Risk report **2012**

Pillar 3 of Basel II

DEXIA

Contents

Introduction

Dexia Group's orderly resolution continued in 2012 and demanded considerable reactivity on the part of the Risk support line in coping with events occurring during the year.

The organization of the Risk support line and its governance were adapted in 2012 following the transfer of activities and teams to Belfius Bank and Insurance (previously called Dexia Bank Belgium) and in order to anticipate the disposal of Dexia Municipal Agency (DMA) and the creation of the Société de Financement Local (SFIL).

Furthermore, three major disposals were finalised in 2012: Denizbank, Banque Internationale à Luxembourg and RBC Dexia Investor Services. These disposals resulted in Dexia's exposure being reduced by EUR 58.9 billion.

Although it remained tense, Dexia's liquidity situation improved greatly in 2012, following the reduction in size of the Group's balance sheet, associated in particular with the disposals and the easing of the sovereign debt crisis. As of 31 December 2012, Dexia had been able fully to repay its emergency liquidity line from the ECB, however, this situation remains temporary. The provisional liquidity guarantee granted by the Belgian, French and Luxembourg States was drawn to an amount of EUR 54.1 billion.

The evolution of the budget situation of sovereign states continued to be at the heart of Dexia's concerns, in view of its exposure to Italy, Spain, Portugal and Greece. Hungary was also paid increasing attention, as recent reforms are weakening the financial health of local authorities.

In France, in 2012, difficulties in the health sector resulted in non-payment situations, the majority of which were settled however. In the local public sector, despite a satisfactory financial situation overall, non-payments rose, albeit moderately. The reasons for this are (i) more difficult access to credit, (ii) a one-off liquidity problem associated with the non-renewal of Dexia credit lines and (iii) the objection by some clients to the conditions of their structured loans.

As a direct consequence of the Dexia Group orderly resolution plan and the significant reduction of its balance sheet, Dexia is no longer considered to be a systemic international bank, a "Global SIFI" or Global Systematically Important Financial Institution. It nonetheless remains a systemic bank at a national Belgian level, a "D-SIFI" or Domestic Systematically Important Financial Institution.

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 to (i) further to strengthen the soundness and stability of the international banking system, (ii) promote the adoption of stronger risk management practices by the banking industry, and (iii) 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 Banking, Finance and Insurance Commission on 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 and non-material portfolios.
Consecutively to the disposal of some entities and to the drastic decrease of some portfolios, Dexia presented an official request to BNB management Board to switch some portfolios from Advanced to Standardized Approach. These portfolios have indeed become non material in terms of exposures and number of counterparts.

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).

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

After further consolidation of Pillar 2 in 2010 and 2011 following inspections by the college of regulators, Dexia's approach is currently being adapted to its new situation. As a reminder, this process, applicable since end of 2008, requires banks to demonstrate to the regulators the adequacy of their risk profile and their capital (Internal Capital Adequacy Assessment Process – ICAAP). In this context, appropriate internal systems should be in place for the calculation and management of the risks and the assessment of the economic capital needs.

The Board of Directors and the Management Board of Dexia SA have been kept closely informed of developments on Pillar 2 and approved the principles of the new approach under development in 2013.

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 Tour Bastion, 5 Place du Champ de Mars, B-1050 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.).

As for 2011 and due to the orderly resolution of the Group, 2012 figures will be presented in a similar way as the 2012 annual report:
The assets and disposal groups held for sale will be identified separately. As of December 31, 2012, these are mainly Dexia Municipal Agency and Dexia Asset Management.

As a result, the 2012 data (tables and graphs) will be disclosed as follows:
- detailed tables and graphs for the continuing operations;
- gross figures for the assets and disposal groups held for sale, otherwise further details will be provided;
- average figures will be calculated taking into account the accounting classification of each entity as of each end-of-quarter, and the effective date of sale. The following entities were disposed in the course of 2012, and therefore will only be taken into account in average figures:
- Dexia Banque Internationale à Luxembourg (except those of its subsidiaries and portfolios which were purchased by Dexia prior to the sale);
- RBC Dexia Investor Services;
- Denizbank.

No pro forma will be applied on the 2011 figures.

Pillar 3 Contents

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

The quality of the provided information is guaranteed by an internal validation process at the level of Dexia. Information is not disclosed if considered non significant or confidential.

1. Risk Management Objectives and Policies

1.1. Mission and Objectives

The task of the Risk support line is to implement independent and integrated risk measures for the various types of risks, to monitor and manage them, to identify risks, to alert the relevant committees proactively and to decide on the amount of provisions necessary.

The organization of the Risk support line has been adjusted following the transfer of Brussels based team members to Belfius Bank and Insurance. Business continuity has been ensured thanks to the conclusion of Service Level Agreements (SLA) between Dexia and Belfius with July-end 2013 as ultimate date.

The organization has been further streamlined in line with the strategic options included in the orderly resolution plan and the new activity perimeter as such anticipating the creation of the 'Société de Financement Local (SFIL).

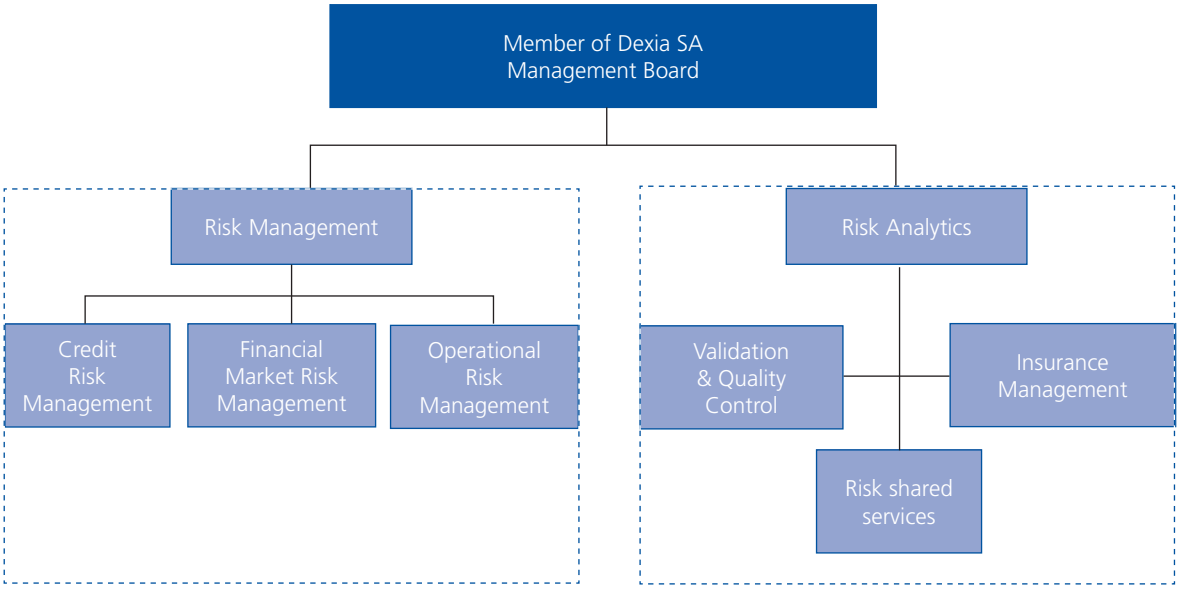
This change in organization has been driven by a mutualization of the DSA and DCL risk teams, by the reconstitution of some of the risk teams following the transfer of team members to SFIL and the creation of a 'restructuring and workout' team in charge of the active restructuring and the recovery of the relating outstanding amounts.

1.2. Risk Organization and Governance

1.2.1. Organization

Since the end of 2012, the Risk support line has operated under two main teams: Risk Management in charge of Credit Risk, Market Risk and Operational Risk and Permanent Control and Risk Analytics in charge of "Risk Quantification. Measurement, Validation and Reporting". The latter bringing together two transverse functions: "Risk Quantification, Measurement and Reporting" (all of the support functions to the Risk support line), and "Validation and Quality Control". This organization also relies on the mutualization of existing risks teams at a Dexia SA and Dexia Credit Local level, organized in competence centres on which the Risks Managements of the Group's subsidiaries can rely.

The organization and governance presented below correspond to the structure in place on the date of publication of the report.



Risk Management

Credit Risk Management

Credit Risk Management is in charge of
- defining policies and guidelines on credit risks, determining impairment and calculating cost of risk
- analyzing counterparties and monitoring portfolios. These teams are responsible for assigning internal ratings to Dexia counterparties but also monitoring and reporting on the portfolios.
- developing and maintaining Pillar 1 Internal Rating Systems (IRS)
- also actively restructuring some deals.

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

Financial Market Risk Management

Financial Market Risk Management (FMRM) is responsible for defining policies and guidelines on financial market activities including Balance sheet and liquidity management, identifying, analysing, monitoring (including valuation, model management) and reporting on risks and results with a holistic view.
Financial Market Risk governance and management of the risk are detailed in part 4.1

Operational Risk and Permanent Control

Operational Risk and Permanent control is responsible for defining the policies and guidelines on operational risk and permanent control, for monitoring operational risk but also for defining business continuity and recovery plans and managing data and information security. Operational Risk and Permanent control governance and management of the risk are detailed in part 5.

Risk Analytics

Risk Shared Services

Risk Shared services gathers all support functions of the risk management support line. Risk Shared Services is particularly responsible for:
- The definition and the development of risk quantification approaches (quantitative risk modelling for credit models, pricing models, Mark to model…), of stress testing framework and scenarios,
- the production of Pillar 1 and Pillar 2 internal and externals reportings,
- the monitoring of the regulatory framework and overall Basel II coordination,
- the development and the maintenance of all risk systems,
- the overall governance of the Risk Management support line (including the overall organization, budgets and human resources issues).

Model Validation and Quality Control

Model Validation and Quality Control is responsible for two main areas:
- Model Validation provides an independent review of all the models used by Dexia (both Basel II models, market risk models, pricing models) and proposes their validation to the Validation Committee and then consecutively to the Risk Committee.
- Quality Control and Operational validation ensures the proper use of the Internal Rating System (IRS).

Insurance Management

Mitigation of operational risks to which Dexia is exposed to is also guaranteed by subscription to collective insurance policies, covering professional liability, fraud, theft and business interruption. Insurance Management is in charge of subscribing such policies and following them.

Local Risk Management

Local risk management located in each subsidiary and branch is focused on local risk management activities and is organized through three main functions:
- Local credit risk responsible for analyzing and monitoring local counterparties including developing and maintaining the local Internal Rating Systems (IRS) and for producing local reportings;
- Local financial market risk management responsible for the day-to-day activity i.e. local risk assessment, local risk monitoring (computation of risk indicators, control of limits, triggers and so on), local reporting, reconciliation with local strategic planning and accounting but also with local information systems.
- Local operational risk is responsible for the local risk assessment/monitoring and producing local reportings;

Each operational entity is also responsible for the monitoring and reporting of entities' risks to local supervisory and regulatory bodies. Besides, each entity steers its subsidiaries.

Local chief risk officers put in place a local governance in line with the Dexia Group practices and policies:
- Local committees organization;
- Delegation rules;
- Local reportings production;
- Defaults and watchlist counterparts detection and monitoring;
- Credit risk provisions computation and monitoring;
- Local operational risks cartography;
- Local management of the data and information security and of the Business Contingency Plan.

1.2.2. Governance

In order to adapt to its new perimeter of activity, Dexia commenced a reshaping and a simplification of its governance with regard to risks. The number of committees was reduced considerably, reflecting on the one hand the abolition of committees specific to certain activities (i .e. the committee dedicated to retail banking activity) and on the other hand the merger of committees with similar responsibilities or fields of activity. This new governance revolves around the Risk Committee

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

The Dexia risk governance model defines four types of committees:
- Transversal Committees;
- Credit Risk Committees;
- Market and Balance Sheet Management (BSM) Committees;
- Operational Risk Committee.

Transversal Committees

Risk Committee

The new governance revolves around the Risk Committee, composed of the members of the Management Board. This committee has responsibility in particular for ruling on all transactions with a major impact on Dexia as well as various policies and guidelines.

The Risk 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 determines the risk management overall strategy, defines and follows up on Risk Management organization, follows up on major regulatory issues, methodologies and projects, and reviews key risk issues. It is organized on a weekly basis and is composed of the Dexia Management Board Member in charge of Risk, the head of Risk and the head of Risk Analytics.

Credit Risk Committees

The decision-making process applies to transactions and is organized via a series of credit committees organized per entity. All of these committees operate under the delegation of the Dexia Credit Committee. A transaction delegation framework has been set, depending upon the type of counterparty, rating levels and credit risk exposure. Subcommittees have been created within the Group (subsidiaries and branches) to deal with credit delegations.

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

Market and Balance Sheet Management (BSM) Committees

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

Operational Risk Committee

Operational Risk Committees include the Operational Risk Acceptance Committee (ORAC) and the Security and Business Continuity Committee (SBCC). These committees are detailed in part 5.

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 report the calculation of capital necessary to perform its activity, in accordance with the prudential banking regulations on the one hand, and with the prudential regulations on financial conglomerates on the other hand.

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

2.1. Own Funds

2.1.1. Accounting and Regulatory Equity Figures

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

Following the sale of Dexia Banque Internationale Luxembourg, there is no longer a difference between the accounting methods and the prudential methods as of 31 December 2012. Until 2011, this difference was related to the consolidation of an insurance company,

	31/12/2011		31/12/2012	
	Financial statements	**Regulatory purposes**	**Financial statements**	**Regulatory purposes**
Total shareholders' equity	-2,018	-2,018	2,852	2,852
of which Core equity	*7,589*	*7,589*	*10,919*	*10,919*
of which Gains and Losses not recognized in the statement of income	*-9,607*	*-9,607*	*-8,067*	*-8,067*
Non-controlling interests	1,698	1,698	458	458
of which Core equity	*1,819*	*1,819*	*473*	*473*
of which Gains and Losses not recognized in the statement of income	*-121*	*-121*	*-15*	*-15*
TOTAL	**-320**	**-320**	**3,310**	**3,310**

Note:
Comments on regulatory requirements are described in the part Capital Management of the Management Report (see the Annual Report 2012).

The EUR 10.9 billion Core equity amount in 2012 includes a EUR 2.9 billion net loss.

The other comprehensive income (OCI) which includes the gains and losses not recognized in the statement of income were EUR -8.1 billion at the end of 2012.

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 based on 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 adjusted the regulatory capital definition. The most important 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 will be deducted for 50% from Tier 1 capital and for 50% from total regulatory capital).
The following table shows Dexia Group regulatory capital calculated under Basel II at year-end.

	31/12/2011	31/12/2012
TOTAL REGULATORY CAPITAL (AFTER PROFIT APPROPRIATION)	**8,589**	**11,535**
Tier 1 capital	**6,305**	**10,989**
Core shareholders'equity	7,589	10,879
Cumulative translation adjustements (group share)	-803	-31
Prudential filters	-335	-186
Non-controlling interests eligible in tier 1	627	422
Dividend payout (minority interests)	0	0
IRB provision shortfall 50% (-)	0	0
Available for sale reserve on equities (-)	0	0
Items to be deducted:	-1,772	-191
Intangible and Goodwill	-1,416	-165
Holdings > 10% in other credit and financial institutions (50%)	-45	-26
Subordinated claims and other items in other credit and financial institutions in which holdings > 10% (50%)	0	0
Excess on limit for holdings, subordinated claims and other items in credit and financial institutions in which holdings < 10% (50%)	-310	0
Subordinated claims and other instruments hold by insurance in which holdings >10% (50%)	0	0
Innovative hybrid tier-1 instruments	999	96
Tier 2 capital	**2,284**	**546**
Perpetuals and excess on innovative hybrid tier-1 instruments for recognition in Tier 1 capital	424	0
Subordinated debts	2,104	530
Available for sale reserve on equities (+)	202	132
IRB provision excess (+); IRB provision shortfall 50% (-)	44	22
Items to be deducted:	**-490**	**-138**
Holdings > 10% in other credit and financial institutions (50%)	**-138**	**-138**
Subordinated claims and other instruments hold by insurance in which holdings >10% (50%)	0	0
Excess on limit for holdings, subordinated claims and other items in credit and financial institutions in which holdings < 10% (50%)	-310	0
Subordinated claims and other items in other credit and financial institutions in which holdings > 10% (50%)"	0	0
Participations in insurance undertakings	-42	0

Note: For regulatory purposes, insurance companies are accounted for by the equity method. In 2012, no insurance companies are consolidated.

At year-end 2012, Tier 1 capital amounted to EUR 10 989 million, a 74% increase compared to last year, driven by the EUR 5.5 billion capital increase at the end of December 2012.

Innovative hybrid tier 1 instruments at Dexia decreased from 999 million to 96 million following the buy-back of hybrid Tier 1 by Dexia Crédit Local and Dexia Funding Luxembourg and the disappearance of the limit for recognition of hybrid issues (haircut) which operated in 2011 (see next table).

Innovative hybrid tier 1 instruments at Dexia (total amount of EUR 96 million) include:
a) the undated deeply subordinated non-cumulative Notes for EUR 56 million, issued by Dexia Crédit Local and booked for EUR 56 million;
b) the undated subordinated non-cumulative Notes for EUR 40 million, issued by Dexia Funding Luxembourg (now merged with Dexia SA) and booked for EUR 40 million.

Issuer	Booked amount (in millions of EUR)	Rate	Call date	Rate applicable after the call
Dexia Crédit Local SA	56	4.30%	18 November 2015	Euribor 3 m + 173 bp
Dexia Funding Luxembourg SA (now merged with Dexia SA)	40	4.892%	2 November 2016	Euribor 3 m + 178 bp

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 the equity 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.
Dexia Crédit Local launched in October 2012 a fixed-price cash-tender offer on the Subordinated Redeemable Notes in a nominal amount of EUR 500 million at a floating rate issued on 20 June 2007 (ISIN: XS0307581883). The purchase price (expressed as a percentage of the nominal) is 65%; and on the Subordinated Redeemable Notes in a nominal amount of EUR 300 million at a fixed / floating rate issued on 19 January 2007 (ISIN: XS0284386306). The purchase price (expressed as a percentage of the nominal) is 65%.

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 2012. 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.

			Continuing operations		Groups held for sale		Continuing operations		Groups held for sale	
			31/12/2011		31/12/2011		31/12/2012		31/12/2012	
Type of risk	Basel II treatment	Exposure class	Weighted Risks	Capital Requirements	Weighted Risks	Capital Requirements	Weighted Risks	Capital Requirements	Weighted Risks	Capital Requirements
Credit risk	Advanced	Corporate	6,865	549	868	69	4 297	344	16	1
		Equities (incl Fund)	286	23	110	9	454	36	-	-
		Financial Institutions	6,990	559	1,285	103	7,316	585	258	21
		Monolines	1,629	130	-	-	1,366	109	-	-
		Project Finance	5,478	438	52	4	5,002	400	1	-
		Public Sector Entities	2,836	227	855	68	2,646	212	746	60
		Retail Mortgage loans	-	-	265	21	-	-	-	-
		Retail Revolving loans	-	-	-	-	-	-	-	-
		Retail Other loans	-	-	386	31	-	-	-	-
		Securitization	5,849	468	716	57	5,054	404	663	53
		Sovereign	3,720	298	83	7	4,754	380	114	9
		Others	-	-	-	-	-	-	-	-
		Total	***33,654***	***2,692***	***4,619***	***370***	***30,888***	***2,471***	***1,799***	***144***
	Standard	Corporate	10,466	837	638	51	1,148	92	1	-
		Equities (incl Fund)	384	31	411	33	1,029	82	260	21
		Financial Institutions	1,474	118	402	32	1,350	108	11	1
		Monolines	-	-	-	-		-	-	-
		Project Finance	664	53	-	-	591	47	-	-
		Public Sector Entities	10,049	804	2,352	188	9,818	785	1,848	148
		Retail Mortgage loans	-	-	-	-	-	-	-	-
		Retail Revolving loans	4,020	322	-	-	-	-	-	-
		Retail Other loans	-	-	55	4	4	-	-	-
		Securitization	-	-	-	-	-	-	-	-
		Sovereign	3,685	295	398	32	124	10	44	4
		Others	219	18	16	1	-	-	-	-
		Total	***30,961***	***2,477***	***4,272***	***342***	***14,063***	***1,125***	***2,164***	***173***
Market risk	Internal Model	Interest Rate & Foreign ExchangeRisk	84	7	65	5	96	8	-	-
		Position Risk on Equities	-	-	-	-	-	-	-	-
		Other Market Risks	-	-	-	-	-	-	-	-
		Total	***84***	***7***	***65***	***5***	***96***	***8***	***-***	***-***
	Standard	Interest Rate Risk	878	70	155	12	876	70	84	7
		Foreign Exchange Risk	785	63	4	-	220	18	-	-
		Position Risk on Equities	10	1	67	5	-	-	-	-
		Other Market Risks	-	-	-	-	-	-	-	-
		Total	***1,673***	***134***	***226***	***17***	***1,096***	***88***	***84***	***7***
Operational Risk	Basic		**7,821**	**626**	**-**	**-**	**5,131**	**410**	**-**	**-**
TOTAL			**74,193**	**5,936**	**9,182**	**733**	**51,274**	**4,102**	**4,047**	**324**

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

At year-end 2012, the weighted risks of the continuing operations of the Dexia Group amounted to EUR 51.3 billion and the weighted risks of the Groups held for sale amounted to 4 billion. The risk weights 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 issued by the Belgian Banking, Finance and Insurance Commission (CBFA) 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 complied with all regulatory solvency capital rules for all periods reported.

The following table shows Dexia Group weighted risks and solvency ratios at 2011 and 2012 year-end. Since 1 January 2008, 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.

		31/12/11	31/12/12
Tier 1 Capital		6,305	10,989
Total Regulatory Capital		8,589	11,535
Total Weighted Risks		83,374	55,321
Credit Risk	**Advanced**	38,273	32,687
	Standard	35,233	16,227
Market Risk	**Advanced**	149	96
	Standard	1,898	1,180
Operational Risk	**Basic**	7,821	5,131
Tier 1 Ratio	**Tier 1 Ratio**	7.6%	19.9%
Capital Adequacy Ratio	**Capital Adequacy Ratio**	10.3%	20.9%

At EUR 55 billion as of 31 December 2012, weighted risks were down EUR 28 billion compared to year-end 2011 due to the sale of DenizBank and Banque Internationale du Luxembourg.
At 19.9% and 19.7% respectively, the Tier 1 and the Core Tier 1 ratios were impacted by the capital increase (+ 5.5 billion EUR) as of 31 December 2012, as well as of the sale of DenizBank (- 368 million EUR) and BIL (- 78 million EUR).

2.3.2. Internal Capital Adequacy

Dexia continued adapting its internal capital adequacy process in line with Basel II Pillar II requirements including the dialogue with the regulators. The impact of the Group's restructuring is taken into account and adjustments to methodology and processes will be made according to a planning submitted to home regulators.

Economic Capital

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, given its global strategy. In other terms, it is also defined as the need of capital to cover potential losses while ensuring the sustainability of the Group and the adequacy with its debt rating.
The economic capital quantification process is organized in three phases: (1) risk identification (definition and mapping updated annually), (2) their joint assessment (essentially on the basis of statistical methodologies) allowing (3) their aggregation while accounting for inter and intra risks diversification.

Internal Capital Adequacy and Risk bearing Capacity

Continuing the dialogue which Dexia has maintained with its regulators in order to respond to the requirements of Pillar 2 of Basel II (capital adequacy in relation to the bank's risks, principally based on the economic capital approach), Dexia presented its regulators with the principles of the approach which will be adopted in 2013, entitled Capital Risks and Adequacy. The progress of the transition phase between the current approach, still in application at the end of 2012, and its evolutions was also presented.

Stress Tests

Dexia has implemented the performance of stress tests in a transversal and integrated approach to the Group's risk management process taking account of the orderly resolution plan undertaken in October 2011.

The aim of stress tests is, in an adverse shock situation, to measure the bank's sensitivity in terms of expected losses, weighted assets, liquidity needs and capital requirements.

In 2012, Dexia performed a series of stress tests (sensitivity analysis, scenario analysis, assessment of potential vulnerabilities) particularly based on macroeconomic scenarios reflecting crisis situations.
In addition to the stress tests for market and liquidity risks performed on a regular basis and meeting regulatory requirements, in 2012 Dexia implemented stress tests covering the majority of credit portfolios. In particular, within the framework of Pillar 1 of Basle II, credit exposures covered by internal rating systems were subject to tests of sensitivity and scenarios of unfavorable evolution of macroeconomic variables.

Given the extent of the Dexia restructuring, a direct consequence of its orderly resolution plan, Dexia is no longer in the sample of banks retained by the EBA for the performance of stress tests. For the proper implementation of that plan, Dexia has the support of a liquidity guarantee granted by the Belgian, French and Luxembourg States.

2.4. Significant Banking Subsidiary: Dexia Crédit Local

Since the sale of DenizBank and Banque Internationale à Luxembourg, Dexia Crédit Local is Dexia Group's sole Significant Subsidiary.

Regulatory capital and solvency ratios under Basel II at year-end 2011 and 2012 for Dexia Crédit Local are disclosed in the following table.

	DCL 2011	DCL 2012
Tier 1 Capital	8,355	8,656
Total Regulatory Capital	9,885	9,217
Total Weighted Risks	50,961	50,497
Tier 1 Ratio	16.40%	17.14%
Capital Adequacy Ratio	19.40%	18.25%

Note: DCL figures include Dexia Municipal Agency (entity sold in February 2013)

The following table shows the weighted risks and capital requirements for each type of risk (and exposure class for credit risk) for Dexia Crédit Local at year-end 2011 and 2012. The minimum capital requirements correspond to 8% of the risk weighted assets.

Dexia Crédit Local figures

			31/12/11		31/12/12			
			Total		Continuing operations		Groups held for sale	
Type of risk	Basel II treat-ment	Exposure class	Weighted Risks	Capital Requirements	Weighted Risks	Capital Requirements	Weighted Risks	Capital Requirements
Credit risk	Advanced	Corporate	6,649	532	4,296	344	16	1
		Equities	16	1	414	33	-	-
		Financial Institutions	8,108	649	7,465	597	252	20
		Monolines	1,079	86	1,366	109	-	-
		Project Finance	5,364	429	5,002	400	1	0
		Public Sector Entities	3,595	288	2,646	212	746	60
		Retail Mortgage loans	-	-	-	-	-	-
		Retail Revolving loans	-	-	-	-	-	-
		Retail Other loans	-	-	-	-	-	-
		Securitization	3,231	258	5,044	404	663	53
		Sovereign	3,377	270	4,754	380	114	9
		Others	-	-	-	-	-	-
		Total	***31,419***	***2,514***	***30,985***	***2,479***	***1,793***	***143***
	Standard	Corporate	1,432	115	1,110	89	1	0
		Equities	967	77	1,003	80	-	-
		Financial Institutions	483	39	1,349	108	11	1
		Monolines	-	-	-	-	-	-
		Project Finance	584	47	591	47	-	-
		Public Sector Entities	11,204	896	9,818	785	1,848	148
		Retail Mortgage loans	-	-	-	-	-	-
		Retail Revolving loans	-	-	-	-	-	-
		Retail Other loans	-	-	0	0	-	-
		Securitization	1,801	144		-		-
		Sovereign	143	11	122	10	-	-
		Others	-	-	-	-	-	-
		Total	***16,614***	***1,329***	***13,993***	***1,119***	***1,860***	***149***
Market risk	Internal Model	Interest Rate & Foreign ExchangeRisk	83	7	96	8	-	-
		Position Risk on Equities	-	-	-	-	-	-
		Other Market Risks	-	-	-	-	-	-
		Total	***83***	***7***	***96***	***8***	***-***	***-***
	Standard	Interest Rate Risk	815	65	876	70	84	7
		Foreign Exchange Risk	636	51	220	18	-	-
		Position Risk on Equities	-	-	-	-	-	-
		Other Market Risks	-	-	-	-	-	-
		Total	***1,451***	***116***	***1,096***	***88***	***84***	***7***
Operational Risk	Basic		1,392	111	589	47	-	-
TOTAL			**50,960**	**4,077**	**46,759**	**3,741**	**3,737**	**299**

3. Credit Risk

3.1. Credit Risk Management and Governance

3.1.1. Definition

Credit risk represents the potential loss, materialised by the reduction in value of an asset or by default of payment, which Dexia may suffer as a result of a deterioration of the solvency of a counterpart.

3.1.2. Governance

Risk Management supervises Dexia's credit risk, under the aegis of the Management Board and specialist committees. It is in charge of defining the Group's credit policy regarding credit risk, which encompasses the decision-making process for the grant of credits, the supervision of processes for rating counterparts, the analysis of credit files and the monitoring of exposures.

Transversal Committees

Credit risk management revolves around the Risk Committee, which approves risk policies for the entire Group and rules on larger transactions from a credit risk perspective. The Risk Committee delegates its decision-making power to credit committees. This delegation is governed by specific rules, by type of counterpart, on the basis of their level of rating and the amount of the exposure.

The Risks Committee remains the decision-making body of last resort for larger credit files or those presenting a level of risk considered sensitive. For each file presented to the credit committee, an independent analysis is performed, presenting the main risk indicators, as well as a qualitative analysis of the transaction. In general, the activity of the credit committees was extremely limited in 2012 in view of the move to management in orderly resolution of most of the Group's portfolio.

Committees Specializing per Expertise Centre

Several committees are in charge of supervising specific risks. These committees meet on a quarterly basis and include:

- the Watchlist committee, which supervises assets considered "sensitive" and placed on watch;
- the Default committee, which qualifies and monitors counterparts in default applying rules prevailing at Dexia and in compliance with the Basel II regulatory framework;
- the Provisions committee, which decides on the amount of provisions allocated and supervises the cost of risk;
- the Rating committee, which ensures the correct application of internal rating systems and the appropriateness of the rating process having regard to the principles established and to the homogeneity of those processes within the various entities.

Credit Risk Management in each Dexia Group entity focuses on its own domestic market and is responsible for the analysis and surveillance of local counterparts.

3.1.3. Management of the Risk

Dexia credit risk policy

In order to manage credit risk, Dexia Risk Management has put a general framework of policies and procedures in place. This framework guides credit risk management in its functions of analysis, decision-making and risk surveillance.
Risk Management manages the process of granting credit by delegation to different committees and heads of support lines, within the limits put in place by the bank's management and chairing credit committees. Within the context of its credit risk surveillance function, Risk Management, and more particularly the different teams in charge of credit risk, follow the evolution of the credit risk of portfolios by regularly analysing credit files and reviewing ratings. It defines and also implements policy regarding provisions. It qualifies files in default, and decides on specific and collective provisions.

Risk measures

As Dexia adopts an IRBA Advanced approach, the assessment of credit risk relies principally on internal rating systems put in place by Dexia within the context of Basel II: in the Advanced approach, each counterpart is attributed an internal rating by credit risk analysts relying on dedicated rating tools. This internal rating corresponds to an assessment of the level of the counterpart's risk of default, expressed through an internal rating scale, constituting a key element in the credit granting process. Ratings are revised at a minimum annually, and this permits proactive identification of the counterparts necessitating regular monitoring by the Watchlist committee, on the basis of objective criteria or expert judgement. In the Basel II Standardized Approach, the portfolio is also subject to regular monitoring.

In order to control the Group's general credit risk profile, and to limit the concentration of risks, credit risk limits are defined for each counterpart, setting the maximum exposure deemed acceptable for a given counterpart. Limits per economic sector and per product can also be imposed by Risk Management. The latter proactively monitors limits, and may reduce them at any time depending on the evolution of associated risks.

Fundamentals of Dexia Credit Risk in 2012

Macroeconomic environment

In 2012, the continuing crisis, linked to uncertainty on public finances in the euro zone, its consequences on the entire global economy, and also a less strong recover than expected in the United States, led the IMF during the year to make a downward revision to its global growth forecasts, from 3.5% to 3.3%.

No real recovery is expected in 2013, in view of the persistence of the pressures observed in 2012. The IMF expects growth of 3.6%. However, this forecast is liable to be significantly adjusted, as there is a strong possibility of a deterioration of the situation: global growth will be extremely sensitive to the evolution of the crisis in the euro zone as well as the effects of a possible deterioration of the state of public finances in the United States.

In the euro zone, the financial markets continue to doubt the capacity of peripheral countries to cope with their high levels of deficit and public debt and also the effectiveness of the responses from European institutions. The implementation in the majority of member states of budget austerity policies weighs on levels of demand and investment. As a consequence, the euro zone again entered recession in 2012, to - 0.4% according to the IMF. The low growth levels observed in Germany and France could not offset the negative evolutions recorded in countries in Southern Europe. For 2013, the IMF anticipates a slight improvement of the situation from the second half-year, with economic growth rising to 0.2%. This forecast is relatively optimistic having regard to the expectations of several forecasters, many of which expect another recession.

In 2012, within the euro zone, market uncertainty related principally to the so-called "PIIGS", i.e. Portugal, Italy, Ireland, Greece and Spain. Outside the euro zone, Hungary was also an increasing worry as a result of the adoption of several economic policy measures weakening the finance sector and in view of a predictably difficult institutional environment.

Although the risk of a departure from the euro zone has lessened, the situation in Greece remains extremely worrying. The country saw a fifth consecutive year of recession in 2012 and the level of public debt now exceeds 160% of GDP. Significant financial aid was granted to the country. This second rescue package (2012) includes aid of EUR 130 billion paid by the European Union and the IMF as well as the abandonment by private investors of 53.5% of their sovereign Greek securities. In exchange, Athens undertook to reduce the deficit and to master public debt by adopting a series of drastic structural reforms. Finally, in view of the efforts made, Athens was given two more years in which to make its budget adjustment, deferring until 2016 the date on which the country has to have the public deficit down to 3% of GDP. Public debt should be at 124% of GDP by 2020. Doubts persist however as to the country's ability to recover. As at 31 December 2012, Dexia no longer has any sovereign exposure to Greece.

In Spain, the conservative government of Prime Minister Mariano Rajoy succeeded in 2012 in avoiding a call for rescue by the European Union. Nevertheless, the country continues to face a lack of confidence on the markets with the result that the cost of debt has increased severely. Although it eased considerably at the end of the year, the cost of debt seems not able to reverse sustainably without major intervention by the European institutions. In this regard the reaction of investors to the introduction at the end of 2012 of the European Stability Mechanism (ESM) will be crucial. Initial aid of EUR 39.5 billion dedicated to recapitalisation of the Spanish banking sector was granted by the ESM. This operation is part of a broader plan to support the financial sector which also includes the creation in December 2012 of a bad bank (SAREB) charged with getting rid of toxic real estate assets. Moreover, Spain is still facing immense unemployment (25% at the end of 2012), a high public deficit (the official target of 6.3% for 2012 will clearly not be achieved) and worrying local authority debt.

In Italy, the reforms implemented since the end of 2011 by the government of Mario Monti enabled the public deficit to be taken to 2.6% of GDP in 2012. However, its public debt remains one of the highest in the euro zone (exceeding EUR 2,000 billion in October 2012) and market confidence is far from re-established, as illustrated by significant fluctuations of refinancing conditions for the Italian State observed during 2012. In addition, the prospect of the resignation of Mario Monti aroused fears as to the country's ability to complete its schedule of reforms, whilst the effects of austerity measures feed popular opposition and harm the chances of economic recovery. The country's future will depend on the constitution of the new government and the decisions it takes, following the legislative elections on 24 February 2013.

In Portugal, the reforming government of Prime Minister Pedro Passos Coelho which came to power at the beginning of 2011 continued to implement a programme in compliance with the requirements of the IMF and the European Union. The refinancing conditions granted to the country softened (with 10-year bond yields approaching 8%) although they remain high. However, in 2013 Portuguese decision-makers will have to deal with growing resistance to reforms among the population as well as a weakening of political consensus regarding austerity policies.

Ireland is continuing to implement reforms and an internaldevaluation policy enabling it to return to a positive growth rate from 2011 (+ 1.4%) and to avoid recession in 2012 (+ 0.4%). The government remains firmly in favour of continuing the programme agreed with the IMF and the European Union with the agreement thus far of the population. More generally, as Ireland is an open economy, it remains seriously exposed to an economic slowdown in the euro zone, the United Kingdom and the United States.

Hungary saw its economic activity slow sharply from 2007, thus distinguishing it from the trends in other countries in Central Europe. Since its accession to power in 2010, the right-wing nationalist government of Viktor Orbán has implemented a series of provisional measures aimed at halting the effects of the severe economic crisis affecting the country, such as the nationalisation of private retirement funds and the introduction of taxes which, although described as "exceptional", were continued into 2013. Although a stabilization of the deficit and public debt was to be observed in 2012, the relatively unpredictable nature of economic policy and the absence of structural reforms resulted in a severe depreciation of the forint (despite a rebound in 2012) considerably accentuating household debt, a significant proportion of which (close to 60%) is denominated in foreign currencies. The government reacted by introducing a plan to ease household debt which was reflected by significant costs for financial organizations, further drying up the flow of credit. Remaining the most heavily indebted country in Central Europe (public debt represented a little less than 80% of GDP in 2012), in 2011 Hungary called a second time in four years for aid from the IMF and the ECB by way of a credit line of EUR 15 billion. In recession in 2012, Hungary is likely to suffer a stagnation of activity in 2013 (+ 0.8%, according to the IMF).

In general, all the so-called sovereign "PIIGS" as well as Hungary are subject to specific and regular monitoring by the Institutional Credit, ABS and Countries Expertise Centres and the Watchlist Committee.

In the United States, the recovery continued modestly in 2012 (+ 2.2%, according to the IMF). Whilst the real estate market stabilises, job creations seem to be marking time. In 2013, US growth, which should reach 2.1% according to the IMF, remains threatened by a deterioration of the situation in the euro zone but, above all, a risk of a sharp budget contraction particularly following the debt ceiling being reached. In the meantime, at the beginning of January 2013, decision takers succeeded in avoiding the "fiscal cliff", which would have involved an automatic triggering at the beginning of the year of a series of tax rises and public expenditure cuts, and which would have resulted in an estimated contraction of 4% of GDP and a very probable entry into recession in the United States with significant repercussions on the global economy. Nevertheless, the agreement obtained is deemed insufficient by the IMF, which thinks that concerns have not been removed in the short term and that new measures must be adopted in order to guarantee the viability of US public finances.

Commitments to the local sector

Against the background of the debt crisis, it is important not to extrapolate the risk of default by a sovereign to that of its local authorities. Nevertheless, the financial data available for local authorities show an alteration of performances in the majority of European countries and in the United States, the consequence of a tense economic climate leading to a fall in tax receipts; savings capacities are restricted and pressures are being placed on cash. This general deterioration, in response to which from 2011 Dexia put collective provisions in place relating in particular to the local public sector in Spain, Italy and North America, has proved to be contained and at this stage is not reflected in an increase of defaults. Situations differ however from one country to another.

France

In France, in 2012 local finances suffered from a scarcity of means. In fact, the freezing of State aid and the problems of credit drying up, as it was already doing in 2011, combined with a low increase in tax resources.
Indeed, resources from the replacement of professional tax proved to be less dynamic: a part was offset by grants frozen in time and new taxes more sensitive to the economic situation, which remains weak. In addition, fiscal reform profoundly altered the local authorities, tax capacity. Therefore the constitution of financial room to manoeuvre by increased rates is increasingly complicated, all the more since rates are today reaching high levels on certain territories and local elections are approaching.
To the low momentum of direct contributions can be added the fall in transfer rights to payment (droits de mutation à titre onéreux – DMTO), which can be estimated at almost 10%.

Although the needs of the population are increasing (social action, training, alternatives to road travel and so on), the strong constraints weighing on resources have consequences on local authority expenditure. Indeed, as it began in 2011, in 2012 local authorities showed a desire to master their current expenditure, in particular with a limitation of the evolution of staff costs.
Despite these efforts by management, gross savings by local authorities[(1)] should show a decline in 2012, whatever the category of authority, in contrast to the rise observed in 2011.
As for investment expenditure, the estimated increase in 2012 (+1.6%) is well below what was expected, particularly with regard to the electoral cycle in the commune sector: 2012, the penultimate year of the current cycle (elections in 2014), should in fact be a year of investment rebound.

Globally, local authorities are victims of a scissor effect between the evolution of their expenditure and their resources resulting in a fall of the level of their gross savings. Nevertheless, in 2012, the appearance of an increase of the cash balances of authorities at the end of the financial year necessitated recourse to debt (positive net flows of debt) comparable to that in 2011 (a little less than EUR 5 billion) resulting in a rise of outstanding debt in the order of 3% over that year.

(1) Balance used for financing debt repayments and investments

Despite the increase observed in State governance and supervision via the Regional Health Agencies with the HPST (Hospitals, Patients, Health and Territories) Act, the health sector presents negative outlook considering (i) pressures on resources against the background of restrictive national budgets, (ii) the necessary adaptation of establishments to the needs of their health area and (iii) the deterioration of access to bank finance. This deterioration is reflected by a rise in the number of health establishment files monitored on the watchlist and by payment arrears following the bank's non-renewal of credit lines reaching maturity. At the end of the year, the majority of payment arrears had been regularised however, by virtue in particular of exceptional financial support from Regional Health Agencies to those establishments.

On the Dexia portfolio, payment arrears on the local public sector rose moderately in 2012. This situation does not result from a general deterioration of the financial situation of local authorities, which remains satisfactory but the following factors: (i) more difficult access to credit which penalises the weaker, (ii) a one-off liquidity problem associated with the non-renewal of Dexia credit lines and (iii) the objection by some clients to the conditions of their structured loans. In the majority of cases, payment arrears on structured loans do not result from clients' inability to honour their deadlines. The policy followed by Dexia not to renew short-term credit lines to the local public sector contributes significantly to the fall of EUR 7.8 billion over 2012 in the Group's outstanding to the French local public sector which amounted to EUR 70 billion as at 31 December 2012, including EUR 48.3 billion through Dexia Municipal Agency.

Germany

In Germany, the year 2010[1] saw a clear economic recovery with a growth rate of 4.2%. Similarly the unemployment rate fell very slightly from 8.2% to 7.7%. Despite this improvement of the economy the Länder posted a fall in their savings, expenditure growth remaining relatively sustained, although some States posted savings severely in deficit. Globally, the rate of indebtedness remains high, and slightly up, at 209%, but this average hides contrasting situations. Although 2011 data are not yet known, initial figures show an improvement, with receipts up, expenditure stable and deficits before borrowing well down at EUR -9.4 billion against EUR -20.8 billion in 2010.

Some German cities seem to be facing tense situations which the robustness of the adjustment system does not reveal. Social expenditure represents a quarter of their budget and it is trending sharply upwards. In order to cope with this burden, cities use "Kassenkredite" (short-term facilities) to finance their operations (EUR 45 billion in 2011). In order to curb this development and in the spirit of the principle of solidarity between levels of authorities, more and more Länder establish aid schemes for municipalities and encourage them to take measures to regulate their finances. These schemes fall fully within the framework of the responsibilities of regions to the local level.
Furthermore, the two major measures taken by the government in 2009 and 2010 continue to have impacts today:
"Debt Brake" aimed at reducing and limiting public debt and deficits with two targets to be reached by 2019, either a deficit of 0.35% of GDP for the Federal State or "zero new borrowing" for Federated States; Introduction of a Stability Council responsible for checking budget discipline and particularly for monitoring the 5 Länder in difficulty (Berlin, Brêmen Saarland, Saxony-Anhalt and Schleswig-Holstein). During the last meeting of the Council, in May 2012, it was stressed that the drastic stabilisation plans put in place by these Länder had borne their fruit and their undertakings had been met for the year 2011.

Internal ratings of Dexia's outstanding to the German local public sector remain at a very good level, from AAA to AA (82% of outstanding rated AA), and stable on the Länder. The portfolio is healthy, despite some operations to desensitise structured products, which represent an extremely marginal proportion of German outstanding. Group outstandings to the German local public sector amount to EUR 20 billion as at 31 December 2012.

Italy

In Italy, reform of the fiscal federalism continues to be implemented and increases the fiscal autonomy of local authorities (re-introduction of land tax in favour of communes, and an increase of the proportion received from income tax, profits tax and VAT, and so on). As a consequence, transfers from the State to local authorities fell by EUR 9.1 billion in 2012 for the regions and EUR 6.6 billion for communes.
As a complement to the internal stability pact, established before the crisis to regulate public expenditure and still applicable, new government measures aimed at reducing the weight of debt are now imposed on regional authorities: debt interest must be less than 8% of current receipts of local authorities in 2012, then 6% in 2013 and 4% in 2014; for the regions, debt servicing (capital + interest) must remain at a maximum of 20% of actual fiscal receipts from 2012 and for coming years. In addition, 2013 will see the extra obligation on local and regional authorities to observe a new debt ratio per inhabitant.

According to the 2010 accounts[2], provinces posted relatively stable savings levels (13% of current receipts) but an average debt which had increased to 109% of current receipts (105% in 2009). The financial ratios of communes have improved slightly. Management savings rose from 9% to 9.4% and debt fell from 90% to 86% of current receipts. The regions show consistent evolutions although on average management savings improved slightly from 6% to 7% of current receipts.

To assist local authorities which present tense liquidity situations, the State is implementing a procedure for multi-annual financial rebalancing which will enable credits to be granted to local authorities with structural imbalances on their balance sheets.

(1) Latest available financial statements
(2) Latest available financial statements

For the Italian local public sector, the 2012 financial year was marked by the evolution of a series of litigations associated with simple derivatives transactions: an increase of objections on the grounds that transactions bring no economic advantage to the authority, then at the end of the year a first major judgement, on appeal, dismissing the complaint.
Beyond these cases, there are no defaults of payment associated with the debtor's difficult solvency situation. The portfolio is relatively stable in terms of credit quality, with the exception of some regions due to of the increase of health expenditure. It is to be noted that the financial regulation of communes and provinces is protective for bank debts. In fact, in the case of the authority's inability to provide essential services and/or to pay demandable expenditure, loan maturities are given a payment delegation which makes them priority and immunises them from any restructuring proceedings.
Group outstandings on the Italian local public sector amount to EUR 18.1 billion as at 31 December 2012, including EUR 2.7 billion borne by DMA.

Spain

In Spain, Spanish local authorities have suffered since 2010 from the extension of the economic crisis which affects some of their resources linked to the economy. Spain adopted drastic austerity measures and set its authorities strict targets in terms of deficits or debt. As a consequence, local authorities also implemented austerity programmes (rationalisation of the public sector, reduction of grants, reduction of investments).
In 2010 management savings by the regions deteriorated to -6% of current receipts, and debt amounted to 86% of receipts. The savings of provinces were at 15%, debt at 80%. For communes, management savings fell slightly to 9% of current receipts whilst debt rose a little, to 74% of receipts. In 2011, the current receipts of the regions fell by 5%, and debt rose by 17%; for communes and provinces, the level of receipts and debt remained stable.

All of the measures adopted enabled the regions to contain their deficits better: for 2012, the target deficit for the regions is -1.5% of GDP, and as at Q3 2012, the regional deficit had reached -0.93% against -2.20% as at Q3 2011, a saving of EUR 13.6 billion made by the regions.

Before the closure of the markets, to aid certain authorities the liquidity of which had become severely hit and in order to revive local economies, the State introduced two mechanisms:
- Debt Settlement Fund to wipe out supplier debts which enabled such debts to be converted into bank debts (benefiting from a pledge of certain transfers from the State);
- Regional Liquidity Fund (Fundo de Liquidez Autonomica – FLA) with EUR 18 billion to enable the Regions to deal with their debt maturities in the second half-year 2012: 10 regions (out of 17) took this up (including Catalunya, Valencia, the Balearic Islands and Andalucia). The FLA will be renewed in 2013.

In 2012, the difficulties of Spanish local authorities were reflected by a fall of the internal rating allocated by Dexia. No loan or obligation borne by the regions suffered from payment arrears. On the other hand, the maturities of four Spanish cities which had been poorly rated for several financial years were settled in arrears or remain unpaid.
Group outstandings to the Spanish local public sector amount to EUR 11.2 billion as at 31 December 2012.

Portugal

In Portugal, the situation remains relatively stable: the occurrence of credit events on certain actors enabled Dexia Sabadell to open negotiations with the Portuguese State and the authorities concerned to optimise the portfolio. It should be noted that the budget policy of Portuguese authorities is more strongly controlled by the central power which has increased its supervision over the regions and introduced programmes to provide aid to communes in exchange for the adoption of drastic savings measures.
Group outstandings to the Portuguese local public sector amount to EUR 2 billion as at 31 December 2012.

Great-Britain

Great Britain is still marked, at a local organization level, by the low degree of decentralisation and fiscal autonomy, and in the field of social housing by a sharing between local authorities and housing associations, the latter forming a sector strictly administered by the public powers in view of the considerable state subsidies for their investments. The result is a reduced level of credit risks, as the budget of each authority has to be ratified year after year by the State, and as housing associations can, on the first signs of difficulties and as is current practice, be subject to intervention by the supervisory authority in their management, or even a forced merger with another housing association if the difficulties are severe. Changes coming shortly for local authorities will in particular involve the evolution of the accounting system and for housing associations the extension of the scheme for low level investment grants, the historical proportion of 50% having been reduced over recent years to 25-30%.

Beyond the strict framework for them and for local authorities, for two decades housing associations have suffered from a marked reduction of investment grants from the State, and this has led to less investment and therefore to an improvement of their individual financial profiles. As a result, and indeed every year since it began its activity in Great Britain, in 2012 Dexia saw no payment incidents in the two sectors. Group outstandings on the British local public sector amount to EUR 9.3 billion as of 31 December 2012.

Central and Eastern Europe

Dexia outstandings on Central and Eastern Europe are considerably lower than those on Western European countries, and all the more since the majority of the Poland portfolio was sold in 2012.

Globally on Eastern Europe, considering the economic situation of Hungary and Romania, the portfolio is principally classified as "non-investment grade", with a slight downgrading of ratings. Although Romanian counterparts cause no particular concern in terms of credit risk, Hungarian cities are subject to close monitoring, in particular considering the deep changes impacting the organization of the local public sector and its finances as well as some cases of tense financial situations.

In Hungary, numerous changes are to be pointed out in local administrative organization, with a recentralisation of competences. At the end of 2011, the debts of counties were taken over by the State. Since 2012, the competences of cities have been undergoing redefinition: education and health services, until now provided by the cities, with in the future be provided by the State. As a consequence, the expenditure of cities will be reduced considerably, but also their receipts in a proportion not yet fully known, the State retaining a portion of the resources previously transferred to guarantee those public services. In this transitional phase and in view of the difficulties of certain cities, particularly in terms of liquidity, the State increased the envelope of discretionary grants (Ohniki). Finally, at the end of October it announced the take-over of HUF 600 billion in municipal debts (54% of total municipal debts) under conditions to be discussed with the banks concerned.
Group outstandings to the Hungarian local public sector amount to EUR 0.1 billion as at 31 December 2012.

In Poland, the institutional framework is relatively stable: the principal measure adopted recently consists of defining an individual debt limit for each authority depending on its average savings capacity over the last three financial years.
Group outstandings to the Polish local public sector amount to EUR 0.1 billion as at 31 December 2012.

In Romania, there have been few changes over recent years in terms of competences. On the other hand, in view of the crisis affecting the Romanian economy, the State reduced the proportion of fiscal receipts it reserved for local authorities and strengthened its control over the local public sector: debt levels are limited, with a debt service which must not exceed 30% of average receipts over three financial years and, since 2011, any authority in arrears of payment is no longer authorised to borrow.
Despite the reduction of the portion of income taxes passing to them, the reduction of current receipts of cities and counties has been contained. Austerity measures have resulted in a notable fall in current expenditure. Management savings have therefore improved, to 25% of current receipts on average for cities and 21% for counties. Debt has stabilised to a level of 65% on average for cities and 52% for counties.
Group outstandings on the Romanian local public sector amount to EUR 0.3 billion as at 31 December 2012.

United States

In the United States, the institutional framework of the Federated States, although varying from one State to another, remains rather protective: autonomy in setting receipts, obligatory budget balance, and an obligation to form reserves. Nevertheless, as State receipts are very directly linked to the economic situation (40% approximately coming from "personal income tax", 30% for "sales tax" and 8% from "corporate income tax"), the States have been impacted from 2009 by the clear slowdown of economic activity and the sharp rise of unemployment. Indeed, State receipts (General Fund) fell overall by almost 3% in 2009 and then 6% in 2010 (or USD -78 billion in two years). This fall was offset by additional receipts from the Federal State under the Recovery Act. A recovery was observed however from the beginning of 2011: fiscal receipts posted a rise of 9% without despite everything reaching their pre-crisis level. Confronted by recession, the States drastically reduced their expenditure and, above all, dipped into their reserves: for the best rated counterparts this only reached one half of the level observed before the crisis and for others was practically zero or even negative. This enabled the level of debt service to be kept at a stable level: 2.8% of receipts from personal income tax against 2.5% the previous financial year.

As for cities, some cases of insolvency declarations (under Chapter 9) as in Stockton and San Bernardino in California, or receivership as for Woonsocket, Central Falls and East Providence in the State of Rhode Island (the only Dexia outstanding on these names is in favour of Woonsocket for USD 28.5 million covered by a guarantee from Assured).
The last rating review saw some fifteen cases of downgrade, the majority limited to one notch. More than one half of the Dexia portfolio of Federated States retains a rating of at least AA. Although cities, counties and school districts also remain well rated as a whole, a dozen counterparts in Dexia's portfolio of some 120 have been downgraded.
Group outstandings on the US local public sector amount to EUR 10.8 billion as at 31 December 2012.

General conclusion on Dexia's Local Public Sector portfolio:

Despite pressures observed on the local public sector, the Dexia portfolio remains very good quality since almost 90% of the outstanding, all countries combined, remain Investment Grade and the number of files requiring monitoring by the Watchlist Committee did not increase much during 2012.

Bond portfolio

As of 31 December 2012 the Dexia bond portfolio amounted to EUR 100.4 billion.
The strategy of deleveraging the residual bond portfolio of Dexia Credit Local in 2012 no longer went in the direction of an accelerated reduction of the size of the balance sheet, but more of asset disposals which did not adversely affect the Group's solvency and depending on market conditions and opportunities, in line with the plan for the orderly resolution of Dexia approved by the European Commission at the end of 2012.

In this regard, the volume of bond sales amounted to approximately EUR 3.2 billion, of which 43% relating to sovereigns, 39% to banking bonds and 8% to ABS/MBS. Among these sales, the sale is to be noted of all Greek sovereign securities (approximately EUR 800 million nominal) at the end of 2012 within the framework of an auction launched by the Greek authorities following the PSI[1]. It is also to be noted that 68% of the asset sales were for bonds denominated in currencies (USD and JPY) other than the euro and for which refinancing conditions were more difficult.

3.2. Credit Risk Exposure

Credit Risk exposure is calculated as follows:
- Balance-sheet assets other than derivative contracts: the accounting value after deduction of specific provisions;
- Derivatives: the market value of the derivative contracts;
- Off-balance sheet commitments: the maximum amounts that can be drawn or the maximum amount Dexia is committed to pay for guarantees granted to third parties.

When a credit risk exposure is guaranteed by a third party with a lower risk weight compared to the underlying asset, the substitution principle is applied.

The total credit risk exposure (continuing activities and activities held for sale) includes fully consolidated subsidiaries of the Dexia Group and, in 2011, 50% of the joint venture RBC Dexia Investor Services.
As of 31 December 2012, the Dexia Group's total exposure to credit risk was EUR 278 billion, of which EUR 210 billion for continuing activities and EUR 68 billion 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 2012.

Exposure at year-end 2011

	Eurozone[1]	Rest of Europe[2]	US & Canada	Rest of the World	Total continuing Operations	Total Groups held for sale
ABS	2,815	377	5,273	754	9,220	79
Debt securities	46,649	10,304	21,625	10,612	89,190	8,662
Derivatives	3,466	1,264	1,368	143	6,241	826
Given Guarentees	10,505	5,978	6,110	2,739	25,331	4,498
Loans & Advances	77,227	20,219	3,164	5,093	105,702	71,956
Others Assets	370	35	63	327	796	354
Repo	26,191	397	1,344	857	28,790	4,382
Retail Loans	146	3,021	44	4,674	7,885	7,624
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 of December 31, 2011.
(2) Including Turkey.

Exposure at year-end 2012

	Eurozone[1]	Rest of Europe[2]	US & Canada	Rest of the World	Total continuing Operations	Total Groups held for sale
ABS	1,909	419	4,571	1,132	8,031	4,908
Debt securities	45,048	9,309	18,139	9,743	82,240	6,445
Derivatives	3,425	973	1,161	139	5,698	314
Given Guarentees	7,302	1,261	3,001	125	11,689	318
Loans & Advances	69,465	14,288	2,483	4,032	90,268	55,975
Others Assets	400	3	19	552	974	73
Repo	7,107	268	2,136	1,672	11,182	
Retail Loans	7	4	2	0	13	
Total continuing operations	**134,662**	**26,525**	**31,513**	**17,394**	**210,094**	
Total groups held for sale	**62,419**	**4,816**	**690**	**108**		**68,033**

(1) Countries using the Euro currency as of December 31, 2012.
(2) Including Turkey.

As of 31 December 2012, Loans and Advances represent 43% of the continuing operations exposure as this category mainly includes loans to the public sector while Debt Securities represent 39,1%.

(1) Private Sector Involvement

As of 31 December 2012, the continuing operations exposure is concentrated in the Eurozone (64% at year-end 2012). The continuing operations exposure of the other regions remains at the same level compared to December 2011: Rest of Europe (13%), US & Canada (15%) and Rest of the World (8%).

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 2012.

For reporting purposes, a rating "masterscale" has been applied. This scale is structured in grades ranging from AAA to CCC and the modifiers plus, flat and minus.

Exposure at year-end 2011

Rating	AAA+ to AA-	A+ to BBB-	Non investment grade	Default	NR	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 & 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 Guarentees	9,577	7,070	1,795	128	6,761	25,331
Repo	24,887	3,505	397	0	1	28,790
Others 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**	

Exposure at year-end 2012

Rating	AAA+ to AA-	A+ to BBB-	Non investment grade	Default	NR	Total continuing Operations
Debt securities	24,878	44,870	12,398	89	5	82,240
Retail Loans	1	0	0	0	12	13
Loans & Advances	35,356	42,604	10,823	768	718	90,268
ABS	5,315	1,770	940	0	5	8,031
Derivatives	617	4,063	702	292	23	5,698
Given Guarentees	5,642	4,727	1,066	89	165	11,689
Repo	1,224	9,951	0	0	8	11,182
Others Assets	173	16	3	18	764	974
Total continuing operations	**73,206**	**108,001**	**25,932**	**1,256**	**1,700**	210,094
Total Groups held for sale	**23,449**	**38,666**	**4,931**	**500**	**486**	

As of 31 December 2012, almost 87% of the exposure relating to the continuing operations is Investment Grade whereas 12% of the exposure of the continuing operations of the Dexia Group is Non-Investment Grade.
It is to be noted that the non-investment grade exposure is predominantly situated in the 'BB' range.
The non-rated category of the continuing operations faced a sharp decrease from 8,4% in 2011 to 0,8% in 2012 due to the sale of Denizbank which concentrated the main part of non-rated exposures.

2011 average exposure

Rating	AAA+ to AA-	A+ to BBB-	Non investment grade	Default	NR	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 & 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 Guarentees	15,722	8,076	2,053	173	6,627	32,652
Repo	6,610	2,878	162	0	1	9,650
Others 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.

2012 average exposure

Rating	AAA+ to AA-	A+ to BBB-	Non investment grade	Default	NR	Total continuing Operations
Debt securities	28,214	46,407	10,936	91	114	85,762
Retail Loans	32	0	18	4	4,501	4,556
Loans & Advances	38,937	41,100	11,980	568	2,615	95,200
ABS	5,960	1,595	900	0	61	8,515
Derivatives	906	3,934	742	263	53	5,899
Given Guarentees	6,983	5,622	1,380	95	3,953	18,033
Repo	8,426	5,749	594	0	7	14,777
Others Assets	209	55	1	19	992	1,275
Total continuing operations	**89,666**	**104,463**	**26,552**	**1,041**	**12,296**	234,017
Total Groups held for sale	**33,913**	**43,462**	**8,319**	**647**	**1,241**	

Note: average exposure is the quarterly average figure.

Average figures are calculated taking into account the accounting classification of each entity as of each end-of-quarter, and the effective date of sale. The following entities were sold in the course of 2012, and therefore are only taken into account in average figures:

- Dexia Banque Internationale à Luxembourg (except those of its subsidiaries and portfolios which were purchased by Dexia prior to the sale);
- RBC Dexia Investor Services;
- Denizbank.

3.2.3. Exposure per Exposure Class and Economic Sector

The following tables show the total exposure with a breakdown by economic sector and exposure class at year-end 2011 and 2012.

Exposure at year-end 2011

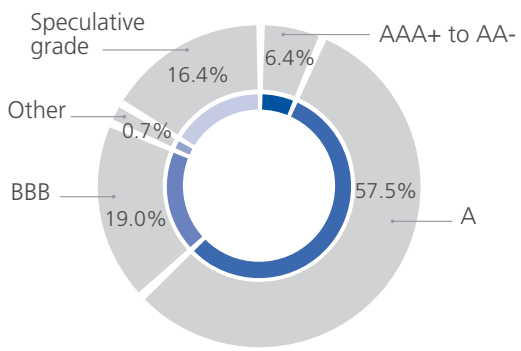
Economic sector		Corporate	Financial Institutions	Monolines	Project Finance	Public Sector Entities	Retail	Securitization	Sovereign	Others	Total continuing operations	Total Groups held for sale
Industry		7,089	39	0	5,235	5,636	110	131	0	8	18,247	2,792
Construction		3,255	0	0	6,169	1,049	63	0	2	2	10,541	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	**58,175**	5,969	1	2,007	1	108	5,293	0	71,933	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	59,054	5,969	16,763	118,841	7,355	9,220	36,222	226	275,017	
Total Groups held for sale		3,535	11,758		235	68,530	6,947	79	7,281	16		98,379

Exposure at year-end 2012

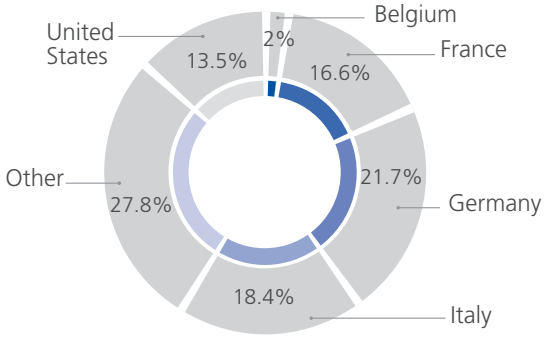
Economic sector		Corporate	Financial Institutions	Monolines	Project Finance	Public Sector Entities	Retail	Securitization	Sovereign	Total continuing operations	Total Groups held for sale
Industry		3,480	36	0	4,554	4,915	0	102	0	13,086	1,498
Construction		1,288	0	0	6,446	656	0	0	0	8,390	232
Trade-Tourism		7	0	0	0	56	0	0	0	63	106
Services	Transportation and storage	1,304	66	0	767	2,236	0	0	39	4,412	423
	Information and communication	261	0	0	91	151		0	0	503	2
	Financial and insurance activities	67	**36,948**	5,652	1	1,750	0	155	1,748	46,320	5,524
	Real estate activities	1,547	173	0	3,701	6,504	0	0	0	11,925	2,147
	Professional, scientific and technical activities	26	0	0	0	125	0	0	0	152	15
	Administrative and support service activities	12	0	0	238	4,933	0	0	0	5,183	12
	Public administration and defence-compulsory social security	0	0	0	27	**77,182**	0	251	**22,710**	100,169	46,602
	Human health and social work activities	62	0	0	0	3,920	0	0	0	3,981	6,909
	Arts, entertainment and recreation	0	0	0	0	187	0	0	0	187	147
	Other service activities	1	39	0	0	395	0	0	0	434	91
	Other Services	4	0	0	0	518	0	0	1,647	2,169	87
Others		339	828		115	16	4	7,524	4,266	13,092	4,235
Total continuing operations		8,398	38,091	5,652	15,939	103,542	4	8,031	30,410	210,067	
Total Groups held for sale		145	1,603		18	56,753	0	4,908	4,606		68,033

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

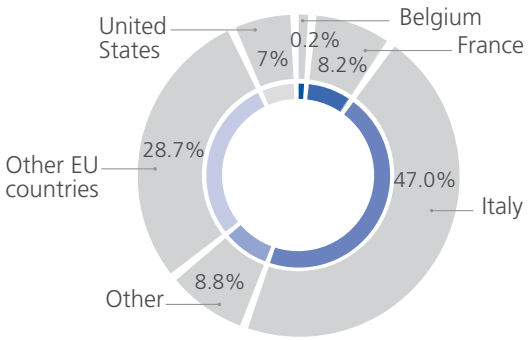
Financial intermediation: split by rating class



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. 49,3% on public sector entities and 14,5% on sovereign), whereas financial institutions account for 18,1%.

3.3. Impairment, Past-Due and Related Provisions

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

Impairment

Dexia records allowances for impairment losses in case of objective evidence that a financial asset or Group of financial assets is impaired, as a result of one or more events occurring after initial recognition and evidencing (a) a decline in the expected cash flows and (b) the impact on the estimated future cash flows that can be reliably estimated.
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.

Financial asset at amortised cost

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.

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

Dexia recognises the impairment of available-for-sale assets on an individual basis if there is objective evidence of impairment as a result of one or more events occurring after initial recognition.

Determination of the impairment:

- Equities – For equities quoted in an active market, any significant decline in their price (more than 50% at reporting date) or a prolonged decline (5 years) compared to the acquisition price is considered as an objective evidence of impairment. In addition, management can decide to recognise impairment losses should other objective evidence be available.
- Interest-bearing financial instruments – In the case of interest bearing financial instruments, impairment is triggered based on the same criteria as applied to individually impaired financial assets valued at amortised cost.

When AFS financial assets are impaired, the total AFS reserve is recycled and these impairment losses are reported by Dexia in the statement of income as "Net income on investments". Additional decline in fair value is recorded under the same heading for equity securities.

When an impairment loss has been recognised on interest-bearing financial instruments, any subsequent decline in fair value is recognised in "Net income on investments" if there is objective evidence of impairment. In all other cases, changes in fair value are recognised in "Other comprehensive income".

Impairments on equity securities cannot be reversed in the statement of income due to later recovery of quoted prices.

Past due

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 tables show the amount of impaired and past-due credit risk exposure broken down by large category of product at year-end 2011 and 2012.

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.

Exposure at year-end 2012

	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	160
Loans and advances (at amortized cost)	325	25	251	1,322
Held to maturity financial assets	0	0	0	0
Other financial instruments – at cost	0	0	0	29
Total continuing operations	325	25	251	1,511
Total Groups held for sale	135	148	425	354
TOTAL	**460**	**173**	**676**	**1,865**

(1) Excluding variable income securities.

In continuing operations:

- The carrying amount of individually impaired financial assets before deducting any impairment loss decreased by EUR 3,601 million in the Available for Sale portfolio, primarily due to the Greek debt restructuring (with a reversal of provision of EUR 3.4 billion), and by EUR 1,066 million in the Loans and Advances category, mainly due to the sale of Denizbank (EUR -566 million), and the sale of some bonds (completely impaired) by DHI (EUR -454 million).
- The past due amount is quite stable, reflecting the increase of the amount of past due in the local public sector on one hand, compensated by the decrease due to the disposal of Denizbank and BIL on the other hand.

3.3.3. Past-Due and Impaired Exposure by Geographic Entity

The following tables present the amount of the impaired exposure and past-due exposure, provided separately, broken down by the main geographic entities at year-end 2011 and 2012.

Exposure at year-end 2011		
Geographical Entity	**Past Due**	**Impaired**
Dexia Crédit Local without DMA	430	4,806
DSA others	244	1,604
Total continuing operations	**674**	**6,410**
Total groups held for sale	**606**	**64**
TOTAL	**1,280**	**6,474**

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

Exposure at year-end 2012		
Geographical Entity	**Past Due**	**Impaired**
Dexia Crédit Local without DMA	600	1503
Total continuing operations	**600**	**1,503**
Total groups held for sale	**707**	**354**
TOTAL	**1,307**	**1,857**

On the Dexia portfolio, non-payments on the French local public sector rose moderately in 2012. This situation does not result from a global deterioration of the financial situation of local authorities, which remains satisfactory, but from the following factors: (i) more difficult access to credit which penalises the weaker borrowers, (ii) a one-off liquidity problem associated with the non-renewal of Dexia credit lines and (iii) the objection by some clients to the conditions of their structured loans. In the majority of cases, non-payments on structured loans do not result from clients' inability to honour their deadlines.

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

The following tables show the amount of provisions for impaired exposure to credit risk broken down by type of asset at year-end 2011 and 2012.

Exposure at year-end 2011

Type of asset	Impairments as of Jan. 1,2011	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 consolidation	Other	Impairments as of Dec. 31,2011	Recoveries directly recognised in profit or loss	Charge-offs directly recognised in profit or loss
Specific allowances for financial assets	**3,850**	**-317**	**-122**	**3,564**	**-313**	**-895**	**-1,270**	**4,497**		
Loans and advances due from banks	25	0	0	5	0	-25	0	5	0	0
Loans and advances to customers	3,213	-205	-109	653	-215	-613	-1,339	1,385	2	-54
Investments held to maturity	0	0	0	149	0	0	4	153	0	0
Financial assets available for sale	612	-112	-13	2,757	-98	-257	65	2,954	0	0
of which fixed income instruments	525	-93	0	2,748	-98	-245	38	2,875	0	0
of which equity instruments	87	-19	-13	9		-12	27	79	0	0
Allowances for incurred but not reported losses on financial assets	**1,283**	**-55**	**-75**	**276**	**-176**	**-394**	**-304**	**555**	**0**	**0**
Loans and advances due from banks	18	0	0	1	-2	-6	1	12	0	0
Loans and advances to customers	1,265	-55	-75	275	-174	-388	-305	543	0	0
Investments held to maturity	0	0	0	0	0	0	0	0	0	0
TOTAL	**5,133**	**-372**	**-197**	**3,840**	**-489**	**-1,289**	**-1,574**	**5,052**	**2**	**-54**
Provision for off balance sheet credit commitment and guarantees	142	0	0	0	0	0	0	142	0	0

Exposure at year-end 2012									
Type of asset	Impairments as of Jan. 1,2012	Transfers in disposal groups held for sale	Utilization	Amounts set aside for estimated probable loan losses	Amounts reversed for estimated probable loan losses	Other	Impairments as of Dec. 31,2011	Recoveries directly recognised in profit or loss	Charge-offs directly recognised in profit or loss
Specific allowances for individually assessed financial assets	**4,497**	**-338**	**-566**	**597**	**-3,603**	**-38**	**549**	**29**	**-367**
Loans and advances due from banks	5	0	0	0	0	-5	0	0	0
Loans and advances to customers	1,385	-334	-515	254	-393	-2	395	29	-367
Held-to-maturity investments	153	0	0	0	-141	-12	0	0	0
Available-for-sale financial assets	2,954	-4	-51	343	-3,068	-19	154	0	0
Of which fixed income instruments	2,877	-4	0	335	-3,068	-18	121	0	0
Of which equity instruments	78	0	-51	8	0	-1	34	0	0
Allowances for incurred but not reported losses on financial assets	**555**	**-203**	**-4**	**315**	**-238**	**-2**	**423**	**0**	**0**
Loans&advances due from banks	11	-3	0	4	-6	0	6	0	0
Loans&advances to customers	543	-200	-4	311	-232	-2	416	0	0
Investments held to maturity	0	0	0	0	0	0	0	0	0
TOTAL	**5,052**	**-541**	**-570**	**912**	**-3,841**	**-40**	**972**	**29**	**-367**
Provision for off balance sheet credit commitment and guarantees	77	-16	-4	2	-6	0	53	0	0

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 (DenizBank).
- Amounts set aside for 'estimated probable loan losses' mainly consist of unpaid amounts regarding the FSAM portfolio, which has been sold in the meantime. Losses are taken by DHI.
- Amounts reversed for 'estimated probable loan losses' consist essentially of impairment on sovereign exposure.

3.4. Credit Risk Mitigation Techniques

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

The Basel II regulation recognizes three main types of CRM:
- Collateral;
- Guarantees and credit derivatives;
- Netting agreements (applicable to on-balance-sheet and off-balance-sheet netting agreements – refer to part 3.4.2.).

Main Types of Collateral

Collateral are a financial product or a physical object set to hedge an exposure. Dexia manages a wide range of collateral types. From a regulatory point of view, three main categories of collateral exist:
- Pledges on financial assets: cash, blocked accounts, term deposits, insurance contracts, bonds and equity portfolios;
- Pledges on real estate (residential mortgages, commercial mortgages, mortgage mandates);
- Pledges on commercial assets.

Main Types of Guarantees

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

Main Types of Netting Agreements

Netting agreements consist in a technique for mitigating credit risk. Banks have legally enforceable netting arrangements for loans and deposits by which they may calculate capital requirements on the basis of net credit exposures subject to specific regulatory conditions.
Types of netting are payment netting, novation netting, close-out netting or multilateral netting.

3.4.2. Policies and Processes

Collaterals and Guarantees/Credit Derivatives

Within Dexia Group, managing the CRMs involves the following tasks:
- Analysis of the eligibility of all CRMs under the Standardized and Advanced approaches;
- Collateral valuation in mark-to-market;
- Description of all CRM characteristics in Dexia Risk Systems, such as:

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.

On and Off-Balance-Sheet Netting

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

For these products, internal policies document the eligibility criteria and minimum requirements that netting agreements need to 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.

3.4.3. Basel II Treatment

For netting agreements (and subject to eligibility conditions), Dexia recognizes their impact by applying the netting impact 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 replacing the PD, LGD and Risk Weight formula of the borrower by those of the guarantor (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 CRMs depends on the Basel II approach.

- AIRB Approach exposures – two methodologies might be applied:
  - CRMs are incorporated into the calculation of LGD based on internal loss data and calculated by the AIRB Approach models (the "so called" preliminary LGD).
  - CRMs 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 CRMs (after regulatory haircuts) are directly taken into account in the EAD.

3.4.4. Exposure Covered by Credit Risk Mitigants by Exposure Class

This section provides with an overview on the EAD covered by Basel II eligible CRMs (after regulatory haircuts) broken down by exposure class at year-end 2011 and 2012. The amounts shown in the tables below take netting agreements into account. For repo transactions, regulatory haircuts have been applied on collateral received.

Exposure at year-end 2011					
Exposure class	**Financial and physical collaterals**	**Guarantee and Credit derivatives**	**Repo**	**Total continuing operations**	**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

Exposure at year-end 2012					
Exposure class	**Financial and physical collaterals**	**Guarantee and Credit derivatives**	**Repo**	**Total continuing operations**	**Total Groups held for sale**
Sovereigns	0	121	0	121	0
Financial Institutions	27,278	5,389	17,348	50,014	8,795
Corporates	350	3,151	0	3,501	691
Total continuing operations	27,628	8,661	17,348	53,637	
Total Groups held for sale	8,655	831			9,486

Financial Institutions represent the overwhelming part of the exposure covered by Basel II eligible credit risk mitigants.

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 developed.
The PD models estimate the one-year probability of default. Each model has its own rating scale and each rating on the scale corresponds to a probability of default used for regulatory and reporting purposes. The correspondence between rating and PD for each scale is set during the calibration process, as part of the model development, and is reviewed and adjusted during the yearly backtesting when applicable. The number of ratings on each scale depends on the characteristics of the underlying portfolio (the number of counterparties, their homogeneity, whether it is a low default portfolio or not) and varies between 6 and 17 non-default classes. In addition each scale has been attributed two default classes (named D1 and D2).
LGD models estimate the ultimate loss incurred on a defaulting counterparty before taking the credit risk mitigants into account. The unsecured LGD depends on different factors such as the product type, the level of subordination or the rating of the counterparty. The granularity of the estimate is a function of the quantity and quality of data available.
CCF models estimate the part of off-balance-sheet commitments that would be drawn should a counterparty go into default. The regulation authorizes the use of CCF models only when CCF under the Foundation Approach is not equal to 100% (as it is for credit substitutes for instance). CCF granularity also depends on availability of data.
Internal estimates of Basel II parameters are increasingly used within Dexia in addition to the calculation of the regulatory risk-weighted exposure amounts. They are notably used in the decision-making process, credit risk management and monitoring, internal limit determination, provisioning methodology and pricing.

The control mechanisms for Internal Rating Systems (IRS) are organized in 3 levels:
- Quality Control is defined, in accordance with the regulatory directives, as an internal and independent audit to ensure that the IRS is being used properly, that it is operationally effective and that the audit trail in the rating process remains clear.
- Validation is responsible for the overall assessment of the IRS: according to the CRD minimal requirement 131, Annex VII Part 4, "Internal Audit has to include in its plan, at least once a year, a review of the IRS and its functioning, including credit scoring and estimation of PD, LGD, EL and CCF and propose their validation to the Validation Committee and then consecutively to the Risk Policy Committee. Compliance with all the minimal requirements has also to be verified; this annual verification has been delegated to the Validation department.
- Audit is responsible for auditing the general consistency and compliance with the regulation of the IRS. Audit acts then as an additional level of control, included in its Audit plan.

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

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

The following table shows the total exposure at default, average exposure at default, undrawn commitments, exposure weighted average PD, LGD and exposure-weighted average risk weights broken down by exposure class and obligor grade at year-end 2011 and 2012.

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). Exposure on monoline insurers is very predominantly indirect exposure by means of credit enhancement.

– Average EAD is the quarterly average figure.

2012								
Exposure class	**Obligor Grade**	**EAD**	**Average EAD**	**Average PD**	**Average LGD**	**Average RW**	**Average EL**	**Undrawn commitment**
Corporate	AAA to AA-	0	0	0.00%	0%	0%	0.00%	0
	A+ to A-	1,142	1,194	0.07%	42%	34%	0.03%	5
	BBB+ to BBB-	3,735	3,841	0.34%	46%	73%	0.16%	1,255
	Others	785	1,439	2.86%	54%	149%	1.64%	117
	Total	***5,662***	***6,474***	***0.63%***	***46%***	***76%***	***0.34%***	***1,376***
Financial Institutions	AAA to AA-	1,982	13,078	0.04%	27%	16%	0.01%	29
	A+ to A-	19,147	13,024	0.06%	27%	13%	0.02%	427
	BBB+ to BBB-	6,819	5,816	0.32%	34%	45%	0.11%	9
	Others	5,087	4,881	2.30%	10%	27%	0.21%	10
	Total	***33,035***	***36,799***	***0.44%***	***26%***	***21%***	***0.06%***	***475***
Monolines	AAA to AA-	4,816	4,929	0.04%	33%	19%	0.01%	941
	A+ to BBB-	156	157	0.34%	41%	82%	0.14%	0
	Others	82	110	30.87%	62%	391%	19.03%	0
	Total	***5,055***	***5,196***	***0.55%***	***34%***	***27%***	***0.32%***	***941***
Project Finance	AAA to AA-	27	28	0.04%	19%	14%	0.01%	0
	A+ to A-	2,247	2,046	0.07%	13%	12%	0.01%	119
	BBB+ to BBB-	8,251	8,415	0.40%	15%	30%	0.07%	886
	Others	4,053	4,312	2.65%	18%	57%	0.47%	429
	Total	***14,578***	***14,801***	***1.00%***	***16%***	***35%***	***0.17%***	***1,434***
Public Sector Entities	AAA	12,451	13,683	0.02%	7%	2%	0.00%	1,571
	AA+ to AA-	11,348	14,388	0.03%	9%	5%	0.00%	1,377
	A+ to A-	11,912	11,391	0.08%	3%	2%	0.00%	1,084
	BBB+ to BBB-	15,971	17,157	0.40%	3%	6%	0.01%	164
	Others	6,886	5,075	1.49%	3%	8%	0.04%	257
	Total	***58,569***	***61,695***	***0.31%***	***5%***	***5%***	***0.01%***	***4,454***
Sovereign	AAA	0	53	0.00%	0%	0%	0%	0
	AA+ to A-	118	37	1%	48%	104%	0%	0
	BBB+ to BBB-	35	108	1%	69%	195%	1%	0
	Others	7	9	26%	16%	337%	0%	0
	Total	***160***	***207***	***2%***	***51%***	***134%***	***0%***	***0***
Equities	AAA to AA-	5,022	4,365	0.00%	9%	0%	0.00%	1,669
	A+ to A-	18,361	18,703	0.07%	11%	9%	0.01%	267
	BBB+ to BBB-	1,027	2,487	0.59%	20%	40%	0.11%	0
	Others	3,338	2,153	0.91%	31%	80%	0.28%	0
	Total	***27,748***	***27,709***	***0.18%***	***13%***	***17%***	***0.04%***	***1,936***
Default		***1,329***	***1,065***					***81***
Total continuing operations		**146,135**	**153,945**					**10,697**
Total Groups held for sale		**58,248**	**80,638**					**313**

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 (59% of the EAD) 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 0.40%), reflecting the exposure on highly rated municipal and public related counterparts.

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

- Sovereign : non-investment grade exposures are concentrated in Portugal (56%) and Hungary (32%)
- Project finance: non-investment grade exposures are concentrated in Western European countries (40%), in America (13%) and in Australia (12%).
- Public sector entities: non-investment grade loans are mainly attributed to Italian local authorities (44%), Spanish local authorities (26%) and French local authorities (10%).
- 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.
- Monolines: the referenced assets of monoline exposures are mainly related to Corporates (31%), Public sector entities (28%) and Project finance (27%) in the investment grade range.

Average LGD is very different by exposure class: public sector entities benefit from very low LGD compared to corporate exposure.

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

Due to the sale of Banque Internationale à Luxembourg (BIL) and DenizBank, Dexia's exposure to retail risk is no longer material.

3.5.5. Backtesting

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

The backtest is the evaluation of the predictive power of the rating system and the assessment of its time evolution to detect any reduced performance of the rating system early. Decreased performance of the rating system decision tool may reduce the bank's profitability and will impact the risk assessments of the defined risk buckets. The performance is tracked by analyzing the ability to discriminate between high and low risk and the stability of the data inputs into the rating system.

The backtest procedure includes three types of tests:

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

Stability

The stability of the population and its data characteristics: the aim is to make sure that the model applied is in line with the reference data sets and with the model where key risk parameters are estimated, or that the population characteristics do not change significantly over time.
The results of the backtesting will be assessed using statistical significance tests. The outcome of the significance tests will drive required action plans.
The additional part of the backtest procedure is related to the impact of judgemental aspects i.e. the importance of judgemental qualitative variables in the final rating and the effect of the expert overrulings.

3.5.6. Stress Testing

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

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

- Sensitivity stress tests: sensitivity of the weighted risks, EL and losses towards changes in explanatory risk parameters (PD, LGD, CCF).
- Scenario stress tests: impact of unlikely but plausible scenarios on the weighted risks, EL and losses. These scenarios can be macro-economic 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 the Stress testing Group governance and guidelines. Time horizon of scenario stress tests, set in accordance with the macro-economic assumptions, is two years.
Stress test reports, including the main assumptions, outcome and proposals of management actions are presented to the Risk Management 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 Committee.

3.6. Standardized Approach

3.6.1. Introduction

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

- Small business units;
- Non-material portfolios;
- Portfolios corresponding to activities in run-off or to be sold;

Consecutively to the disposal of some entities and to the drastic decrease of some portfolios, Dexia presented an official request to the home regulators to move some portfolios from Advanced to Standardized Approach. These portfolios have indeed become non material in terms of exposures and number of counterparts. This should be applicable as from June 2013.

3.6.2. 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 and Poors	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.

3.6.3. 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 2012.

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).

Exposure at year-end 2012

Exposure class	Obligor Grade	EAD	Average RW	Undrawn commitment
Corporate	AAA+ to AA-	465	20%	66
	A+ to A-			
	BBB+ to BBB-			
	BB+ to B-			
	Below B-	0	150%	0
	No rating available	1,474	72%	149
	Total	***1,939***	***60%***	***214***
Financial Institutions	AAA+ to AA-	2,047	1%	0
	A+ to A-	947	9%	0
	BBB+ to BBB-	86	100%	0
	BB+ to B-	333	44%	0
	Below B-	84	19%	0
	No rating available	4,291	23%	63
	Total	***7,788***	***17%***	***63***
Public Sector Entities	AAA+ to AA-	40,135	8%	269
	A+ to A-	1,332	50%	31
	BBB+ to BBB-	1,000	101%	0
	BB+ to B-	243	118%	15
	Below B-			
	No rating available	591	100%	403
	Total	***43,302***	***19%***	***718***
Sovereign	AAA+ to AA-	1,359	0%	1
	A+ to A-	283	20%	0
	BBB+ to BBB-			
	BB+ to B-	624	11%	0
	Below B-			
	No rating available			
	Total	***2,266***	***5%***	***1***
Project Finance	AAA+ to AA-			
	A+ to A-			
	BBB+ to BBB-			
	BB+ to B-			
	Below B-			
	No rating available	591	100%	1
	Total	***591***	***100%***	***1***
Retail	**No rating available**	**9**	**100%**	**0**
Equities	AAA+ to AA-	6	150%	0
	A+ to A-	88	150%	0
	BBB+ to BBB-	172	150%	0
	BB+ to B-	190	150%	0
	No rating available	295	130%	0
	Total	***750***	***142%***	***0***
Others	No rating available	***0***	-	***0***
Total continuing operations		**56,646**		**998**
Total Groups held for sale		**11,590**		**5**

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

The decrease of exposures treated under Standardized Approach is driven by the disposal of DenizBank as all its exposures are in Standardized Approach. It mainly concerns the Corporate, Financial Institutions and Sovereign segments. The decrease of Public Sector exposures is driven by portfolio amortization.

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 (76% or EUR 43 billion) and is predominantly rated in the AAA/AA/A range.

- About 20% of the Standardized exposures to public sector entities are related public sector entities for which there is no advanced model available (mainly public satellites, other satellites or *Groupements de communes sans fiscalité propre*).
- German Länder counterparties, representing 41% 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 the UK, Japan and Canada

3.7. Counterparty Risk on Derivatives

3.7.1. Management of the Risk

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

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

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

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

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

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

3.7.2. Basel II Treatment

The mark-to-market method is applied.

The following tables show 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 2012.

Exposure at year-end 2011

Type of Derivative	Gross EAD	Net EAD	Capital Requirement
Credit Derivatives	**974**	**926**	**15**
Trading Book	***211***	***163***	***2***
CDS Back to Back	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.

Exposure at year-end 2012			
Type of Derivative	**Gross EAD**	**Net EAD**	**Capital Requirement**
Credit Derivatives	**1,334**	**858**	**18**
Trading Book	***666***	***190***	***4***
CDS Back to Back	148	148	3
Other CDS	519	42	1
Total Return Swap	0	0	0
Banking Book	***668***	***668***	***14***
CDS Bought	0	0	0
CDS Sold	668	668	14
Other Derivatives	**33,494**	**6,845**	**193**
Commodities	0	0	0
Equity Derivatives	224	36	3
Exchange Derivatives	2,383	696	28
Rate Derivatives	30,887	6,112	162
Total continuing operations	**34,829**	**7,702**	**211**
Total Groups held for sale	**9,018**	**482**	**11**

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 remains almost stable in net EAD terms.
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

The calculation of the capital requirement for equity exposure is different in function of the booking date of the exposure:
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 of 31 December 2007 and this for a maximum period of ten years (CRD 267). Traded securities therefore receive a risk weight of 100% and non-traded securities receive a risk weight of 150%.

3.8.1.2 Accounting Rules

Available-for-sale financial assets are subsequently remeasured at fair value based on quoted bid prices and/or bid prices derived from available market spreads or amounts derived from internal valuation models in the case of inactive markets. Unrealized gains and losses arising from changes in the fair value of financial assets classified as available-for-sale are recognized within equity.
Available-for-sale quoted equities are measured at fair value through "Gains and losses on securities not recognized in the statement of income" or within the statement of income in the case of impairment. For equities quoted in an active market, any significant decline in their price (more than 50% at reporting date) or a prolonged decline (5 years) compared to the acquisition price is considered as an objective evidence of impairment. In addition, management can decide to recognise impairment losses should other objective evidence be available.
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 tables show 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 2012.

Exposure at year-end 2011

Type of asset	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**
Financial assets designated at fair value	34	34	0	34	0
Available-for-sale financial assets	407	407	225	32	150
Total Groups held for sale	**441**	**441**	**225**	**66**	**150**
TOTAL	**895**	**895**	**256**	**137**	**501**

(1) Level 1 = Fair value based on market prices quoted in 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 2012

Type of asset	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	490	490	28	130	332
Total continuing operations	**490**	**490**	**28**	**130**	**332**
Financial assets designated at fair value	0	0	0	0	0
Available-for-sale financial assets	182	182	151	31	0
Total Groups held for sale	**182**	**182**	**151**	**31**	**0**
TOTAL	**672**	**672**	**179**	**161**	**332**

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

The equity portfolio of the continuing operations remains stable. The majority of equity exposures is classified as Available for Sale financial assets and is assessed via pricing models as some key market data are not 'observable'.
The decrease of the total equity portfolio of the disposal groups held for sale between 2011 and 2012 is mainly due to the sale of BIL. The remaining portfolio is held by DAM.

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 2012. Equity for which Dexia share exceeds 10% and which are deducted from own funds for the calculation of the regulatory solvency ratio are not included in these figures.

Breakdown per type of market

Exposure 2011

Type of market	Total continuing operations		Total Groups held for sale	
	EAD	RWA	EAD	RWA
Private Equity	395	534	28	27
Recognized Market	3	0	68	90
Unrecognized Market *	186	136	265	405
TOTAL	**584**	**670**	**362**	**521**

** Exposures of Global Funding were not reported in the 2011 Risk Report.*

Exposure 2012

Type of market	Total continuing operations		Total Groups held for sale	
	EAD	RWA	EAD	RWA
Private Equity	225	481	0	0
Recognized Market	28	25	0	0
Unrecognized Market *	706	976	223	260
TOTAL	**959**	**1 482**	**223**	**260**

Exposure henceforth also integrates the Global Funding portfolio treated in 'look through' method. As consequence, the EAD of Unrecognized Market equity (Standardized Approach) increases by EUR 478 million and the corresponding RWA by EUR 717 million.

Breakdown per Basel II Approach

Exposure 2011				
Type of market	**Total continuing operations**		**Total Groups held for sale**	
	EAD	**RWA**	**EAD**	**RWA**
Standardized approach *	298	384	291	411
PD/LGD	286	286	71	110
TOTAL	**584**	**670**	**362**	**521**

** Exposures of Global Funding were not reported in the 2011 Risk Report.*

Exposure 2012				
Type of market	**Total continuing operations**		**Total Groups held for sale**	
	EAD	**RWA**	**EAD**	**RWA**
Standardized approach	757	1,044	223	260
PD/LGD	202	439	0	0
TOTAL	**959**	**1,482**	**223**	**260**

As of 31 December 2012, the majority of the equity exposure of the continuing operations of the Dexia Group is treated in standardized approach.

3.8.3. Gains or Losses

3.8.3.1. Realized Gains or Losses Arising from Sales and Liquidations in 2011 and 2012

The following table shows the cumulative realized gains or losses arising from sales and liquidations in 2011 and 2012.The figures only apply to the continuing operations of the Dexia Group.

Exposure	**2011**	**2012**
Gains on available-for-sale financial assets	41	12
Losses on available-for-sale financial assets	– 14	– 54
TOTAL	27	– 42

3.8.3.2. Unrealized Gains or Losses Included in Own Funds

The total unrealized losses related to equity instruments amounted to EUR 12 million as of 31 December 2012 (compared to EUR 202 million as of 31 December 2011). This amount is net of tax.

3.9. Focus on Securitization Activities

3.9.1. Objectives and Roles of Dexia(1)

Dexia is managing in run off mode a portfolio of senior ABS bonds.
Dexia also manages a synthetic securitization (WISE) with Public Finance and Utility assets as underlying.
No more securitization transactions have been originated since 2011. The same goes for new investments or acting as sponsor for providing liquidity facilities in Dexia securitization transactions or third parties.

3.9.2. Management of the Risk

ABS positions are monitored by the Credit Risk Management department. The process in place to monitor the changes in the underlying credit or market risk is organized as follows:

- Depending on the level of risk of each position, an annual or semi-annual 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 this individual analysis (with cash-flow models for the RMBS and CDOs), an internal rating is attributed to each position.

(1) For more detailed information on securitization concepts, please refer to Appendix 4 – Basics on Securitization

- On a quarterly basis, the most sensitive exposures classified in the Watchlist or Special Mention List are reviewed by a dedicated Risk committee. This Committee also decides on impairments.

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

As to the inherent liquidity risk in ABS positions:
- The vast majority of the ABS positions are characterized by static pools of assets, limiting the risk of cash-flow mismatches between the asset and liabilities of our positions.
- Liquidity risk might be partially related to the difference between the interest rate paid by the pool of underlying assets and the rate paid to the notes issued, in case of a mistmach between the assets.

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 derecognition of financial assets and liabilities relating to securitization transactions, their valuation and accounting treatment are pursuant to IAS 39 relating to Financial Instrument Recognition and Measurement.
For consolidation purposes, a Securitization Special Purpose Entity (SPE) is consolidated, in accordance with IAS 27 and SIC 12 relating to consolidation, at Dexia's level if the majority of the benefits of the SPE are retained, or the majority of the residual or ownership risks related to the SPE or its assets are retained.

Control may arise through the predetermination of the activities of the SPE (operating on 'autopilot') or otherwise. The following circumstances require judgment and may indicate a relationship in which Dexia controls an SPE:
- The activities of the SPE are being conducted on behalf of Dexia according to its specific business needs;
- Dexia has the decision-making powers or delegated these powers to obtain the majority of the benefits of the activities of the SPE;
- Dexia has the right to obtain the majority of the benefits of the SPE and may be exposed to its risks or
- Dexia retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain benefits from its activities.

3.9.4. Securitization Activity as Originator

All Dexia's origination operations, except WISE 2006-1 and the DRECM originations, were carried out with a view of obtaining long term funding or establishing a liquidity buffer. The risk was not transferred out of the Group. In 2012, no new transaction has been closed. No new securitization transaction is scheduled for the future, and subsequently there is no asset on the balance sheet awaiting securitization or that can be identified as such.

The WISE 2006-1 operation included some risk transfer and regulatory capital relief (WISE 2006-1).

The 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.

Dexia has not securitized any revolving exposure nor liquidity facilities which are shared between investors and Dexia as originator.

The following tables show 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.

Variations between 2011 and 2012 are due to the sale of DenizBank and the amortization of the securitization portfolios.

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 & Losses on Sales in 2011[4]						0
Synthetic securitizations						0
Underlying Assets[1]				977	281	1,258
Defaulted Assets[2]						0
Exposure securitized in 2011[3]						0
Dexia as Originator/Contributor						0
Underlying Assets[1]		227 [5]				227
Defaulted Assets[2]		43 [5]				43
Exposure securitized in 2011[3]						0

	Denizbank	DRECM	DCC Triplus	Tevere s3 Wise	Tevere s2 Wise	

(1) Outstanding amount at the end of the year of reference obligations in the pool securitized.
(2) Amount of defaulted assets (as of the date of default) using the definitions used in the securitization transaction
(3) Gross amount of exposure (as of year-end based on reference obligations)
(4) Applicable only to cash transactions where assets are sold to a vehicle and the sale is done at market value
(5) The DRECM originations were reported in initial origination amount in the 2011 Risk Report.

Exposure at year-end 2012

	Commercial Mortgage Loans	Public Sector	Corporate Exposures	Other	Total
Traditional securitizations					
Underlying Assets[1]		3,877	244	194	4,315
Defaulted Assets[2]					0
Exposure securitized in 2012[3]					0
Gains & Losses on Sales in 2012[4]					0
Synthetic securitizations					0
Underlying Assets[1]			1,004 [5]	289 [5]	1,293
Defaulted Assets[2]					0
Exposure securitized in 2012[3]					0
Dexia as Originator/Contributor					0
Underlying Assets[1]	131				131
Defaulted Assets[2]	17				17
Exposure securitized in 2012[3]					0

	DRECM	DCC Triplus	Tevere s3 Wise	Tevere s2 Wise	

(1) Outstanding amount at the end of the year of reference obligations in the pool securitized.
(2) Amount of defaulted assets (as of the date of default) using the definitions used in the securitization transaction
(3) Gross amount of exposure (as of year-end based on reference obligations)
(4) Applicable only to cash transactions where assets are sold to a vehicle and the sale is done at market value
(5) the increase of the Synthetic securitization amount (WISE) is due to the evolution of the GBP/EUR fixing.

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 tables show the outstanding amount of securitization positions retained or purchased, broken down by type of securitization and risk-weight class at year-end 2011 and 2012.

Exposure at year-end 2011

Type of securitization	[0 - 8%]	]8% - 16%]	]16% - 106%]	]106% - 1250%[	1250%	Total Banking	Total Trading
ABS	4,669	176	173		35	5,052	
CDO	192	26	261			479	178
Consumer Asset Securitization						0	
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**

Exposure at year-end 2012

Type of securitization	[0 - 8%]	]8% - 16%]	]16% - 106%]	]106% - 1250%[	1250%	Total
ABS	3,655	585	249	94	11	4,594
CDO	100	44	107		9	260
MBS	293	965	804	181	262	2,505
Other ABS			75		13	88
Total continuing operations	**4,048**	**1,594**	**1,235**	**275**	**294**	**7,447**
Total Groups held for sale	**69**	**3,532**	**1,303**		**3**	**4,908**

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

85% of the portfolio (risk weights below or equal to 16%) is within the A or above rating range and 98% of the portfolio is Investment Grade (a risk weight of 106% corresponding to a BBB- rating).

The decrease of the outstanding amount of securitization positions retained or purchased is mainly due to the natural amortization and some deleveraging/de-risking transactions during 2012, especially in the first bucket [0 – 8 %].

The following table shows the outstanding amount of securitization positions retained or purchased, broken down by seniority.

Tableau seniority

	2011		2012
SENIORITY	TOTAL BANKING	TOTAL TRADING	TOTAL BANKING
ABS NON-GRANULAR	220		174
ABS NON-SENIOR GRANULAR	307		163
ABS RESEC NON-SENIOR	35		36
ABS SENIOR GRANULAR	7,864	178	6,578
SENIOR SECURED			232
SENIOR UNSECURED			221
Unknown	28		42
Total continuing operations	**8,454**	**178**	**7,447**
Total Groups held for sale	**79**	**0**	**4,908**

The bulk of the exposure, at 31 December 2012, 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 2012 arising from sales of securitization positions. The total losses related to securitization sales for the years 2011 and 2012 amounted respectively to EUR 2488 million and to EUR 90 million before reversal of collective impairments. A very limited number of positions have been sold in 2012 explaining the relatively low P&L impact.

Gains or losses in 2011

Payments rights	Residential Mortgage Loans	Commercial Mortgage Loans	Public Sector	Corporate Exposures	ABS	Total
	-2,383				-105	-2 488

Gains or losses in 2012

Payments rights	Residential Mortgage Loans	Commercial Mortgage Loans	Public Sector	Corporate Exposures	ABS	Total
	-79				-11	-90

4. Market and Balance Sheet Management Risks

4.1. Market Risk

In order to ensure integrated market risk management, Dexia has developed a framework based on the following elements:
- A complete risk measurement approach which is an important part of the process of surveillance and control of the Dexia Group risk profile;
- A structure of limits and procedures consistent with the entire process for measuring and managing risk.

4.1.1. Market Risk Definition

Market risk represents the potential negative evolution of a financial instrument or portfolios following changes in market parameters.
Interest rate risk and spread risk are the main contributors to market risk at Dexia.

4.1.2. Market Risk Governance

Financial Market Risk Management (FMRM) supervises market risk under the aegis of the Management Board and specialist risk committees. Relying on its global risk management approach, it is responsible for identifying, analysing, monitoring and reporting risks and results (including the valuation of financial instruments) associated with market activities.
Policies, directives and procedures documenting and framing each of the market activities are applied to the entire Dexia Group. Central teams within the competence centres have the task of defining methods of calculation of the income statement and measuring risks, 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 operating entities, local FMRM teams are in charge of monitoring daily activity, i.e. inter alia the implementation of policies and directives defined at a Group level, the assessment and monitoring of risks at a local level (calculating risk indicators, controlling limits and triggers, framing new activities / new products, etc.), as well as reporting, reconciliation with local management control, accounts and information systems. Each operating entity is also responsible for monitoring and reporting to local management committees as well as to local supervisory and regulatory bodies.

Committees

The Market Risks Committee (MRC) meets each month and deals with the following matters: definition and revision of limits, analysis of ratios in relation to risks and results triggers[1] and decisions relating to them, discussion of directives, governance and norms with regard to risks, risk concepts and methods for measuring risks, and the quality of the valuation process.
A Valuation and Collateral Market Risk Committee (V&C MRC) meets each quarter to analyse indicators relating to the management of collateral and to examine the quality of valuations of structured products.
The Risk Committee (RC) and the Risk Management Executive Committee validate all major changes to be made to the risk profile or risk governance.

4.1.3. Market Risk measures and Management

4.1.3.1. Market Risk Measures

VaR

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

(1) Results triggers warn of a deterioration of results and are expressed as a percentage of VaR limits, i.e. generally 50%, 75% and 100% for triggers 1, 2 and 3 and cease activity at 300% of VaR.

- General interest rate risk and Forex risk are measured through a parametric VaR approach. This method consists of computing the loss of economic value based on assumptions regarding the distribution of price fluctuations and correlations. The main assumption is that returns of the risk factors follow a normal distribution. This parametic VaR is completed by a historical full valuation VaR to measure market risk related to FX derivatives and interest rate volatility risk.
- Spread risk and other risks in the trading books are measured through a historical VaR approach. This method is based on historical data; on each position, 250 historical scenarios are applied: observed spread variations of the exposure, observed spread variations of bonds of the same issuer or observed spread variations of bonds with similar characteristics.

The VaR methodologies have been constantly improved. The "Market Risk Engine" now provides historical VaR figures for all risk factors.
As a complement to VaR measures and result triggers, Dexia applies a wide range of additional measures for assessing associated risks (limits in terms of maturity, market and authorised products, sensitivity to different risk factors among all others).
The bond portfolio is not subject to VaR limits given its different investment horizon but is subject to regular stress tests.

Stressed VaR

The Stressed VaR (SVaR) is an additional regulatory requirement for the calculation of the Market Risk Regulatory Capital with first application on the 31st of December 2011.
The Stressed VaR intends to replicate a value-at-risk calculation calibrated to a period of significant and relevant financial stress specific for the bank, based on a 10-day, one tailed 99% percentile confidence interval. Dexia implemented the Stressed VaR based on an historical VaR methodology in order to allow diversification between the risk factors and to fit with the target methodology required by regulators.

4.1.3.2. Market Risk Exposure

VaR

Average VaR was EUR 9,7 million in 2012 (compared to EUR 8,8 million in 2011 for the entire Dexia Group).

The overall VaR limit has been progressively reduced since 2008, in line with the objectives put forward in the orderly resolution plan.

VALUE AT RISK OF MARKET ACTIVITIES

VaR (10 jours, 99 %) by risk factor (in millions of EUR)	2011						
	IR [1] & FX [2] [3] (Trading and Banking)	EQT Trading [4]	Spread Trading	Other risks [5]	Activities held for sale	Continuing activities	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	

VaR (10 jours, 99 %) by risk factor (in millions of EUR)	2012						
	IR [1] & FX [2] [3] (Trading and Banking)	EQT Trading [4]	Spread Trading	Other risks [5]	Activities held for sale	Continuing activities	Limit
Average	4.7	0.1	6.5	0.4	2.0	9.7	22
End of period	1.8	0.0	8.2	0.4	0.0	10.4	
Maximum	11.9	0.6	9.6	0.4	4.7	18.3	
Minimum	1.1	0.0	2.6	0.4	0.7	4.7	

(1) IR: interest rate
(2) FX: foreign exchange
(3) IR & FX: exluding asset & liability management (BSM)
(4) EQT: equity
(5) Other risks: inflation, CO2, commodities, BMA

Stressed VaR

Stressed VaR figures are evidenced in the table below.

Stressed VaR (10 days, 99%)	2012
Average	1.3
End of Period	1.0
Maximum	2.3
Minimum	0.7

Bond Portfolio

Dexia bond portfolios (ongoing activities) represent EUR 89.1 billion as at 31 December 2012. The sensitivity in economic value of these bond portfolios to interest rate variations is limited, as interest rate risk is hedged. A major part of the bond portfolios is classified as Loans & Receivables. The related AFS reserve is not sensitive to credit spread variations.
As to the bond portfolios classified as Available for Sale (AFS), the sensitivity in fair value (and the AFS reserve) to a basis point credit-spread increase amounts to EUR -27.3 million.
The bond portfolios of entities in the disposal programme (activities held for sale) amount to EUR 11.3 billion. The sensitivity in economic value of these bond portfolios to interest rate variations is limited, as the interest rate risk is hedged. A major part of the bond portfolios is classified as Loans & Receivables. The sensitivity in fair value (and the AFS reserve) of this subportfolio to a basis point credit-spread increase amounts to EUR -0.8 million.

Considering the limited liquidity of the markets and the lower visibility of prices/spreads in the valuation process, mark to model valuations have been applied to the "illiquid" part of AFS portfolio.

4.1.3.3. Stress-Testing

Stress testing completes the risk management framework by stressing potential events outside the probability framework of VaR measurement techniques. A number of scenarios are regularly assessed and their analysis and results presented to the MRC and RC on a quarterly basis.

Stress tests performed by Dexia can be broken down in 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 eurozone;
- Specific stress tests (which are oriented towards the risks specific to certain activity line of TFM)

Stresses in bp, unless explicitely in %		IR Risk				FX Risk	Equity Risk	Volatility Risk			Spread Risk
Scenarios		1M	1Y	5Y	10Y	EUR		IR	FX	Equity	
SINGLE RISK FACTOR											
D01	IR Parallel shift (+100bp)	100	100	100	100						
D02	IR Parallel shift (-100bp)	-100	-100	-100	-100						
D07	Flattening of the rates	100	0	-100	-100						
D08	Steepening of the rates	-100	0	100	100						
D09	Fx spot EUR: +10%					10%					
D10	Fx spot EUR: -10%					-10%					
D11	Equity: +10%						10%				
D12	Equity: -25%						-25%				
D13	Implied Vol: +25% (relative)							25%	25%	25%	
D14	Implied Vol: -25% (relative)							-25%	-25%	-25%	
C01	Asset class (2008)										By Market Sector & Illiquidity Percentage
HISTORICAL SCENARIOS											
B01	Equity crash (1987)	-50	-50	-50	-50		-25%	15%		30%	30
B02	Monetary crisis (1992)[1]	150	110	74	30	-8%					
B03	Terrorist attack (2001)[1]	-80	-50	-37	-20	3%	-10%	15%	15%	15%	25
B05	Financial crisis (2008)	EUR: -245 USD: -530	EUR: -240 USD: -290	EUR: -170 USD: -190	EUR: -245 USD: -185		-25%	EUR: +15% USD: +30%	10%	40%	C01
B06	Sovereign crisis										By Rating class & SOV/FIN
HYPOTHETICAL TESTS											
C02	IR +100bp & Spread*1.5	100	100	100	100						50%
C03	IR +100bp & Spread*1.5 & Vol. +25%	100	100	100	100			25%			50%
C04	IR -100bp & Spread*1.5	-100	-100	-100	-100						50%
C05	IR -100bp & Spread*1.5 & Vol. +25%	-100	-100	-100	-100			25%			50%

[1] *Interest rate shifts: linear interpolation, flat extrapolation*

4.1.3.4. Regulatory Internal Model and Backtesting

Basel Treatment

Internal Model

Dexia applies the internal VaR model for the regulatory capital requirement calculation of foreign exchange risk and general interest rate risk within the trading scope (refer to part 2.2. for figures on market risk capital requirements).
The Stressed VaR is computed on a weekly basis using parameters from the period May 2008 – June 2009. The regulatory capital is calculated as the sum of both a multiple of VaR and a multiple of Stressed VaR. Nevetheless, Belgian National Bank (BNB) requires Dexia to apply a floor of 2.5 times the VaR while calculating the SVaR.

Standardized Approach

The other market risks (spread, equity) are treated under the Basel II standardized approach. However, a backtesting is performed on a daily basis on the trading scope.

Backtesting

The result of the backtesting is the number of losses exceeding their corresponding VaR figures (i.e. "the number of exceptions"). For backtesting purposes, the VaR amounts need to be recalculated using a 1-day holding period. For VaR figures calculated under a parametric approach, rescaling is achieved through the application of a square root of 10 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 backtesting as the main indicator. The hypothetical statement of income is calculated under the assumption that the portfolio breakdown remains stable and is only impacted by the change of the corresponding risk factors.
Hypothetical backtesting runs under the following scenarios: change in all market data, change in interest rate alone, change in exchange rate alone, change in equity price, or change in credit spread.
The backtesting process provides the Market Risk Management department with a view of the number of exceptions. This number is taken into account to adjust the multiplier used for calculating the bank's risk capital requirements for market risk under the regulatory internal model.

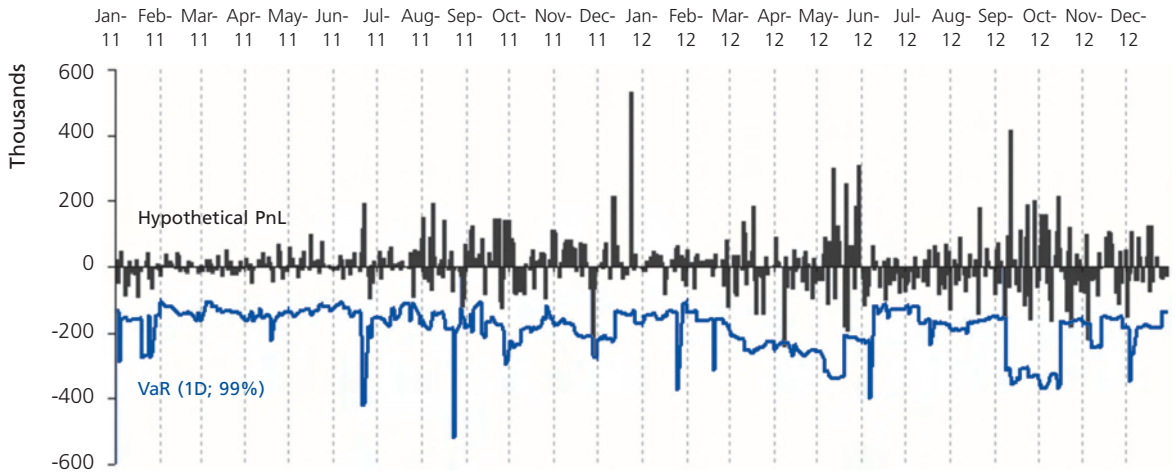
In 2012, Dexia noticed on internal models:
- 4 "downward" exceptions on its IR and FX perimeter (as compared with 1 exception in 2011);
- 8 "downward" exceptions on its spread perimeter (as compared with 4 exceptions in 2011);

Most exceptions in the spread perimeter were observed during summer 2012, due to the sovereign debt crisis which has triggered high spread volatility. By the end of 2012, the remaining spread VaR exposure became not material as shown in the graph below. IR & FX perimeter remains within the regulatory threshold.

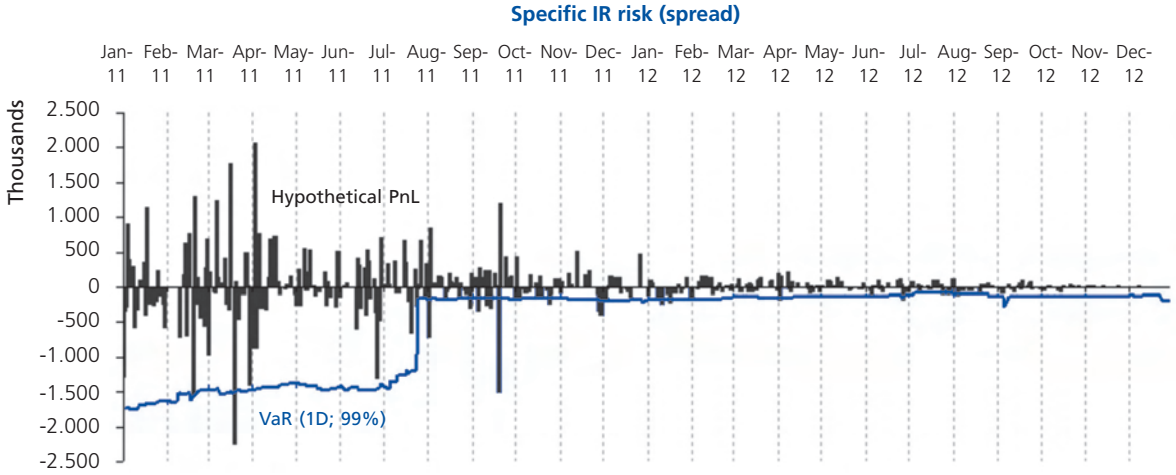
The following charts evidence backtesting results for 2011 and 2012 on each perimeter:

Interest Rate and Foreign Exchange

FebFX and General IR risks



Spread



4.1.3.5. Validation

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

4.1.3.6. Systems and Controls

On a daily basis, FMR calculates, analyses and reports the risks and results on entity and 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.
As 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 Executive Operational Market Committee (EOMC). During this formal process, FMR will analyze and propose a valuation strategy for each product and present its validation to the MRC prior to its formal validation by the EOMC. 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 of balance sheet management is to preserve the economic value of the Group and to minimise income volatility.
The focus of Liquidity Management is to manage the ability to deal with the funding requirements.

4.2.1. BSM Risk Definition

Balance Sheet Management (BSM) implements strategies approved by the Governance Committees within the Risk Management framework developed by the Risk support line.
Liquidity risk measures the ability to deal with the current and future funding requirements of the Group both under normal and adverse conditions.

4.2.2. BSM Risk Governance

Balance Sheet Management (BSM) is under the responsibility of the Finance support line and has the task of managing the structural risks of the entire Group.

Within Risk Management, a dedicated team, called BSM Risks, is in charge of defining the risk framework (risk factors, limits, investment universes, parameters), of validating models used in the effective management of this risk, of monitoring exposures and checking the compliance in relation of Group standards, of defining stresses to be applied to different risk factors and of validating risk management by the Finance support line and ensuring the compliance of the framework with external regulations in force.

Committees

ALM risks (Balance Sheet Management – BSM) are managed within the Dexia ALCo committee (Group Assets & Liabilities Committee) which meets on a quarterly basis. The Dexia ALCo committee decides on the global risk framework, fixes limits, guarantees the consistency of strategy and delegates operational implementation to local ALCo. The Dexia ALCo committee decides globally on the level of exposures, consistent with the decisions of the Management Board. Local ALCo committees manage the risks specific to their balance sheet within the framework defined by and under the responsibility of the Group ALCo committee.

The Funding and Liquidity Committee (FLC), by delegation from the Dexia ALCo committee, centralises and coordinates the decision-making process regarding liquidity matters. The FLC is responsible for surveillance of the Group's liquidity position, its evolution and its cover by short, medium and long-term resources. It monitors the achievement of liquidity targets set by the Management Board and contributes to elaborating strategies for funding and the disposal of assets which will enable the Group to overcome deteriorating stress scenarios realised internally or on the request of the regulators. It validates the price mechanisms for internal disposals within the Dexia Group. The FLC, which meets on a weekly basis is doing everything to improve the Group's liquidity profile.

4.2.3. BSM Risk Management

4.2.3.1. BSM Risk Measures

Interest Rate

The measurement of balance-sheet risks is harmonised among the Group's various entities. The risk sensitivity measures reflect balance sheet exposure to a parallel movement of 1% on the rate curve. Sensitivity of the net current value of BSM positions to an interest-rate trend is the main indicator for fixing limits and monitoring risks.

Global and partial sensitivities per interval of time are still the main risk indicators on which asset-liability risk committees (ALCo) manage risks.

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

(Structural) Foreign Exchange

Dexia's reporting currency is the euro, but its 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. As it happens, a systematic and ongoing hedge was applied to these exposures.

The structural risks associated with the funding of holdings with equity in foreign currencies (limited to the US dollar) as well as the volatility of the Group's solvency ratio are also monitored regularly.

4.2.3.2. BSM Risk Exposure

BSM Interest Rate Risk Exposure (Sensitivity)

Interest rate sensitivity measures the change in the balance sheet net economic value if interest rates move by 1% across the entire curve.

The sensitivity for the continuing activities was EUR -6 million as at 31 December 2012. The sensitivity substantially decreased as compared to year-end 2011 following the execution of the orderly resolution plan.

4.2.4. Liquidity Risk

Dexia Policy

Dexia measures and manages liquidity risk by an internal management process redefined in 2011. The cornerstone of this management process is the Funding and Liquidity Committee (FLC), a central committee composed of all parties concerned by liquidity as well as funding and coordinating their actions.

In 2012, the Funding and Liquidity Committee met on a weekly basis to monitor the evolution of Group liquidity and, mandated by the ALCo, to take structural decisions aimed at its improvement. Collateralised long-term funding transactions, securities swaps, guaranteed issues and non-covered funding as well as the surveillance of funding sources and production are some of the levers used by Dexia on the initiative of this committee to remedy the Group's liquidity situation. Furthermore, particular attention is paid to entity disposals and to the implementation of the SPA including the sale of Belfius Bank and Insurance (previously Dexia Bank Belgium) (cf. infra, Liquidity Management).

The liquidity management process aims to cover the Group's funding requirements. Funding requirements are assessed prudently, dynamically and exhaustively taking into consideration existing and planned on and off-balance sheet transactions; reserves are formed of assets eligible to the refinancing facilities of central banks to which Dexia has access.

Regular information channels have been put in place for the management bodies:
- weekly meetings of the FLC during which the evolution of the liquidity situation is studied and analysed in detail;
- regular meetings of the audit committee and the board of directors.

Considering the pressures suffered by the liquidity situation in 2012, specific and regular modes of information have been introduced:
- daily, weekly and monthly reporting to members of the Management Board, to the shareholder and guarantor States and to the regulators. This information moreover serves all those involved in the management of Dexia Group liquidity, i,e, BSM, BSM Risk Management and TFM;
- monthly dissemination to the shareholder and guarantor States, central banks and regulators of the multi-annual funding plan;
- a weekly call with the regulators and French and Belgian central banks (BDF, ACP, BNB).

Risk Measures

Liquidity indicators have evolved to take account of the constraints weighing on the liquidity situation. The four week liquidity ratio comparing liquidity reserves to Dexia's liquidity deficits following various scenarios is completed by the drawings ceiling authorised by the Bank of France on the emergency liquidity assistance (ELA) line and by the maximum authorised amount of guaranteed issues.
Dexia liquidity risk is also framed by liquidity ratios monitored by its various regulators, the Belgian National Bank (BNB) for Dexia SA and the Prudential Control Authority (ACP) for Dexia Credit Local:
- The BNB ratio to which Dexia SA is subject calculates the liquidity position of an establishment by comparing the required liquidity (as the numerator) and the available liquidity (as the denominator) at one week and one month. It must be lower than 100% at each of those deadlines (Circular CBFA_2009_18-1 dated 8 May 2009),
- The ACP coefficient to which Dexia Credit Local is subject is defined as the ratio between liquidities (as the numerator) and liabilities (as the denominator) over a prospective period of one month; the coefficient thus calculated must at any time be above 100 (Instruction No 2009-05 dated 29 June 2009 relating to the standard liquidity risk approach),

These ratios are sent to the BNB and to the ACP on a monthly basis.

Liquidity management

The improvement of the Dexia Group's financial structure and the reduction of its liquidity requirement were priority objectives of the transformation plan put forward in 2008. From the summer of 2011, the exceptionally difficult environment severely damaged the Group's liquidity situation, leading at the end of December 2012 to funding of about EUR 90.7 billion via central banks and guaranteed issues (EUR 109.7 billion with the 2008 guarantee).
The year 2012 was marked however by a fall in pressures on the liquidity situation and by finalisation of the 2013 guarantee scheme granted by the Belgian, French and Luxembourg States.
More detailed information on this new guarantee agreement is provided in the Annual Report of Dexia SA (page 11) and Appendix 9.3.C to the consolidated accounts in this Annual Report (page 147). In particular, the second semester benefited from an easing of the various credit indicators whilst the persisting uncertainties on sovereign debts within the euro zone weighed heavily on the markets during the first half of the year, resulting in a fall of long-term rates and very severe volatility.

This was reflected by a fall of pressures weighing on the Dexia Group's liquidity situation which is illustrated in particular by the following favorable developments:
- The upward trend of long-term rates in the second half-year resulted in a EUR 2.4 billion reduction in the net collateral required to be lodged with derivatives counterparts compared to the end of June 2012.
- In view of the structural reduction of the balance sheet and the maintenance of long-term funding over the quarter, the Group's short-term funding requirement was EUR 44.3 billion at the end of December, constantly down from the end of 2011 (EUR 88 billion at the end of December 2011 and EUR 60.3 billion at the end of June 2012).
- The respite in the European sovereign debt crisis enabled Dexia to refinance its liquidity deficits better by taking some advantage of the increased investor appetite for the State guaranteed debt, particularly on the US market.

Despite these positive elements, Dexia made full use of the provisional guarantee mechanism granted by the three States at the end of 2011. The provisional guarantee ceiling was taken to EUR 55 billion in June 2012 and guaranteed funding under the 2011 agreement reached EUR 54.1 billion at the end of December 2012. As previously indicated, the 2013 guarantee ceiling was set at EUR 85 billion in principal including funding already covered by the 2011 provisional guarantee and the guaranteed debt issued under the 2011 provisional agreement and the 2013 agreement reached EUR 54 billion at the end of February 2013. It is to be noted that USD 4.7 billion of guaranteed debt was placed with US institutional investors and the average maturity of the guaranteed debt was 1.3 years. On the other hand, in February the Group participated in the 3-year refinance from the European Central Bank (LTRO) in an amount of EUR 13.6 billion, on top of the EUR 20 billion from the LTRO operation in December 2011, which has not been repaid. Finally, the Dexia Group is preparing specific short and long-term issue programmes to be deployed in 2013.
The placement of guaranteed debt issues and the EUR 5.5 billion capital increase have enabled the emergency liquidity assistance (ELA), which was EUR 14.2 billion at the end of June, to be fully repaid on 31 December 2012, however, this situation is temporary, as a recourse to this exceptional funding mode could be envisaged in the course of 2013.
Furthermore, it should be noted that the fruit of the finalisation of the sales of DenizBank and Banque Internationale à Luxembourg did not directly serve to improve the Group's liquidity profile. In fact, meeting undertakings made on the sale of Belfius Bank and Insurances to the Belgian State. Dexia continued the break-up of the financial links between the two institutions which

began at the end of 2011. Whilst noncovered funding was fully repaid during the first half of 2012. Dexia undertook the conclusion of covered funding relying on the amounts received on sales. Indeed such funding fell from an amount of approximately EUR 12 billion outstanding at the end of September to EUR 6.6 billion at the end of December.
As a consequence, the Dexia Group's funding structure evolved significantly during 2012 under the combined effect of the disposals of strategic entities, increased recourse to central banks and the market evolutions described above.

These elements resulted in:

- The disappearance of deposits of the Retail and Commercial Banking division, following the sales of Banque Internationale à Luxembourg and DenizBank (which accounted EUR 17.6 billions of deposits at the end of 2011);
- The increase of long-term funding outstanding (12 months and more) via the increased issue of guaranteed debts and long-term covered funding more than offsetting the reduction of senior non-guaranteed debt and covered bonds (or EUR +4.7 billion net);
- A sharp fall in short-term funding outstanding (EUR -43.7 billion), reflected over the period under consideration by a very sharp reduction in the portion of the balance sheet funded in the short term. This in fact fell from 22% at the end of December 2011 to approximately 12% at the end of December 2012.

Dexia was generally not able, in the course of the year 2012, to reach the minimum regulatory threshold defined for the liquidity ratios to which Dexia SA and Dexia Credit Local are each subject. Observance of those ratios in the future will depend on the implementation of the Group's issuance plan which is still subject to much uncertainty.

5. Operational Risk

5.1. Definition

Operational risk represents the risk of financial or non-financial impact arising from a shortcoming or failure of internal processes, personnel or systems, or even external factors. This definition includes IT, legal and compliance risks.

Permanent Control (excluding compliance) has the task of checking that the risk control mechanism in place is robust and effective, and of ensuring the quality of accounting and financial information and the quality of information systems.

5.2. Governance

The operational risk management framework within Dexia relies on governance including clearly defined responsibilities and roles.

- The Management Board regularly examines the evolution of the risk profile of the various Group activities.
- The Risks Committee approves policy for the entire Group.
- The Operational Risk Acceptance Committee (ORAC), meeting on a quarterly basis, examines the main risks identified, decides on whether they are acceptable or not, and the corrective actions possibly to be taken. It also validates proposals for assessing prevention or improvement in relation to the various elements of the mechanism (permanent control, IT security, insurance programmes and so on). It is chaired by the member of the Management Board in charge of Risk analysis, shared services and international subsidiaries.
- Middle management remains the principal guarantor of operational risk management. In each field of activity, it appoints a correspondent for operational risks whose role is to coordinate the collection of data and to assess risks, with support from the local operational risk management function.
- The IT systems security committee examines and decides on actions to be taken to ensure business continuity and the implementation of IT systems security policy.

Permanent Control excluding compliance in the Dexia Group is run by the Head of operational risks. In order to ensure consolidated surveillance, permanent control relies on risk measurement and surveillance teams, on decentralised means within departments, subsidiaries and branches, and on consulting mechanisms within the framework of permanent control committees.

5.3. Management of the Risk

5.3.1. Operational Risk Framework

Dexia policy regarding operational risk and permanent control

Dexia policy regarding operational risk management consists of regularly identifying and assessing the various risks and existing controls, in order to check that the level of tolerance defined per activity is observed. If that is not the case, the governance in place must lead to the rapid establishment of corrective actions or improvements which will bring about a return to an acceptable situation, This mechanism is completed by a prevention policy in particular regarding information security, guaranteed continuity of activities and, when necessary, the transfer of certain risks through insurance.

As for permanent control, Dexia policy aims to ensure cover for the types of risks provided by CRBF Regulation 97-02 through a mechanism of first and second level controls. Heads and staff members of operational divisions are the guarantors of adaptation and good operation of the first level permanent control in their fields of activity. The second level of control is for specialist functions, independent of the activities controlled and reporting directly to the Management Board. The execution of second level permanent controls is checked each quarter as part of the reporting at a permanent control level. Their results are compared with previously defined objectives and any shortcoming in control or in the result is allocated a corrective action plan monitored by a permanent control steering team. The supports and traceability elements of the results are also checked each quarter.

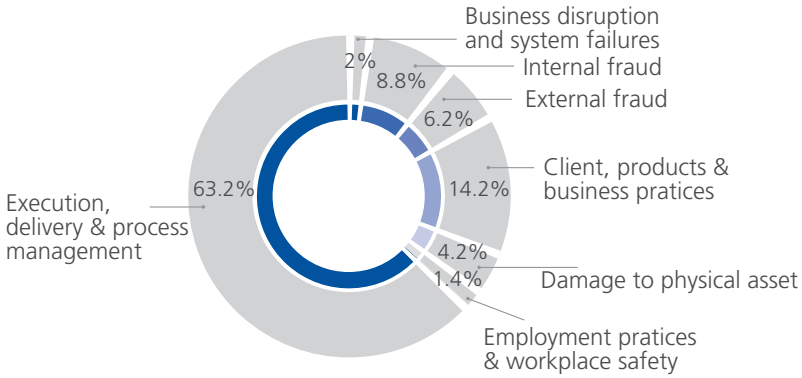
Risk measures and management

The operational risk management mechanism relies on the following elements.

Operational risk database

The systematic capture and monitoring of risk events is one of the most important requirements stated by the Basel Committee, whatever the approach chosen for the capital calculation (Standardized or Advanced Measurement Approach): "Data on a bank's historical loss experience could provide meaningful information for assessing the bank's exposure to operational risk and developing a policy to mitigate/control the risk".
The collection of risk event data enables Dexia to be compliant with regulatory requirements and to obtain valuable information in order to improve the quality of the internal control system. In terms of reporting, beyond the threshold for obligatory declaration set at EUR 1,000, rules have been defined and deployed at Group level, in order to ensure that the most important information is escalated in due time to Senior Management. The Management Board receives a report on the main events, including an action plan enabling risks to be reduced, defined by the bank's *Middle Management*.

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



Considering the reduced perimeter of the Dexia Group, the breakdown of the different categories of events has again been considerably modified. Internal frauds characteristic of Retail and Private Banking activity have practically disappeared with the sale of DenizBank, and the broadly preponderant category is now « Execution, Deliveries and Process Management », knowing that very few major events have occurred since 2009.
The other categories present few events and a low level of losses. The item "Clients, products and commercial practices" is in second position. The main events are subject to corrective actions approved by management bodies.

Self-assessment of risks and associated controls

In addition to building a history of losses, the exposure of Dexia to main risks is determined through risk mapping. To do this, all the entities of the Dexia Group perform *bottom-up* self-assessment exercises regarding risks and associated controls. They can give rise to the definition of risk limitation actions. They provide a good view of the most important risk areas in the different entities and activities, with the objective of reporting the results to Management across the organization. These exercises are repeated each year.

Definition and monitoring action plans

The bank's Middle Management defines the corrective actions to deal with major incidents, deficient controls or notable risks identified. There is regular monitoring by operational risk management. By virtue of this process, the internal control system is continuously improved and the main risks appropriately mitigated over time.

Permanent control

The permanent control mechanism is aimed at checking the existence and quality of key controls in all activities and enabling major risks to be covered, whatever their nature. This involves first level controls made by operational functions, like those at the second level performed by non-operational support functions.
On the basis of a control plan updated each year, confirmation actions in relation to the accuracy of execution of those controls are organized quarterly, and give rise to a detailed report presented to the various governance bodies. Shortcomings always give rise to the definition of corrective actions.

Information security and business continuity management

Information security policy and the related guidelines, norms 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.

As required by Group policy on business continuity, business lines must establish impact analyses for vital activities in case of interruption. They must define and back up recovery plans and ensure that business continuity plans are tested and updated at least once a year. On the basis of regular reporting, the Management Board validates recovery strategies, residual risks, and action plans for continuous improvement.

Management of insurance policies

The reduction of the operational risks to which Dexia is exposed is also guaranteed by subscription to Group insurance policies, covering professional liability, fraud, theft and activity interruption. The global insurance policy establishes the principles of cover for the different risks run, to be implemented at Group and entity levels. It is also a matter of providing a centralised framework for negotiations with brokers and insurance companies.

Increased coordination with other functions involved in the internal audit system

A software tool introduced into service in 2010 covers most of the building blocks of the operational risk management framework, also offering some key functions (links between risks/ controls/ recommendations and action plans, automated data entry controls, traceability of modifications, etc,) for other central functions (internal audit, compliance, validation, permanent control or quality control). It permits 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.

Operational risk management in the transition period

2012 constituted a key phase in implementation of the orderly resolution of the Dexia Group including the disposal of several important operating entities and the elaboration of a new scheme for French local public sector finance activities. These transition phases are by nature favourable to the development of certain operational risks, particularly by virtue of well-identified elements such as the departure of key people, the possible demotivation of staff members, the modification of processes for treatment when operational applications have to be replaced and so on.

Nevertheless, the main elements of the management mechanism previously described remain valid. More particularly regarding the self-assessment of risks and controls, the bank's management was asked on several occasions during the year to assess the risk of discontinuity associated with the elements mentioned above. A map of critical tasks was gradually drawn up and, in case incidents occur, action plans were systematically defined. The results of those analyses and the monitoring of action plans were regularly presented to the ORAC and to the Management Board for validation.

Each major entity disposal (Belfius Bank and Insurance, BIL, DenizBank) gave rise moreover to regular monitoring of the main "untying" work by a dedicated transition committee, involving members of management of the two entities concerned. The separation between Dexia and the SFIL was also subject to specific analysis, particularly from the point of view of the continuity of critical tasks.

Finally, psycho-social risks were subject by Dexia to preventive actions (information, awareness) and assistance (hotline, support of an independent external firm), particularly within the context of the ongoing reorganization.

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.

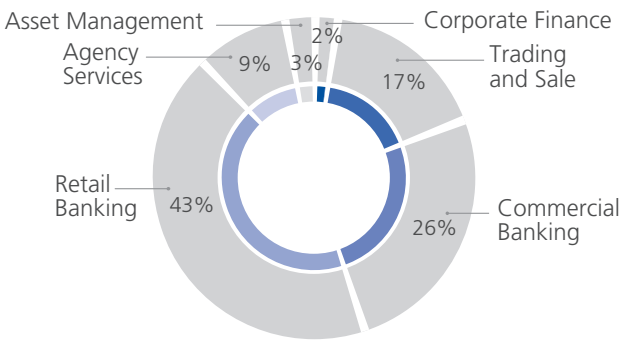
This approach consists principally in applying a percentage (called the beta factor, in a range from 12% to 18%) to an appropriate activity indicator, calculated for each of the eight business lines defined by the Basel Committee (Corporate Finance, Commercial Banking, Retail Banking, Market Activities, Asset Management, Agency Functions, Retail Brokerage, Payments and Settlements).

Capital requirement for operational risk was EUR 410 million at year-end 2012, down from EUR 626 million at year-end 2011.

The 34% reduction compared to the year 2011 is due principally to the method of calculation. In fact this relies on the 3-year average of net banking income reprocessed; revenues for the year 2009 (including those of all entities which have left the Group perimeter since October 2011) were replaced by those for 2012, which are much more limited.

The breakdown of capital requirement for operational risk by Basel II business line did not change significantly, as the income history of sold entities still plays a significant role in the 3 year average calculation. As a consequence, Retail Banking remains the most important business line.

Capital Requirement (626 EUR Million)
by Basel Business Line - 31/12/2011



Capital Requirement (410 EUR Million)
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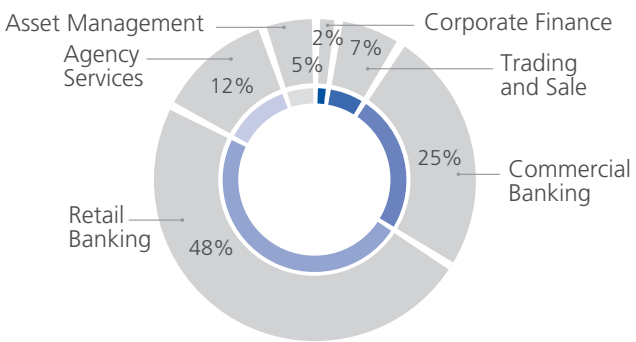


6. Remuneration policies and practices

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.
CCF	**Credit Conversion Factor**	The ratio of the currently undrawn amount of a commitment that will be drawn and outstanding at default to the currently undrawn amount of the commitment. The extent of the commitment will be determined by the advised limit, unless the unadvised limit is higher.
CDO	**Collateralized Debt Obligation**	Type of structured asset-backed security (ABS) the value of and payments for which are derived from a portfolio of fixed-income underlying assets. CDO securities are split into different risk classes, or tranches, whereby "senior" tranches are considered the safest securities. Interest and principal payments are made in order of seniority, so that junior tranches offer higher coupon payments (and interest rates) or lower prices to compensate for additional default risk.
CDS	**Credit Default Swap**	Swap contract in which the buyer of the CDS makes a series of payments to the seller and, in exchange, receives a pay-off if a credit instrument (typically a bond or loan) undergoes a defined "Credit Event", often described as a default (fails to pay).
CLN	**Credit Linked Note**	A credit linked note (CLN) is a form of funded credit derivative. It is structured as a security with an embedded credit default swap allowing the issuer to transfer a specific credit risk to credit investors. The issuer is not obligated to repay the debt if a specified event occurs. This eliminates a third-party insurance provider.
CRD	**Capital Requirements Directive**	The Capital Requirements Directive (CRD) for the financial services industry introduce a supervisory framework in the EU which reflects the Basel II rules on capital measurement and capital standards.
CRM	**Credit Risk Mitigant**	Range of techniques whereby a bank can, partially, protect itself against counterparty default (for example by taking guarantees or collateral, or buying a hedging instrument).
EAD	**Exposure At Default**	Estimate of the amount outstanding (drawn amounts plus likely future 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.
IAS	**International Accounting Standards**	IAS stands for International Accounting Standards. IAS are used outside the US, predominantly in continental Europe.
ICAAP	**Internal Capital Adequacy Assessment Process**	The main objective of the Pillar 2 requirements is to implement procedures which will be more sensitive to an institution's individual risk profile. This is to be achieved by introducing implementation of internal processes (ICAAP).
IFRS	**International Financial Reporting Standards**	International Financial Reporting Standards published by the IASB and adopted by most countries but the USA. They have been designed to ensure globally transparent and comparable accounting and disclosure.
IR	**Interest Rate**	Interest expressed as an annual percentage rate.
ISDA	**International Swap and Derivative Association**	Trade organization of participants in the market for over-the-counter derivatives. Its headquarters are in New York, and it has created a standardized contract (the ISDA Master Agreement) to enter into derivatives transactions.
IT	**Information Technology**	Study, design, development, implementation, support or management of computer-based information systems, particularly software applications and computer hardware IT deals with the use of electronic computers and computer software to convert, store, protect, process, transmit, and securely retrieve information.
LGD	**Loss Given Default**	The ratio of the loss on an exposure due to the default of a counterparty to the amount outstanding at default.
L&R	**Loans & Receivables**	Non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than held for trading or designated on initial recognition as assets at fair value through profit or loss or as available for-sale.
MBS	**Mortgage-Backed Securities**	Asset-backed security or debt obligation that representing a claim on the cash flows from mortgage loans.
NBB	**National Bank of Belgium**	The National Bank of Belgium is the Belgian Financial Institutions regulator.
PD	**Probability of Default**	The probability of default of a counterparty over a one-year period.
P/L	**Profit and Loss**	The statement of income is a document showing all wealth-creating revenues and wealth-destroying charges. There are two major statement of income formats: the by-nature statement of income format and the by-function statement of income format. Also called profit and loss account (or P&L).
RAROC	**Risk Adjusted Return On Capital**	Risk-based profitability measurement framework for analysing risk-adjusted financial performance and providing a consistent view of profitability across businesses.
RMBS	**Residential Mortgage-Backed Securities**	RMBS are securities where the primary source of payments is a mortgage loan or a pool of mortgage loans secured mostly on residential real property. Investors receive payments of interest and principal that are derived from payments received on the underlying mortgage loans.
RWA	**Risk Weighted Assets**	Used in the calculation of risk-based capital ratios. They are the total assets calculated by applying risk-weights to the amount of exposure.
SIFI	**Systemically Important Financial Institution**	A SIFI is a bank, insurance company, or other financial institution whose failure might trigger a financial crisis. Domestic SIFI represents a risk at a national level. Global SIFI describes a risk at an international level.

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.
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 developed.

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

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

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

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

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

2. Description of the Internal Rating Process

General Organization of the Internal Rating Process

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

Development of the Models

The different steps of models development 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;

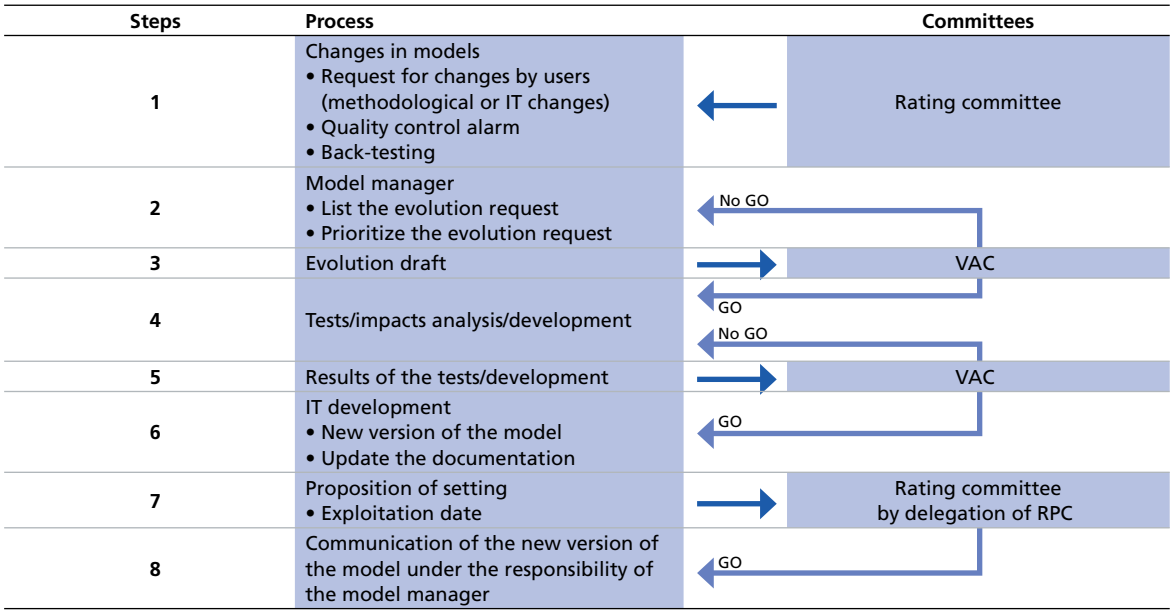
- Testing these ratios (repetitive processes between statisticians and analysts);
- Building the score function. A score function is the mathematical function that allows determination of the counterparty (or exposure) PD, LGD or CCF based on its characteristics. Score function is established by the modelling team on the basis of statistical analysis and modelling techniques; After the score function is constructed, it is segmented into homogeneous risk classes and rating respecting optimal discrimination and stable through-the-cycle rating migration behavior. The risk classes are conservatively calibrated taking into account the data size and macro-economic volatility of risk parameters to limit frequent model revisions on low default portfolios and to respect §451
- 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 LGD model used for US municipalities) do not include a score function. They are based on internal experience and qualitative knowledge and not on statistical data (which may not be available due to very low number of defaults for instance).
- Models based on a derivation approach are derived from an existing model.
- Models based on an assimilation approach are not *stricto sensu* models due to the fact that counterparties treated by assimilation simply inherit the rating of their "master" counterpart.
- Assimilations and derivations are applied when it is neither financially intuitive nor statistically relevant to develop, adapt or use an existing model. Such cases occur typically for low default portfolios with a low number of observations, limited data availability (both for design and for model use) and for portfolios where strong relations exist between the "master' counterparty and the "assimilated" or "derived" counterpart. These relations can be legally bound or based upon long-term past experience and practice.

Maintenance of the Models

As mentioned above, the model manager is responsible for the entire process linked to the model developed, including the maintenance of the model.
The model maintenance process is detailed in the diagram hereafter.



Legend: Validation Advisory Committee (VAC), Risk Committee (RC)

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 (Specialized 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 specialized 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.

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.

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.

Public Sector Entities.

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

West European Local Authorities

This model encompasses local authorities from France, Belgium, Spain, Italy and Portugal. From this model, the models applicable for German Länder and French Groupements à fiscalité propre have been inferred.
Dexia defines local authorities as sub-sovereign governmental elected bodies empowered by the legislation of the country in which they are located with specific responsibilities in providing public services and with certain resources and capacity to decide their own practical organization in terms of administrative procedures, personnel, buildings, equipment, etc.

US States

The scope of application of the US State model encompasses the 50 States of the United States of America and the Commonwealth of Puerto Rico. The model only rates US State general funds or general obligations.
Every US State or local government has a general fund and generally issues general obligation or general fund debt. The general fund of a public entity is the main revenue coming from direct or indirect taxes and is used for common and general purposes. For instance, a general fund usually backs general obligation bonds, lease or certificate of participation bonds.

US Local Governments

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

Other Counterparties from the US Municipal Sector (Expert Model)

The scope of application of these expert models covers only the counterparties related to the special revenue funds, i.e. the following categories for Dexia: Special Tax, Utilities (including water and sewer, gas and electricity), Higher Education, General Airport, Toll Facilities, Mass Transportation, Housing, Healthcare, Public Facility Lease.
Every local government or public authority generally has one or several special revenue funds, the financial characteristics of which differ from one sector to another. The special revenue funds of a public entity are usually used for a special purpose and they receive either utility revenues (water, public power, toll...) or special taxes (sales tax, allocation tax, excise tax…).

Social Housing

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

Assimilations to Public Sector Entities

The in-depth analysis of some public sector counterparties 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/LGD as their "master" counterparties.

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 Counterparts	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
Local Public Sector		Default at 180th day		Cf. following table
Corporates		Transverse	> 10 years	External
Specialized Lending		Transverse	>10 years	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 Counterparts	Time Series Used	Internal/External Data
Western Europe Local Authorities	From 5 years (e.g. Italy) to over 10 years (e.g. French Municipalities,).	Internal + External
US Municipalities	> 10 years	External
Groupements à fiscalité propre	> 10 years	Internal
Social Housing	> 10 years	Internal

Main Principles Used for Estimating the LGD

Types of Counterparts	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 integrating I risk factors adapted to banking counterparts (country of residence, business profile, etc).	> 10 years	Internal + External
Corporates	Statistical model based on external rating agencies loss data. The LGD depends on counterpart rating, exposure seniority level, geographic region and macro-economic factors.(calibrated to define the downturn LGD)	> 10 years	Internal + External
Local Public Sector	Cf. next table.		
Specialized 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
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

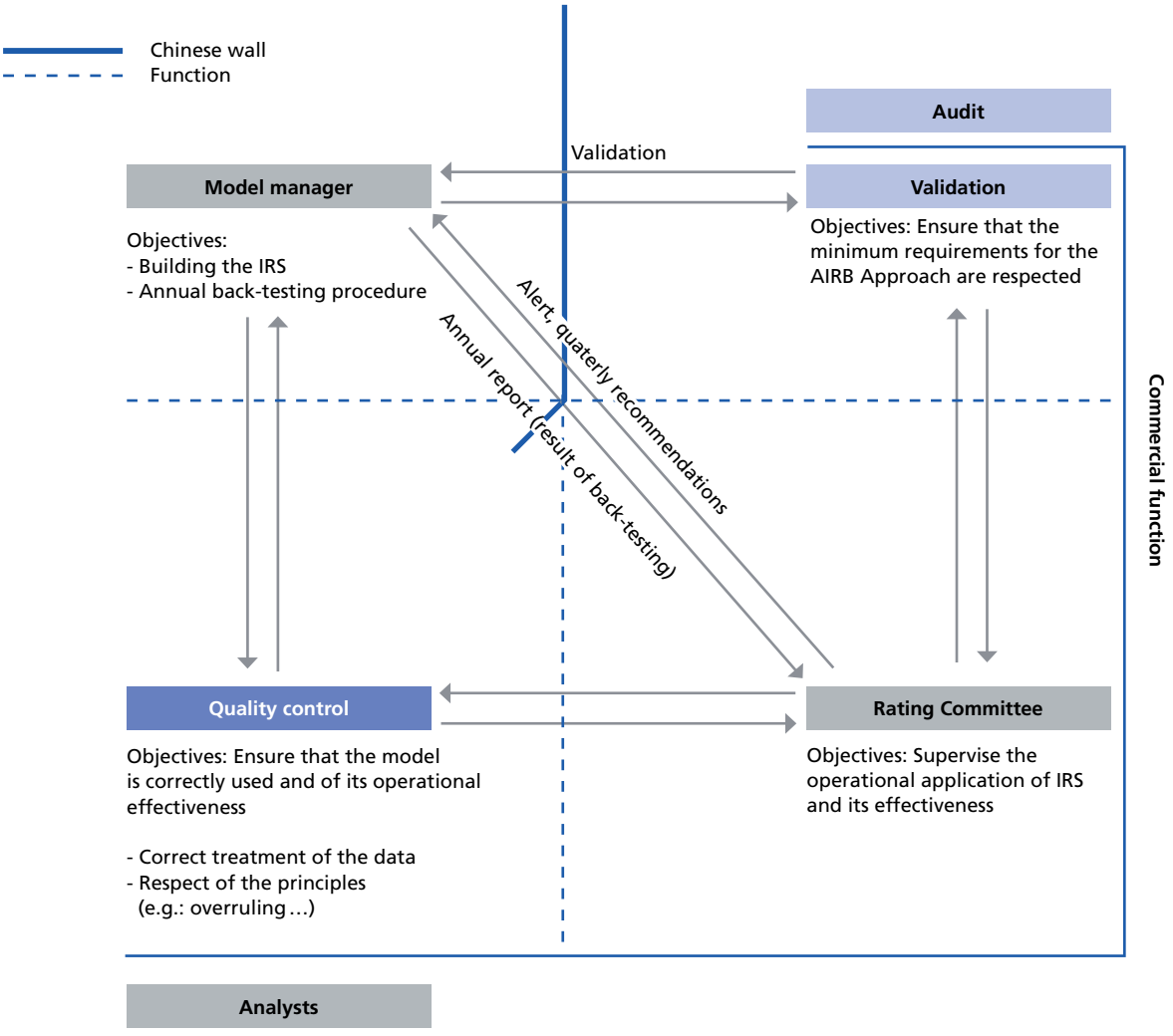
Types of Counterparts	Main Hypotheses	Time Series Used	Internal/ External Data
Western Europe Local Authorities	Statistical model based on the internal existing default cases observed which were related to French municipalities. Final LGD are segmented on the basis of the number of inhabitants and on an economic parameter reflecting the financial flexibility.	>10 years	Internal
Municipalities US	The Muni US LGD model is an expert model guided by external recovery rate factors and estimates. The final segmentation is based on business sectors.	N/A	External
Groupements à fiscalité propre	A mixed analytical – expert model was chosen and constructed based on the indicative available observations to determine indicative LGD and quantify potential loss related to a default in this sector.	9 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 Specialized Lending CCF model. Otherwise, Foundation Approach is applied.

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:
- Operational Validation & Quality Control (OV QC) is responsible for the monitoring of the models' use and environment review, pertaining to the permanent control of IRS (models' scope, model's inputs quality, overruling, audit trail);
- Market and Credit Validation are responsible for the overall assessment of the IRS (models' set up, models' reviews, back testing and stress testing);
- Audit is responsible for auditing the general consistency and compliance with the regulation of the IRS, operational validation being carried out by the OV QC Department.

The Operational Validation & Quality Control (OV QC) is integrated in the Validation dept.
Chinese walls between Model manager and Validation & QC, Model manager and Rating and Operational Validation Committee (ROVC) and Credit Validation & QC and Audit ensure the control system independence.

Operational Validation & Quality Control

Purpose

Operational Validation & 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 reactivity of IRS supervision 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.

Global and specific key controls are applied for the monitoring of the models' use and environment review. The global controls are applied without distinction of the model reviewed and the specific ones (i.e. dependent of the model) reflect the monitoring of existing issues related to the model in question. These controls encompass the review of:
- the rating scope exhaustiveness,
- the quality of the audit trail,
- the quality of the models' inputs and their accuracy/relevance,
- human overruling of the models,
- the correct application of rating guidelines & procedures (mother support/BE, country ceilings, re-rating, piercing of LCCC & FCCC, country/mother company downgrade impacts, rating inheritances on counterparts etc.)

Scope

The scope of the quality control process covers:
- All Advanced Basel II models;
- All entities within Dexia; and
- All geographical locations.

Process: Parties Involved

- **Key Stakeholders and Functions**

The organization follows that of the Credit Risk teams: the principle is that IRS that are specific to an entity are used and controlled with the help of local correspondents while "transversal" IRS are treated at Dexia Group level. Annual visits are carried out to ensure of the coordination and steering of the global quality control process.
To enhance the efficiency and increase the uniformity of the control procedures, Operational Validation & Quality Control monitoring tasks have been permanently united in 2012.

- **Rating and Operational Validation Committee (ROVC)**

The key role of the ROVC 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 ROVC:
- 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.

- **Processes and Guarantee of Independence**

Fully aware of the importance of preserving the neutrality of the control process, a Chinese wall have been set between the development departments, model managers, sales functions, analysis functions and the Operational Validation & Quality Control function. These walls ensure a high credibility of the final quality control outcomes. This way any potential conflict of interest is fully avoided:
- The operational validation & quality control function is independent;
- The operational validation & quality control function submit their proposals to the ROVC and to the Validation Advisory Committee that can deliberate on any subject concerning IRS or modes of applying the IRS within the Group.

Market and Credit Validation

The Market and Credit Validation Departments

All the models used within Dexia, either market risk models, pricing models, Basel II Pillar 1 credit rating models, BSM models, economic capital models have to be validated by an independent entity. The Validation departments ensure that the models used within the Bank:

- provide reliable outcomes that are in line with the objectives assigned by the management;
- are correctly implemented and adequately used;
- meet the regulatory requirements.

The main objectives of the Validation departments 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 Committee (RC).

Validation Approval Process

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

Two Validation Advisory Committees have been processing the Validation outcomes:

- The Markets VAC covering market risk and pricing models;
- The Credit and Transversal VAC covering Basel II Pillar 1 credit rating models, operational risk models as well as transversal Pillar II models (such as economic capital and BSM models).

The VAC are composed of the representatives from the Validation departments, the Model Management, the head of Risk Governance and Regulatory Watch, the heads of Risk, Market Risk and Risk Analytics, as well as representatives of the business lines and/or Modelling teams for the validation of their respective business lines/models, this in line with the type of models they cover. Internal Audit is also present as it constitutes an additional level of control on the validation process.

Validation Scope

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

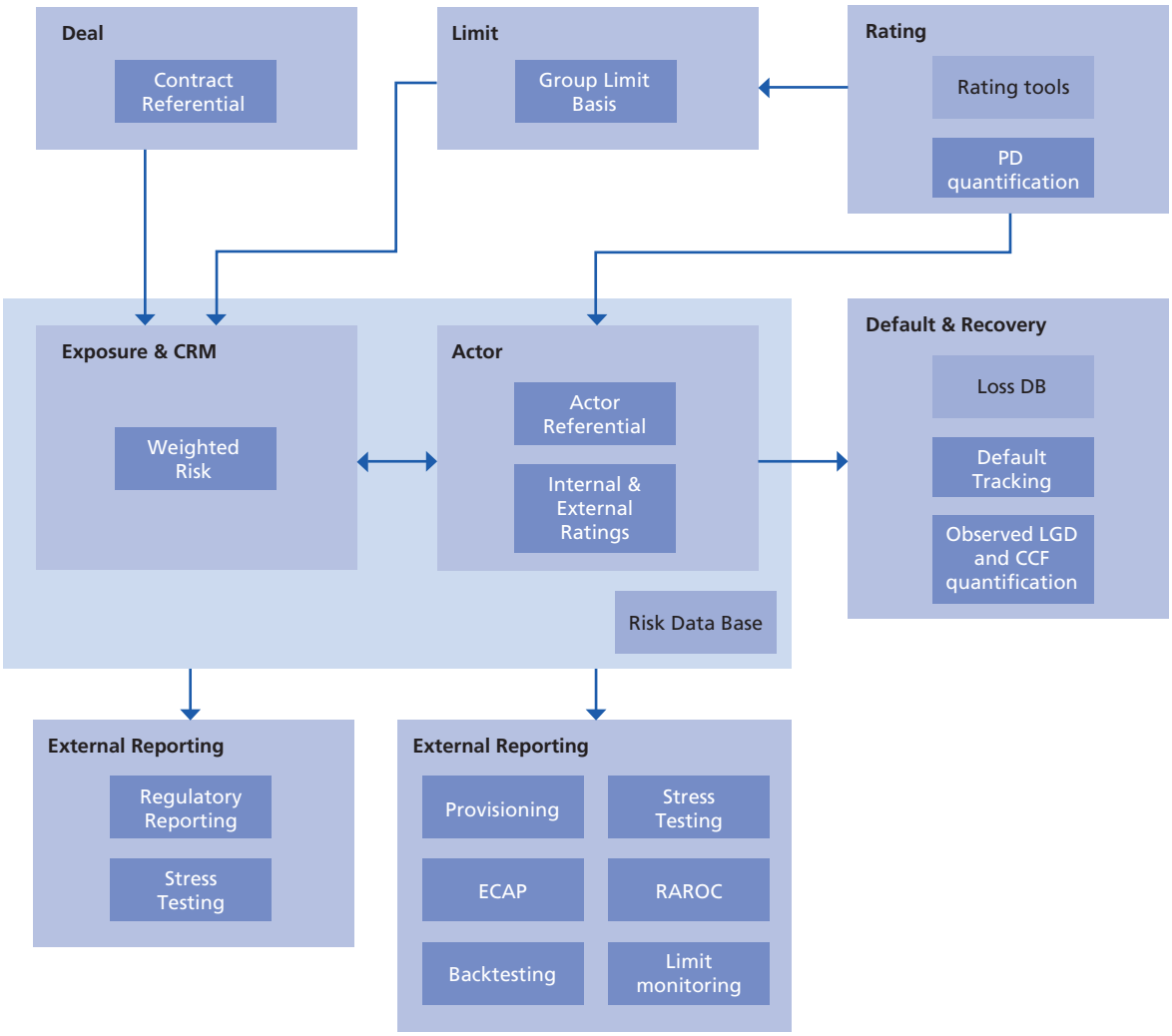
- All models requested by regulators (e.g. Basel II, IFRS II) or for business purposes;
- All risks deployed in the company, such as credit, market, operational and BSM related risk…;
- All Dexia Group entities (cross-entity dimensions);
- All geographical locations (cross-border dimensions).

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 Operational Validation & Quality Control department. Audit acts as an additional level of control, included in its audit plan.
The Risk Committee can delegate application modalities for their decisions to other specialized Risk Committees (within the limits and rules defined by the RC).

4. Credit Risk IT Systems

Since the implementation of Basel II Dexia reinforced the integration of its risk management IT systems and promoted 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 risk IT architecture was partially reviewed in order to meet to the integrate Dexia unwinding process.
The following chart provides a global view of the functional architecture of the credit risk information system within Dexia Group as of 2012/12/31.



The core of credit risk IT systems is build around the actor and exposure information. Both concepts are united the central risk data base system which gathers information on all Dexia credit counterparties (identified by a unique internal identification number) and their corresponding exposures and credit risk mitigants.

The actor universe consists of referential information and rating information:
- Type of counterparty (bank, corporate,,local authority, 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 individual rating analysis is made within different rating tools, either individually or in batch, by the credit risk expertise centers. This internal rating data together with the external ratings are collected and linked in the actor data base.

The second component of the central risk data base is the exposure and CRM universe. A precise view on the exposure with significant amounts valuations (nominal, outstanding, mark-to-market, accrued interests, etc) are joined with the credit risk mitigants (collateral and guarantees) to have a integrated risk view on the positions taken by the group.

Around the central risk three other data situate for different purposes.
- The *contract referential data bases* containing (product type, seniority level, maturity,..).
- In *limit data bases* current limits on any credit counterparty (limit database) are defined using the counterparty rating information. Comparisons are made of current exposure towards the limits in order to take appropriate actions when needed.
- Dexia's *default database* is used to collect the default and recovery information. This serves to calibrate and backtest Dexia internal rating systems.

Dexia's centralized IT systems are linked to a centralised by a reporting infrastructure allowing to produce credit risk reports based on the information gathered on different levels. All these IT and reporting systems support the general risk monitoring for both internal and external purposes are there are:
- External Reporting
  - Regulatory Reporting
  - Pillar 3
  - Regulatory Stress Testing, (EBA)
- Internal Risk Reporting
  - Provisioning
  - Economical Capital Calculations (ECAP)
  - AIRB model backtesting
  - Stress Testing
  - RAROC
  - Limit Monitoring

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

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

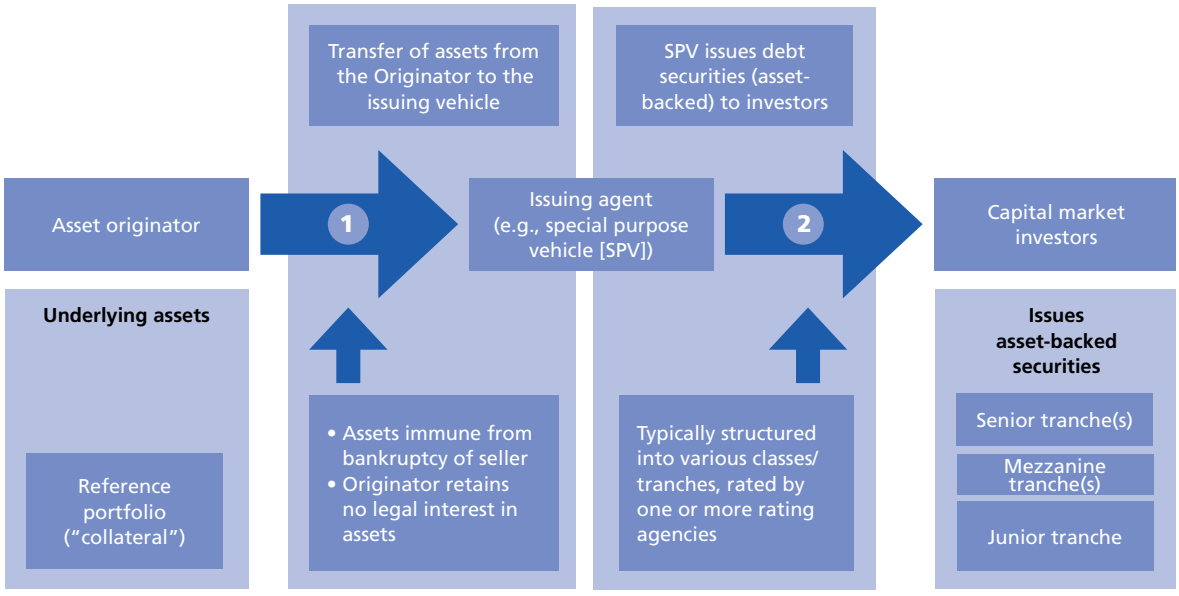
Appendix 3
Basics on Securitization

Securitization is the financial practice of pooling various types of contractual debt such as residential mortgages, commercial mortgages, auto loans or credit card debt obligations and selling said debt as bonds to various investors. The principal and interest on the debt, underlying the security, is paid to the various investors on a regular basis. Securities backed by mortgage receivables are called mortgage-backed securities, while those backed by other types of receivables are called asset-backed securities. A variant is the collateralized debt obligation, which uses the same structuring technology as an ABS but includes a wider and more diverse range of assets.
The originator initially owns the assets engaged in the deal. This is typically a company looking to seek financing or to raise capital.
A suitably large portfolio of assets is « pooled » and transferred to a "special purpose vehicle" or « SPV » (the issuer), a company or trust formed for the specific purpose of purchasing or funding the assets. Once the assets are transferred to the issuer, there is normally no recourse to the originator. The issuer is "bankruptcy remote," meaning that the assets of the issuer are legally separated from the creditors of the originator. Additionally, the governing documents of the issuer will restrict its activities to only those necessary to complete the issuance of securities.

Tranching

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

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



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 and Dexia Crédit Local have securitization vehicles:
- Two for Dexia Crediop (DCC and Tevere Finance);
- One for DCL (Triplus)

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

Dexia Crediop arranged an issuance programme composed of three transactions in order to securitize local public sector 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 of 31 December 2012, the outstanding commitments amounted to EUR 690.7 million and EUR 3 million respectively (Series 2004-1) for class A and class B; the outstanding commitments amounted to EUR 614.5 million and EUR 3 million respectively (Series 2005-1) for class A and class B and the outstanding commitments amounted to EUR 2,054.5 million and EUR 46.2 million respectively (Series 2008-1) for class A and class B.
Class A securities were subscribed by DMA and Class B securities were subscribed by Dexia Crediop.

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 (Tevere Finance series I & II) with the intention of providing funding with the use of senior ABS (previously re-purchased) in Repo transaction with the European Central Bank (the underlying assets are not ECB eligible).
The Tevere Finance series I has been closed during the last quarter of 2010 and all the underlying bonds have been transferred part to Dexia Kommunalbank Deutschland and part to the Dexia Crediop portfolios.
The underlying assets of Tevere Finance series II are loans granted to an Italian financial institution. Two classes of notes were issued: Class A (original size: EUR 253.9 million) and Class B (original size: EUR 1 million). Class A is rated A (S&P) while class B is unrated. As of 31 December 2012 the outstanding commitments amounted to EUR 199.6 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, whose 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 of 31 December 2012 the outstanding commitments amounted to EUR 307.2 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 JPY 70.2bn of Japanese municipal loans with the intention of providing funding with the placement of senior tranches (JPY 65.5bn) 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 JPY 4.7 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 has been arranged by Mitsubishi UFJ Securities Co., Ltd. The final maturity (corresponding to the maturity of the class B note) is May 20, 2039.
As of December 2012, the outstanding amount is JPY 63.14bn (EUR 552 million) and is composed as follow:
- Class B note: JPY 4.7bn (EUR 41 million) – non rated note retained by DCL Paris
- Class A1 note: JPY 36m (EUR 0.3 million) – note placed on the market
- Class A2 note: JPY 40.4bn (EUR 353 million) – note placed on the market
- Class A3 note: JPY 5.7bn (EUR 50 million) – note placed on the market
- Class A4 note: JPY 12.3bn (EUR 108 million) – note placed on the market

Amortization are allocated to each note one by one: A1, then A2, etc. This explains why only the A1 notes have amortized since 12/31/2011.

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 of 31 December 2012 the rating of the class A notes was B+/Ba3, the rating of class B notes was CCC+/B3 and the rating of the class C notes was CCC/Caa2 (S&P and Moody's respectively). The tranches have been placed with several investors. The bonds (underlying assets) will remain on the Dexia Crédit Local Dublin Branch balance sheet and will continue to be administered by the company. The portfolio amounted to GBP 1.05 billion (EUR 1.29 billion) as of 12/31/2012.

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 2012, the outstanding amount of all securitizations originated by DRECM in the previous years amounted to USD 173 million (EUR 131 million).