Credit risk exposure

Credit-risk exposure includes:
- the net carrying amount for balance-sheet assets other than derivative contracts (i.e. the accounting value after deduction of specific provisions);
- the market value for derivatives contracts;
- the total amount of off-balance-sheet commitments: the full commitment is either the undrawn portion of liquidity facilities or the maximum amount Dexia is committed to paying for the guarantees granted to third parties.

When credit-risk exposure is guaranteed by a third party with a lower risk weight, the principle of substitution is applied.

The maximum credit risk exposure (continuing activities and activities held for sale) includes fully consolidated subsidiaries of the Dexia Group and 50% of the joint venture RBC Dexia Investor Services.
As at 31 December 2011, the Dexia Group's maximum credit risk exposure was EUR 371,533 million, of which EUR 273,154 million for continuing activities and EUR 98,379 million for activities held for sale.

## 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 2011 and 2010.

Exposure at year-end 2010

| Type of product | Euro-zone (1) | Rest of Europe (2) | 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 & 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** |
| Others assets | 171 | 100 | 102 | 1,529 | **1,903** |
| **TOTAL** | **360,846** | **61,593** | **74,064** | **35,089** | **531,592** |

*(1) Countries using the euro currency as of 31 December 2010.*
*(2) Including Turkey.*

Exposure at year-end 2011

| Type of product | Euro-zone (1) | Rest of Europe (2) | US & Canada | Rest of the world | Total | Total groups held for sale |
|---|---|---|---|---|---|---|
| Debt securities | 46,649 | 10,304 | 21,625 | 10,612 | **89,190** | **8,662** |
| Retail loans | 146 | 3,021 | 44 | 4,674 | **7,885** | **7,624** |
| Loans & advances | 77,227 | 20,219 | 3,164 | 5,093 | **105,702** | **71,956** |
| ABS | 2,815 | 377 | 5,273 | 754 | **9,220** | **79** |
| Derivatives | 3,466 | 1,264 | 1,368 | 143 | **6,241** | **826** |
| Given guarantees | 10,505 | 5,978 | 6,110 | 2,739 | **25,331** | **4,498** |
| Repo | 26,191 | 397 | 1,344 | 857 | **28,790** | **4,382** |
| Others assets | 370 | 35 | 63 | 327 | **796** | **354** |
| **Total continuing operations** | **167,369** | **41,595** | **38,991** | **25,199** | **273,154** | |
| **Total groups held for sale** | **82,577** | **7,337** | **7,184** | **1,281** | | **98,379** |

*(1) Countries using the euro currency as at 31 December 2011.*
*(2) Including Turkey.*

As at 31 December 2011, Loans and Advances represent 39% of the continuing operation exposure as this category mainly includes loans to the public sector.
Dexia counterparties on debt securities are public sector entities, financial institutions and sovereigns.
Retail loan exposure fell sharply in 2011, due to the sale of Dexia Bank Belgium and the forthcoming sale of Dexia Banque Internationale à Luxembourg. The retail loans activity of the continuing operations of the Dexia Group is concentrated in DenizBank.

As at 31 December 2011, the continuing operation exposure was concentrated in the euro-zone (61% at year-end 2011), even if the exposure to Belgium, France and Luxembourg has decreased (25.2% at 31 December 2012 compared to 40.9% at 31 December 2010), due to the sale of Dexia Bank Belgium and the forthcoming sale of Dexia Municipal Agency and Dexia Banque Internationale à Luxembourg.
The decrease of exposure to the Rest of Europe is driven by the disposal of Dexia Bank Belgium. The decrease of exposure to the USA and Canada is due to the disposal of Dexia Bank Belgium, the sale of the guaranteed assets from the Financial Products portfolio exposures and the sharp decrease of the Stand-By Purchase Agreements (liquidity lines) portfolio at Dexia Crédit Local New York.

## 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 2011 and 2010.
For reporting purposes, a rating "master scale" 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 2010

| Rating | 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** |
| **TOTAL** | **237,971** | **205,564** | **54,259** | **2,364** | **31,434** | **531,592** |

Exposure at year-end 2011

| Rating | AAA+ to AA- | A+ to BBB- | Non-investment grade | Default | Non-rated | Total continuing operations |
|---|---|---|---|---|---|---|
| Debt securities | 31,154 | 47,119 | 9,989 | 895 | 33 | **89,190** |
| Retail loans | 63 | 0 | 37 | 18 | 7,767 | **7,885** |
| Loans and advances | 44,403 | 44,212 | 12,010 | 600 | 4,516 | **105,741** |
| ABS | 6,736 | 1,649 | 755 | 0 | 80 | **9,220** |
| Derivatives | 1,102 | 4,116 | 744 | 160 | 120 | **6,241** |
| Given guarantees | 9,577 | 7,070 | 1,795 | 128 | 6,761 | **25,331** |
| Repo | 24,887 | 3,505 | 397 | 0 | 1 | **28,790** |
| Other assets | 180 | 17 | 0 | 18 | 542 | **756** |
| **Total continuing operations** | **118,101** | **107,688** | **25,727** | **1,820** | **19,818** | **273,154** |
| **Total groups held for sale** | **39,420** | **47,780** | **8,855** | **537** | **1,787** | |

As at 31 December 2011, 43.2% of the exposure relating to continuing operations is rated AAA or AA, reflecting the Dexia portfolio's highly rated municipal and public sector related exposure. 9% of the exposure of the continuing operations of the Dexia Group is classified as non-investment grade.
The non-rated category of the continuing operations increased from 6% in 2010 to 8.4% in 2011 due to the increased relative part of DenizBank following the restructuring plan. As DenizBank does not currently apply for the advanced Basel II methodology, local internal rating assignment is currently not yet fully mapped to the Dexia Group format. DenizBank exposures are subsequently reported in the "not rated" category of the Dexia Risk Report.

2010 average exposure

| Rating | 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** |
| **TOTAL** | **256,573** | **207,443** | **53,571** | **2,581** | **36,010** | **556,177** |

*Note: average exposure is the quarterly average figure.*

2011 average exposure

| Rating | AAA+ to AA- | A+ to BBB- | Non-investment grade | Default | Non-rated | Total continuing operations |
|---|---|---|---|---|---|---|
| Debt securities | 37,790 | 40,585 | 9,756 | 303 | 882 | **89,316** |
| Retail loans | 38 | 0 | 37 | 20 | 7,755 | **7,849** |
| Loans and advances | 44,534 | 42,059 | 11,859 | 600 | 5,182 | **104,234** |
| ABS | 8,346 | 1,411 | 716 | 0 | 807 | **11,279** |
| Derivatives | 1,247 | 2,731 | 764 | 128 | 115 | **4,986** |
| Given guarantees | 15,722 | 8,076 | 2,053 | 173 | 6,627 | **32,652** |
| Repo | 6,610 | 2,878 | 162 | 0 | 1 | **9,650** |
| Other assets | 49 | 14 | 0 | 5 | 799 | **868** |
| **Total continuing operations** | **114,336** | **97,754** | **25,347** | **1,228** | **22,169** | **260,833** |
| **Total groups held for sale** | **102,065** | **78,180** | **21,945** | **2,846** | **4,036** | |

*Note: average exposure is the quarterly average figure.*

Average exposure is calculated including Dexia Bank Belgium (classified as "groups held for sale") for the first 3 quarters and excluding Dexia Bank Belgium for the fourth quarter. This explains why the 2011 average exposure is higher than the year-end exposure.

## 3.2.3. Exposure per exposure class and economic sector

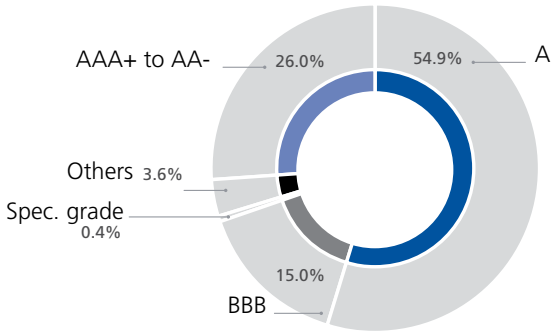
The following table shows the total exposure with a breakdown by economic sector and exposure class at year-end 2011 and 2010.

Exposure at year-end 2010

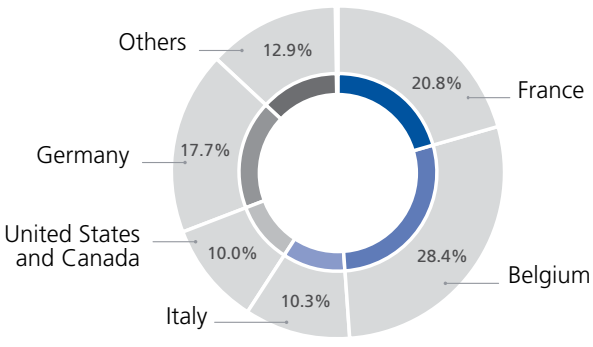
| Economic sector | | Corporate | Financial institutions | Monolines | Project finance | Public sector entities | Retail | Securitization | Sovereign | Others | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Industry | | 13,416 | 419 | 0 | 5,138 | 6,886 | 729 | 0 | 5 | 0 | **26,592** |
| 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** |
| | *Others* | 38 | 0 | 0 | 0 | 1,175 | 12 | 9 | 1,059 | 0 | **2,293** |
| Others | | 3,144 | 6,561 | 0 | 109 | 353 | 42,209 | 23,956 | 1,488 | 258 | **78,078** |
| **TOTAL** | | **49,294** | **69,989** | **11,544** | **19,127** | **252,445** | **47,905** | **25,168** | **55,862** | **258** | **531,592** |

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

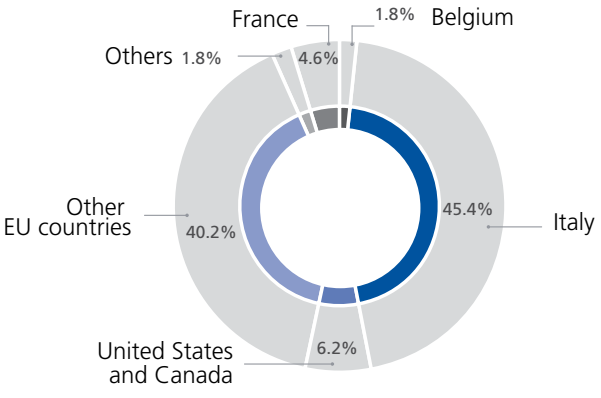
Financial intermediation:
split by rating class




PSE (public administration, social security):
split by country




Sovereign (public administration, social security):
split by country

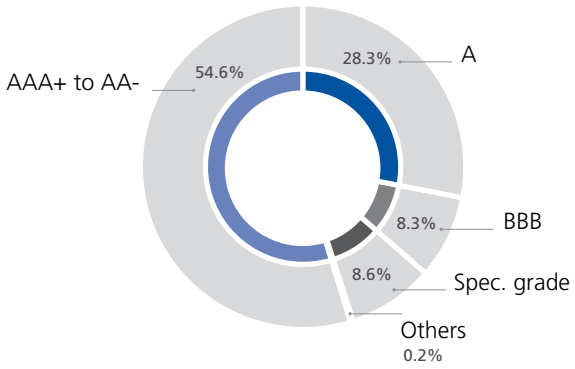


## Exposure at year-end 2011

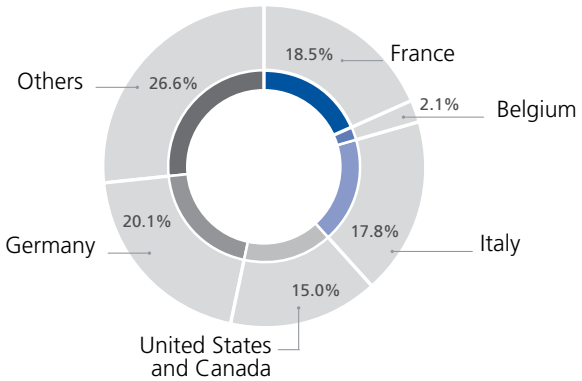
| Economic sector | | Corporate | Financial institutions | Monolines | Project finance | Public sector entities | Retail | Securitization | Sovereign | Others | Total continuing operations | Total groups held for sale |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Industry | | 7,089 | 39 | 0 | 5,235 | 5,636 | 110 | 131 | 0 | 8 | **18,247** | **2,792** |
| Construction | | 3,255 | 0 | 0 | 6,169 | 1,049 | 63 | 0 | 2 | 2 | **10,541** | **1,252** |
| Trade-Tourism | | 1,872 | 0 | 0 | 0 | 90 | 27 | 0 | 0 | 0 | **1,989** | **703** |
| Services | *Transportation and storage* | 2,336 | 66 | 0 | 800 | 2,156 | 14 | 0 | 40 | 1 | **5,414** | **596** |
| | *Information and communication* | 700 | **0** | 0 | 123 | 174 | 9 | 0 | 0 | 0 | **1,006** | **162** |
| | *Financial and insurance activities* | 380 | **56,312** | 5,969 | 1 | 2,007 | 1 | 108 | 5,293 | 0 | **70,070** | **16,114** |
| | *Real estate activities* | 2,403 | 175 | 0 | 4,012 | 7,107 | 0 | 0 | **0** | 0 | **13,696** | **3,092** |
| | *Professional, scientific and technical activities* | 318 | 0 | 0 | 0 | 159 | 3 | 0 | 0 | 0 | **480** | **104** |
| | *Administrative and support service activities* | 137 | 0 | 0 | 242 | 5,249 | 8 | 0 | 0 | 0 | **5,636** | **86** |
| | *Public administration and defence-compulsory social security* | 1 | 35 | 0 | 30 | **89,168** | 0 | 499 | **29,861** | 0 | **119,595** | **58,481** |
| | *Human health and social work activities* | 208 | 0 | 0 | 0 | 4,598 | 21 | 0 | 2 | 0 | **4,830** | **7,460** |
| | *Arts, entertainment and recreation* | 64 | 0 | 0 | 0 | 192 | 0 | 0 | 0 | 0 | **257** | **171** |
| | *Other service activities* | 79 | 44 | 0 | 0 | 412 | 0 | 0 | 0 | 0 | **536** | **199** |
| | *Other services* | 33 | 0 | 0 | 0 | 699 | 0 | 0 | 851 | 0 | **1,582** | **127** |
| Others | | 2,492 | 520 | 0 | 151 | 144 | 7,099 | 8,482 | 173 | 215 | **19,275** | **7,041** |
| **Total continuing operations** | | **21,367** | **57,192** | **5,969** | **16,763** | **118,841** | **7,355** | **9,220** | **36,222** | **226** | **273,154** | |
| **Total groups held for sale** | | **3,535** | **11,758** | | **235** | **68,530** | **6,947** | **79** | **7,281** | **16** | | **98,379** |

Exposure in the coloured cells is further detailed in the following diagram (continuing operations of the Dexia Group only).

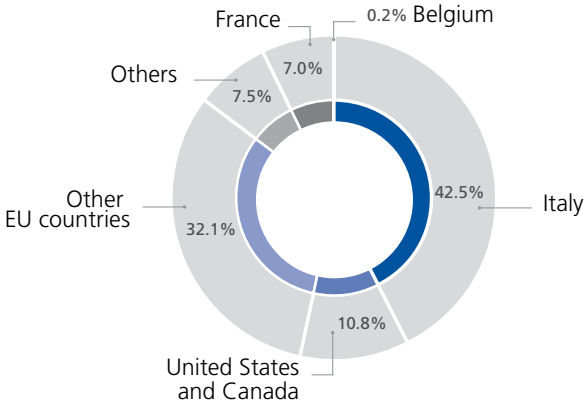
### Financial intermediation: split by rating class




### PSE (public administration, social security): split by country




### Sovereign (public administration, social security): split by country




More than half of the exposure of the continuing operations of the Dexia Group is related to the public sector (i.e. 43% on public sector entities and 13% on sovereign), whereas financial institutions count for 21.5%. The breakdown is relatively stable compared to 2010, except for financial institutions, which represent 21.5% (14.3% for the previous year) following the disposal of Dexia Bank Belgium which is no longer reported as an intra-group counterparty.

The portion of exposure to public sector entities decreases from 47.5% in 2010 to 43% in 2011 due to the disposal of Dexia Bank Belgium and the forthcoming sale of Dexia Municipal Agency.

# 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 analyses 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 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 2011 and 2010.

Exposure at year-end 2010

| | Past-due but not impaired financial assets | | | Carrying amount of individually impaired financial assets |
|---|---|---|---|---|
| Large type of product | < 90 days | > 90 days < 180 days | > 180 days | |
| Available for sale portfolio [1] | 0 | 0 | 0 | 679 |
| Loans and advances (at amortized cost) | 875 | 174 | 413 | 5,587 |
| Held to maturity financial assets | 0 | 0 | 0 | 0 |
| Other financial instruments – at cost | 0 | 1 | 2 | 287 |
| **TOTAL** | **875** | **175** | **415** | **6,552** |

*(1) Excluding variable income securities.*

Exposure at year-end 2011

| | Past-due but not impaired financial assets | | | Carrying amount of individually impaired financial assets |
|---|---|---|---|---|
| Large type of product | < 90 days | > 90 days < 180 days | > 180 days | |
| Available for sale portfolio [1] | | | | 3,761 |
| Loans and advances (at amortized cost) | 407 | 19 | 248 | 2,388 |
| Held to maturity financial assets | | | | 234 |
| Other financial instruments – at cost | | | | 27 |
| **Total continuing operations** | **407** | **19** | **248** | **6,410** |
| **Total groups held for sale** | **432** | **95** | **79** | **64** |
| **TOTAL** | **839** | **114** | **327** | **6,474** |

*(1) Excluding variable income securities.*

In 2011, the carrying amount of individually impaired financial assets, before deducting any impairment loss includes an impairment on Greek sovereign and assimilated exposures for an amount of EUR 4.2 billion on which an impairment of EUR 3.4 billion has been recognized.

## 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 2011 and 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 |
| **TOTAL** | **1,465** | **6,552** |

Exposure at year-end 2011

| Geographical entity | Past due | Impaired |
|---|---|---|
| Dexia Crédit Local excluding DMA | 430 | 4,806 |
| DSA others [1] | 244 | 1,604 |
| **Total continuing operations** | **674** | **6,410** |
| **Total groups held for sale** | **606** | **64** |
| **TOTAL** | **1,280** | **6,474** |

*(1) DSA others: Financial Products, DenizBank, the Legacy portfolio of Dexia Banque Internationale à Luxembourg, Dexia Lettre de Gage, Parfipar.*

Past-due exposures remain quite stable despite the disposal of Dexia Bank Belgium. This is mainly due to an increase of the past-due on public sector counterparties.

The evolution of the impaired exposures is due on the one hand to the disposal of Dexia Bank Belgium and on the other hand to the increase of Dexia Crédit Local impaired exposure, as a consequence of the Greece default.

## 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 2011 and 2010.

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 31 Dec. 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 | 13 | (80) |
| *Loans and advances due from banks* | *8* | *0* | *15* | *0* | *2* | *25* | *0* | *0* |
| *Loans and advances to customers* | *2,656* | *(181)* | *1,054* | *(286)* | *(30)* | *3,213* | *13* | *(80)* |
| *Investments held to maturity* | *0* | *0* | *0* | *0* | *0* | *0* | - | - |
| *Available-for-sale financial assets* | *713* | *(50)* | *14* | *(74)* | *8* | *611* | - | - |
| *Of which fixed income instruments* | *582* | *0* | *11* | *(73)* | *5* | *525* | - | - |
| *Of which equity instruments* | *131* | *(50)* | *3* | *0* | *3* | *87* | - | - |
| Allowances for incurred but not reported losses on financial assets | 1,460 | (40) | 322 | (499) | 40 | 1,283 | - | - |
| *Loans and advances due from banks* | *56* | *0* | *5* | *(43)* | *0* | *18* | - | - |
| *Loans and advances to customers* | *1,404* | *(40)* | *317* | *(456)* | *40* | *1,265* | - | - |
| *Investments held to maturity* | *0* | *0* | *0* | *0* | *0* | *0* | - | - |
| **TOTAL** | **4,838** | **(271)** | **1,405** | **(858)** | **19** | **5,133** | **13** | **(80)** |
| Provision for off-balance-sheet credit commitment and guarantees | 152 | (10) | 8 | (10) | 2 | 142 | 0 | 0 |

Exposure at year-end 2011

| Type of asset | As at 1 Jan. 2011 | Transfers in disposal groups held for sale | Utilization | Amounts set aside for estimated probable loan losses | Amounts reversed for estimated probable loan losses | Changes in scope of consolida-tion | Other adjustments | As at 31 Dec. 2010 | Recoveries directly recognized in profit or loss | Charge-offs directly recognized in profit or loss |
|---|---|---|---|---|---|---|---|---|---|---|
| Specific allowances for individually assessed financial assets | 3,850 | (317) | (122) | 3,564 | (313) | (895) | (1,270) | 4,497 | | |
| *Loans and advances due from banks* | *25* | | | *5* | *0* | *(25)* | *0* | *5* | *0* | *0* |
| *Loans and advances to customers* | *3,213* | *(205)* | *(109)* | *653* | *(215)* | *(613)* | *(1,339)* | *1,385* | *0* | *0* |
| *Investments held to maturity* | *0* | | | *149* | | | *4* | *153* | | |
| *Available-for-sale financial assets* | *612* | *(112)* | *(13)* | *2,757* | *(98)* | *(257)* | *65* | *2,954* | | |
| *Of which fixed income instruments* | *525* | *(93)* | *0* | *2,748* | *(98)* | *(245)* | *38* | *2,875* | | |
| *Of which equity instruments* | *87* | *(19)* | *(13)* | *9* | | *(12)* | *27* | *79* | | |
| Allowances for incurred but not reported losses on financial assets | 1,283 | (55) | (75) | 276 | (176) | (394) | (304) | 555 | | |
| *Loans and advances due from banks* | *18* | | | *1* | *(2)* | *(6)* | *1* | *12* | | |
| *Loans and advances to customers* | *1,265* | *(55)* | *(75)* | *275* | *(174)* | *(388)* | *(305)* | *543* | | |
| *Investments held to maturity* | *0* | | | | | | | *0* | | |
| **TOTAL** | **5,133** | **(372)** | **(197)** | **3,840** | **(489)** | **(1,289)** | **(1,574)** | **5,052** | **0** | **0** |
| Provision for off-balance-sheet credit commitment and guarantees | 142 | 0 | (47) | 13 | (4) | (24) | (3) | 77 | | |

The evolution from opening balance sheet to closing balance sheet can be explained by the following adjustments:

- Amounts set aside for "Transfers in disposal groups held for sale" consist of the restatement of the opening balance sheet of the held for sale assets (Dexia Banque Internationale à Luxembourg, RBC Dexia Investor Services, Dexia Asset Management and Dexia Municipal Agency).
- Amounts set aside for "Estimated probable loans losses" in 2011 amounts mainly consist of impairments on sovereign exposure.
- Amounts set aside for "Changes in scope of consolidation" consist of the restatement of the opening balance sheet of the disposed assets (Dexia Bank Belgium and its subsidiary Dexia Insurance Belgium, Dexia banka Slovensko and the insurance subsidiary of DenizBank).
- The category "Other" is mainly related to the transfer of the Financial Products portfolio to "Non-current assets and disposal groups held for sale".

# 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 constitute 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 an overview of the EAD covered by Basel II eligible CRM (after regulatory haircuts) broken down by exposure class at year-end 2011 and 2010. The amounts shown in the tables below take netting agreements into account and include collateral values for repo transactions.

Exposure at year-end 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 |
| **TOTAL** | **51,061** | **16,128** | **77,454** | **144,643** |

Exposure at year-end 2011

| Exposure class | Financial and physical collaterals | Guarantee and credit derivatives | Repo | Total | Total groups held for sale |
|---|---|---|---|---|---|
| Sovereigns | 0 | 122 | 322 | 443 | 78 |
| Financial institutions | 23,525 | 4,351 | 15,000 | 42,876 | 39,708 |
| Corporates | 1,073 | 4,028 | 0 | 5,101 | 1,038 |
| **Total continuing operations** | **24,598** | **8,501** | **15,322** | **48,421** | |
| **Total groups held for sale** | **11,974** | **1,645** | **27,205** | | **40,824** |

The decrease of the exposure covered by CRM is mainly due to the disposal of Dexia Bank Belgium.
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 mainly consist 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 (SMEs) included in the 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 exposures. 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.
"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 the Standardized Approach, a large proportion of local authorities (German Länder or Japanese local authorities for instance) benefit from the State guarantee allowing 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, like financial collateral (cash, debt securities, quoted equity and Undertaking for Collective Investment). The part of the EAD covered by collateral (including repo transactions) is predominantly composed of cash collateral and the remaining part of debt securities.

### Overview of guarantees and credit derivatives by provider

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 former Belgian Regulator (the Banking, Finance and Insurance Commission), 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

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 back-testing 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 the 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 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 three 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 then acts as an additional level of control, included in its Audit plan.

Refer to Appendix 2 for more details regarding Internal rating systems.

## 3.5.3. Average PD, LGD and risk weight by exposure class and obligor grade

The following table shows the total exposure at default, average exposure at default, undrawn commitments, exposure-weighted average PD, LGD and exposure-weighted average risk weights broken down by exposure class and obligor grade at year-end 2011 and 2010.

Exposure at year-end 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 |
| | ***Total*** | ***29,766*** | ***30,460*** | ***1.36%*** | ***47%*** | ***82%*** | ***0.58%*** | ***11,797*** |
| 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 |
| | ***Total*** | ***62,012*** | ***68,534*** | ***0.28%*** | ***25%*** | ***16%*** | ***0.05%*** | ***3,275*** |
| 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 |
| | ***Total*** | ***7,779*** | ***7,895*** | ***0.49%*** | ***35%*** | ***29%*** | ***0.30%*** | ***5,343*** |
| 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 |
| | ***Total*** | ***17,003*** | ***16,748*** | ***0.69%*** | ***16%*** | ***36%*** | ***0.12%*** | ***2,959*** |
| 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 |
| | ***Total*** | ***162,631*** | ***164,855*** | ***0.16%*** | ***4%*** | ***3%*** | ***0.00%*** | ***35,723*** |
| 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 |
| | ***Total*** | ***39,313*** | ***38,410*** | ***2.12%*** | ***16%*** | ***11%*** | ***0.31%*** | ***5,979*** |
| 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 |
| | ***Total*** | ***50,275*** | ***54,090*** | ***0.08%*** | ***11%*** | ***8%*** | ***0.02%*** | ***2,036*** |
| 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 |
| | ***Total*** | ***241*** | ***295*** | ***1.70%*** | ***82%*** | ***175%*** | ***0.63%*** | ***0*** |
| Default | | ***3,349*** | ***3,552*** | | | | | ***265*** |
| **TOTAL** | | **372,368** | **376,053** | | | | | **67,379** |

*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.*

Exposure at year-end 2011

| Exposure class | Obligor grade | EAD | Average EAD | Average PD | Average LGD | Average RW | Average EL | Undrawn commitment |
|---|---|---|---|---|---|---|---|---|
| Corporate | AAA to AA- | 0 | 101 | 0.00% | 0% | 0% | 0.00% | 0 |
| | A+ to A- | 1,301 | 1,343 | 0.06% | 42% | 34% | 0.03% | 39 |
| | BBB+ to BBB- | 4,318 | 4,322 | 0.36% | 47% | 78% | 0.18% | 1,591 |
| | Others | 1,958 | 2,206 | 2.19% | 63% | 156% | 1.37% | 235 |
| | ***Total*** | ***7,577*** | ***7,972*** | ***0.78%*** | ***50%*** | ***91%*** | ***0.46%*** | ***1,864*** |
| Financial institutions | AAA to AA- | 30,879 | 11,602 | 0.04% | 27% | 8% | 0.01% | 2,312 |
| | A+ to A- | 13,307 | 12,812 | 0.06% | 28% | 17% | 0.02% | 541 |
| | BBB+ to BBB- | 3,130 | 3,267 | 0.32% | 19% | 23% | 0.06% | 0 |
| | Others | 4,635 | 4,127 | 2.01% | 9% | 21% | 0.20% | 180 |
| | ***Total*** | ***51,950*** | ***31,808*** | ***0.23%*** | ***25%*** | ***12%*** | ***0.03%*** | ***3,034*** |
| Monolines | AAA to AA- | 4,895 | 5,015 | 0.04% | 33% | 20% | 0.01% | 1,472 |
| | A+ to BBB- | 158 | 149 | 0.34% | 41% | 82% | 0.14% | 0 |
| | Others | 135 | 91 | 30.87% | 62% | 391% | 19.03% | 0 |
| | ***Total*** | ***5,189*** | ***5,256*** | ***0.85%*** | ***34%*** | ***31%*** | ***0.51%*** | ***1,472*** |
| Project finance | AAA to AA- | 28 | 27 | 0.04% | 19% | 10% | 0.01% | 0 |
| | A+ to A- | 1,563 | 1,153 | 0.07% | 13% | 12% | 0.01% | 124 |
| | BBB+ to BBB- | 9,318 | 9,435 | 0.44% | 16% | 33% | 0.07% | 1,408 |
| | Others | 4,042 | 4,362 | 2.12% | 18% | 56% | 0.37% | 520 |
| | ***Total*** | ***14,951*** | ***14,978*** | ***0.85%*** | ***16%*** | ***37%*** | ***0.15%*** | ***2,053*** |
| Public sector entities | AAA | 15,251 | 16,429 | 0.02% | 7% | 2% | 0.00% | 3,358 |
| | AA+ to AA- | 18,684 | 20,137 | 0.03% | 8% | 4% | 0.00% | 4,235 |
| | A+ to A- | 12,039 | 13,153 | 0.08% | 3% | 3% | 0.00% | 1,081 |
| | BBB+ to BBB- | 19,893 | 19,549 | 0.42% | 3% | 6% | 0.01% | 930 |
| | Others | 2,623 | 2,630 | 1.61% | 2% | 6% | 0.03% | 137 |
| | ***Total*** | ***68,490*** | ***71,899*** | ***0.21%*** | ***5%*** | ***4%*** | ***0.01%*** | ***9,741*** |
| Sovereign | AAA | 8,348 | 18,417 | 0.00% | 9% | 0% | 0.00% | 81 |
| | AA+ to A- | 18,093 | 7,308 | 0.06% | 11% | 9% | 0.01% | 295 |
| | BBB+ to BBB- | 3,924 | 3,692 | 0.24% | 13% | 22% | 0.04% | 0 |
| | Others | 1,598 | 2,482 | 1.08% | 24% | 58% | 0.23% | 0 |
| | ***Total*** | ***31,963*** | ***31,899*** | ***0.11%*** | ***11%*** | ***10%*** | ***0.02%*** | ***376*** |
| Equities | AAA to AA- | 86 | 21 | 0.04% | 26% | 18% | 0.00% | 0 |
| | A+ to A- | 0 | 0 | 1.25% | 31% | 97% | 0.39% | 0 |
| | BBB+ to BBB- | 200 | 200 | 0.18% | 90% | 135% | 0.16% | 0 |
| | Others | 0 | 0 | 30.87% | 11% | 243% | 0.62% | 0 |
| | ***Total*** | ***286*** | ***222*** | ***0.14%*** | ***71%*** | ***100%*** | ***0.11%*** | ***0*** |
| Default | | ***3,696*** | ***1,644*** | | | | | ***129*** |
| **Total continuing operations** | | **184,102** | **165,681** | | | | | **18,670** |
| **Total groups held for sale** | | **85,260** | **179,967** | | | | | **3,820** |

*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.*

The majority of the continuing operations of the Dexia Group exposure is concentrated on the public sector (i.e. public sector entities and sovereign exposure).

A vast majority of average PD levels is situated below 1% (the average PD is 0.58%), reflecting the exposure to highly rated municipal and public related counterparties.

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

- Corporate: non-investment grade exposures are concentrated in France (39%), United Kingdom (15%), Canada (12%) and United States (11%).
- Project finance: non-investment grade exposures are concentrated in Western European countries (40%), in America (35%) and in Australia (14%).
- Public sector entities: non-investment grade loans are mainly attributed to French local authorities (34%) and to UK Public Housing Bodies (33%).
- 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 within 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.

- 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.

- 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.

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 |
| | ***Total*** | ***23,124*** | ***22,641*** | ***1.60%*** | ***10%*** | ***7%*** | ***0.16%*** | ***253*** |
| 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 |
| | ***Total*** | ***1,034*** | ***1,043*** | ***0.66%*** | ***51%*** | ***10%*** | ***0.34%*** | ***939*** |
| 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 |
| | ***Total*** | ***15,155*** | ***14,726*** | ***3.01%*** | ***22%*** | ***17%*** | ***0.54%*** | ***4,787*** |
| Default | | ***957*** | | | | | | ***46*** |
| **TOTAL** | | **40,270** | | | | | | **6,026** |

*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.*

At year-end 2011, retail exposure is henceforth concentrated in DenizBank and is treated in the Standardized Approach (see paragraph 3.6.2.).
For the groups held for sale, the total EAD amounts to EUR 6,758 million, the average EAD (including Dexia Bank Belgium from 1Q to 3Q 2011) amounts EUR 32,525 million and the undrawn commitments EUR 1,119 million as at 31 December 2011.

## 3.5.5. Back-testing

The purpose of the back test 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 back test relating to Pillar 1 rating systems is based on the back test of the input parameters PD, LGD and EAD in the Basel II credit risk portfolio model.
The back-test 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. 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 back-test procedure is mainly related to back-testing:

### 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 or that the population characteristics do not change significantly over time.

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

The additional part of the back-test 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 expert overruling.

### 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 macroeconomic 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 according to stress testing Group governance and guidelines. The time horizon of scenario stress tests, set in accordance with the macroeconomic assumptions, is 2 years.

Stress test reports, including the main assumptions, outcome and proposals of management actions are presented to the Risk Executive Committee and the Validation Advisory Committee. After validation of the overall process of the stress test implementation, the stress test exercises 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, The 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 exposure is currently treated in Standardized Approach[6]. The process to move to the advanced method has been put on hold.

[6] DenizBank regulatory local calculation is currently performed with Basel I rules. Basel II Standardized calculation will be requested by the BRSA – Turkish regulator – by the end of 2012.

## 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 National Bank of Belgium (NBB) 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 | NBB 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 2011 and 2010.

Exposure at year-end 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 |
| | ***Total*** | ***14,307*** | ***94%*** | ***5,250*** |
| 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 |
| | ***Total*** | ***13,276*** | ***28%*** | ***1,475*** |
| 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 |
| | ***Total*** | ***70,449*** | ***27%*** | ***5,368*** |
| 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 |
| | ***Total*** | ***11,310*** | ***51%*** | ***77*** |
| Project finance | No rating available | ***664*** | ***100%*** | ***97*** |
| Retail | No rating available | ***6,550*** | ***71%*** | ***2,301*** |
| Equities | No rating available | ***642*** | ***143%*** | ***0*** |
| Others | No rating available | ***188*** | ***99%*** | ***30*** |
| **TOTAL** | | **117,387** | | **14,598** |

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

Exposure at year-end 2011

| Exposure class | Obligor grade | EAD | Average RW | Undrawn commitment |
|---|---|---|---|---|
| Corporate | AAA to AA- | 123 | 20% | 0 |
| | A+ to A- | 0 | 0% | 0 |
| | BBB+ to BBB- | 4 | 100% | 0 |
| | BB+ to B- | 98 | 9% | 0 |
| | Below B- | 83 | 85% | 28 |
| | No rating available | 11,457 | 92% | 4,528 |
| | ***Total*** | ***11,765*** | ***90%*** | ***4,556*** |
| Financial institutions | AAA to AA- | 3,059 | 1% | 4 |
| | A+ to A- | 1,052 | 8% | 7 |
| | BBB+ to BBB- | 233 | 81% | 19 |
| | BB+ to B- | 788 | 62% | 50 |
| | Below B- | 92 | 149% | 23 |
| | No rating available | 3,231 | 17% | 127 |
| | ***Total*** | ***8,454*** | ***18%*** | ***230*** |
| Public sector entities | AAA to AA- | 40,810 | 8% | 741 |
| | A+ to A- | 1,205 | 51% | 79 |
| | BBB+ to BBB- | 1,389 | 101% | 10 |
| | BB+ to B- | 600 | 98% | 54 |
| | Below B- | | | |
| | No rating available | 4,372 | 100% | 503 |
| | ***Total*** | ***48,376*** | ***21%*** | ***1,388*** |
| Sovereign | AAA to AA- | 1,177 | 0% | 42 |
| | A+ to A- | 289 | 20% | 0 |
| | BBB+ to BBB- | 129 | 50% | 0 |
| | BB+ to B- | 3,794 | 94% | 5 |
| | Below B- | | | |
| | No rating available | | | |
| | ***Total*** | ***5,389*** | ***68%*** | ***47*** |
| Project finance | AAA to AA- | 0 | 20% | 0% |
| | A+ to A- | | | |
| | BBB+ to BBB- | | | |
| | BB+ to B- | | | |
| | Below B- | | | |
| | No rating available | 666 | 100% | 71 |
| | ***Total*** | ***666*** | ***100%*** | ***71*** |
| Retail | No rating available | ***6,067*** | ***70%*** | ***2,454*** |
| Equities | No rating available | ***298*** | ***148%*** | ***0*** |
| Others | No rating available | ***227*** | ***100%*** | ***26*** |
| **Total continuing operations** | | **81,243** | | **8,772** |
| **Total groups held for sale** | | **14,220** | | **352** |

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

For the continuing operations of the Dexia Group, the bulk of the exposure treated under the Standardized Approach is in the public sector entities class (60% or EUR 48 billion) and is predominantly rated in the AAA/AA/A range.

- About 18% of the standard exposure to public sector entities will be treated under advanced approaches in coming years as part of the roll-out plan. Most of it is classified in public sector entities (mainly public satellites, other satellites or Groupements de communes sans fiscalité propre).
- German Länder counterparties, representing 45% of this portfolio, are permanently treated in Standardized Approach (0% risk weight – partial use).
- The remaining part of the exposure is related to local authorities located in countries no longer strategic for Dexia and for which Dexia did not develop a specific advanced model (mainly UK, Japan and Canada).

DenizBank is treated under the Standardized Approach, and its activity is focused on retail, corporate and financial institutions. It represents the major contributor to the corporate standard portfolio and thus to the unrated corporate counterparties.
The Group's exposure to the sovereign non-investment grade category (EUR 3,794 million) is mostly concentrated in Turkey through DenizBank exposure. The sovereign exposures rated AAA+ to AA- are mainly international banks of development, which are treated in standard approach.

# 3.7. Counterparty risk on derivatives

## 3.7.1. Management of the risk

A counterparty risk on derivatives exists in all Over-The-Counter (OTC) transactions such as interest rate swaps, foreign exchange swaps, inflation or commodity swaps and credit default swaps.
Counterparty risk is measured and monitored according to the general principles described in the Dexia credit risk policies. The credit risk equivalent for derivative transactions is based on the mark-to-market value of the derivatives plus the application of an add-on, which is a 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 impacts of potential downgrades are analysed 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 2011 and 2010.

Exposure at year-end 2010

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

*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 2011 | | | |
|---|---|---|---|
| **Type of derivatives** | **Gross EAD** | **Net EAD** | **Capital requirement** |
| **Credit derivative** | **974** | **926** | **15** |
| ***Trading book*** | ***211*** | ***163*** | ***2*** |
| Back-to-back CDS | 144 | 144 | 2 |
| Other CDS | 67 | 18 | 0 |
| Total return swap | 0 | 0 | 0 |
| ***Banking book*** | ***763*** | ***763*** | ***14*** |
| CDS bought | 0 | 0 | 0 |
| CDS sold | 763 | 763 | 14 |
| **Other derivatives** | **30,854** | **7,455** | **222** |
| Commodities | 0 | 0 | 0 |
| Equity derivatives | 520 | 101 | 3 |
| Exchange derivatives | 2,909 | 941 | 27 |
| Rate derivatives | 27,425 | 6,413 | 193 |
| **Total continuing operations** | **31,829** | **8,381** | **238** |
| **Total groups held for sale** | **9,001** | **1,408** | **31** |

*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

The credit derivatives portfolio decreased from EUR 8,174 million to EUR 974 million between 2010 and 2011, following the disposal of Dexia Bank Belgium.

Credit Default Swaps consist of residual positions from former credit trading activities in order to mitigate credit/concentration risk on specific asset classes such as infrastructure finance securities.

### 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 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 re-measured 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 analyses 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 2011 and 2010.

Exposure at year-end 2010

| Type of assets | Accounting value | Fair value | Level 1 (1) | Level 2 (2) | Level 3 (3) |
|---|---|---|---|---|---|
| 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 |
| **TOTAL** | **1,257** | **1,257** | **281** | **179** | **796** |

*(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.*

Exposure at year-end 2011

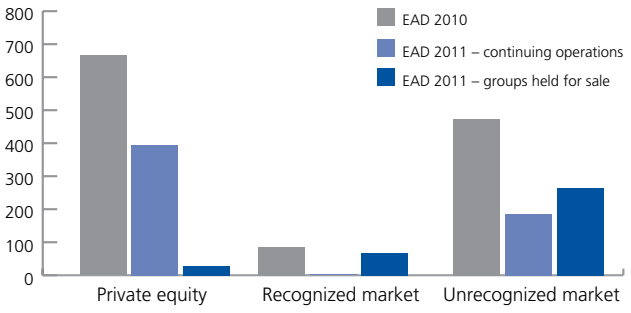
| Type of assets | Accounting value | Fair value | Level 1 (1) | Level 2 (2) | Level 3 (3) |
|---|---|---|---|---|---|
| Financial assets designated at fair value | 0 | 0 | 0 | 0 | 0 |
| Available-for-sale financial assets | 453 | 453 | 31 | 71 | 352 |
| **Total continuing operations** | **453** | **453** | **31** | **71** | **352** |
| **Disposal groups held for sale** | **441** | **441** | **225** | **66** | **150** |
| Financial assets designated at fair value | 34 | 34 | 0 | 34 | 0 |
| Available-for-sale financial assets | 407 | 407 | 225 | 32 | 150 |
| **Total continuing + discontinuing** | **895** | **895** | **256** | **137** | **501** |

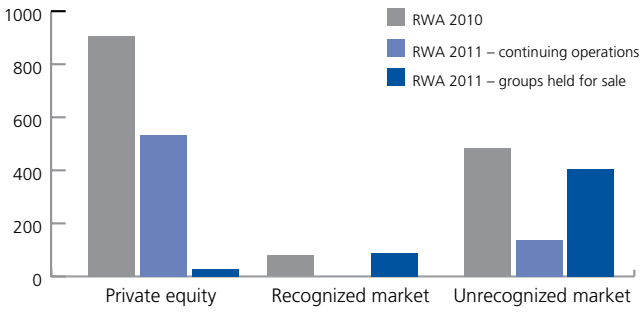
*(1) Level 1 = fair value based on market prices quoted in an active market.*
*(2) Level 2 = fair value based on observable market data.*
*(3) Level 3 = fair value based on pricing models for which some key market data are unobservable.*

The decrease of the equity portfolio between 2010 and 2011 is mainly due to the sale of Dexia Bank Belgium. The majority of equity exposures are classified as Available-for-sale financial assets and assessed via pricing models as some key market data are unobservable.

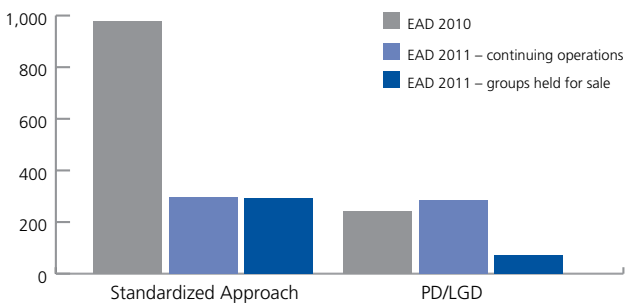
### 3.8.2.2. Equity exposure by type of market and Basel II approach

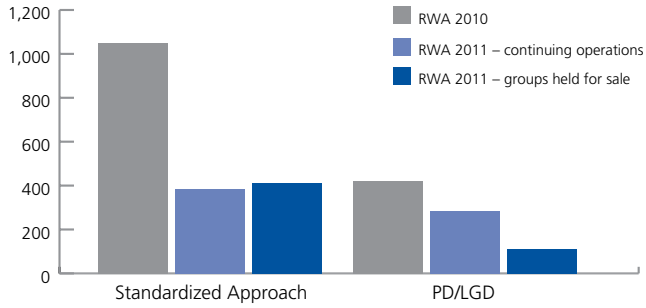
The following tables show the exposure at default in equities not included in the trading book broken down by type of market and by Basel II treatment at year-end 2011 and 2010. Equities for which Dexia share exceeds 10% are not included in these figures as they are deducted from own funds for the calculation of the regulatory solvency ratio.




As at 31 December 2011, for the continuing operations of the Dexia Group, the majority of equity exposures are private equities.




As at 31 December 2011, half of the equity exposure of the continuing operations of the Dexia Group is treated in Standardized Approach whereas the remaining part is treated with the PD/LGD Approach.

## 3.8.3. Gains or losses

### 3.8.3.1. Realized gains or losses arising from sales and liquidations in 2010 and 2011

The following table shows the cumulative realized gains or losses arising from sales and liquidations in 2011 and 2010. The 2011 figures only relate to the continuing operations of the Dexia Group.

| Gains or losses | 2010 | 2011 |
|---|---|---|
| Gains on available-for-sale financial assets | 281 | 41 |
| Gains on assets and liabilities held for sale | | |
| **Total gains** | **281** | **41** |
| Losses on available-for-sale financial assets | (50) | (14) |
| Losses on assets and liabilities held for sale | | |
| **Total losses** | **(50)** | **(14)** |
| **TOTAL** | **231** | **27** |

### 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 202 million as at 31 December 2011 (compared to EUR 308 million as at 31 December 2010). This amount is net of tax.

# 3.9. Focus on securitization activities

## 3.9.1. Objectives and roles of Dexia[7]

### 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 2011 and previous years, Dexia entities were able to pledge eligible asset-backed securities as collateral for repurchase agreements with major central banks, which allows banks temporarily to swap high quality asset-backed securities for cash, among other things. This process has contributed to the sources of funding of Dexia during 2010 taking into consideration constraints still existing in the interbank market and the relatively reduced investor base for securitizations.

### Roles

#### Dexia as originator

In 2011 Dexia did not originate any new securitization transactions.

[7] For more detailed information on basic explanations on securitization concepts, please refer to Appendix 3. Basics on securitization.

**Dexia as investor**

Dexia no longer invests in securitization transactions. In addition and in line with the strategy for the bond portfolio, Dexia has continued its de-risking/de-leveraging strategy during 2011 in order to reduce the size of its balance sheet.

**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 specialist parties.

**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 or corporate service provider. Nevertheless, Dexia no longer underwrites securitization deals and is not acting as a sponsor when providing liquidity facilities 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

Such involvement is a function of the role Dexia plays in securitization transactions. As Dexia did not act as originator in 2011, the extent of the involvement has become less significant.

## 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 6.8. 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.
As Dexia does not hedge the risks related to retained or re-securitization exposures, there are no specific policies in place to address these issues.

Post closing, the transaction follow-up involves 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 reporting 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 run-off since three years. The ABS positions are reviewed by the Risk Management ABS Expertise Centre (EC). The process in place to monitor the changes in the underlying credit or market risk is as follows:

- Depending on the level of risk of each position, an annual or biannual full review is realized analyzing both the market on which the underlying assets are based on (real estate markets for RMBS, corporate markets for CDOs…) but also the underlying performance and credit or market risk features of each individual transaction. Based on such individual analysis (with cash-flow models for the RMBS and CDOs), an internal rating is attributed to each position.
- On a quarterly basis, the most sensitive exposures classified in the Watchlist or Special Mention List are reviewed by a dedicated Risk Committee and if necessary, determine any need for impairment.

Analysis of ratings migration related to external rating agencies is based on a daily monitoring.

Some comments on the inherent liquidity risk in the ABS positions:

- The majority of the ABS positions have static pools of assets, limiting the risk of cash-flow mismatches between the asset and liabilities of our positions.
- The few remaining non-static positions are mainly CDOs with reinvestment periods and a few revolving RMBS (Master Trust). However, it must be pointed out that any new asset added to the pool is subject to strict guidelines so that the credit quality of the pool is at least maintained.
- The liquidity risk could also partially be linked to the difference between the interest rate paid by the pool of underlying assets and the rate paid to the notes issued by the ABS. Generally speaking, there is a natural hedge as the indexes used on

the asset and liability sides are equivalent. However, in some cases, when there is a mismatch (example in RMBS: loans in the underlying pools paying fixed rate while the notes issued to investors are paying floating rates), swaps have been put in place at origination. Beyond the risk on the swap provider, during the life of the transactions, the underlying swaps are not necessarily readjusted if the composition of the pool evolves. However, such a risk has so far been limited and mitigated by the cash flow within the structure, all the more that our exposures at Dexia are senior notes.

## 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 securitization/re-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.

### 3.9.3.2. Accounting rules

The recognition and de-recognition 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

Dexia performed one operation including some risk transfer and regulatory capital relief (WISE 2006-1).

Dexia has not yet securitized any revolving exposure or liquidity facilities shared between investors and Dexia as originator.

The other originations, except DRECM ones, were carried out with a view to obtaining long-term funding or establishing a liquidity buffer. The risk was not transferred out of the Group. In 2011, no new transaction has been closed. No new securitization transactions are scheduled for the near future, and so there are no assets on the balance sheet awaiting securitization or that can be identified as such.

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 full risk transfer and regulatory capital relief.

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.

Due to the sale of Dexia Bank Belgium, which hosted the securitization competence centre, few transactions remain in the Dexia portfolio.

The other changes are due to the amortization of the securitization portfolio and to exchange rate variations.

Exposure at year-end 2010

| | Payment rights | Residential mortgage loans | Commercial mortgage loans | Public sector | Corporate exposures | ABS | Other | Total |
|---|---|---|---|---|---|---|---|---|
| **Traditional securitizations** | | | | | | | | |
| Underlying assets [1] | 241 | 12,219 | - | 12,056 | 566 | - | 255 | **25,336** |
| Defaulted assets [2] | - | 14 | - | | | - | - | **14** |
| Exposure securitized in 2010 [3] | - | 5,760 | - | 475 | 430 | - | - | **6,665** |
| Gains and losses on sales in 2010 [4] | - | - | - | - | - | - | - | **-** |
| **Synthetic securitizations** | | | | | | | | |
| Underlying assets [1] | - | | | | 1,355 | 1,754 | 389 | **3,498** |
| Defaulted assets [2] | - | | | | - | - | - | **-** |
| Exposure securitized in 2010 [3] | - | | | | - | - | - | **-** |
| **Dexia as originator/ contributor** | | | | | | | | |
| Underlying assets [1] | - | - | 5,092 | - | - | - | - | **5,092** |
| Defaulted assets [2] | - | - | 693 | - | - | - | - | **693** |
| Exposure securitized in 2010 [3] | - | - | 0 | - | - | - | - | **0** |
| | DenizBank | Penates MBS4 | DRECM | DSFB DCC Tevere SI | Atrium 1, 2 WISE Tevere SIII | Dublin Oak | Tevere SII 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 2011

| | Payment rights | Commercial mortgage loans | Public sector | Corporate exposures | Other | Total |
|---|---|---|---|---|---|---|
| **Traditional securitizations** | | | | | | |
| Underlying assets [1] | 480 | | 4,253 | 373 | 217 | **5,323** |
| Defaulted assets [2] | | | | | | **0** |
| Exposure securitized in 2011 [3] | | | | | | **0** |
| Gains and losses on sales in 2011 [4] | | | | | | **0** |
| **Synthetic securitizations** | | | | | | **0** |
| Underlying assets [1] | | | | 1,395 | 391 | **1,786** |
| Defaulted assets [2] | | | | | | **0** |
| Exposure securitized in 2011 [3] | | | | | | **0** |
| **Dexia as originator/ contributor** | | | | | | **0** |
| Underlying assets [1] | | 4,681 | | | | **4,681** |
| Defaulted assets [2] | | 481 | | | | **481** |
| Exposure securitized in 2011 [3] | | | | | | **0** |
| | DenizBank | DRECM | DCC Tevere SI Triplus | Tevere SIII WISE | Tevere SII 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.*

Compared to 2010, the main changes in 2011 are due to the amortization of the securitized assets in the underlying portfolios and to the exit of Dexia Bank Belgium from the scope of the Group.

Refer to Appendix 4 for more details regarding Dexia originations.

## 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, separately for the trading and the non-trading book, broken down by type of securitization and risk-weight class at year-end 2011 and 2010.

Exposure at year-end 2010

| Type of securitization | [0-8%] | ]8%-16%] | ]16%-106%] | ]106%-1,250%[ | 1,250% | Total |
|---|---|---|---|---|---|---|
| ABS | 6,261 | 443 | 174 | 80 | 74 | **7,032** |
| CDO | 703 | 958 | | 0 | 69 | **1,730** |
| Consumer asset securitization | - | - | - | - | - | **-** |
| MBS | 6,268 | 2,504 | 719 | 77 | 41 | **9,609** |
| Other ABS | - | - | - | - | 27 | **27** |
| **TOTAL** | **13,232** | **3,905** | **893** | **157** | **211** | **18,398** |

Exposure at year-end 2011

| Type of securitization | [0-8%] | ]8%-16%] | ]16%-106%] | ]106%-1,250%[ | 1,250% | Total banking | Total trading |
|---|---|---|---|---|---|---|---|
| ABS | 4,669 | 176 | 173 | | 35 | **5,052** | |
| CDO | 192 | 26 | 261 | | | **479** | **178** |
| Consumer asset securitization | - | - | - | - | - | **-** | **-** |
| MBS | 819 | 1,302 | 473 | 165 | 137 | **2,897** | |
| Other ABS | | | | | 28 | **28** | |
| **Total continuing operations** | **5,680** | **1,504** | **906** | **165** | **199** | **8,454** | **178** |
| **Total groups held for sale** | **73** | **6** | | | | **79** | **0** |

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

85% of the portfolio (weighted risks below or equal to 16%) is within the A or above rating range and 96% of the portfolio is Investment Grade (106% corresponding to BBB- weighted risks).

The decrease of the outstanding amount of securitization positions retained or purchased is mainly due to the sale of Dexia Bank Belgium and of a large part of the Financial Products portfolio.

The following table shows the outstanding amount of securitization positions retained or purchased, separately for the trading and the non-trading book, broken down by seniority at year-end 2011.

Exposure at year-end 2011

| Seniority | Total banking | Total trading |
|---|---|---|
| ABS non-granular | 220 | |
| ABS non-senior granular | 307 | |
| ABS resec non-senior | 35 | |
| ABS senior granular | 7,864 | 178 |
| Unknown | 28 | |
| **Total continuing operations** | **8,454** | **178** |
| **Total groups held for sale** | **79** | **0** |

The bulk of the exposure, as at 31 December 2011, is senior granular.

### 3.9.5.2. Gains or losses on sales

The table below shows the recognized gains or losses by type of exposure in 2011 and 2010 arising from sales of securitization positions. The total losses arising from securitization sales for the year 2011 and 2010 amounted respectively to EUR 2,488 million and to EUR 32 million before reversal of collective impairments.

The large losses recognized in 2011 are due to the disposal of a large part of the FP Portfolio (RMBS).

Gains or losses at year-end 2010

| | Payment rights | Residential mortgage loans | Commercial mortgage loans | Public sector | Corporate exposures | ABS | Total |
|---|---|---|---|---|---|---|---|
| Recognized gains or losses by exposure type in 2010 arising from sales of securitization positions | - | (25) | - | - | - | (7) | (32) |

Gains or losses at year-end 2011

| | Payment rights | Residential mortgage loans | Commercial mortgage loans | Public sector | Corporate exposures | ABS | Total |
|---|---|---|---|---|---|---|---|
| Recognized gains or losses by exposure type in 2011 arising from sales of securitization positions | - | (2,383) | - | - | - | (105) | (2,488) |

# 4. Market and Balance-Sheet Management risks

## 4.1. Market risk

### 4.1.1. Definition

Market risk comprises the Group's exposure to adverse movements in market prices as a result of interest rate risk, equity price risk and foreign exchange risk.
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 account of previous definitions, such as inflation, carbon ($CO_2$) and commodity risks.

### 4.1.2. Governance

Financial Markets Risk Management (FMRM) oversees market risk under the supervision of the Management Board and specialist risk committees. The 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, analysing, monitoring and reporting on risks and results (including the valuation of assets) associated with financial market activities.
The policies, directives and procedures documenting and governing each of the activities are defined within Dexia SA and applied to all the entities of the Dexia Group. Central teams with expertise centres or transversal teams have the responsibility of defining methods of income statement calculation and risk measurement, as well as guaranteeing the 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 FMR teams are responsible for day-to-day activity, namely and inter alia the implementation of policies and directives defined at Dexia SA level, and also the assessment and monitoring of risks at a local level (calculation of risk indicators, control of limits and triggers, framing new activities/new products and so on), as well as reporting, reconciliation with local management audit, accounting and IT systems. Each operational entity is also responsible for monitoring and reporting to its own Management Board and 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: risks and income statement trigger reporting analysis[8] and related decisions, definition and revision of limits, proposals for the approval of new products, discussion of directives, risk governance and standards, risk concepts and risk measurement methodology, and the quality of valuation processes.
An ad-hoc MRGC may be 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 examine reports relating to activity and management of risks associated with market activities.
Dexia Market Risk Committee (DMRC) meets bimonthly and acts as supervisory committee of the MRGC.
The Risk Policy Committee and the Risk Management Executive Committee validate all major changes in risk profile or risk governance.

[8] Income statement triggers warn of a deterioration of results and are expressed as a percentage of VaR limits, typically 50%, 75% and 100% for triggers 1, 2 and 3 and stop the activity at 300% of VaR.

## 4.1.3. Management of the risk

### Dexia policy

Dexia developed a framework based on the following components:

- a comprehensive risk measurement approach, which constitutes an important part of the process of monitoring and controlling the Group's risk profile;
- a sound structure of limits and procedures governing risk taking, consistent with the entire risk measurement and management process and with the adequacy of the capital position.

### Risk measures

The Dexia Group adopted the Value at Risk (VaR) 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 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, the methodology of which is based on a hypothesis of normal distribution of yields from risk factors.
- Specific interest-rate risk, equity risk and other risks in trading books are measured by means of a historical VaR approach. The historical VaR is a VaR the distribution of which is constructed by applying historical scenarios of the risk factors concerned to the current portfolio.

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

The VaR methodologies are improved on an ongoing basis. The "Market Risk Engine" project launched in 2010 aims for an historical VaR over all risk factors (with a complete revaluation on non-linear risk factors).

The historical VaR which is confirmed as the standard in many banks provides a consistent and precise risk measure. In addition, this new tool facilitates stress testing, the analysis of extreme values and the implementation of stressed VaR in accordance with CRD 3.

An application was made to the National Bank of Belgium (NBB) at the end of 2011 for authorization to use the historical VaR as a replacement for the parametric VaR in determining the regulatory capital requirement for interest-rate and foreign-exchange risks. Once the authorization has been obtained, historical VaR will also be used for internal risk management.

As a complement to VaR measures and income statement triggers, Dexia applies a broad range of other measures aimed at assessing risks associated with the different business lines and portfolios (nominal limits, maturity limits, market limits and those on authorized products, sensitivity to different risk factors and so on).

Stress testing completes the risk management mechanism, exploring a range of low-probability events outside the predictive capacity of VaR measurement techniques. As such, VaR measures assess market risk in a classic daily market environment, whereas stress testing measures market risk in an abnormal market environment. Against that background, the different scenario hypotheses are regularly revised and updated. In 2011, stress scenarios were introduced on sovereign issues, rate correlations and credit value adjustments. The results of consolidated stress tests and the corresponding analyses are presented quarterly to the MRGC and the DMRC.

The bond portfolio in the banking book is not subject to VaR limits, given its different investment horizon, but is the object of regular stress tests.

### 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 are the following:

**General interest rate and Forex risk**

The parametric methodology is implemented for the computation of VaR on general interest rate risks (excluding volatility risk) and Forex (FX) risk (excluding FX derivative books). This methodology consists of computing variances and correlations for all risk factors and the entire framework is broadly based on the RiskMetrics methodology. The main assumption is that returns of those risk factors follow a normal distribution. Dexia calculates delta VaR and also uses delta gamma parametrical VaR for assets where the convexity is significant and must be taken into consideration. This parametric VaR 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.

## 4.1.3.2. Market risk exposure

The detailed VaR use of market activities (bond portfolio in the banking book not included) is disclosed in the table below. The average Value at Risk of the continuing activities was EUR 8.8 million in 2011, against EUR 44.6 million in 2010 for the whole Group.

Since 2008, limits have been considerably lowered, in line with the reduced risk appetite. The limits were reduced from EUR 178 million in the third quarter of 2008 to EUR 100 million in the first quarter of 2009. They were again reduced in 2011: from EUR 82 million at the end of the second quarter to EUR 29 million at the end of the year, which also reflects the exit of Dexia Bank Belgium from the Dexia scope. They will be further reduced when other entities are disposed of.

TFM Value at Risk

| **VaR** (10 days, 99%) (in millions of EUR) | **2010** | | | | | |
|---|---|---|---|---|---|---|
| | **IR [1] & FX [2] (Trading and banking) [3]** | **EQT [4] trading** | **Spread trading** | **Other risks [5]** | **Total 2010** | **Limit** |
| Average | 16.6 | 2.1 | 22.4 | 3.5 | 44.6 | 100 |
| End of period | 19.0 | 1.0 | 15.3 | 3.7 | 39.1 | |
| Maximum | 28.0 | 4.7 | 30.0 | 5.8 | 55.5 | |
| Minimum | 12.1 | 0.9 | 14.7 | 2.9 | 35.8 | |

| **VaR** (10 days, 99%) (in millions of EUR) | **2011** | | | | | | |
|---|---|---|---|---|---|---|---|
| | **IR [1] & FX [2] (Trading and banking) [3]** | **EQT [4] trading** | **Spread trading** | **Other risks [5]** | **Activities held for sale** | **Continuing operations** | **Limit** |
| Average | 11.4 | 1.6 | 11.6 | 1.8 | 1.6 | 8.8 | 29 |
| End of period | 5.9 | 0.0 | 2.7 | 0.0 | 1.5 | 7.2 | |
| Maximum | 24.5 | 5.6 | 20.7 | 3.8 | 7.4 | 14.1 | |
| Minimum | 3.9 | 0.0 | 2.5 | 0.0 | 0.4 | 5.2 | |

*(1) IR: interest-rate*
*(2) FX: forex*
*(3) IR & Forex: without BSM*
*(4) EQT: equities*
*(5) Other risks: inflation, $CO_2$ commodities*

### Bond portfolio

Bond portfolios amounted to EUR 114.6 billion as at 31 December 2011. A significant part of this portfolio is managed in run-off in the Legacy Division (EUR 75.2 billion in the bond portfolio in run-off and EUR 5.5 billion in the Financial Products portfolio). The interest rate risk of these portfolios is hedged. Accounting-wise, a major proportion of the bond portfolios were reclassified in Loans and Receivables, leading to a related Available For Sale (AFS) reserve insensitive to market spread evolutions. Regarding the other bond portfolios classified in AFS, the fair value sensitivity to a basis point credit spread increase amounted to EUR 31.4 million, impacting the AFS reserve.

Given the illiquidity of the markets and the lack of visibility on prices/spreads in the valuation process, mark-to-model valuations were applied to the "illiquid" part of the AFS bond portfolio.

## 4.1.3.3. Stress testing

Dexia implemented different stress test scenarios. 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.

Stress tests carried out by Dexia can be broken down into three categories:

- Sensitivity stress tests (on interest rate rates, foreign exchange risks, volatility 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, financial crisis scenario of 2008 capturing the turmoil triggered by the Lehman default) and a scenario simulating the recent sovereign debt crisis in the euro-zone;
- Specific stress tests (oriented towards the risks specific to certain activity line of Treasury and Financial Markets).

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

The results show that spread risk remains the most important risk parameter for Treasury and Financial Markets, followed by interest rate risk. Subsequent to the disposal of Dexia Bank Belgium in 3Q 2011, stress tests are performed excluding Dexia Bank Belgium from the scope of the Group. This exclusion enforces the already existing decrease of the stress test results noticed from 2010 onwards until 3Q 2011 and underlines the Group's deleveraging efforts.

| | | Interest rate risk | | | | FX risk | Equity risk | Volatility risk | | | Credit spread |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Type** | **Stress test description** | **1M** | **1Y** | **5Y** | **10Y** | **EUR** | | **IR** | **FX** | **Equity** | **risk** |
| Sensitivity stress tests | Parallel shift of the interest rate curves - 6 scenarios | | ±100bp<br>±200bp<br>±300bp | | | | | | | | |
| | Steepening/flattening of interest rate curves (all currencies) - 2 scenarios | +100bp<br>-100bp | | +100bp<br>-100bp | +100bp<br>-100bp | | | | | | |
| | EUR appreciates/depreciates against all currencies - 2 scenarios | | | | | ±10% | | | | | |
| | Increase of the equity prices<br>Decrease of the equity prices | | | | | | +10%<br>-25% | | | | |
| | Increase of the volatility in each market - 2 scenarios | | | | | | | ±25% | ±25% | ±25% | |
| | Increase/decrease of all the spreads - 2 scenarios | | | | | | | | | | ±25bp |
| Historical stress scenarios | Equity crash 1987 - 1 scenario | | | | -50bp | | -25% | +15% | | +30% | +15bp or +30bp |
| | Monetary crisis 1992 - 1 scenario(1) | +150bp | +110bp | | +30bp | -8% | | | | | |
| | Terrorist attack 2001 - 1 scenario(1) | -80bp | -50bp | | -20bp | +3% | -10% | -10% | +15% | +15% | +25bp |
| | Financial crisis 2008 - 1 scenario | Decrease and steepening of interest rate curve for EUR/USD/TRY/GBP/JPY | | | | | -25% | Increase EUR/USD/ TRY | +10% | +40% | by asset class |
| | Sovereign crisis 2008 - 1 scenario | | | | | | | | | | by rating class & category |
| Specific stress tests | Short term asset class | | | | | | | | | | by asset class & account-ing class |
| | Stress tests on customer CVA - 4 scenarios | | ±100bp<br>±200bp | | | | | | | | x1.5 |

*(1) Interest rate shifts: linear interpolation, extrapolation flat*

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 back-testing

### Basel treatment

#### Internal model

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 (refer to part 2.2. for figures on market risk capital requirements). A formal request for approval has been submitted to the regulator to use a historical VaR instead of a parametric VaR currently used through the Internal Model approach.

Since 31 December 2011, and in line with CRD 3 requirements, Dexia also calculates a stressed VaR in addition to internal VaR in order to determine regulatory capital.

The stressed VaR will be computed on a weekly basis using parameters from the period May 2008 – June 2009. The regulatory capital will be calculated as the sum of both the VaR and the Stressed VaR.

### Standard approach

The other market risks (spread, equity) are treated under the Basel II standardized approach. Back-testing is nevertheless performed daily on the trading scope.

## Back-testing

The result of the back test 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 back-testing 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 conversions. 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 back-testing 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 back-testing 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 back-testing 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 back-testing 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.

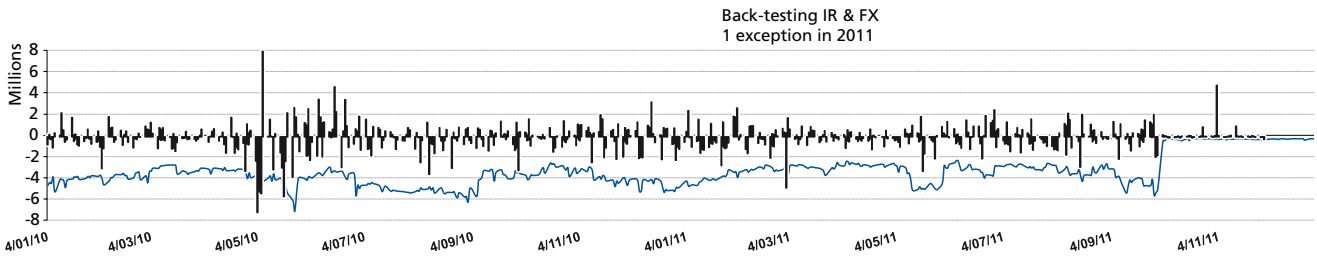
In 2011, Dexia noticed on internal models:

- 1 "downward" exception on its IR and FX perimeter (as compared with 3 exceptions in 2010);
- 7 "downward" exceptions on its equity perimeters (as compared with 3 exceptions in 2010). The equity perimeter has been abandoned as from 4Q 2011 following the disposal of Dexia Bank Belgium which held the bulk of the quoted equity positions;
- 4 "downward" exceptions on its spread perimeter (as compared with 0 exception in 2010).

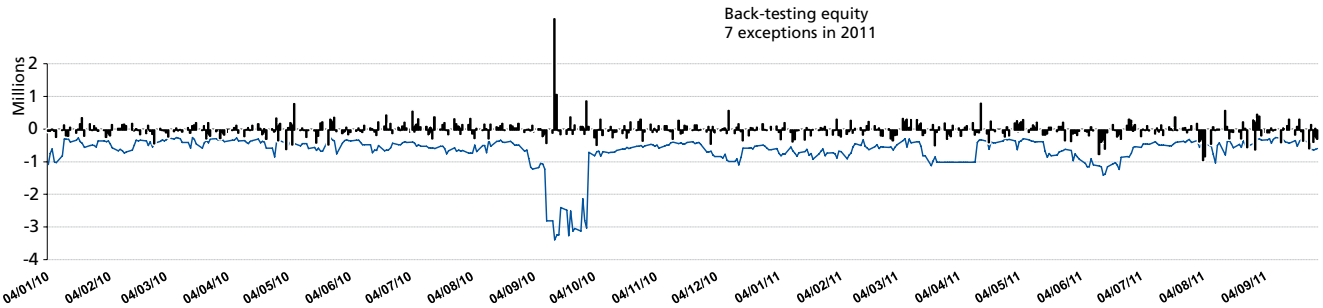
These exceptions were observed in August and September for the Equity perimeter during a period of higher volatility in the equity markets. All four exceptions in the spread perimeter were observed during 4Q, after the disposal of Dexia Bank Belgium. Both periods of higher volatility were driven by the turmoil due to the sovereign debt crisis. The IR & FX exception occurred in March 2011. This number of exceptions is in line with the expectations of the model.

The following charts evidence back-testing results for 2011 and 2010 on each perimeter:

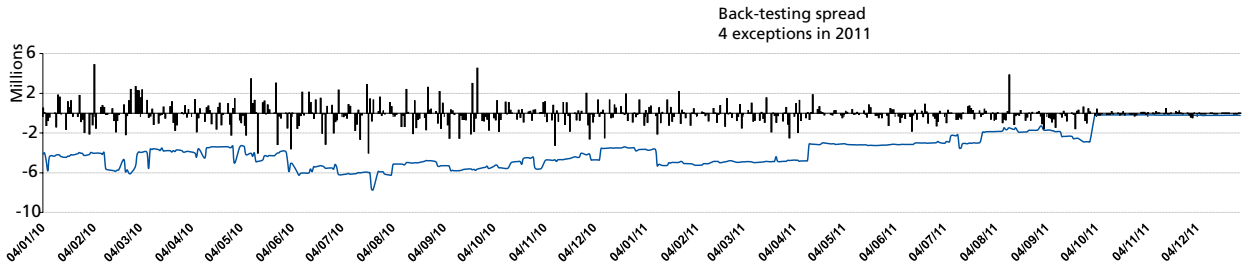
### Interest rate and foreign exchange




### 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 the 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.

## 4.1.3.6. Systems and controls

On a daily basis, FMR calculates, analyzes and reports the risks and results at an entity and a consolidated level. On a monthly basis, the regular Market Risk and Guidelines Committee (MRGC) meets to analyze the risk and results, to propose the market limits, to present procedures, guidelines and policies and to approve or amend new valuation methodologies.

All market activities are backed by specific guidelines describing the objectives, the authorized products, sensitivity, VaR and/or outstanding limits. The systems and controls established inside the Dexia Group are described in various procedures to ensure a complete and formal framework established to support all the market risk responsibilities.

By way of example, the New Product Approval Procedure (NPAP) describes the process to approve requests to trade new products from the Front Office until the formal approval of each new product by the New Product Committee (NPC). During this formal process, FMR will analyze and propose a valuation strategy for each product. Dexia has put forward two ratios to conduct a self-assessment on its capacity to deliver correct valuations. The results are discussed in the VCC MRGC (Valuation, Collateral and Counterpart Market Risk and Guidelines Committee) and if necessary, this committee will put in place an action plan to improve the valuation strategies.

# 4.2. Balance-Sheet Management risk

The main objective in Dexia's balance sheet management is to minimize volatility of the income statement, by immunizing the commercial margin generated by the business lines and also by preserving the Group's overall value creation. There is no objective of creating additional revenue through voluntary interest-rate risk taking, as the focus is on stabilizing bank revenues.

## 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 Risk (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, and if the situation deteriorates.

## 4.2.2. Governance

Balance sheet management (BSM) is the responsibility of the Finance support line and involves management of the structural risks of the entire Group.
Within risk management, the role of BSM Risk is to define the risk framework in which 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 risk management performed by the Finance support line and to ensure compliance of the framework with external regulations in force throughout the Group.

**Committees**
BSM risks are managed via the Group Assets & Liabilities Committee (ALCo) which meets monthly. The Dexia SA ALCo decides on the global risk framework, fixes limits, ensures consistency of strategy and delegates its implementation to local ALCo. It 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 ALCos manage risks specific to their balance sheet within the framework defined by and under the responsibility of the Group ALCo.
The Funding and Liquidity Committee (FLC), by delegation from the Dexia SA ALCo, centralizes and coordinates the decision-making process in relation 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 to enable the Group to overcome regulatory and internal stresses. Meeting bimonthly, the FLC does all it can to improve the Group's liquidity profile.

## 4.2.3. Management of the risk

### 4.2.3.1. Risk measures

**Interest rate**
Balance-sheet risk measurement is harmonized between the different Group entities. Risk sensitivity measures reflect balance sheet-exposure to a parallel movement of 1% on the rate curve. Sensitivity of the net present value of BSM positions to an interest-rate trend is currently the main indicator for measuring and monitoring risks, and fixing limits.
A parametric VaR based on interest-rate sensitivities is calculated on an indicative basis at a Group level. Global and partial sensitivities per interval of time nonetheless remain the main risk indicators on which asset-liability risk committees (ALCo) manage 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 after hedging rate risk.

**Equity**
Equity risk is now marginal following the sale in October 2011 of Dexia Bank Belgium and its insurance subsidiary Dexia Insurance Belgium, in which the equity portfolio was largely kept.

### (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. Since 2010, a systematic and ongoing hedge was made of these exposures.
The structural risks of financing participations (equity) in foreign currencies as well as the volatility of the Group's solvency ratio are also monitored regularly.

## 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.
For continuing activities, ALM long-term sensitivity was EUR -60 million as at 31 December 2011 (against EUR -150 million as at 31 December 2010 for the total Dexia Group).
The sensitivity limit on interest rates was EUR 196 million/% as at 31 December 2011 (against EUR 400 million/% at year-end 2010). This limit is in line with Balance-Sheet Management strategy, which aims to minimize the volatility of the statement of income whilst protecting overall value creation.
These variations of sensitivity and limits are explained by the redefinition of the Dexia scope.

| | 2010 | 2011 | |
|---|---|---|---|
| (in millions of EUR) | | Continuing activities | Activities held for sale |
| Sensitivity | (150) | (60) | 49 |
| Limit | 400 | 196 | 79 |

### BSM equity exposure (quoted shares)

Following the sale of Dexia Bank Belgium and Dexia Insurance Belgium, the sensitivity of the balance sheet to equities is henceforth extremely low.

# 4.2.4. Liquidity risk

## Dexia policy

Since 2010, Dexia has completely revised its internal process for managing liquidity risk, including its contingency funding plan, so as to achieve 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.
In 2011, the Funding and Liquidity Committee met two or three times a month, closely monitoring the evolution of the Group's liquidity and, mandated by the Management Board, taking formative decisions aimed at its improvement. The disposal of non-strategic assets and riskier assets in loan and bond portfolios, long-term collateralized funding transactions, securities swaps, long-term secured funding (via the covered bond issuers of the Group – Dexia KommunalBank Deutschland, Dexia Municipal Agency and Dexia LdG Banque) and unsecured funding as well as the close monitoring of funding sources and production are all levers which were deployed by Dexia on the initiative of this committee to remedy the Group's liquidity situation.
The liquidity management process is based on covering the Group's funding requirements with its available liquidity reserves. Funding requirements are assessed prudently, dynamically and comprehensively by taking existing and planned on and off-balance-sheet transactions into consideration; reserves are constituted with assets eligible for refinancing with central banks to which Dexia has access (European Central Bank, Federal Reserve, Central Bank of Turkey).

Regular information channels have been established for management bodies:

- daily reporting to members of the Management Board and all those involved with Group liquidity management, namely members of ALCo, the FLC, Audit, Finance, Risk Management, Cash & Liquidity Management and TFM ;
- weekly reporting to the Management Board on developments and actions undertaken during the week;
- meetings of the FLC several times a month, during which the evolution of the liquidity situation is studied and analyzed in detail;
- very frequent meetings of the Audit Committee and the Board of Directors;
- annual challenging of Dexia's long-term funding plan by the Management Board and the FLC.

An emergency funding plan has also been implemented, supplementing these information and decision-taking processes. It alters the structure of governance in order to make it more reactive in the case of liquidity stress necessitating rapid decision-taking.
Despite these improvements to the Group's liquidity management process and the diligence with which Dexia had ensured that the appropriate liquidity reserves were maintained, the sudden aggravation of the European crisis and its consequences on the liquidity market severely impacted the Group in the summer of 2011.

## Risk measures

The internal framework for managing liquidity risk defines indicators enabling Dexia's resistance to liquidity risk to be measured. These indicators include, but are not limited to, "liquidity ratios" comparing liquidity reserves to liquidity deficits. They also include limits on the absolute size of liquidity requirements as well as limits on the proportion of short-term funding. 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 the Audit Committee on a regular basis.
Dexia's liquidity risk is also framed by liquidity ratios monitored by the various regulators, the National Bank of Belgium (NBB) for Dexia SA and the Prudential Control Authority (ACP) for Dexia Crédit Local.
The NBB ratio to which Dexia SA is subject calculates the liquidity position of a credit institution by comparing the liquidity required (the numerator) and the available liquidity (the denominator) on a weekly and a monthly basis. It must be less than 100% on each of those time scales (Circular 2009 18-1 of 8 May 2009).
The ACP ratio to which Dexia Crédit Local is subject is defined as the ratio between liquidities (the numerator) and liabilities falling due (the denominator) over a prospective period of one month; the coefficient thus calculated must be above 100 at all times (Instruction No. 2009-05 of 29 June 2009 relating to the standard liquidity risk approach).
These ratios are communicated to the NBB and to the ACP on a monthly basis.
As from the summer of 2011, pressures were applied to Group liquidity, leading to a significant deterioration of the regulatory liquidity coefficient of Dexia SA and its subsidiary Dexia Crédit Local, although a continuous improvement of those ratios had been observed in previous months. Consequently, Dexia SA and Dexia Crédit Local have not been in a position to achieve the minimum regulatory threshold for observance of the liquidity coefficient to which those entities were respectively subject at the end of 2011. Observance of this ratio in future will depend on implementation of the Group financing programme which is still affected by many uncertainties.

## Liquidity management

An improvement of the Dexia Group's financial structure and a reduction of its liquidity requirement were the priority objectives of the transformation plan introduced in 2008. Until the summer of 2011, significant progress had been made in this regard, in particular enabling:

- to reduce the Group's short-term funding requirement by EUR 164 billion between the end of 2008 and June 2011 via a voluntary programme of asset disposals and a contraction of commercial loan production;
- to improve the diversification of its funding sources via growth of retail deposits (+EUR 15.3 billion between the end of 2008 and the end of June 2011) and a fall of short-term market resources aimed in particular at reducing dependence on central bank funding (-EUR 75 billion between the end of 2008 and the end of June 2011);
- to manage actively the off-balance-sheet liquidity risk to which the Group was severely exposed in particular via liquidity lines in US dollars granted to US local authorities (Stand-by Bond Purchase Agreements); to recall, these reached USD 50.8 billion at the beginning of October 2008 and were reduced to USD 4.3 billion at the beginning of February 2012.

As from mid-2011, the exceptionally challenging environment severely impacted the Group's liquidity situation (cf. chapter entitled "Highlights" in the Annual Report), leading at the end of December 2011 to funding of the liquidity gap of EUR 88 billion relying almost exclusively on central bank and guaranteed funding.
Between the end of June and the end of December 2011, the share of central bank borrowings increased by EUR 17 billion,[9] partially offsetting the Group's loss of unsecured funding. At the end of December 2011, the EUR 31 billion in central bank borrowings included drawings on the emergency liquidity assistance (ELA) activated by the Dexia Group from the beginning of October 2011 with the entire central bank system. At that same date, i.e. after the departure of Dexia Bank Belgium from the Group perimeter, the amount of emergency liquidity assistance was EUR 18.7 billion. The Group will endeavour to reduce this amount which is not significantly different to the peak reached in October 2011 before the disposal of Dexia Bank Belgium. The timetable for a reduction of drawings from the ELA will nonetheless depend on the Group's ability to issue guaranteed debt.
Considering the extremely negative evolution of the environment and growing distrust in the signature of the Dexia Group, considerably restricting its access to market funding, a new guarantee mechanism was put in place by the Belgian, French and Luxembourg States aimed at supporting implementation of the structural measures announced by the Group in October.
A temporary agreement on this guarantee scheme was reached with the European Commission on 21 December 2011, enabling Dexia Crédit Local to execute its first short-term debt issues. At the end of December 2011, debt issued with the

[9] Excluding the Group's participation in the "LTRO" or "longer-term refinancing operation" launched on 21 December 2011 with a 3-year maturity.

benefit of this guarantee amounted to EUR 22 billion (EUR 41 billion as at 15 March 2012). The resources thus raised on the one hand enabled the drawings of emergency liquidity assistance to be reduced and on the other hand permitted repayment of some of the unsecured funding granted by Dexia Bank Belgium to Dexia Crédit Local, in line with the undertakings made by the Group.

More detailed information on this new guarantee agreement is provided in Appendix 9.3.D. to the consolidated financial statements in the Annual Report.

The execution of the Group's medium and long-term funding programme in 2011 is to be appraised in two halves: during the first part of the year financial markets were in fairly good shape, providing relatively favourable conditions to issuers. However from June onwards the mounting sovereign crisis and tensions on the short-term US dollar market had virtually shut the market for financial institutions. The impact was felt on the volume of primary issues and on their margins: the iBoxx France Banks Senior index saw the average margin on senior bank debt rise from 86 basis points in January 2011 to 234 basis points at the end of that year, after reaching a peak of 284 basis points in November 2011. Similarly, the iBoxx France Covered index posted a sharp increase in the margin on covered bonds from 52 basis points in January 2011 to 154 basis points at the end of December 2011. Although in 2011 the amount issued on the covered bond market in Europe was in line with expectations, at EUR 180 billion, the pace of execution of issues followed the market trend: EUR 98 billion issued in the first quarter 2011, EUR 42 billion in the second, EUR 28 billion in the third and EUR 15 billion in the last quarter 2011, with the market closing the year in a wait-and-see mood.

Against that background, the Dexia Group's long-term funding activity was sustained during the first part of the year, enabling practically the entire 2011 budget to be achieved by the end of June. In all, Dexia raised EUR 38.2 billion in medium and long-term resources, including EUR 9.5 billion in the form of covered bonds, posting an average duration of 7.2 years, and EUR 2.0 billion in the form of senior unsecured funding with an average duration of 3.2 years. Among the noteworthy transactions were two benchmark transactions by Dexia Municipal Agency at 10 and 5 years (the latter, issued in May 2011, was broadly over-subscribed) as well as two benchmark issues at 3 and 5 years by Dexia KommunalBank Deutschland. Several bilateral secured funding transactions also enabled EUR 6.8 billion in long-term funding to be raised with an average duration of 5.4 years, and the Group took part in the 3-year refinancing operation launched in December by the European Central Bank (LTRO) in an amount of EUR 20 billion.

# 5. Operational risk

## 5.1. Definition

Operational risk represents the risk of financial or non-financial impact resulting from inadequate or failed internal processes, people and systems, or from external events. This definition includes IT, legal and compliance risks, 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 gathering of data on events generating financial gains.

## 5.2. Governance

Dexia's Operational Risk Management framework relies on strong governance with clearly defined roles and responsibilities.

- The Management Board regularly reviews the evolution of the risk profile of the different Group activities and takes the required decisions.
- The Risk Policy Committee, composed of members of the Management Board, approves Group-wide policies.
- The Operational Risk Acceptance Committee meets quarterly to examine the main risks identified, to decide on whether they are acceptable or not, and the corrective actions to be taken if necessary. It also validates proposed measures for prevention or improvement in relation to the different elements of the mechanism (Permanent Control, Information Security, insurance programme and so on). It is chaired by the Group Chief Risk Officer.
- The Operational Risk Management Committee, chaired on a monthly basis by the Group head of operational risks, develops a consistent operational risk management mechanism for the entire Group, including business continuity, crisis management, information security and insurance policy.
- Middle Management remains principally responsible for operational risk management. In each field of activity it appoints a correspondent for operational risks whose role is to coordinate the gathering of data and the assessment of risks, with the support of local operational risk management.

## 5.3. Management of the risk

### 5.3.1. Operational risk framework

#### Dexia's policy regarding operational risk

Dexia's operational risk management policy consists of identifying and regularly assessing the existing risks and current controls in order to check that the acceptance level defined per activity is respected. If not, adequate governance in place must lead to the rapid corrective or improvement actions permitting a return to an acceptable situation. This framework is implemented by a prevention policy, particularly with regard to information security, business continuity and whenever it is necessary by the transfer of certain risks through insurance.

#### Risk measures and management

The operational risk framework relies on the following elements:

**Operational risk event data collection**

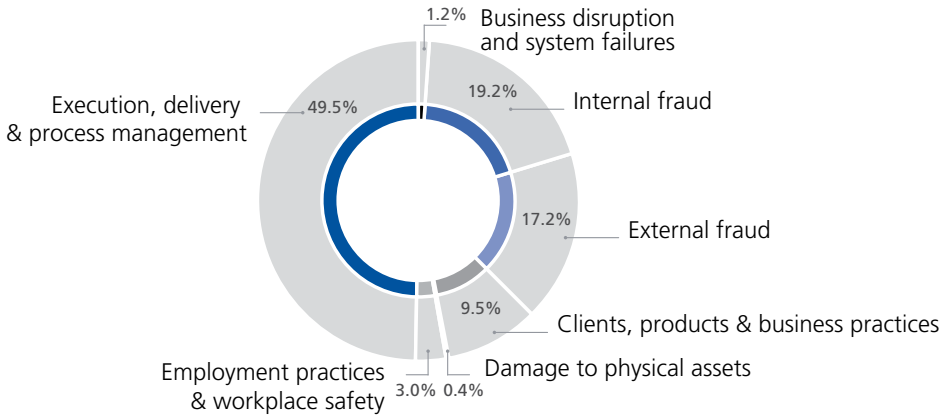
The systematic capture and monitoring of risk events is one of the most important requirements stated by the Basel Committee, whatever the approach chosen for the capital calculation (Standardized or Advanced Measurement Approach): "Data on the bank's historical loss experience could provide meaningful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

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. In terms of reporting, in order to

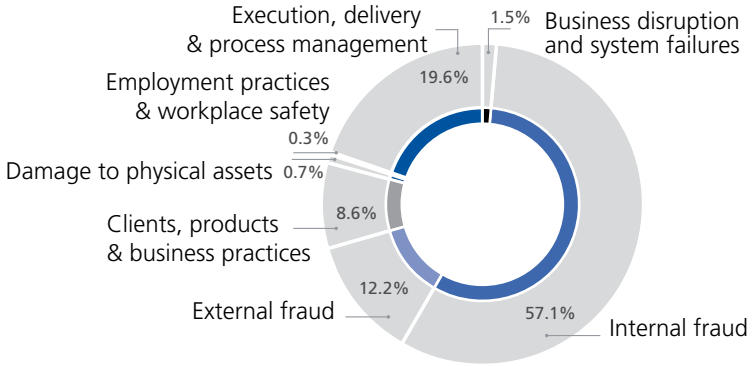
ensure that the most important information is escalated in due time to Senior Management, in addition to the compulsory declaration threshold being set at EUR 1,000, rules have been formulated and disseminated at Group level. The Management Board receives a report on the main events, including action plans defined by the bank's Middle Management enabling risks to be reduced.

The breakdown of the total amount of losses by nature of incident for continuing activities is evidenced in the charts below:

2010




2011




The breakdown of the different categories by nature of incident has changed considerably as the classification is based on a 3-year period, internal fraud incidents occurred in 2009 in the Turkish entity are still taken into account and largely impact its relative importance.
Appropriate actions have been implemented to improve the internal control system.
Losses due to incidents in "Execution, Delivery and Process Management" category events represent the second largest category. The most significant events recorded in this risk category also occurred in 2009. These events have been subject to corrective actions approved by the governance bodies.
The other categories present incidents limited in number and in loss amount.

### Self-assessment of risks and associated controls

In addition to building a history of losses, it is also necessary to determine Dexia's exposure to the main risks through the risk mapping of all significant activities. To do this, all the entities of the Dexia Group perform bottom-up self-assessment exercises regarding risks and associated controls. They can lead to the definition of mitigation actions. They provide a good view of the most important risk areas in the different entities and activities, with the objective of reporting the results to management across the organisation. These exercises are repeated each year.

### Definition and follow-up of action plans

Middle Management defines corrective actions for major events, deficient controls or notable risks. Regular monitoring is in the hands of operational risk management. This process enables the internal control system to be constantly improved and risks to be reduced appropriately over time.

### Permanent control

The aim of the permanent control framework is to check the existence and quality of the key controls present in all activities ensuring that major risks are covered. Initially deployed in France, it was extended in 2011 to a number of significant activities (Compliance, Risk Management, Operations) in other Group entities.

### Information security and business continuity management

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

Security programmes and well-defined responsibilities ensure that all business activities are organized in a secure environment. The Group business continuity policy requires each business line to analyse the impact of interruptions on critical business activity. Business continuity and recovery plans are tested and updated at least once a year. The Management Board validates recovery strategies, residual risks and action plans for continuous improvement.

### Management of insurance policies

Mitigation of the operational risks to which Dexia is exposed is also guaranteed by subscription to collective insurance policies, covering professional liability, fraud, theft and business interruption. Through an insurance policy elaborated for the entire Group, the aim is 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 negotiations with brokers and insurance companies. Against that background, existing policies in each entity and subsidiary were mapped in 2010, in order to improve effective cover. The adaptation of local policies continued in 2011 with a view to harmonization within the Group.

### Increased coordination with other functions involved in the internal audit system

A new software tool was introduced in 2010 to cover most of the building blocks of the operational risk management framework, also offering some key functionalities for other central functions such as Internal Audit, Compliance, Validation, Permanent Control or Quality Control. This software 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. Use of this tool was intensified in 2011 with an inventory taken of the principal controls in the most important entities.

### Operational risk management in the transition period

The current transition period, with the disposal or run-off of several Group activities, could be conducive to the development of certain operational risks, particularly from well-identified factors: the departure of key staff, possible loss of staff motivation, changes of processes when operational applications have to be replaced and so on.

Nevertheless, the main elements of the management mechanism described previously are still perfectly valid, particularly the self-assessment of risks and controls, which have to be updated with increased frequency.

On the other hand, a process for the escalation of new risks or those increasing as a consequence of the current situation has been introduced with inter-entity transition committees intended to manage the main work involved in transition and the problems arising from it.

Finally, all Dexia SA heads of department have been made specifically aware of the need to be attentive to the deterioration of the risk factors mentioned above, to ensure the best possible continuity in particular from the point of view of activity documentation and to alert management if required.

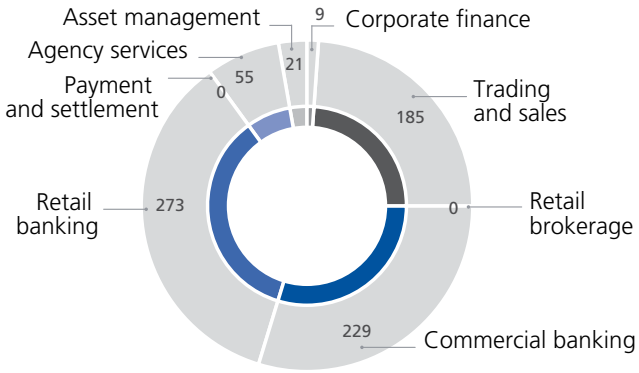
## 5.3.2. Calculation of regulatory capital requirements

Dexia applies the Basel II Standardized Approach to calculate regulatory capital within the context of its operational risk management.
This approach consists principally of applying a percentage (called the beta factor, in a range from 12% to 18%) to an appropriate activity indicator, calculated for each of the eight business lines defined by the Basel Committee (Corporate Finance, Commercial Banking, Retail Banking, Market Activities, Asset Management, Agency Functions, Retail Brokerage, Payments and Settlements).
The relevant indicator is defined by the regulator and is in essence based on the operational results of the underlying business using an average over the last three years. The calculation is updated at the end of each year.

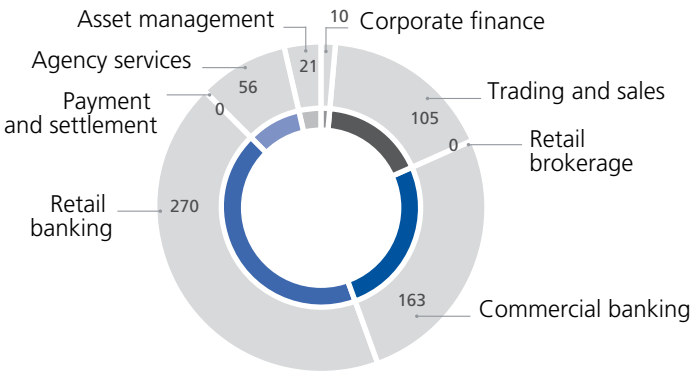
Capital requirement for operational risk was EUR 625 million at year-end 2011, down from EUR 772 million at year-end 2010, reflecting the decreased operational results over the last years.

Capital requirement (in millions of EUR) by Basel business line

as at 31/12/2010




as at 31/12/2011




The breakdown of capital requirement for operational risk by Basel II business line still predominantly reflects the former Group structure as evidenced in the charts above.

# 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 the Pillar 2 framework.
The Pillar 1 and Pillar 2 approaches to 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 includes a number of risk types not included in pillar 1: behavioural risk, business risk, strategic risk, reputation risk, model risk, pension risk, insurance risk, concentration risk, settlement risk and securitization risk.
Economic capital is defined as the potential deviation of the Group's economic value in relation to the value expected at a determined interval of confidence and time horizon. The 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 Pillar 1 (99.97%, 1 year).
Qualitative risks such as reputation, strategic, liquidity and securitization risks are part of the pillar 2 risks although not capitalized, either because they are considered as not material (securitization) or because an appropriate framework for managing these risk types is in place.

## 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.

### Organization and management of the risk

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

### Capitalization

Behavioural risk will be less material following the disposal of DBB and DIS, and the forthcoming sale of DBL.

## 6.2. Business risk

### Definition

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

### Organization and management of the risk

Business risk is at the heart of the daily management of the bank and is steered by governance committees and in fine the Board of Directors.

### Capitalization

The capitalization methodology is based on the potential impact of projected volatility of revenues.

## 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 under the responsibility of the Strategic Committee and the Board of Directors are:
- to ensure the adequacy of the Group strategic plan to the business environment;
- to react efficiently to changes in the business environment or to development opportunities;
- to ensure the correct implementation of decisions taken by Group top management in the business lines/entities.

### Capitalization

This risk is managed through an appropriate governance process 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:
- Compliance;
- Operational Risk Management;
- Secretary General, Tax & Legal;
- Communication.

An appropriate risk management framework and policies have been set up to prevent, detect and monitor potential reputation impacts of the risks identified and assessed by each of the departments involved.

### Capitalization

The risk is managed thanks to 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 of errors resulting from inadequate methodology and model, and/or data uncertainty or inappropriate use of models.
The major issues to be addressed by model risk are:
- 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 occurrence of model risk is mitigated by:
- Allocating experienced team members to the development of risk models;
- Systematically applying the "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 of risk capital resulting from model risk is assessed by expert judgment. An "uncertainty coefficient" is applied to calibrate a capital buffer covering model risk based on comfort level following expert judgement.

# 6.6. Pension risk

## Definition

The risk for a pension fund reflects the risk that the net present value of its liabilities (future commitments) exceeds 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 is driven by an appropriate risk management framework, diversification needs, liquidity requirements and asset allocation limitations.

## Capitalization

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

# 6.7. 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).

# 6.8. 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

Dexia currently calculates the risk transferred at inception on the basis of a regulatory weighted-risk calculation.

### Maturity mismatches in synthetic securitization

There is a maturity mismatch when the residual maturity of the credit protection is shorter in time compared to 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.

### Implicit support

At origination Dexia pays 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 change 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.

# 6.9. Basis risk

## Definition

Basis risk arises from imperfect correlation between the earned and paid rates or indexes on different instruments with otherwise similar re-pricing characteristics.
For instance: funding a 5Y loan indexed on OLO1Y with a 5Y deposit indexed on Euribor1Y exposes the institution to changes in the spread between OLO1Y and Euribor1Y.

## Organization and management of the risk

This risk was identified during the RICAP 2010 process. Its location and materiality are being assessed and will be reported in the RICAP 2011 Report due by mid-year 2012.

## Capitalization

If the risk is classified as financial or operating, and if it is found to be material, the methodology team will be requested to provide a way to measure it in a recurrent manner. Then the risk is capitalized and included in the quarterly production and reporting.

# 7. Remuneration policies and practices

Information about remuneration policies and practices is available on the website of Dexia (*www.dexia.com*).

# Appendix 1
# Glossary

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

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

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

# Appendix 2
# Internal rating systems

## 1. Structure of internal rating systems

The internal rating systems developed by Dexia are set up to evaluate the three Basel II parameters: Probability of Default (PD), Loss Given Default (LGD) and Credit Conversion Factor (CCF). For each counterparty type in the advanced method, a set of three models, one for each parameter, has been or will be developed as part of the roll-out plan validated by the regulator.
The PD models estimate the one-year probability of default. Each model has its own rating scale and each rating on the scale corresponds to a probability of default used for regulatory and reporting purposes. The correspondence between rating and PD for each scale is set during the calibration process, as part of the model development, and is reviewed and adjusted during the yearly back-testing 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 "master scale" has been set up. This master scale 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 master scale bucket. Rating classes provided in the present document stem from the master scale.
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 master scale 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:

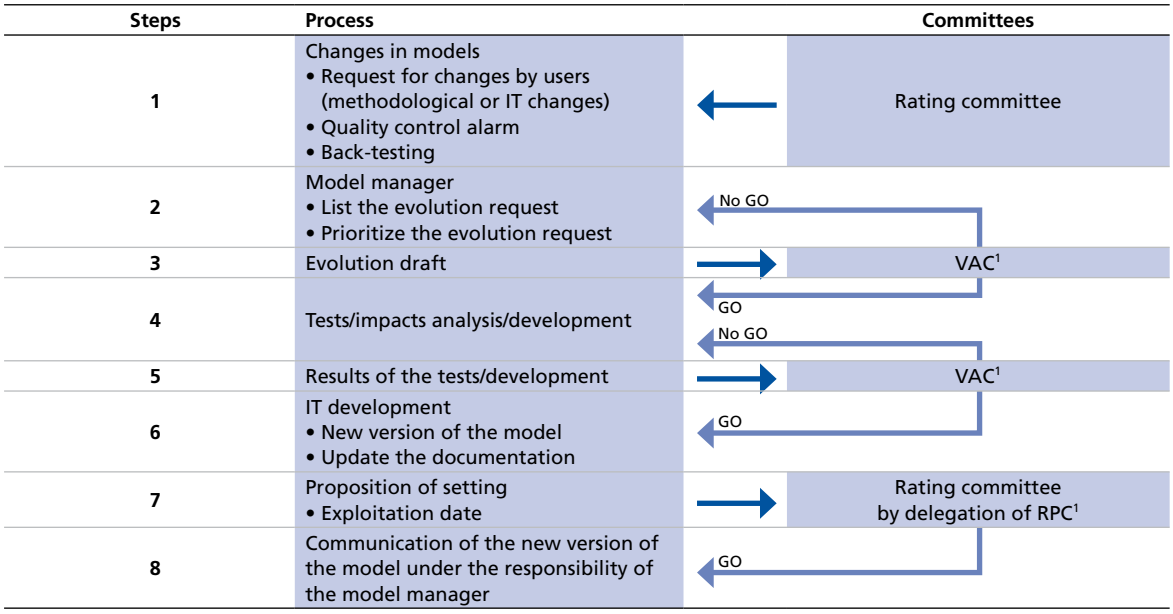
- Defining the scope of the counterparties concerned;
- Identifying and gathering the most relevant available data (financial data, data on defaults of the segment concerned, institutional framework);
- Building a database if needed;
- Defining a broad list of financial ratios and qualitative criteria;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




*(1) 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.

## 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 writing 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.

### 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.
Since DBB is out of the Dexia Group scope, this model is restricted to Luxembourg.

## 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.

### Western 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* (GSFP) have been inferred. This last model (GSFP) is currently in an experience-test period. Homologation file was delivered to NBB in May 2011. Feedbacks are still expected.
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 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.

- 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 non-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. Homologation file was delivered to NBB in April 2011. Feedbacks are still expected.

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 above.

### 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 landlord'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 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 Banque Internationale à Luxembourg defined as individuals with a self-employed activity or a liberal profession (i.e. doctors, lawyers, etc) or small companies generating a turnover lower than a certain threshold.

### Retail – small companies

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

### Retail – Lombard products

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

# Equity and securitization transactions

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

## Default definition used in the models

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

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

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

## Definition, methods and data for estimating PD, LGD and CCF

### Main principles used for estimating the PD

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

### Overview of the local public sector

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

### Overview of the local public sector

| Types of counterparties | Main hypotheses | Time series used | Internal/external data |
|---|---|---|---|
| Western European 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 |
| US municipalities | The Muni US LGD model is an expert model guided by external recovery rate factors and estimates. The final segmentation is based on business sectors. | N/A | External |
| *Groupements à fiscalité propre* | A mixed analytical - expert model was chosen and constructed based on the indicative available observations to determine indicative LGD and quantify potential loss related to a default in this sector. | 4 years | Internal |
| Social housing | Expert model based on a global evaluation of security/credit risk mitigant. Segmentation is based on the number of houses and on a performance ratio. | 9 years | Internal + External |

### Main principles used for estimating CCF

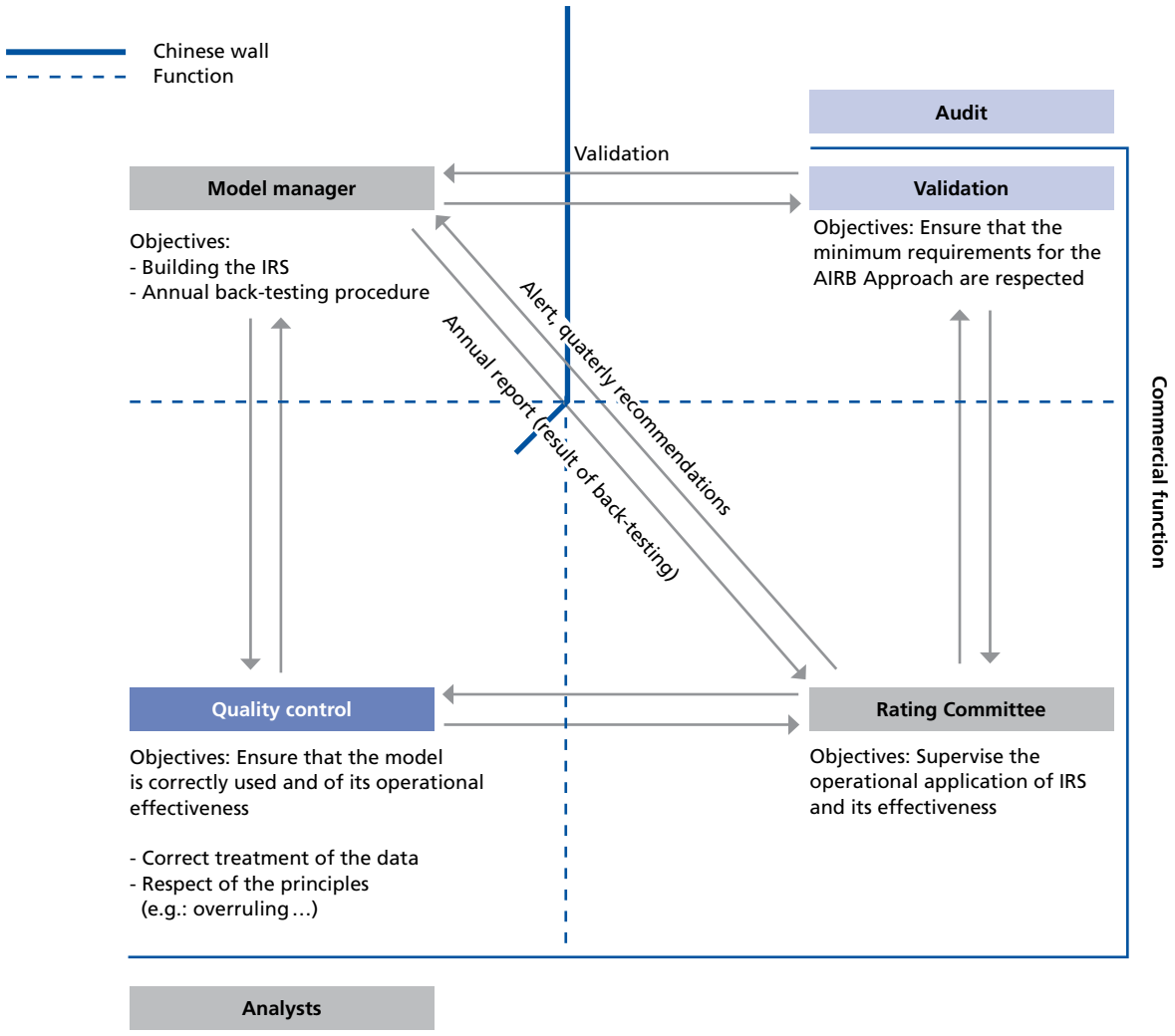
At present Dexia does not use CCF models for regulatory purposes except for Specialist Lending CCF model. Otherwise, Foundation Approach is applied.

Most of the CCF models were calibrated and internally validated in 2008 or 2009 based on a statistical approach using the data of the internal loss database or based on expert approaches when such approaches are not available.

CCF homologation files have been delivered to NBB in 2011. These models will be allowed to be in applied for regulatory purposes after NBB validation.

# 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 (QC) 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 Operational validation and QC Department.

Chinese walls between Model manager and Validation, Model manager and Rating Committee and Validation and Audit ensure the 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 are 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 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 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 meet 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, Chinese walls 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) 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).

## Validation approval process

The process set up to endorse the validation of models deployed within the 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, three 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 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, 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 the Dexia Group applies to:
- All models requested by regulators (e.g. Basel II, IFRS II) or for business purposes;
- All risks deployed in the company, such as 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, Annex VII Part 4, "Internal Audit has to include in its plan, at least once a year, a review of the IRS and its functioning, including credit scoring and estimation of PD, LGD, EL and CCF. Also compliance with all the minimal requirements has to be verified".
At Dexia, this annual verification has been delegated to the Validation department. Audit acts as an additional level of control, included in its audit plan.
Nevertheless for the smallest entities, the Validation department relies on the work carried out by the local auditors. To support this, the Validation department dispatches its methodology/key controls.
The RPC can delegate application modalities for their decisions to other specialized Risk Committees (within the limits and rules defined by the RPC).

# 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 Watchlist 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

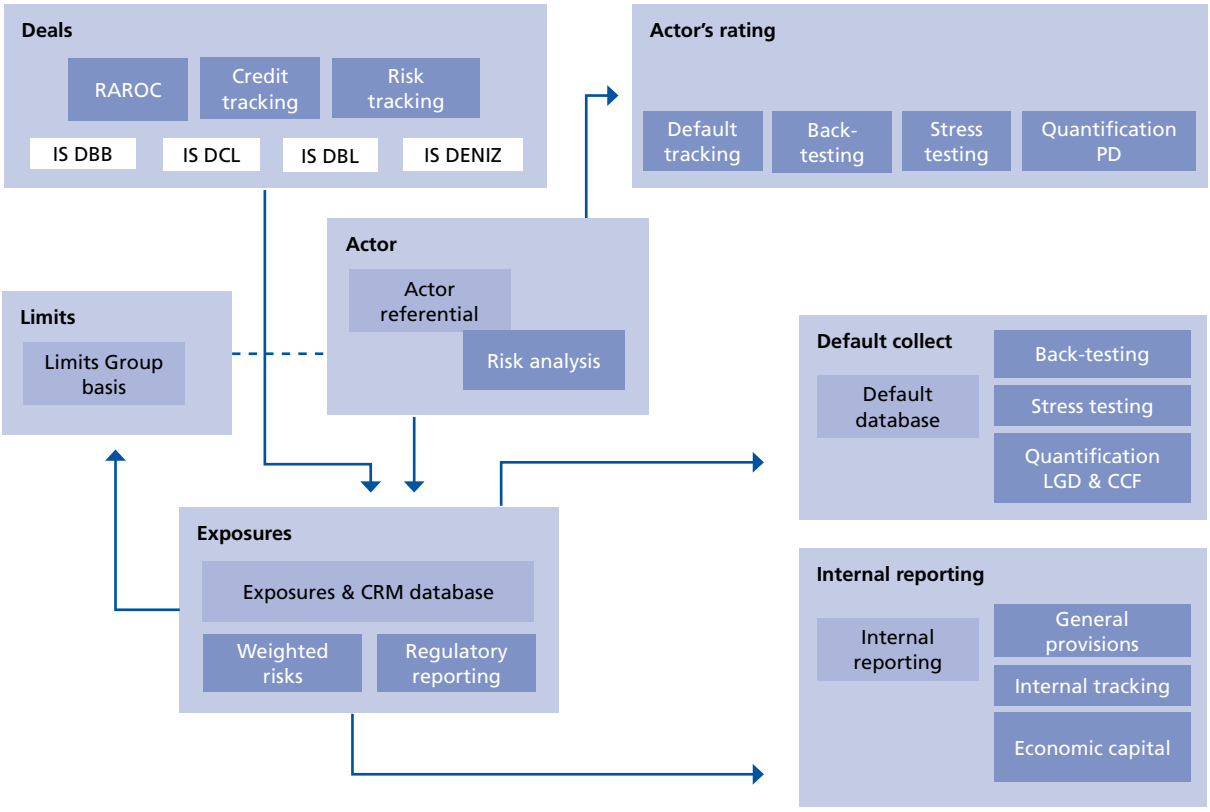
The capital allocation process is managed through reporting, budgeting and cost control procedures within the Dexia Group. This capital allocation relates to both regulatory and economic capital.
All credit files submitted to the Dexia Credit Committees include a weighted risk calculation based either 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 the Dexia Group as of 31 December 2011. All this architecture is currently under review in order to integrate the Dexia unwinding process.




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

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

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

- Attribution of an external and/or internal rating to credit counterparties (actor rating database).
- A precise view of 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, back test and stress test Dexia internal rating systems.

## Process used to transfer the issuers and issue credit assessments into items not included in the trading book

Issuers and issue credit assessments into 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 that 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.

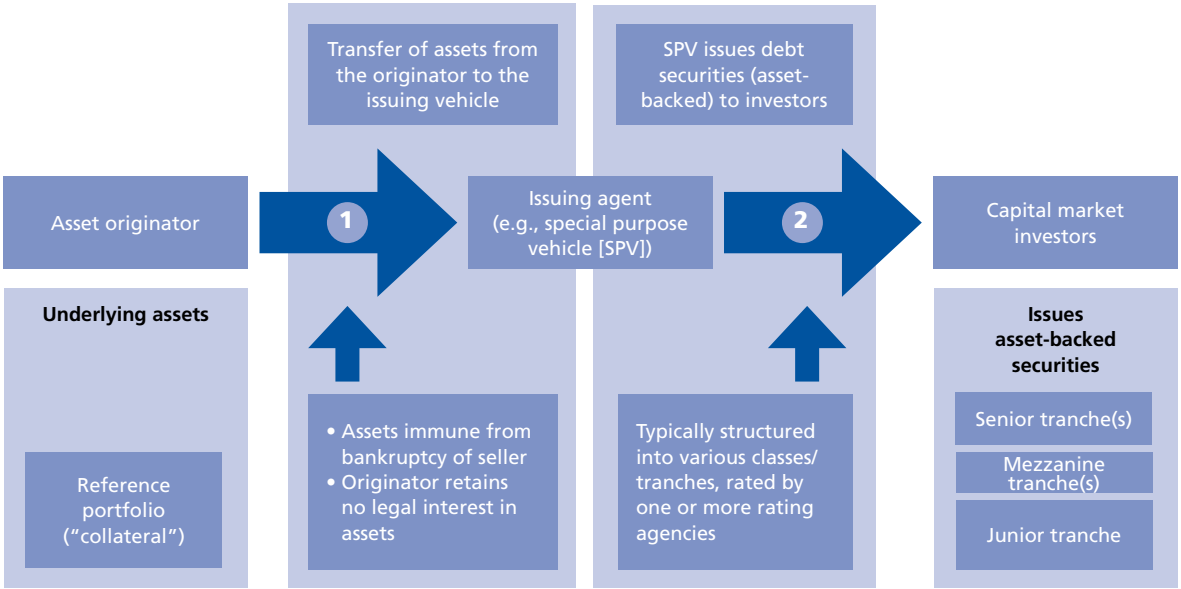
The originator initially owns the assets engaged in the deal. This is typically a company looking to seek financing or to raise capital.

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 repayment or default risk.

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



# 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 Crediop, DenizBank and Dexia Crédit Local have securitization vehicles:
- two for Dexia Crediop (DCC and Tevere Finance);
- one for DenizBank (DFS Funding Corporation Cayman);
- one for DCL (Triplus).

### 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 Corp." 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 2005), USD 80 million/EUR 57 million (Series 2005-B fixed-rate notes due 2012 have been reimbursed partially every three months and amounted to USD 5 million as at 31 December 2011), USD 70 million/ EUR 50 million (Series 2005-C fixed-rate notes due 2010 have 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 have been reimbursed partially every three months and amounted to USD 130 million as at 31 December 2011) and USD 150 million/EUR 108 million (Series 2007-C floating-rate notes due 2015 have been reimbursed partially every three months and amounted to USD 97.5 million as at 31 December 2011).
In April 2011, WestLB arranged five tranches under the existing DPR Securitization Programme: EUR 50 million (Series 2011-A floating-rate notes due 2018), EUR 75 million (2011-B floating-rate notes due 2023), EUR 75 million (2011-C floating-rate notes due 2023), EUR 75 million (2011-D floating-rate notes due 2016) and EUR 25 million (2011-E floating-rate notes due 2018). Reimbursements under these tranches have not yet started. Thus, outstanding balances of 2011 Series equal to their original sizes.
As at 31 December 2011, total of EUR 480 million (USD 232.5 million from USD Series and EUR 300 million from EUR Series) were outstanding.

### 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 consisting 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: Baa3/BBB+/A) (on the basis of the unconditional guarantee of Dexia Crediop, and class B is not rated.
As at 31 December 2011, the outstanding commitments amounted to EUR 743.8 million and EUR 3 million respectively (Series 2004-1) for class A and class B; the outstanding commitments amounted to EUR 677.7 million and EUR 3 million respectively (Series 2005-1) for class A and class B and the outstanding commitments amounted to EUR 2,110 million and EUR 46.2 million respectively (Series 2008-1) for class A and class B.
An amount of EUR 3.5 billion (as of 31 December 2011) 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 repurchased) 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 was closed during the last quarter of 2010 and all the underlying bonds transferred one part to Dexia Kommunalbank Deutschland and another 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 2011 the outstanding commitments amounted to EUR 215.6 million and EUR 1 million respectively for Class A and Class B.
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 2011 the outstanding commitments amounted to EUR 370.8 million and EUR 2.6 million respectively for class A and class B. Both classes are unrated.

### Triplus – 2010 repackage transaction (type of underlying assets: Japanese public sector loans)

On 27 January 2010, DCL Tokyo has securitised 70.2bnJPY of Japanese municipal loans with the intention of providing funding with the placement of senior tranches (65.5bnJPY) to Investors.
The equity tranche (class B note) has been retained by DCL Paris.
DCL Tokyo has entrusted a pool of its municipal loan receivables to the trustee ("First Trust"), and the trustee issued the Class A Beneficial Interests (Classes A1 through A4) and the Class B Beneficial Interests.
Entrustment of the receivables is perfected against relevant obligors and third parties by obtaining the obligors' approval in writing with a certified date pursuant to the rules under Article 467 of the Civil Law.
Then DCL Tokyo entrusted the Class B Beneficial Interests (the principal amount is approximately JPY4.7 billion) to the trustee (the "Second Trust"), and the trustee issued the Beneficial Interest. The Second Trust used the proceeds from the asset back loans, Loans A1 through A4, with the limited recourse assets of the respective Class A1 through A4 Beneficial Interests, to purchase each of the Class A Beneficial Interests. These notes are rated Aa2 by Moody's.
Each of the Beneficial Interests is secured by way of transfer ("joto tampo"). The entrustment and the transfer were perfected against relevant obligors and third parties by obtaining the approval of the trustee of the First Trust in writing with a certified date pursuant to the rules under Article 94 of Japan's Trust Law. The proceeds from the dividends and the redemption of the principal of the Class A1 through A4 Beneficial Interests are being used for the payment of interest and principal of Loans A1 through A4, respectively.
The transaction was arranged by Mitsubishi UFJ Securities Co., Ltd. The final maturity (corresponding to the maturity of the Class B note) is 20 May 2039.
As of December 2011, the outstanding amount is JPY 66.73 billion (EUR 669 million) and is composed as follows:
- Class B note: JPY 4.7 billion (EUR 47 million) – non-rated note retained by DCL Paris;
- Class A1 note: JPY 3.6 billion (EUR 36 million) – note placed on the market;
- Class A2 note: JPY 40.4 billion (EUR 405 million) – note placed on the market;
- Class A3 note: JPY 5.7 billion (EUR 57 million) – note placed on the market;
- Class A4 note: JPY 12.3 billion (EUR 123 million) – note placed on the market.

## 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 2011 the rating of the class A notes was C+/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 amortised slightly to GBP 1.49 billion (EUR 1.79 billion) at the end of 2011.

# Dexia as originator/contributor

## DRECM securitization activity (type of underlying assets: commercial mortgage loans)

Between 1997 and early 2008, Dexia Real Estate Capital Markets (DRECM) originated 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 was mainly a loan originator/contributor and relied on the large brokers/dealers it worked 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 participated. 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 were also sold to an outside entity, which has the task of monitoring the loans on an ongoing basis on behalf of the trust.

DRECM did not participate in the securitization market in 2009 and 2010. As of December 31, 2010 DRECM was placed into run-off. As of 31 December 2011, the outstanding amount of all securitizations originated by DRECM in the previous years amounted to USD 6 067 billion (EUR 4 685 billion).