2014

Risk Report

Pillar 3 of Basel III

DEXIA

Contents

Introduction

Basel III is the response of the Basel Committee on Banking Supervision (BCBS) to the financial crisis, which revealed some deficiencies in the Basel II regulation as to appropriately measuring credit risk.

As a result the Basel Committee undertook a comprehensive set of reform measures, known as the Basel III reform, aimed at strengthening the regulation, supervision and risk management of the banking sector.

In 2013, the European Parliament and Council adopted a set of measures to implement the Basel III reform within the EU legal framework. Taking effect on 1 January 2014, with some provisions to be phased-in between 2014 and 2019, the Capital Requirement Regulation (CRR) and Capital Requirement Directive IV (CRD IV) form the common regulatory bases for all Member States in implementing Basel III capital requirements. The CRR contains detailed prudential requirements for credit institutions and investment firms while the CRD IV was transposed by Member States within their respective national legal frameworks.

The Basel III capital standards have significantly improved the minimum requirements framework by introducing:

- New capital definition and capital buffers;
- Liquidity and stable funding requirements;
- Governance requirements;
- A leverage ratio to complement the risk-weighted framework and restrict the build-up of excessive leverage;
- Own funds for Credit Valuation Adjustment (CVA) risk;
- Additional disclosure for large exposures.

The general framework defined by Basel II, which is developed around three pillars, is upheld.

First Pillar

The first pillar, related to 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 through three different approaches: Standard Approach, Foundation Internal Rating-Based Approach and Advanced Internal Rating-Based Approach;
- Market risk through two approaches: Standard Approach and Internal Model Approach; and
- Operational risk through three approaches: Basic Indicator Approach, Standard Approach and Advanced Measurement Approach.

Regarding credit risk, since 1 January 2008, Dexia has been authorised to use the Advanced Internal Rating-Based Approach (AIRB Approach) for the determination of its regulatory capital requirements under the Basel III Pillar 1 for credit risk and for the calculation of its solvency ratios.
This 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 nevertheless decided to maintain a Standard Approach for some portfolios for which this approach is specifically authorised by the Basel III framework, such as small business units and non-material portfolios.

As a result of the disposal of some entities and to the drastic decrease of some portfolios, Dexia presented an official request to the National Bank of Belgium (NBB) to switch some portfolios from the Advanced to the Standard Approach. These portfolios have indeed become non material in terms of exposures and/or number of counterparties. The switch from Advanced to Standard Approach has been implemented as from June 2013 reporting date following the NBB's official acceptance. There have been no changes in the list of portfolios under the Advanced Approach in 2014.

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 Standard Approach for specific interest rate risk.

For operational risk, Dexia applies the Standard Approach. In this regard, an information file was submitted to the regulator in June 2007. Incident collection and reporting are made on a regular basis and the Risk and Control Self-Assessment (RCSA) process covers the entire bank, including foreign subsidiaries and branches.

Second Pillar

The aim of the second Pillar processes is to enhance the link between an institution's risk profile, its risk management and risk mitigation systems, and its capital planning. Pillar 2 can be divided into two major components:

- aimed at institutions, where those are expected to establish sound, effective and complete strategies and processes to assess and maintain, on an ongoing basis, the amounts, types and distribution of internal capital commensurate to their risk profiles (ICAAP), as well as robust governance and internal control arrangements, and
- Supervisory Review and Evaluation Process (SREP). The key purpose of SREP is to ensure that institutions have adequate arrangements, strategies, processes and mechanisms as well as capital and liquidity to ensure a sound management and coverage of their risks, to which they are or might be exposed.

Third Pillar

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.

New Items under Basel III

Part Eight of Regulation No 575/2013 of the European Parliament and Council dated 26 June 2013 defines the disclosure requirements updating the framework of the Pillar 3 report. New items include in particular:

- *a declaration by the Management Board on the adequacy of risk management arrangements with the institution's profile and strategy;*
- *a description of the institution's overall risk profile associated with the business strategy;*
- *precisions regarding counterparty credit risk, due to the implementation of CVA under Basel III.*

Frequency of Disclosure

The Pillar 3 report has been published since 2008. The disclosure is organised on an annual basis together with the publication of the annual report.

Medium

Dexia releases the Risk Report – Pillar 3 of Basel III on Dexia and Dexia Crédit Local's websites: www.dexia.com and www.dexia-creditlocal.fr.

Currency

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

Scope of Application

Dexia Credit Local, as an institution controlled by a EU parent financial holding company, shall comply with the obligations laid down in Part Eight of the CRR in the framework of Pillar 3 disclosure requirements under the new Basel III capital framework on the basis of the consolidated situation of the financial holding company.
This consolidation is achieved by Dexia located at Tour Bastion, 5 Place du Champ de Mars, B-1050 Brussels, Belgium.

Due to the Group orderly resolution, in the 2014 Pillar 3 report, gross figures of activities held for sale as at 31 December 2013 (mainly Dexia Asset Management Group and Banca Popular Privada) are presented separately from figures of continuing activities. There was no more entity held for sale as at 31 December 2014.

Pillar 3 Contents

Part of the information requested by the CRR to comply with the disclosure requirements is provided in Dexia and Dexia Crédit Local's annual reports. In such case, a clear reference has been included.

Dexia Crédit Local's annual report 2014 is available on http://www.dexia-creditlocal.fr/DCL/informations-juridiques-financieres/annual-report/Documents/DCL_RA_2014_EN.pdf

Dexia's annual report 2014 is available on http://www.dexia.com/EN/journalist/publications/annual_reports/Documents/RA_2014_EN.pdf

The quality of the provided information is guaranteed by an internal validation process at the level of Dexia. The Pillar 3 report is a joint publication of the Risk Management and Finance support lines. Final validation of the Pillar 3 disclosure is performed by the Management Board. Statutory Auditors' approval is not required. Information is not disclosed if considered non material, proprietary or confidential.

Dexia's Key Figures and Risk Profile

Due to the orderly resolution plan, Dexia's residual assets are managed in run-off. New transactions are only performed with a view to reducing the risk profile.

The risk profile is illustrated by the following key figures as at 31 December 2014:

- Common Equity Tier 1 ratio stood at 16.4% and Total Capital ratio at 17.2%.
- Total weighted risks amounted to EUR 53.4 billion.
- Credit risk
  - Dexia's maximum credit risk exposure (MCRE) amounted to EUR 172.2 billion, mostly concentrated on Public Sectors Entities (50%), considering the former activity of the Group, and on the Eurozone (61%) as well as the United States and Canada (17%);
  - high quality assets with 86% of the portfolio Investment Grade; the non-investment grade exposures are predominantly situated in the 'BB' range;
  - Total impairments amounted to EUR 894 million, of which EUR 490 million of collective impairment on loans and advances to customers, and EUR 309 million of specific impairments on loans and advances to customers;
  - Weighted credit risks (EUR 49.4 billion) are mostly on Financial Institutions (27%), Public Sector Entities (23%), Corporate & Project Finance (20%), and Sovereigns (17%);
  - Counterparty credit risk on derivatives and repo is included in the weighted credit risks figure and amounted to EUR 6.1 billion.
- Market Risk (including interest rate and FX risk)
  - The end-of-period value at risk amounted to EUR 13.3 million, mostly concentrated on interest rate and FX (EUR 8.3 million) and spread (EUR 4.7 million);
  - Weighted market risks amounted to EUR 2.9 billion.
- Operational risk
  - Weighted operational risks amounted to EUR 1 billion.

1. Risk Management Objectives and Policies

The Risk activity line defines and controls the banks' risk appetite while providing an accurate view on the risks that Dexia faces. It ensures that new emerging risks are timely identified through best practice watch-list management.

The role of the Risk activity line is to define the Group's strategy on monitoring and managing risk and to put in place independent and integrated risk measures. The activity line seeks to identify and manage risk. If necessary it proactively alerts the relevant committees and proposes corrective actions where applicable. In particular, the Risk activity line decides on the amount of impairments deemed necessary to cover the risks to which the Group is exposed.

The main missions of the Risk activity line are to:

- Set up risk policies, guidelines, calculation methodologies and limits to constrain risk generated by the bank activities;
- Establish a comprehensive and integrated assessment of risks: integrated risk map with appropriate granularity of risk factors, demonstrating diversification and major sensitivities/vulnerabilities in order to assess the adequacy of capital to Dexia's risk profile;
- Control and monitor credit, market and operational risks;
- Anticipate negative risk evolution so that action can be taken by the Bank to mitigate such risk;
- Pro-actively manage strategic and regulatory projects and evaluate potential impact of regulatory evolutions;
- Set frameworks to better identify areas increasing operational risk so that dedicated mitigating action plans can be implemented by the relevant activity lines;
- Maintain appropriate data-warehouses and risk systems ensuring timely and accurate regulatory and internal risk reporting;
- Implement best risk management practices in the whole Group and maintain efficient coordination with subsidiaries' and branches' risk units.

1.1. Risk Organisation and Governance

Implementation of the company project initiated by the Group in 2013 resulted in significant developments for the Risk activity line, which now focuses on its control functions. The organisation and governance of the activity line therefore evolved considerably over the year 2014.

1.1.1. Organisation

The role of the Risk activity line is to define the Group's strategy on monitoring and managing risk and to put in place independent and integrated risk measures. The activity line seeks to identify and manage risk. If necessary it proactively alerts the relevant committees and proposes corrective actions where applicable. In particular, the Risk activity line decides on the amount of impairments deemed necessary to cover the risks to which the Group is exposed.

1.1.1.1 Role of the Management Board and the Transaction Committee

The Management Board is responsible for the various policies and directives framing Group strategy, particularly with regard to risk. To facilitate Group operations, a system of delegation of Management Board powers has been put in place.
The Management Board delegates its decision-taking powers in relation to operations giving rise to credit risks to a Transaction Committee. This committee includes the heads of the Assets, Funding and Markets, Finance, Risk and General Secretariat, Legal and Compliance activity lines. It can decide to submit larger credit files or those presenting a risk level considered sensitive to the Management Board which remains the body taking the ultimate decision. For each file presented to the Transaction Committee, an independent analysis is performed, to reveal the main risk indicators, and a qualitative analysis of the transaction.
Some of the powers of the Transaction Committee are delegated to the Assets and the Risk activity lines depending on the nature of the portfolios or risks concerned.
The Risk activity line establishes risk policies and submits its recommendations to the Management Board and to the Transaction Committee. It deals with the monitoring and operational management of Group risks under the supervision of these two committees.

1.1.1.2 Organisation of the Risk Activity Line

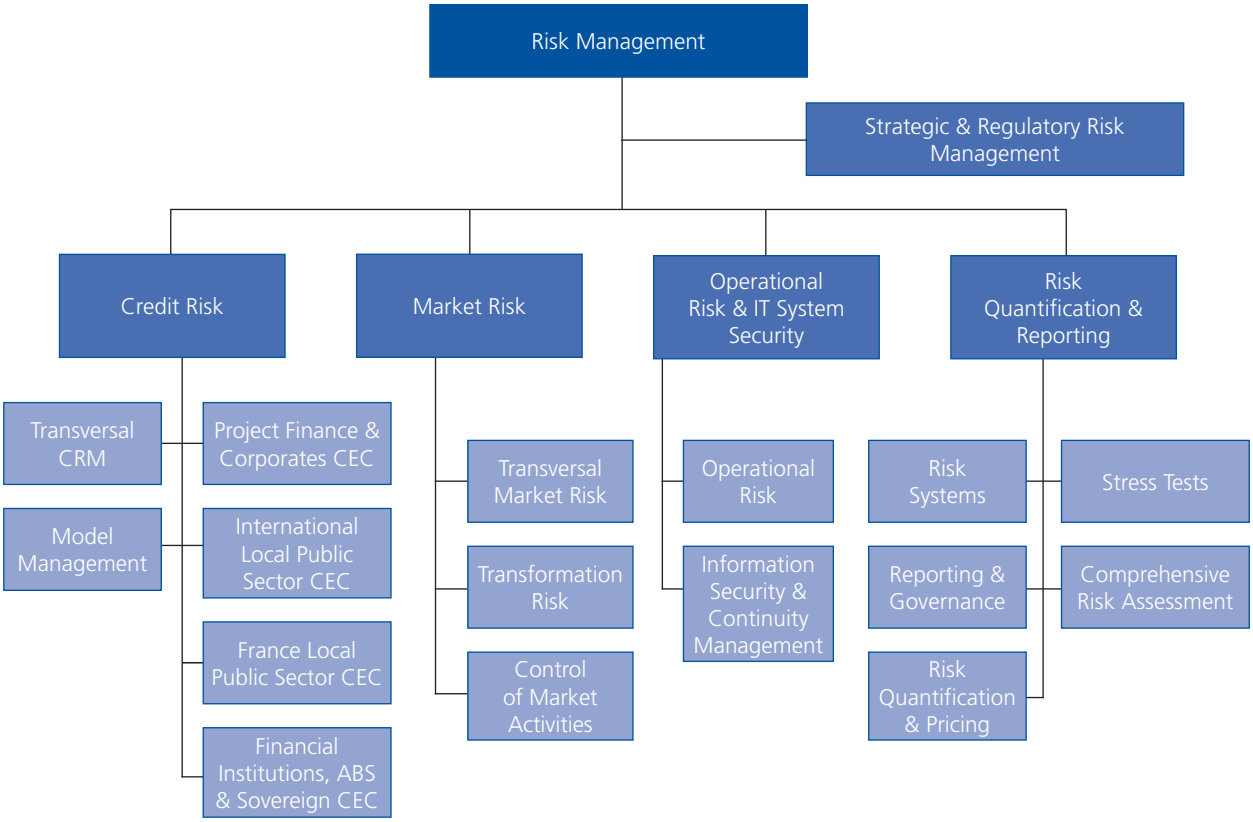
The Risk Management Executive Committee

The decision-taking body of the Risk activity line is its Executive Committee. This committee consists of the Chief Risk Officer and the five heads of:

- The credit risk department,
- The market risk department,
- The operational risk department,
- The strategic risk and regulatory supervision department,
- The risk quantification and reporting department, combining all the support functions of the activity line.

It meets on a weekly basis to review risk management strategies and policies as well as the main internal reports prior to their dissemination outside the activity line. In addition, it is responsible for monitoring regulatory issues, validating collective provisioning methodologies and the general organisation of the activity line.

The organisation and operation of the activity line also relies on certain committees, the prerogatives of which are governed by a system for the delegation of powers.



Credit Risk

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

The credit risk department defines the Group's credit risk policy, which encompasses supervision of the processes for rating counterparties, analysing credit files and monitoring exposures within the Group. It also determines the impairments and collective provisions presented quarterly within the accounts coordination committee.

Along with the Management Board and the Transaction Committee, several committees, which meet quarterly, supervise the handling of specific risks:

- The **Watchlist Committee** supervises assets considered "sensitive", placed under watch, and decides on the amount of impairments set aside;
- The **Default Committee** screens and monitors counterparties in default by applying Group internal rules, in compliance with the regulatory framework;
- The **Rating Committee** ensures that rating processes are aligned with the established principles and that those processes are consistent across the Group's various entities.

Market Risk

Market risk represents the Group's exposure to changes in market parameters, such as interest and exchange rates.
Interest rate risk consists of structural interest rate risk and specific interest rate risk associated with a given credit counterparty. The latter arises from fluctuations in the credit spread on specific counterparties within a rating class.
The foreign exchange risk represents the potential decrease in the value of assets arising from fluctuations in exchange rates against the euro, which is the reference currency in which the Dexia Group prepares its financial statements.
The market risk department is responsible for supervising the market risk under the aegis of the Management Board and specialist risk committees. It identifies, analyses and monitors risks and results (including financial instrument valuations) associated with market activities.
The risk management department consists of both central and local teams. The central teams define Group-wide methods for calculating and measuring risks and results. They are tasked with measuring, reporting and monitoring the risks and results on a consolidated basis for each of the activities for which they are responsible, on the basis of reports produced by the product control department, recently created within the Finance activity line. Local teams within each operating entity are tasked with monitoring day-to-day activity. They ensure that Group policies and guidelines are properly applied, and are responsible for assessing and monitoring risk, working directly with the operational teams.
Market risk policy and management are in the hands of the Management Board and the Risk Management Executive Committee. To facilitate operational management, a system of delegated authority has been put in place within the Group.

- The **Market Risk Committee** is responsible for market risk governance and standards. It defines the risk limits that form the general framework for the Group's risk policy and approves hedge transactions by delegation from the Management Board. It meets on a monthly basis.
- The **Valuation and Collateral Monitoring Committee** meets quarterly to analyse indicators relating to the collateral management and to monitor the valuation of structured products.

Transformation Risk

Monitoring transformation risk involves monitoring the risk of loss associated with the transformation of the banking portfolio as well as liquidity risk.
Transformation risk arises when assets are refinanced by resources presenting a different maturity, indexation or currency. It includes structural risks associated with the financing of holdings with equity in foreign currencies.
Liquidity risk measures Dexia's ability to deal with its current and future cash requirements, both on a discounted basis and in the event of a deterioration in the Group's environment, on the basis of a range of stress scenarios.
Within the Risk activity line, a dedicated Asset and Liability Management (ALM) Risk team is in charge of defining the risk framework within which management may be placed in the hands of the Financial Strategy department within the Finance activity line, of validating the models used to actually manage risk, and of monitoring exposures and checking compliance with Group standards. ALM Risk also defines the stresses to be applied to the various risk factors, validates the risk management approach adopted by the Finance activity line and ensures that it complies with the regulatory framework in force.
ALM is supervised by the Dexia Management Board, which meets on a quarterly basis to determine the global risk framework, set limits, guarantee the consistency of strategy and delegate operational implementation to local ALM committees.
The Management Board approves ALM transactions, centralises and coordinates the decision-taking process concerning liquidity matters. It is periodically informed of the Group's liquidity position and its evolution and its cover by short, medium and long-term resources. It ensures that liquidity targets are met and contributes to elaborating strategies for funding and asset deleveraging.
In the Group's subsidiaries and branches, local committees manage specific balance-sheet risks within the framework defined by the Group's Management Board, under the latter's responsibility.

Operational Risk and IT Systems Security

Operational risk represents the risk of financial or non-financial impacts arising from a shortcoming or failure in internal processes, personnel or systems, or external factors. This definition includes IT, legal and compliance risks.
Operational risk, activity continuity and IT systems security management is coordinated by a central team within the Risk activity line supported by a network of correspondents within all subsidiaries and branches, as well as within the Group's various departments. Within each activity domain, an operational risk correspondent coordinates data collection and assesses risks, supported by the operational risk management function, ensuring good continuity management.
The Management Board regularly monitors the evolution of the risk profile of the various Group activities and delegates the operational management of risk monitoring to the **Operational Risk Committee**. Meeting quarterly, this committee examines the main risks identified and decides on the corrective actions to be taken. It validates measurement, prevention or improvement proposals in relation to the various elements of the mechanism.
The Operational Risk Committee relies on committees dedicated to activity continuity and IT systems security, meeting every two months. They examine and decide on actions to be taken to guarantee activity continuity and the implementation of a policy for IT systems security.

1.1.2. Governance

The elements related to the description of governance arrangements pursuant to Article 435 §2 of the regulation (EU) no. 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms ("CRR") are disclosed in Section "Corporate goverance and internal control" of Dexia Crédit Local's registration document 2014, on pages 58-83, as well as, if needed at the Dexia level, in the Declaration of corporate governance published in Dexia 's annual report 2014, on pages 42-67.

The Management Board presides over Risk Management governance. The Risk activity line puts in place independent and integrated risk measurements and indicators. The governance of the Dexia Group is adapted to its run-off situation and to its risk profile.

2. Own Funds and Capital Adequacy

Dexia monitors changes in its solvency using the rules defined by the Basel Committee on Banking Supervision and the European CRD Directive, as well as the ratios set for the Group by the Committee of European Supervisors. The year 2014 was marked by the implementation of the Basel III reform, a consequence of the adoption of the texts of the CRD IV Directive in Europe in 2013. The passage from Basel II to Basel III was reflected from 1 January 2014 by:

- Replacement of the Core Tier 1 ratio by the Common Equity Tier 1 or CET1 ratio, the latter being the ratio of the amount of Tier 1 equity to total weighted risks;
- Redefinition of the Tier 1 ratio, being the ratio of the amount of regulatory capital in the strict sense including hybrid Tier 1 capital to total weighted risks;
- Replacement of the Capital Adequacy ratio (CAD) by the Total Capital ratio, the latter being the ratio of total regulatory capital to total weighted risks as defined by CRD IV.

2.1. Own Funds

2.1.1. Accounting and Regulatory Equity Figures

The consolidation scope of the Pillar 3 report is the same as the consolidation scope of the financial statements (as released in Dexia's annual report).

	31/12/2014		
	Financial Statements	Regulatory purposes	Difference
Equity, Group share	2,711	8,695	5,984
of which share capital and related reserves	*2,486*	*2,446*	*(40)*
of which consolidated reserves	*7,470*	*7,470*	*0*
of which gains and losses directly recognised in equity	*(6,639)*	*(615)*	*6,024*
of which net result of the period	*(606)*	*(606)*	*0*
Minority interests	417	341	(76)
TOTAL EQUITY	**3,128**	**9,036**	**5,908**
Prudential filters		(283)	
Common Equity Tier 1		8,754	
Additional Tier 1		75	
Tier 2		327	
TOTAL CAPITAL		**9,157**	

2.1.2. Regulatory Capital

The regulatory capital can be broken down as follows:

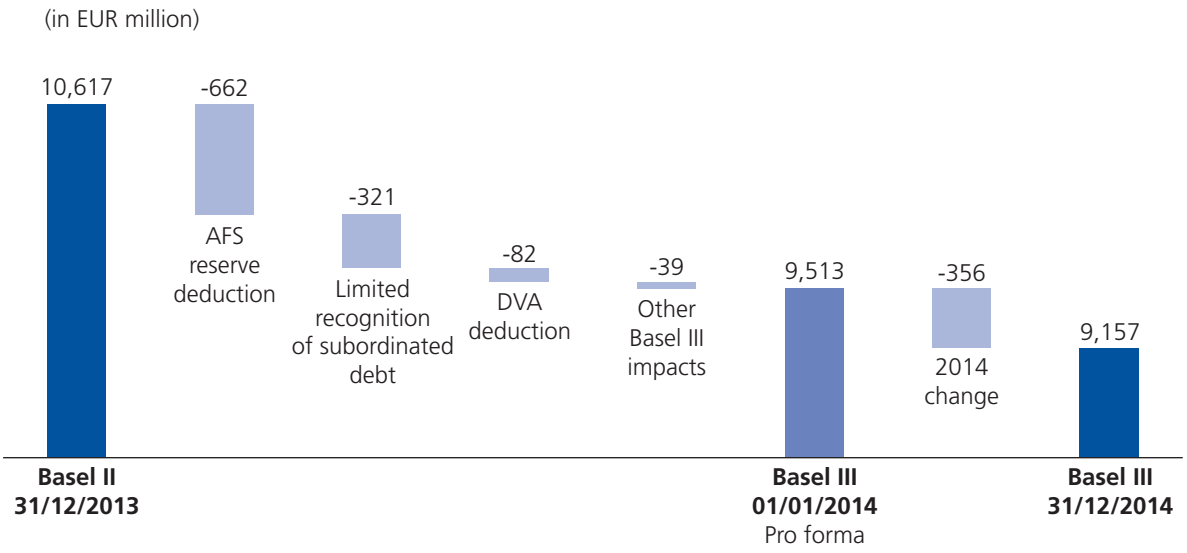
- Common Equity Tier 1 capital, consisting of regulatory capital including share capital, premiums, retained capital including profits for the year, gains and losses directly recognised in equity (revaluation of financial assets available for sale, revaluation of cash flow hedge derivatives and translation adjustments), the eligible amount of non-controlling interests after deduction intangible assets, goodwill, accrued dividends, own shares, the amount exceeding thresholds provided with regard to deferred tax assets and for holding shares and interests in credit or financial institutions and elements subject to prudential filters (own credit risk, Debit Valuation Adjustment, cash flow hedge reserve), possibly adjusted for prudent valuation;
- Regulatory capital in the strict sense including Common Equity Tier 1 and hybrid capital (Tier 1 Capital);
- Additional Tier 2 capital which includes the eligible portion of long-term subordinated debt as well as surplus provisions on the level of expected losses, reduced by the surplus amount of thresholds provided with regard to holding subordinated debt issued by financial institutions;

In accordance with regulatory requirements and applicable transitional provisions:
- Gains and losses directly recognised in equity as revaluation of non-sovereign bonds[1] classified as "available for sale" (AFS) are progressively taken into consideration over a period of five years from 1 January 2014 at 20% per annum cumulatively;
- Gains and losses directly recognised in equity as revaluation of shares are progressively taken into consideration in Tier 1 capital over a period of five years at 20% per annum from 1 January 2014. However gains and losses directly recognised in equity are excluded from the transitional provisions in 2014;
- Non-controlling interests are partially eligible for Tier 1 capital; their limited inclusion is the object of transitional provisions;
- Certain adjustments on subordinated debts and debts must be taken into consideration in the calculation of capital in order to reflect the loss-absorption characteristics of these instruments.

With the adoption of Basel III on 1 January 2014, Dexia Group's regulatory capital decreased by EUR -1.1 billion, mainly due to following factors:
- A 20% deduction of the AFS reserve on non-sovereign securities, with an impact of EUR -662 million;
- A reduction of the recognition of subordinated loans, with an impact of EUR -321 million;
- A deduction of the Debit Valuation Adjustment (DVA), for EUR -82 million.

These elements are illustrated in the graph below.

Main impacts of the first-time application of the CRD IV / CRR on Dexia's regulatory capital



At the end 2014, Dexia Group's Total Capital amounted to EUR 9,157 million, compared to EUR 10,617 million as at 31 December 2013. This EUR -1,460 million decrease can mainly be explained by the impact of the first-time application of the Basel III standards and the loss recorded over the year.
Common Equity Tier 1 followed a similar trend and was at EUR 8,754 million as at 31 December 2014, compared to EUR 10,054 million as at 31 December 2013.

(1) The National Bank of Belgium (NBB) and the French "Autorité de Contrôle Prudentiel et de Résolution" (ACPR) have confirmed that the rules applicable to Dexia and to Dexia Crédit Local for the calculation of their regulatory solvency ratios during the transitional period from 1 January 2014 to 31 December 2017 would be identical. For both Dexia Group and Dexia Crédit Local, the AFS reserve on sovereign securities does not have to be taken into account for the calculation of the solvency ratios and the AFS reserve relating to non-sovereign exposures has to be deducted from the regulatory capital up to an amount of 20% per annum.

	Regulatory Capital		
	Basel II 31/12/2013	Basel III 01/01/2014*	Basel III 31/12/2014
TOTAL CAPITAL	**10,617**	**9,513**	**9,157**
Common Equity Tier 1	**10,054**	**9,268**	**8,754**
Core shareholders' equity		9,919	9,311
Gains or losses directly recognised in equity on available-for-sale or reclassified assets		(661)	(642)
Cumulative translation adjustements (group share)		(55)	32
Actuarial differences on defined benefit plans		(2)	(5)
Non-controlling interests eligible in Tier 1		353	341
Items to be deducted:		(285)	(283)
Untangible assets and goodwill		*(95)*	*(23)*
Ownership of Common Equity Tier 1 instruments in financial institutions (>10%)		*0*	*(2)*
Own credit risk		*(104)*	*(104)*
Deferred tax assets		*(4)*	*0*
DVA		*(82)*	*(154)*
Additional Tier 1	**96**	**77**	**75**
Subordinated debt		77	77
Items to be deducted:		0	(1)
Ownership of Tier 1 instruments in financial institutions (>10%)		*0*	*(1)*
Tier 2 Capital	**467**	**168**	**327**
Subordinated debt		108	69
of which additional Tier 1 reclassified		*19*	*19*
IRB provision excess (+); IRB provision shortfall 50% (-)		68	318
Items to be deducted:		(8)	(59)
Ownership of Tier 2 instruments in financial institutions (>10%)		*(8)*	*(59)*

**Pro forma*

On that date, the Group's Tier 1 hybrid capital securities represented a nominal total of EUR 96 million, including EUR 77 million eligible as additional Tier 1 as at 31 December 2014.

No hybrid debt buyback operations were carried out in 2014. The Group's hybrid Tier 1 capital therefore consists of:

- EUR 56.25 million nominal of perpetual non-cumulative securities issued by Dexia Crédit Local. These securities (FR0010251421) are listed on the Luxembourg Stock Exchange
- EUR 39.79 million nominal of perpetual non-cumulative securities issued by Dexia Funding Luxembourg, today incorporated with Dexia. These securities (XS0273230572) are listed on the Luxembourg Stock Exchange.

Tier 2 capital amounted to EUR 327 million as at 31 December 2014 and includes EUR 69 million of subordinated debt eligible as at 31 December 2014 and issued by Dexia Crédit Local and its subsidiaries.

Dexia's revised orderly resolution plan includes certain restrictions concerning the payment of coupons and the exercise of calls on subordinated debt and hybrid capital from the Group's issuers. In this way, Dexia is only required to pay coupons on hybrid capital and subordinated debt instruments if there is a contractual obligation to do so. Dexia cannot exercise any discretionary options for the early redemption of these securities.

In addition, as announced by Dexia on 24 January 2014[2], the European Commission refused to authorise the Group's proposal to repurchase the hybrid capital debt issued by Dexia Funding Luxembourg (XS0273230572), noting that the subordinated creditors must share in the financial burden resulting from the restructuring of financial institutions that have been granted State aid. The European Commission has also informed Dexia that it is authorised to communicate this information to the holders of this instrument and to the holders of financial instruments with identical characteristics. Financial instrument FR0010251421 issued by Dexia Crédit Local has similar characteristics.

The European Commission requested that Dexia communicates that this decision relates to its own situation and does not mean that similar decisions will be taken in respect of such financial instruments issued by other European banks subject to orderly resolution plans under the supervision of the Commission.

(2) Cf. press release from 24 January 2014 published on www.dexia.com.

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 2014.

Regarding credit risk, the breakdown by exposure class presented in the following table reflects the presence of Dexia in financing public sector entities and project finance. Details on exposure classes are provided in Appendix 2.

			31/12/2013		31/12/2014	
Type of risk	**Basel III treatment**	**Exposure class**	**Weighted risks**	**Capital requirements**	**Weighted risks**	**Capital requirements**
Credit risk	Advanced	Corporate	3,173	254	4 032	323
		Equities	350	28	2	0
		Financial Institutions [1]	5,270	422	11 731	938
		Project Finance	4,152	332	4 354	348
		Public Sector Entities	2,595	208	2 761	221
		Securitisation [2]	31	2	29	2
		Sovereign	7,507	601	7 998	640
		Total	***23,078***	***1,846***	***30,908***	***2,473***
	Standard	Corporate	678	54	783	63
		Equities	1,037	83	1,063	85
		Financial Institutions [1]	956	76	1,384	111
		Monolines	1,329	106	2,014	161
		Project Finance	713	57	730	58
		Public Sector Entities	8,069	645	8,726	698
		Retail (leasing)	2	0	1	0
		Securitisation [2]	12	1	113	9
		Sovereign	128	10	232	19
		Total	***12,923***	***1,034***	***15,047***	***1,204***
	RBA	***Securitisation [2]***	***5,780***	***462***	***3,482***	***279***
		Total	***5,780***	***462***	***3,482***	***279***
Market risk	Internal Model	Interest Rate and Foreign Exchange Risk	971	78	1,415	113
		Total	***971***	***78***	***1,415***	***113***
	Standard	Interest Rate Risk	1,523	122	1,007	81
		Foreign Exchange Risk	173	14	519	42
		Total	***1,697***	***136***	***1,526***	***122***
Operational risk	Basic		**2,526**	**202**	**1 000**	**80**
Total continued activities			**46,975**	**3,758**	**53,378**	**4,190**
Total activities held for sale			**360**	**29**	**0**	**0**

(1) In 2014: o/w weighted risks related to CVA Capital Charge: EUR 3,357 million in Advanced and EUR 116 million in Standard.
(2) Original counterparty is a securitisation vehicle, and final counterparty is in an exposure class in Advanced or Standard Approach.

At year-end 2014, the weighted risks of the Dexia Group amounted to EUR 53,4 billion. The risk weights per type of risk are detailed in the related chapters (credit, market and operational risks).

2.3. Capital Adequacy

2.3.1. Regulatory Solvency Ratios

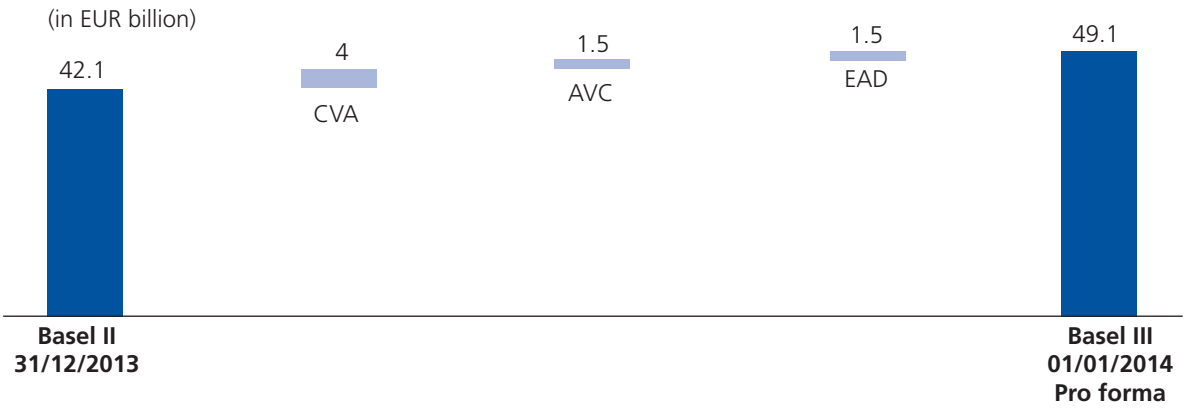
Dexia's Total Capital ratio was 17.2% and its Common Equity Tier 1 ratio was 16.4% as at 31 December 2014. The fall of these ratios by -5.2% and -4.8% respectively from 31 December 2013 was mainly associated with the first-time application of the Basel III regulatory framework, the decrease in regulatory capital resulting from the loss recorded in 2014 having been offset by the reduction of weighted risks.

	Basel II 31/12/2013	Basel III 01/01/2014*	Basel III 31/12/2014
Common Equity Tier 1 ratio	21.2%	17.1%	16.4%
Total Capital ratio	22.4%	17.5%	17.2%

**Pro forma*

As at 31 December 2014, weighted risks were EUR 53.4 billion, including EUR 49.4 billion for credit risk, EUR 2.9 billion for market risk and EUR 1 billion for operational risk.
The first-time application of the Basel III solvency rules resulted in an increase in total weighted risks by EUR 7 billion, particularly the Credit Valuation Adjustment (CVA) (EUR 4 billion), the Asset Value Correlation (AVC) (EUR 1.5 billion), and a change in methodology of the calculation of the Exposure at Default (EaD) (EUR 1.5 billion). These elements are illustrated in the graph below.

Main impacts of the first-time application of the CRD IV / CRR on Dexia's weighted credit risks



Credit Valuation Adjustment (CVA): the CVA is the expected loss resulting from a credit spread move following the potential default of the counterparty on derivatives. Banks are subject to a capital charge for CVA aiming at absorbing potential volatility of CVA associated with the deterioration in the creditworthiness of a derivative counterparty.
Asset Value Correlation (AVC): during the crisis, credit quality of financial institutions deteriorated in a highly correlated manner and proved to be relatively more sensitive to systemic risk than non-financial companies. Consequently, Basel III has increased the Asset Value Correlation (AVC) used in the weighted risk calculation formula for Large Financial Institutions (LFIs) and Unregulated Financial Institutions (UFI) by 25%.
Exposure at Default (EAD): the evolution of the weighted risks has become more volatile following the EAD definition under Basel III. EAD is now directly impacted by interest moves and/or credit spread variations. These evolutions have been implemented in the risk systems in 2013 and the first quarter of 2014.

Excluding this Basel III related impact, the decrease of weighted risks over the year is due to operational risk, down following the reduction of the Group's scope. As for weighted credit risks, the positive impact of natural amortisation and the sale of assets was offset by fair value and exchange rates movements.

Weighted risks			
	Basel II 31/12/2013	Basel III 01/01/2014*	Basel III 31/12/2014
Weighted credit risks	42,141	49,075	49,437
Weighted market risks	2,668	2,668	2,941
Weighted operational risks	2,526	2,526	1,000
Total	**47,335**	**54,269**	**53,377**

**Pro forma*

2.3.2. Internal Capital Adequacy

Following the approval by its Management Board, Dexia has already informed its home regulators (the French Autorité de Contrôle Prudentiel et de Résolution and the National Bank of Belgium) in 2012 about developing an internal holistic capacity, integrating all risks and addressing, inter alia, the Basel Pillar 2 framework and related requirements. A plan has been submitted including a joint estimation of capital and liquidity demand according to this new approach applied as from 2013 closing figures.

This capacity, initially identified as "Risk & Capital Adequacy" (RCA), builds upon key strengths of regular economic capital approaches, stress testing techniques and risk appetite frameworks. It is also devised to be fully integrated into the financial planning process, thus demonstrating the capital and liquidity adequacy as required by regulations. The comparisons between, on the one hand, the levels of available capital and liquidity and, on the other hand, those required to withstand crises at multiple severity levels and horizons are also provided. The articulation of the RCA with more specific stress testing exercises is fully aligned with the one described in the Pillar 2.

In practical terms, the RCA capacity encompasses three key achievements with dedicated IT tools:

1. An Integrated Risk Map (IRM): this IRM is Dexia's comprehensive risk taxonomy and cartography allowing inter alia assessments to measure the sensitivities of the financial and prudential statements to each major identified risk factor (default, rating migration, spread indices, foreign exchange, interest rates…). It covers all qualitative and quantitative risks affecting Dexia beyond the risks of Pillar 1. As an illustration, this IRM provides the sensitivity to a decrease of a major interest rate tenor simultaneously on liquidity reserve, CVA, cash collateral, AFS reserve, hedge accounting, weighted risks, etc. and eventually on available capital, capital ratios and funding sources. This risk map establishes a transparent link between a comprehensive and economic approach of risks and their impact on accounting and prudential measures.

2. Multiple scenario analysis: consistent comparison of risk scenarios and assessment of their impact: multiple risk scenarios (expert, historical, market forwards and Monte Carlo) are consolidated in a single format for comparison and benchmarking purposes. Their impact in terms of capital and liquidity requirements is assessed and benchmarked towards base case scenarios. This achievement aims at ensuring the adequacy between available financial and funding resources and the risks facing the bank for a variety of risk scenarios at different severity levels.

3. Reporting: an integrated cascade of reporting is devised ranging from the most synthetic ones submitted to the boards, to more detailed reporting for intermediate Finance and Risk committees. These reports are designed to meet regulatory requirements in terms of ICAAP and ILAAP (Internal Capital/Liquidity Assessment Process) and above all to provide insights on key risks and drivers of the volatilities of key accounting and prudential indicators. These reports will eventually be used by the departments in charge of optimising Dexia's wind down.

In 2014, the assessment of internal capital demand of multiple forward-looking scenarios following the RCA framework was submitted to Dexia's Audit Committee and Management Board.

The RCA is actually Dexia's answer to ECB's Pillar 2 requirements in the Single Supervisory Mechanism framework. It is the holistic approach assessing Dexia's intrinsic risk profile by "addressing key risks and embodying quantitative and qualitative analysis based on backward and forward-looking information".

As such, it was submitted to the ECB and home regulators in 2014 in the context of the Comprehensive Assessment and the corresponding annual Supervisory Review and Evaluation Process (SREP). It will be subject to further discussion with the regulators in the scheduled regulatory SREP in 2015.

Internal approval and formalisation based on 31 December 2014 closing is underway following an action plan submitted to regulatory authorities.

Finally, the RCA leads to an internally shared transparency on risk providing volatility analysis of financial and strategic planning while addressing multiple requirements of external stakeholders, namely Dexia's regulatory authorities.

2.3.3 Stress Tests

Taking into account the orderly resolution plan, Dexia has carried out Group-wide stress tests in a manner consistent with its risk management process. The purpose of these stress tests is to measure the sensitivity of the Group in the event of adverse shocks, in terms of expected losses, weighted risks, liquidity and capital requirements.

In 2014, Dexia performed a series of stress tests (including sensitivity analysis, scenario analysis and the assessment of potential vulnerabilities) based on macroeconomic scenarios reflecting crisis situations. In addition to regular stress tests covering market and liquidity risk in accordance with regulatory requirements, In 2014 Dexia also carried out stress tests covering the majority of its credit portfolios. In particular, within the framework of Pillar 1 of Basel, the credit exposure covered by internal rating systems is tested for sensitivity and performance under adverse macroeconomic scenarios.

Finally, the comprehensive assessment by the European Central Bank (ECB) integrated stress tests under various scenarios. The main conclusions of the ECB comprehensive assessment are described in the chapter entitled "Highlights" of Dexia's annual report 2014, on pages 11-12.

2.3.3.1. Stress Tests Related to Credit Risk

In the context of the Pillar 1 of the Basel framework, credit exposures covered by the internal rating based approach (IRBA) are regularly subject to sensitivity tests and scenario analyses based on macroeconomic and expert scenarios reflecting crisis situations.

The objective is to estimate the impact of adverse although plausible assumptions of economic recession on the main credit risk parameters: Probability of Default (PD) and Loss Given Default (LGD), and risk measures such as weighted risks, Expected Loss (EL) or direct losses.

A quantitative point in time modelling per credit sector has been developed to link the evolution of the credit risk parameters to the change of the main macroeconomic variables (GDP evolution rate, unemployment rate, interest rate, etc.) under stressed rating migration matrices.

This quantitative modelling is completed by an expert approach to take into account the actual vulnerabilities of each credit sector and the inner limits of historical observations between macroeconomic variables and risk parameters (PD, LGD). These expert scenarios are designed and discussed during the credit workshops with credit risk experts involved in the different asset classes.

A stress test report is drafted for each credit sector, including data description, methodology principles, results and conclusions of different sensitivity and scenarios, as well as possible management actions to face hypothetical and unfavourable situations. The results of the stress test exercise are presented to the Dexia Group Risk Management Executive Committee. All stress test reports are submitted for validation by the internal credit validation team in charge of IRBA models.

2.3.3.2. Stress Tests Related to Market Risk

Market risk stress tests complete the risk management framework by stressing potential exceptional events outside the probability framework of VaR measurement techniques.

They are performed on a quarterly basis on the Group scope. The stress test results are reported to the Market Risk Committee.

A number of scenarios are regularly assessed covering the main market risk factors: interest rate, foreign exchange rate, volatility, credit spread.

Stress tests performed by Dexia can be broken down in three categories:

- Single risk factor (mono-factorial) stress tests, including some stress tests recommended by the banking regulators;
- Integrated historical scenario stress tests: equity crash (1987), monetary crisis (1992), terrorist attack (2001), financial crisis scenario (2008) capturing the turmoil triggered by the Lehman default, sovereign crisis (2012) simulating the crisis propagation of the recent sovereign debt crisis in the Eurozone;
- Integrated hypothetical scenario stress tests.

2.3.3.3. Stress Tests Related to Interest Rate Risk

Dexia applies the supervisory standard shock as defined by the EBA, assessing the change in economic value by more than 20% on own funds as a result of a sudden and unexpected change in interest rates. This test is achieved by means of a 200 basis point parallel shift of the yield curve.

The stress test results are reported to the Management Board.

2.3.3.4. Stress Tests Related to Liquidity Risk

Dexia performs liquidity stress tests to estimate the additional liquidity needs under exceptional although plausible scenarios in a certain time horizon such as:

- Market-wide shocks that affect all banks in the system;
- Idiosyncratic shocks, e.g. due to the deterioration of Dexia's financial situation;
- Combined scenario.

Stress scenarios are applied on balance-sheet and off-balance-sheet components of the residual gap which is the main liquidity driver.

The residual gap is the difference between:

- The dynamic liquidity gap composed of the static liquidity gap profile adjusted of gap assumptions (new transactions, roll of repo, roll of short-term funding,…) defined by the Assets and Liabilities Management (ALM) and Cash and Liquidity Management (CLM) teams;
- The dynamic buffer of reserves composed of the static buffer of eligible reserves adjusted of reserve assumptions defined by the ALM and CLM teams.

Stress tests are mainly performed on wholesale funding, cash collateral and reserves (assets) eligible for Central Bank refinancing funding, deposits and secured funding. The stress encompasses off-balance-sheet commitments and downgrade triggers.

2.4. Significant Banking Subsidiary: Dexia Crédit Local

Dexia Crédit Local (DCL) is Dexia Group's sole significant subsidiary following the orderly resolution plan. DCL exposure amounts are almost the same as those of the Dexia Group.

Dexia Crédit Local's Total Capital ratio was 13.1% and its Common Equity Tier 1 ratio was 12.8% as at 31 December 2014. The fall of these ratios by -5.9 and 5 percentage points respectively from 31 December 2013 was mainly associated with the first-time application of the Basel III regulatory framework.

	Basel II 31/12/2013	Basel III 01/01/2014*	Basel III 31/12/2014
Common Equity Tier 1 ratio	17.8%	14.3%	12.8%
Total Capital ratio	19.0%	14.8%	13.1%

**Pro forma*

As at 31 December 2014, weighted risks were EUR 53.2 billion, including EUR 49.3 billion for credit risk, EUR 2.9 billion for market risk and EUR 1 billion for operational risk.
The first-time application of the Basel III solvency rules resulted in an increase in total weighted risks by EUR 7 billion, particularly the Credit Valuation Adjustment (CVA) (EUR 4 billion), the Asset Value Correlation (AVC) (EUR 1.5 billion), and a change in methodology for the calculation of the Exposure at Default (EaD) (EUR 1.5 billion).
Excluding this impact, the increase of weighted risks over the year is due to operational risk, the amount of weighted risk for which has been brought into line with that of Dexia. As for weighted credit risks, the positive impact of natural amortisation and the sale of assets was offset by fair value and exchange rate movements.

Weighted risks			
	Basel II 31/12/2013	Basel III 01/01/2014*	Basel III 31/12/2014
Weighted credit risks	41,405	48,339	49,252
Weighted market risks	2,668	2,668	2,941
Weighted operational risks	372	372	1,000
Total	**44,445**	**51,379**	**53,193**

**Pro forma*

3. Credit Risk

3.1. Credit Risk Management

Dexia Credit Risk Policy

In order to manage credit risk, Dexia Risk Management has established 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 contributes to the process of granting credit by delegation to different committees and heads of activity lines, within the limits and delegations put in place by the bank's management board and taking part to the Transaction Committee. Within the context of its credit risk surveillance function, Risk Management, and more particularly the different teams in charge of credit risk, follows the evolution of the credit risk of portfolios by regularly analysing credit files and reviewing ratings. It defines and also implements the provisioning policy by qualifying files in default and deciding on specific and collective provisions.

Risk Measures

As Dexia applies the IRBA Advanced approach, the assessment of credit risk relies principally on internal rating systems developed within the context of the Basel reform: in the Advanced approach, each counterparty 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 counterparty's risk of default, expressed through an internal rating scale, constituting a key element in the credit granting process. Ratings are revised annually, allowing proactive identification of the sensitive counterparties and risks. Watch-list committees are organised to monitor sensitive exposures on the basis of objective criteria or expert judgment.

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

3.2. Maximum Credit Risk Exposure

Credit risk is expressed as Maximum Credit Risk Exposure (MCRE) and represents the net carrying amount of exposures, being the notional amounts after deduction of specific impairment and available-for-sale reserve amounts, and taking into account accrued interest and the impact of fair value hedge accounting.
As at 31 December 2014, Dexia's maximum credit risk exposure amounted to EUR 172.2 billion, compared to EUR 173.5 billion at the end of December 2013.

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 2013 and 2014.

Exposure at year-end 2013					
	Eurozone [1]	Rest of Europe [2]	US & Canada	Rest of the World	Total
Loans and advances	**62,784**	**13,085**	2,599	4,440	82,908
Debt securities	37,423	8,201	14,997	8,122	68,743
Repo	470	670	1,552	969	3,661
ABS	1,700	348	4,714	139	6,901
Derivatives	2,697	719	668	66	4,150
Given guarantees	3,307	603	2,007	113	6,030
Retail loans	2	0	0	0	2
Others assets	378	1	15	542	936
Total continued activities	**108,761**	**23,627**	**26,552**	**14,391**	**173,331**
Total activities held for sale	**23**	**0**	**0**	**102**	**125**

(1) Countries using the Euro currency as at year-end.
(2) Including Turkey.

Exposure at year-end 2014					
	Eurozone (1)	**Rest of Europe**	**US & Canada**	**Rest of the World**	**Total**
Loans and advances	**57,974**	**13,601**	3,413	4,859	79,847
Debt securities	35,908	8,173	15,757	8,051	67,889
Repo	3,021	918	2,513	551	7,003
ABS	1,369	258	4,569	48	6,244
Derivatives	3,339	1,003	696	84	5,123
Given guarantees	2,493	619	1,723	67	4,901
Retail loans	3	0	0	0	3
Others assets	423	1	19	783	1,227
Total continued activities	**104,531**	**24,574**	**28,689**	**14,443**	**172,238**

(1) Countries using the Euro currency as at year-end.
(2) Including Turkey.

The overall exposure was stable between 2013 and 2014.

As at 31 December 2014, Dexia's exposure amounted to EUR 172.2 billion, mainly concentrated in the Eurozone (61%).

The fall linked to natural portfolio amortisation and asset sales was offset by an exchange rate effect due to the appreciation of the US dollar and the pound sterling against the euro over the year 2014, fair value adjustments resulting from the tightening of credit spreads and the increase of repos.

Exposure on the other regions remained at the same level compared to December 2013: Rest of Europe (14%) 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 2013 and 2014. For reporting purposes, a rating "master scale" has been applied. This scale is structured in grades ranging from AAA to CCC and the modifiers plus, flat and minus.

Due to different metrics, figures can differ from accounting publications.

Exposure at year-end 2013						
	AAA+ to AA-	A+ to BBB-	NIG(1)	Default	Unrated	Grand Total
Loans and advances	31,474	38,754	11,349	755	574	82,906
Debt securities	22,401	37,719	8,397	222	4	68,743
Repo	0	3,661	0	0	0	3,661
ABS	4,570	1,324	880	101	27	6,901
Derivatives	787	2,487	682	174	19	4,150
Given guarantees	2,347	2,786	753	81	63	6,030
Retail loans	1	0	0	0	4	4
Others assets	177	4	1	12	742	936
Total continued activites	**61,756**	**86,736**	**22,062**	**1,345**	**1,433**	**173,331**
Total activities held for sale	**35**	**12**	**0**	**0**	**79**	**126**

(1) Non-investment grade.

Exposure at year-end 2014						
	AAA+ to AA-	A+ to BBB-	NIG(1)	Default	Unrated	Grand Total
Loans and advances	34,409	33,185	11,031	779	444	79,847
Debt securities	21,560	38,246	7,991	84	9	67,889
Repo	877	6,126	0	0	0	7,003
ABS	4,795	990	446	0	12	6,244
Derivatives	984	3,236	790	92	18	5,120
Given guarantees	2,123	2,048	626	52	52	4,901
Retail loans	0	0	2	0	0	3
Others assets	231	8	1	13	976	1,230
Total	**64,980**	**83,840**	**20,885**	**1,020**	**1,512**	**172,238**

(1) Non-investment grade.

As at 31 December 2014, 86.4% of the exposure was Investment Grade. Non-Investment Grade (NIG) files represented 12.1% of total Dexia portfolio, 0.9% were unrated and 0.6% were in default.

The geographical split of NIG files shows a predominance of European assets (91.3%), including 73.5% of total NIG in GIIPS countries, mostly Spain, Italy and Portugal. Public Sector (54.0%) and Project Finance/Corporate (21.4%) are the sectors in which the largest amount of NIG files is observed. The majority of the files (93.2%) are in the BB category.

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 2013 and 2014.

Exposure at year-end 2013

Economic sector		Corporate	Financial institutions	Monoliners	Project finance	Public sector entities	Retail	Securitisation	Sovereign	Total continued activities	Total activities held for sale
Industry		2,617	59	0	3,844	3,906	0	0	0	10,425	0
Construction		535	0	0	6,136	518	0	0	0	7,189	0
Trade-Tourism		5	0	0	0	52	0	0	0	57	0
Services	Transportation and storage	875	64	0	720	2,023	0	0	38	3,720	0
	Information and communication	176	0	0	85	76	0	0	0	337	0
	Financial and insurance activities	0	24,763	3,143	0	1,437	0	42	2,123	31,508	47
	Real estate activities	1,238	5	0	3,451	6,112	0	0	0	10,806	0
	Professional, scientific and technical activities	20	0	0	0	91	0	0	0	111	0
	Administrative and support service activities	9	0	0	218	4,489	0	0	0	4,716	0
	Public administration and defence-compulsory social security	0	0	0	26	67,197	0	177	19,780	87,180	0
	Human health and social work activities	55	0	0	0	3,572	0	0	0	3,627	0
	Arts, entertainment and recreation	0	0	0	0	155	0	0	0	155	0
	Other service activities	0	27	0	0	368	0	0	0	395	0
	Other Services	0	0	0	0	400	0	0	1,374	1,774	0
Others		296	752	0	13	64	2	6,683	3,521	11,331	79
Total continued activities		**5,827**	**25,669**	**3,143**	**14,493**	**90,460**	**2**	**6,901**	**26,836**	**173,331**	**0**
Total activities held for sale		**79**	**47**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**126**

Exposure at year-end 2014

Economic sector		Corporate	Financial institutions	Monoliners	Project finance	Public sector entities	Retail	Securitisation	Sovereign	Total
Industry		2,736	67	0	3,602	3,728	0	0	0	10,133
Construction		319	0	0	6,618	475	0	0	0	7,412
Trade-Tourism		4	0	0	0	52	0	0	0	55
Services	Transportation and storage	894	73	0	932	1,885	0	0	43	3,827
	Information and communication	109	0	0	83	26	0	0	0	218
	Financial and insurance activities	0	**26,282**	3,232	0	1,342	0	84	3,559	34,498
	Real estate activities	1,081	4	0	3,498	5,832	0	0	0	10,416
	Professional, scientific and technical activities	1	0	0	0	80	0	0	0	81
	Administrative and support service activities	39	0	0	0	4,568	0	0	0	4,606
	Public administration and defence-compulsory social security	0	0	0	0	**64,557**	0	145	**23,150**	87,854
	Human health and social work activities	30	0	0	0	3,081	0	0	0	3,111
	Arts, entertainment and recreation	0	0	0	0	132	0	0	0	132
	Other service activities	0	0	0	28	342	0	0	0	370
	Other services	3	0	0	0	353	0	0	0	356
		0	0	0	0	0	0	0	1,308	1,308
Others	Others	322	914	0	0	73	1	6,463	88	7,860
Total		**5,538**	**27,340**	**3,232**	**14,761**	**86,526**	**1**	**6,692**	**28,148**	**172,238**

The exposure is mainly concentrated on the public sector entities and sovereigns (67%).

In 2014, the portfolio of Dexia on the public sector entities continued to decrease.

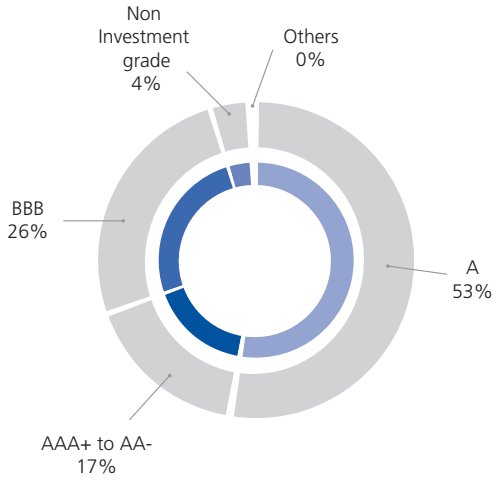
Exposure to financial institutions increased by 6.5%, and now represents 16% of the total exposures. This increase can be explained by the set up of new repo transactions in the frame of the funding and liquidity activities that offset natural amortisation of the bond portfolio.

The "corporate" and "project finance" segments' exposure levels were stable with respect to 2013 year-end due to foreign exchange rates evolution (depreciation of the euro with respect to the US dollar and pound sterling) offset by the natural amortisation of the portfolio and the effect of early repayments and sales.

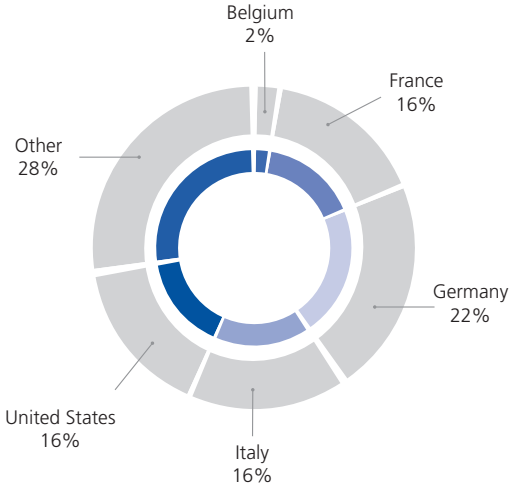
Dexia's exposure to SME is included in the corporate segment and is almost nil.

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

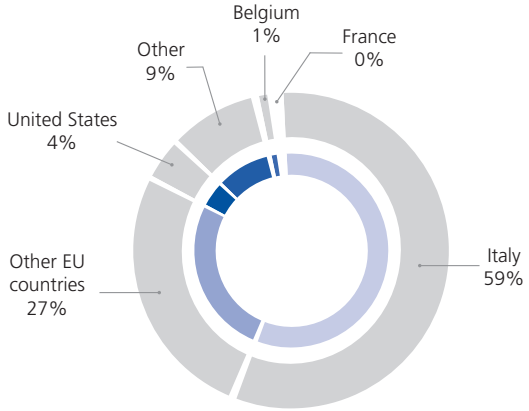
Financial Institutions: split by rating class



Public administration / Public sector entities: split by country



Public administrations / Sovereign: split by country



3.2.4. Fundamentals of Dexia's Credit Risk in 2014

3.2.4.1. Dexia Group Commitments on Sovereigns

Dexia Group outstanding on sovereigns is focussed essentially on Italy, Poland and the United States and to a lesser extent on Portugal, Hungary, France and Japan.
The Group has no sovereign exposure to Russia and Ukraine.

	Sovereigns	
	2013	2014
Italy	13,855	13,901
Poland	2,046	2,145
United States & Canada	1,974	2,880
Portugal	1,420	1,980
Japan	1,197	1,257
Hungary	1,185	1,006
France	624	862
Greece	0	0
Others	4,534	4,117
Total	**26,836**	**28,148**

France
In 2014, economic growth remained weak. The public deficit continued to swell with the level of public debt gradually reaching 100% of GDP. Nevertheless, despite a difficult economic situation, large public deficits and limited room for any tax manoeuvre, France still benefits from favourable funding conditions on the financial markets.
Dexia's sovereign exposure to France amounted to EUR 0.9 billion as at 31 December 2014.

Italy
The contraction of Italian GDP continued in 2014. Despite reform undertakings made by Prime Minister Matteo Renzi, room for manoeuvre remains limited. Although sovereign funding conditions have improved significantly and the fiscal balance shows a primary surplus, pubic debt, estimated at 132% of GDP in 2014, remains extremely high. The maintenance of growth at a near-zero level impairs the country's debt reduction.
Dexia's sovereign exposure to Italy amounted to EUR 13.9 billion as at 31 December 2014, composed mainly of bonds.

Greece
At the beginning of 2015, concerns on Greek sovereign debt revived after the change of political cycle. Dexia no longer has any direct exposure to Greek sovereign debt.

Portugal
The return to growth in 2014 is a positive factor, after three consecutive years of recession and a reform programme imposed under the international aid plan from which the country made a successful exit last May. The economic recovery which began in 2014 should continue in 2015 accompanied by a significant fall of the public deficit. On the financial markets, Portugal's funding conditions have improved considerably. Estimated at 5% of GDP, its liquidity reserves reassured investors with regard to the State's capacity to honour its financial commitments. However, the outcome of the legislative elections scheduled for October 2015 could result in a change of agenda for the promised reforms.
Dexia's sovereign exposure to Portugal amounted to EUR 2 billion as at 31 December 2014, composed almost exclusively of bonds.

Poland
Poland is the only country among the 28 in the European Union to have seen positive economic growth since the crisis began in 2008. After growth of 1.7% in 2013, the increase in GDP could reach 3% in 2014, according to the government, and 3.1% in 2015. However, although resisting external shocks, the country could see its economy affected by growth problems in Europe, to which 55% of its exports are shipped, or by the Ukrainian conflict if it persists.
Dexia's sovereign exposure to Poland amounted to EUR 2.1 billion as at 31 December 2014, composed almost exclusively of bonds.

Hungary
In Hungary, Prime Minister Viktor Orban was re-elected to parliament with an absolute majority last April. The economy improved with growth at 3.2% in 2014, a stabilisation of public finances and a reduction of external debt. In 2014, the authorities adopted measures aimed at resolving the problem of currency loans granted by banks to their customers during the period from 2000, which acted as a significant economic brake.
Dexia's sovereign exposure to Hungary amounted to EUR 1 billion as at 31 December 2014, composed almost exclusively of bonds.

United States
With growth at 3.5% year-on-year in the third quarter 2014, the US economy shows strong signs of recovery. Private consumption and corporate investment confirm their progress with the latter rising 7.2%. The labour market is improving, despite a historically low employment rate. The momentum of the recovery led the Federal Reserve to end its unconventional measures of quantitative easing in October 2014. The impact on rates, kept at a very low level, should be felt from mid-2015.
Dexia's sovereign exposure to the United States amounted to EUR 2.9 billion as at 31 December 2014, of which EUR 0.8 billion in bonds and EUR 2 billion in short-term deposits.

Japan
Japan went into recession at the end of the third quarter 2014. In a reform context, the Japanese government decided to raise VAT from 5% to 8% on 1 April last, in order to generate additional tax receipts and to contain a large public debt. The government had intended to increase VAT to 10% in 2015, but Prime Minister Shinzo Abe decided to postpone this second increase until 2017 so that it does not further impact household consumption. Following his victory in the early elections held in December 2014, Prime Minister Shinzo Abe introduced a recovery plan for Japan in an amount of EUR 24 billion aligned to the reconstruction of regions affected by the tsunami, household consumption and support for small businesses.
Dexia's sovereign exposure to Japan amounted to EUR 1.3 billion as at 31 December 2014. The entirety of this exposure consists of bonds in yen, the currency risk of which is hedged.

3.2.4.2. Dexia Group Commitments on the Local Public Sector

	Local public sector	
	2013	2014
France	19,499	18,069
Germany	17,840	16,489
United States & Canada	11,074	11,855
Italy	11,604	11,125
Spain	9,281	7,929
United Kingdom	8,825	9,267
Portugal	1,805	1,788
Greece	82	72
Others	10,450	9,932
Total	**90,460**	**86,526**

France

Traditionally, election years are marked by a fall in investment. This was confirmed in 2014, with investments contracting 7.4% to EUR 53 billion. Concentrating one half of investment expenditure on the local public sector, the municipalities still remain the main actors.

Local authorities are continuing in their efforts to control expenditure against a background of falling operational receipts and a reduction of State subsidies of EUR -1.5 billion, or -3% compared to 2013. As a consequence, gross savings continued their slow erosion for the third consecutive year, from 18.2% to 17% of operating receipts. The contraction of savings is particularly marked for municipalities (15% in 2013 and 13.6% in 2014).

The increase of debt outstanding remains steady; it reached EUR 173 billion, or a rate of indebtedness of 81%. The regions are more severely impacted by the increase of debt outstanding (+6%) with the rate rising from 87.5% to 93.5% of operating receipts. Whatever the level of the local authority, debt reduction capacity remains very reasonable, at less than five years on average and less than six years for municipalities alone.

The fall in subsidies is nonetheless weighing on the financial outlook for local authorities, with the announcement of a reduction of EUR 3.7 billion per annum until 2017. In addition, local authorities must overcome the double challenge of lower momentum in tax receipts on the one hand and the difficulties in controlling expenditure on the other hand, particularly the social expenditure of departments. The institutional context is also evolving with a plan to merge the 26 regions into 13 in 2016.

Very few payment incidents are to be noted on Dexia's French public sector portfolio in 2014, three quarters of which outstanding is concentred on local authorities and social housing. Rating levels are high, with 70% of outstanding rated A- or better. Non-Investment Grade outstanding only represents 4% and defaults 1% of total exposure to this sector.

Dexia's exposure to the French local public sector amounted to EUR 18.1 billion as at 31 December 2014.

Update on the Desensitisation of Structured Loans in France

The year 2014 saw a continuation of the desensitisation of structured and/or sensitive loans subscribed before the financial crisis, jointly by borrowers and lenders.

Structured loans are defined by reference to the classification of types of contracts by their risk level as established several years ago on the request of the French government[3]. This classification has five levels, as well as an "off-charter" perimeter. Structured and/or sensitive credits are defined there as:

- All loan contracts in categories B to E of that classification;
- All so-called "off-charter" contract;
- With the exception of all loans whose structured phase has ended and whose interest rate is definitively set, or variable according to the simple addition of an index normally used on the eurozone interbank or money market, and a fixed margin expressed in percentage points.

Sensitive structured loans are subject to specific monitoring and actions aimed at "reducing the associated risk" of these types of loans (according to the terms of Article 32-II of the Law No 2013-672 of 26 July 2013 on the separation and regulation of banking activities). The sensitive structured loan exposure on Dexia's balance sheet has been reduced to EUR 1.2 billion at the end of 2014.

In order to reduce the risk of litigation in relation to structured sensitive loans and to enable Dexia to desensitise such loans, the European Commission has authorised Dexia to grant new production flows up to a maximum of EUR 600 million, during two specific production windows, from February to July 2013 and from June to November 2014, within the context of the Group's orderly resolution plan. During the second and last production window, between June and November 2014, Dexia was able to respond to requests from customers wishing to take this opportunity to desensitise eligible loans.

The legal framework for structured loans evolved considerably in 2014, following measures implemented by the French government. Such framework is aimed at securing the legal environment for the lending banks while providing assistance mechanisms to help local authorities and hospitals facing financial difficulties, through the implementation of two support funds. The resources of these two mechanisms will be sharply increased in 2015, as announced by the French government on 24 February 2015, to enable "contracts to be definitively desensitised and refinanced in order to neutralise their risk". In real terms, the

(3) www.collectivites-locales.gouv.fr/lemprunt-structure-et-charte-gissler

envelope of assistance offered to local authorities, inter-communal groups and HLM (rent-controlled housing) offices for the desensitisation of their sensitive structured loans was increased from EUR 1.5 billion to EUR 3 billion over 15 years, and that available for the same loans to public hospitals was raised from EUR 100 million to EUR 400 million.

Italy

Since 2011 the Italian State has faced a significant deterioration of national macroeconomic indicators. Having fallen into recession in 2011, the country seems to have escaped in 2014 with a very low rate of growth of GDP estimated at 0.7%. However, the unemployment rate is constantly increasing, and is now above 10%.

For a few years Italy has been committed to a policy of limiting the expenditure of all public administrations, particularly local authorities. Their income has been severely impacted by the reductions of State transfers, particularly for the public health sector, which represents 70% to 75% of the current expenditure of the Italian regions.

According to the latest available accounts, the financial situation of the various authorities is improving. In particular, Italian municipalities have seen a clear increase in their receipts, higher than the rate of current expenditure. Finally, municipal debt is down, confirming the development which began in 2011.

Furthermore, Law 213/2012 introduced the possibility for municipalities to declare themselves "pre dissesto", an interim stage enabling the authority to establish a refinancing plan submitted for approval to the Regional Court of Auditors, and aiming to give room for manoeuvre in the effort to return to financial stability. At present, three Dexia counterparties have declared themselves "pre dissesto": the cities of Catania, Naples and Messina.

The financial evolutions of the Italian regions have been much more contrasted. The fall of current income was offset by a reduction of their current expenditure. The level of debt is down slightly, representing a total of EUR 41.3 billion. The financial situation of the regions is still fragile however, as they are now extremely sensitive to a rise of expenditure. This situation led Dexia to lower the ratings of seven regions following an examination of the latest available accounts.

Dexia's exposure to the Italian local public sector amounted to EUR 11.1 billion as at 31 December 2014.

Spain

Introduced by the Spanish government, the assistance programmes from the Autonomous Liquidity Fund (ALF) – intended for the regions and provinces) and a fund dedicated to clearing supplier debts intended for the regions and municipalities (FFPP) provided significant support to local authorities, the financial outlook of which is marked by fall in their income, closely linked to the crisis in the real estate sector.

The financial situation over recent financial years suggests an evolution which differs from one local authority to another. The situation of the provinces has improved. In contrast, autonomous communities and municipalities have seen their indicators follow more mixed developments. According to the latest available accounts, the current receipts of the regions have fallen and some, such as the Regions of Valencia and Catalonia continue to present very high debt levels, at 282% and 225% respectively of current receipts. Finally, financial elements suggest an improvement of the situation of municipalities, with an increase of current receipts. The level of gross savings is still low, and does not cover debt amortisation.

Current prospects confirm the trend. The regions have seen their debt increase whilst their current receipts have fallen. The provinces continue to post limited debt. Finally, municipalities post a deteriorating evolution, marked by a fall in their gross margin and a slight rise in their debt.

These persisting difficulties and the contrasted developments have led to a downgrade of the internal ratings of 3 of the 17 regions.

Dexia's exposure on the Spanish local public sector amounted to EUR 7.9 billion as at 31 December 2014.

Portugal

Portugal is marked by a sharp contrast between the financial situation of its regions, which has deteriorated somewhat, and that of its municipalities, which is more favourable. Financial developments in the country's two autonomous regions, Madeira and the Azores, are contrasted. The island of Madeira in particular presents an extremely high debt level, reaching 400% of its current income. As a result, the Portuguese State is continuing in its efforts to control the region's expenditure, strengthening the criteria of the stabilisation plan introduced on Madeira in 2012. The financial situation of the islands of the Azores presents a more stable profile, marked by a control of debt at a level of 120% of current income.

In contrast, according to the latest available accounts, the financial data and current outlook suggest that the financial situation of the Portuguese municipalities is positive overall and improving.

However, due to the persistence of a difficult economic environment for the country and internal problems encountered by the autonomous region of Madeira the internal rating of Portuguese local authorities could not be upgraded.

Dexia's exposure on the Portuguese local public sector amounted to EUR 1.8 billion as at 31 December 2014.

Germany

The initial financial indicators for the year 2014 suggest that the financial situation of local authorities is unchanged overall and still very favourable. Nevertheless, developments in the different Länder are contrasted. Some experience constant improvement, like Baden-Württemberg, Bavaria and Saxony, the 2014 growth rates of which are estimated to be higher than 1.5%. On the other hand, other regions present a worrying level of debt, although this fell in 2013 and 2014. Berlin, Bremen and even the Saar have debt rates which were still above 200% of current income in 2013 and data available for 2014 does not offer any hope of this trend easing.

The efforts of the Länder aimed at facilitating debt reduction in some municipalities posting very high debt levels continue, with the elaboration of programmes to support their communes so as to foster a reduction of their debt levels. The results of this policy, launched from 2011, are still limited however.
Some risks appear on operations to desensitise structured loans, which only represent a limited portion of Dexia's overall exposure in Germany.
Dexia's exposure on the German local public sector amounted to EUR 16.5 billion as at 31 December 2014.

United Kingdom

The target of achieving a budget balance in 2019, without increasing taxes, is confirmed by the government of David Cameron. Since 2010 State expenditure has already been reduced by 21% and over the next three years (excluding the health, education and development aid budgets) these should fall another 25%. At the same time, numerous reforms are being introduced on a fiscal or accounting level.
Against this background of falling subsidies and the freezing of local taxes, local authorities have so far succeeded in adapting and, without deterioration, preserving the most vital services to the population, by virtue in particular of the gains in productivity and severe cuts to secondary budget items. So, despite some historically difficult situations and an almost 14% fall in receipts expected in 2014/2015, at this stage the close of the financial year raises no particular concerns.
As for the social housing sector, the government target clearly means a fall in subsidies granted to finance new programmes even though demand remains high. The slowdown of investments is confirmed and henceforth only the best organised structures or those of critical size will receive the largest proportion of aid. Other associations will thus be forced to develop commercial activities at the same time, to offset the fall in public financing. Although the extent of this phenomenon is still limited, the impact of these more risky activities should be carefully monitored.
Dexia's exposure on the United Kingdom local public sector amounted to EUR 9.3 billion as at 31 December 2014, of which EUR 4.6 billion on local authorities and EUR 4.7 billion on social housing.
In terms of risk, the British institutional framework enables the quality of outstanding on local authorities to be considered close to sovereign risk. As for the social housing portfolio, to date it presents no sensitivity.

Greece

The two local authorities to which Dexia is exposed, the municipalities of Athens and Achamai, have continued to pay debt maturities despite the crisis of recent years. Their financial resources partially remain tributaries of State payments. Dexia's exposure amounted to EUR 72 million as at 31 December 2014.

United States

The federated States have benefited from the economic recovery in the United States since 2011, in view of the strong correlation of their receipts (mostly consisting of income and sales taxes) to the economic situation. These federated States remain among the most important issuers on the US bond market, creditors benefiting from a protective institutional framework.
More than 75% of the Dexia Crédit Local portfolio on the federated States consists of counterparties rated AA or higher. Nevertheless, Dexia remains exposed to risky counterparties, given their deteriorating economic and financial situation. In particular, the Group is paying close attention to the situation of the City of Detroit and the Commonwealth of Puerto Rico.
The City of Detroit, which declared insolvency on 18 July 2013, has succeeded in reaching agreements with all of its creditors and in November 2014 the courts approved the recovery plan which asks a great deal of creditors and insurers. The City, which had already made significant budgetary efforts, was deemed capable of fulfilling its obligations and achieving its projections in relation to financial results.
Dexia's exposure to the City of Detroit at the beginning of 2014 was USD 305 million. This exposure was subject to a restructuring (COPs) but was backed by a guarantee from two monoliners. After increasing the impairment on the outstanding exposure in the first quarter of 2014, Dexia pursued an active balance sheet management policy and sold its direct exposure to the City, recording a gain of USD 32 million after reversal of impairments. Total impairments for this exposure amounted to USD 154 million at the end of 2013. Dexia's remaining exposure to public sector entities associated with the City of Detroit was USD 26 million on the city waste water service, 100% guaranteed by quality monoliners, and USD 137 million on the School district, benefiting from the Michigan State constitutional protection on its debt service and 90% guaranteed by quality monoliners.
In 2014, considerable attention was also paid to the situation of the Commonwealth of Porto Rico in view of its particularly tense financial situation, especially in terms of liquidity, structural deficit and high debt, which is in fact ten times higher than the average of the federated States. Some improvements have been observed however since the arrival of Governor Padilla in January 2013. Among these positive points are the presentation of the first balanced budget for more than a decade, the passing of the "Puerto Rico Public Corporations Debt Enforcement and Recovery Act" (a debt restructuring mechanism for public companies, similar to Chapter IX of the Bankruptcy Act), the implementation of retirement reforms, and the process for reducing expenditure and deficit financing. This recovery programme aims to take the deficit to zero by 2016. The gross book value of Dexia's commitments on Puerto Rico amounted to USD 411 million at the end of December 2014. Total impairments amounted to USD 46 million. Moreover, this exposure is 95% guaranteed by quality monoliners.

Dexia's exposure on the US local public sector amounted to EUR 10.6 billion as at 31 December 2014.

3.2.4.3. Dexia Group Commitments on Project Finance and Corporates

	Corporate		Project Finance	
	2013	2014	2013	2014
France	2,262	1,909	2,559	2,663
United Kingdom	1,591	1,851	3,935	4,453
Spain	145	124	2,480	2,354
United States & Canada	317	213	1,446	1,433
Germany	17	19	439	469
Italy	903	918	482	482
Portugal	0	74	221	133
Greece	0	0	87	73
Others	671	430	2,844	2,702
Total	**5,906**	**5,538**	**14,493**	**14,761**

The portfolio of project financing and corporate loans remained stable over the year, at EUR 20.3 billion as at 31 December 2014. It is composed 73% of project financing[4], the balance being in corporate loans, such as acquisition funding, commercial transactions and corporate bonds.

Over the year, natural amortisation of the portfolio and early redemptions of debt refinancing by borrowers were offset by the effects of foreign exchange rates variation.

As at 31 December 2014, the project finance portfolio amounted to EUR 14.8 billion. It consists 54% of Public-Private Partnerships (PPP), principally in the United Kingdom and France, 22% in energy sector projects, mostly in the field of renewable energies, and 10% in projects presenting a traffic risk. 73% of the portfolio is placed in Western Europe, 18% in the United States, Canada and Australia. 70% of the portfolio is on average rated "investment grade".

Some projects require very close monitoring. The various mechanisms for Spanish State support to local authorities (ALF and FFPP) enabled all or some of the payment arrears on public-private partnerships posted previously in Spain to be cleared. On the other hand, the changes to the Spanish regulatory framework on renewable energies adopted on 16 June last, revising existing tariffs, will have an unfavourable impact on part of Dexia's portfolio of Spanish renewable energy projects, necessitating debt restructuring. To date, only one restructuring has been finalised, without generating a loss for Dexia. As a result, Dexia increased its provision on counterparties from the renewable energy sector in Spain up to EUR 68 million at the end of December 2014. This impairment has not been extended to Italy, as the retroactive review of green electricity purchase tariffs in that country is considered unlikely.

Dexia's exposure to project finance in Greece (2 projects) amounted to EUR 73 million as at 31 December 2014, with impairments for an amount of EUR 14 million.

The corporate loan portfolio is approximately EUR 5.5 billion at the end of 2014. It consists 44% of companies in the utilities sector (water, environment, distribution and transmission of energy or gas) and 35% of companies in the infrastructure sector (motorway operators, airports, ports and car parks). 90% of the portfolio is situated in Western Europe, 7% in the United States, Canada and Australia. 84% of the portfolio is rated "investment grade". The main difficulties have been encountered on acquisition funding prior to the financial crisis, presenting too high leverage and difficult to refinance under current market conditions.

3.2.3.4. Dexia Group Commitments on ABS

	ABS/MBS	
	2013	2014
United States & Canada	4,714	4,569
Spain	852	691
United Kingdom	269	221
Italy	174	170
Portugal	146	138
France	114	0
Germany	28	9
Greece	46	11
Others	558	884
TOTAL	**6,901**	**6,692**

As at 31 December 2014, Dexia's ABS portfolio amounted to EUR 6.7 billion, down EUR 0.2 billion on the end of 2013 as a result of the natural amortisation of positions and some strategic sales.

(4) Transactions without recourse to their sponsors, the redemption of which is only on the basis of their own cash-flows and strongly secured in favour of the bank, for example via sureties on assets and contracts or a limitation of dividends.

This portfolio consists of EUR 4.2 billion in US government student loans, which present a rather long amortisation profile and good credit quality, benefiting from the US State guarantee. The balance is principally in residential mortgage backed securities (RMBS) in an amount of EUR 1.2 billion with EUR 0.5 billion in Spain.
The year 2014 showed encouraging signs by virtue of the slowdown of the fall in residential real estate prices in Spain, a slight fall in unemployment and an improvement in the performance of Spanish borrowers. In addition, external ratings benefited from the upgrade of the Spanish sovereign rating.
The quality of the ABS portfolio remains stable overall, with 87% of the portfolio rated "investment grade" at the end of 2014, almost all of the tranches in which Dexia invested being senior level.

3.2.4.5. Dexia Group Commitments on Financial Institutions

	Financial Institutions	
	2013	2014
Spain	6,723	7,344
United States & Canada	4,295	4,915
Germany	3,355	4,086
France	3,038	3,153
United Kingdom	1,651	1,597
Italy	748	582
Portugal	149	10
Greece	0	0
Others	5,758	5,654
Total	**25,716**	**27,340**

Dexia's commitments on financial institutions amounted to EUR 27.3 billion as at 31 December 2014. 51% of these are bonds and covered bonds. The balance consists of loans to financial institutions, exposures associated with repo and derivative transactions.
Commitments on financial institutions were up by 5.8% over the year. In fact, the natural amortisation of the bond portfolio was offset by the increase of exposures associated with repo transactions with financial institutions. The pace of amortisation of the bond portfolio will remain sustained over coming years, a fifth of the residual commitments having to be redeemed in 2015 and two thirds before 5 years.
Dexia's exposure is concentrated 17% in the United States and 69% in Europe, principally in Spain (27%), Germany (15%), France (12%), the United Kingdom (6%) and Belgium (4%).
More than 93% of the portfolio is rated "investment grade". No new defaults were observed in 2014 on this portfolio and the portfolio's credit quality remained stable.
In Southern Europe, the situation of Spanish banks improved overall. In addition, Dexia's exposure to the Spanish financial sector is for the most part in covered bonds. Dexia's exposure to the Portuguese financial sector was almost fully redeemed in the second half of 2014.
In Europe, the year 2014 was marked by the comprehensive assessment made by the European Central Bank, the aim of which was to assess the quality of assets held by European banks and their ability to withstand stress situations. In the end, only 25 banks failed, essentially non-systemic banks, in Italy and Greece (to which Dexia is respectively exposed either very little or not all).
As a result of developments in the regulatory framework, including the entry into force of the Bank Recovery and Resolution Directive (BRRD), the Group also booked a collective provision of EUR 32 million on the banking sector.
On 1 March 2015, under the Federal Act on the Recovery and Resolution of Banks (Bundesgesetz über die Sanierung und Abwicklung von Banken), the Austrian Financial Market Authority (FMA-Finanzmarktaufsicht) issued a decree initiating the resolution of Heta Asset Resolution AG, previously Hypo Alpe Adria Bank International AG, responsible for managing the legacy assets of Hypo Alpe Adria in run-off, and imposed a temporary moratorium until 31 May 2016 on a substantial part of the debt of the entity (capital and interests).
Dexia notes this decision and states that the nominal value of its exposure to Heta Asset Resolution AG, affected by this moratorium, amounts to EUR 395 million. This exposure has the benefit of a guarantee granted by the State of Carinthia. This outstanding is booked on Dexia Kommunalbank Deutschland AG's balance sheet, it being specified that it is not included in the cover pool of Dexia Kommunalbank Deutschland AG.
The Dexia Group is currently studying the appropriate actions to be taken with regard to the decision of the FMA. Nevertheless, as a precaution and following the announcement on 1 March 2015, the Group will pass a specific provision on its exposure in the first quarter 2015, the amount of which will be determined in light of further developments of the situation.

3.2.4.6. Dexia Group Commitments on Monoliners

Inherited from Dexia's activity in the United States on the US municipalities sector and on ABS, traditionally enhanced, the Dexia portfolio guaranteed by monoliners amounted to EUR 17.6 billion (notional amount) as at 31 December 2014. 83% of the underlying assets are "investment grade".

With the exception of the Assured Guaranty group, whose activity is ongoing and which enhances more than 46% of the guaranteed portfolio, the other monoliners are in run-off.
In general, monoliners have put various mechanisms in place, such as commutations, court actions with the originators of securitisations in the United States or securities repurchases to consolidate their solvency and to be in a position to fulfil their obligations as insurers.
With the exception of FGIC and Ambac's Segregated Account, all the credit enhancers continue to pay insurance indemnities in full and without delay in accordance with contractual conditions. FGIC and Ambac's Segregated Account pay a part of the indemnities due.
The year 2014 was marked by negative developments in relation to Puerto Rico. Although the accumulated exposure of credit enhancers to Puerto Rico is high, no major liquidity problems are to be foreseen for these counterparties, an opinion recently shared publicly by Moody's.

3.3. AIRB Approaches

3.3.1. Competent Authority's Acceptance of Approach

By letter sent on 21 December 2007 by the Belgian regulatory authorities, Dexia was authorised 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.

3.3.2. Internal Rating Systems

The internal rating systems developed by Dexia are set up to evaluate the three Basel 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 two or 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 back-testing when applicable. The number of ratings on each scale depends on the characteristics of the underlying portfolio (the number of counterparties, their homogeneity, whether it is a low default portfolio or not) and varies between 6 and 17 non-default classes. In addition each scale has been attributed two default classes (named D1 and D2).

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

CCF models estimate the portion of off-balance-sheet commitments that would be drawn should counterparties go into default. The regulation authorises 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 data availability. As a consequence of the orderly resolution plan, internal CCF models are used only on project finance assets; on all other asset classes the foundation parameters are applied. Internal estimates of Basel parameters are used within Dexia in addition to the calculation of the regulatory risk weighted exposure amounts. They are used particularly 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 organised in 3 levels:
- Credit IRS Control is defined, in accordance with the regulatory directives, as an internal and independent containment function to ensure that the IRS are being used properly, that they are operationally effective and that the audit trail in the rating process remains clear;
- The validation team is responsible for the independent review of all models used within Dexia, back testing and stress testing, either market risk models, pricing models, Basel Pillar 1 credit rating models, ALM models, economic capital models;
- 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.

Please refer to Appendix 2 for more details regarding internal rating systems.

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

The following tables show the total exposure at default, average exposure at default, exposure-weighted average PD, LGD and exposure-weighted average risk weights broken down by exposure class and obligor grade at year-end 2013 and 2014.

The counterparties are the final counterparties, i.e. after taking into account the Basel III eligible guarantees (substitution principle). Monoliner exposure is essentially an indirect exposure.

Average EAD is the quarterly average figure.

		2013					
Exposure class	**Obligor grade**	EAD	Average EAD	Average PD	Average LGD	Average RW	Average EL
Corporate	AAA to AA-	9	2	0.03%	35.95%	21.92%	0.01%
	A+ to A-	872	1,030	0.07%	41.33%	28.51%	0.03%
	BBB+ to BBB-	2,896	3,031	0.28%	46.18%	74.94%	0.13%
	Other	483	666	4.25%	52.47%	155.75%	2.50%
	Total	**4,260**	**4,729**	**0.68%**	**45.88%**	**74.49%**	**0.38%**
Financial institutions	AAA to AA-	1,599	1,281	0.04%	26.36%	14.57%	0.01%
	A+ to A-	11,448	13,385	0.06%	25.89%	14.78%	0.02%
	BBB+ to BBB-	5,577	5,848	0.49%	31.99%	48.03%	0.14%
	Other	4,505	4,566	5.75%	4.95%	14.78%	0.16%
	Total	**23,129**	**25,081**	**1.27%**	**23.32%**	**22.78%**	**0.07%**
Monoliners	AAA to AA-	-	1,235	-	-	-	-
	BBB+ to BBB-	-	40	-	-	-	-
	Other	-	21	-	-	-	-
	Total	**-**	**1,296**	**-**	**-**	**-**	**-**
Project finance	AAA to AA-	23	26	0.04%	18.98%	12.17%	0.01%
	A+ to A-	2,698	2,488	0.07%	12.44%	11.26%	0.01%
	BBB+ to BBB-	6,591	7,088	0.38%	15.25%	30.02%	0.06%
	Other	3,478	3,798	1.74%	17.62%	53.68%	0.31%
	Total	**12,789**	**13,399**	**0.68%**	**15.31%**	**32.47%**	**0.12%**
Public sector entities	AAA	9,858	10,334	0.02%	7.89%	3.04%	0.00%
	AA+ to AA-	8,930	10,155	0.03%	11.21%	6.66%	0.00%
	A+ to A-	10,170	10,775	0.08%	2.30%	2.20%	0.00%
	BBB+ to BBB-	12,469	13,850	0.34%	3.21%	5.66%	0.01%
	Other	8,666	8,999	1.48%	2.94%	8.90%	0.04%
	Total	**50,092**	**54,114**	**0.36%**	**5.33%**	**5.18%**	**0.01%**
Securitisation	AAA to AA-	14	36	0.00%	5.00%	0.00%	0.00%
	BBB+ to BBB-	57	114	0.57%	3.00%	7.31%	0.02%
	Other	99	106	2.24%	6.21%	26.54%	0.36%
	Total	**171**	**256**	**1.50%**	**5.04%**	**17.91%**	**0.21%**
Sovereign	AAA to AA-	3,744	4,401	0.00%	8.94%	0.00%	0.00%
	A+ to A-	16,763	17,617	0.07%	18.80%	19.14%	0.01%
	BBB+ to BBB-	1,170	1,118	0.56%	34.89%	75.52%	0.20%
	Other	3,165	3,168	0.88%	35.56%	107.92%	0.31%
	Total	**24,842**	**26,303**	**0.18%**	**20.21%**	**30.22%**	**0.06%**
Equities	A+ to A-	45	73	0.06%	29.07%	25.67%	0.00%
	BBB+ to BBB-	0	10	0.21%	90.00%	134.15%	0.19%
	Other	4	4	27.80%	23.32%	227.53%	0.65%
	Total	**49**	**87**	**2.13%**	**29.21%**	**41.74%**	**0.05%**
Default		**1,460**	**1,347**				
Total continued activities		**116,792**	**126,612**				
Total activities held for sale		**47**	**118**				

Exposure class	Obligor grade	2014 EAD	Average EAD	Average PD	Average LGD	Average RW	Average EL
Corporate	*AAA to AA-*	11	463	0.03%	35.95%	21.92%	0.01%
	A+ to A-	1,835	1,287	0.07%	42.96%	35.68%	0.03%
	BBB+ to BBB-	3,360	3,078	0.25%	46.31%	73.90%	0.12%
	BB+ to B-	428	405	2.46%	66.54%	184.94%	1.61%
	No External Rating	24	48	30.87%	66.20%	420.02%	20.44%
	Total	**5,658**	**5,280**	**0.49%**	**46.82%**	**71.26%**	**0.29%**
Financial institutions	*AAA to AA-*	4,616	4,298	0.05%	18.50%	18.04%	0.01%
	A+ to A-	14,492	13,910	0.32%	25.07%	25.96%	0.02%
	BBB+ to BBB-	6,649	6,331	4.07%	24.38%	46.73%	0.10%
	BB+ to B-	1,137	2,002	7.72%	14.04%	58.81%	0.62%
	No External Rating	9	6	0.07%	2.88%	33.97%	0.00%
	Total	**26,904**	**26,546**	**1.51%**	**23.30%**	**31.13%**	**0.06%**
Project finance	*AAA to AA-*	21	301	0.04%	19.49%	11.56%	0.01%
	A+ to A-	2,924	2,843	0.07%	12.58%	11.28%	0.01%
	BBB+ to BBB-	7,819	7,410	0.36%	14.93%	28.42%	0.06%
	BB+ to B-	3,166	3,198	1.83%	17.48%	53.45%	0.32%
	Below B-	88	28	30.87%	19.49%	122.01%	5.93%
	Total	**14,018**	**13,780**	**0.82%**	**15.05%**	**31.06%**	**0.14%**
Public sector entities	*AAA to AA-*	23,678	23,713	0.03%	8.55%	4.40%	0.00%
	A+ to A-	7,673	7,767	0.08%	3.64%	3.48%	0.00%
	BBB+ to BBB-	11,945	12,110	0.36%	2.84%	5.22%	0.01%
	BB+ to B-	9,019	8,644	1.48%	2.90%	8.99%	0.04%
	No External Rating	130	152	1.48%	4.00%	12.61%	0.06%
	Total	**52,444**	**52,386**	**0.36%**	**5.55%**	**5.26%**	**0.01%**
Securitisation	*AAA to AA-*	13	14	0.00%	5.00%	0.00%	0.00%
	A+ to A-	67	69	1.48%	3.00%	9.70%	0.04%
	BBB+ to BBB-	67	69	1.48%	3.00%	9.70%	0.04%
	Below B-	18	40	0.00%	45.00%	350.65%	0.00%
	No External Rating	29	54	0.00%	45.00%	518.46%	0.00%
	Total	**141**	**151**	**1.60%**	**5.64%**	**20.27%**	**0.27%**
Sovereign	*AAA to AA-*	4,523	11,169	0.00%	9.36%	0.00%	0.00%
	A+ to A-	19,471	19,324	0.07%	22.92%	19.64%	0.02%
	BBB+ to BBB-	1,098	1,041	0.42%	39.77%	69.66%	0.16%
	BB+ to B-	3,095	2,594	0.89%	41.91%	110.18%	0.37%
	No External Rating	0	1,150	30.87%	25.00%	158.69%	7.72%
	Total	**28,187**	**35,278**	**0.16%**	**23.48%**	**28.38%**	**0.06%**
Equities	*A+ to A-*	0	0	0.09%	90.00%	96.45%	0.08%
	BBB+ to BBB-	0	1	0.21%	90.00%	134.15%	0.17%
	BB+ to B-	1	1	3.31%	90.00%	195.89%	1.75%
	No External Rating	2	2	33.38%	11.11%	42.97%	0.25%
	Total	**3**	**4**	**21.60%**	**40.66%**	**89.87%**	**0.55%**
Default		**1,117**	**1,114**	-	-	-	-
TotaL		**128,472**	**134,539**	**-**	**-**	**-**	**-**

(*) The securitisation exposures shown in this chart are guaranteed by a non-securitisation counterparty treated in Advanced Approach. Most of Dexia's securitisation exposure is non-guaranteed and is treated in Rating Based Approach, as shown in the chart in section 2.2.

The increase of EAD is due in particular to the new definition of EAD: in 2014 under Basel III, it includes the fair value of loans hedged in interest rate, which was not the case in 2013 under Basel II. Another factor is the evolution of EUR vs. USD and GBP.

The increase of average RW on financial institutions is explained in particular by the increase of the repo activity, and by the Asset Value Correlation (AVC) on large financial institutions (LFI) and unregulated financial institutions (UFI).

The majority of the Dexia Group exposure in AIRB approach (63% of the EAD) is concentrated on the public sector (i.e. public sector entities and sovereign exposures). A vast majority of average PD levels is situated below 1% (the average PD is 0.61%), reflecting the exposure on highly rated municipal and public related counterparties.

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

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

The retail exposure is no longer material since the sale of Belfius Bank, Banque Internationale à Luxembourg (BIL) and DenizBank.

3.3.5. Back testing

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

The back-test is the evaluation of the predictive power of the rating system and the assessment of its time evolution to detect any reduced performance of the rating system. With this purpose three properties are in particular analysed: the model's calibration, its discriminatory power and its stability.

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 analysing the ability to discriminate between high and low risk and the stability of the data inputs into the rating system.

The back-test procedures include 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 or CCF) slightly exceed the actual default rates (or loss or CCF observed).

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 discriminatory 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. For LGD and CCF, the precision of the calibration is assessed.

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 back-tests are assessed using statistical significance tests on the available short-term and long-term data histories. The outcome of the significance tests indicating an unacceptable decreased performance will drive required action plans. The additional part of the back-test procedure is related to ad hoc analysis (qualitative, benchmarking, expert overruling, model risks…)

3.4. Standard Approach

3.4.1. Introduction

Consecutively to the disposal of some entities and to the sharp decrease of some portfolios, Dexia presented an official request to the home regulators to move some portfolios from Advanced to Standard Approach. The portfolios involved have become non material in terms of exposure and number of counterparties.

The switch from Advanced to Standard Approach has been implemented as from June 2013 reporting date, following official acceptance of the proposal by the National Bank of Belgium for the following types of counterparties:

Insurance companies including monoline insurers;
Belgian 'other' satellites;
Belgian Region and Communities expert models and assimilated counterparties;
Mid-corporate counterparties.

3.4.2. Nominated External Credit Assessment Institutions (ECAI)

The Standard Approach provides weighted risk figures based on external ratings. In order to apply the Standard 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 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 Standard Approach provides specific risk weights that vary depending on the counterparty type.

Credit rating agencies and credit quality step under Standard approach

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

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

3.4.3. Exposure at Default and Average Risk Weights

The following table shows the total exposure at default and exposure weighted-average risk weights broken down by exposure class and obligor grade at year-end 2013 and 2014.

		2013		2014	
Exposure class	**Obligor Grade**	**EAD (M)**	**Average RW**	**EAD (M)**	**Average RW**
Corporate	A+ to A-	0	0%	81	50%
	No External Rating	169	53%	207	58%
Total Corporate		**169**	**53%**	**288**	**55%**
Equities	No External Rating	763	143%	743	150%
Total Equities		**763**	**143%**	**743**	**150%**
Financial Institutions	AAA to AA-	1,605	0%	1,291	0%
	A+ to A-	500	17%	450	16%
	BBB+ to BBB-	0	0%	29	81%
	BB+ to B-	133	91%	138	100%
	Below B-	147	0%	0	0%
	No External Rating (1)	295	92%	1,335	28%
Total Financial Institutions		**2,679**	**18%**	**3,244**	**19%**
Monolines	A+ to A-	2,670	50%	3,889	50%
	BB+ to B-	0	0%	3	150%
	No External Rating	0	0%	98	100%
Total Monolines		**2,670**	**50%**	**3,990**	**51%**
Project Finance	AAA to AA-	68	20%	163	20%
	A+ to A-	23	50%	26	50%
	BBB+ to BBB-	19	100%	22	100%
	No External Rating	670	100%	675	100%
Total Project Finance		**779**	**92%**	**886**	**84%**
Public Sector Entities	AAA to AA-	31,150	6%	34,439	7%
	A+ to A-	1,494	51%	5,224	25%
	BBB+ to BBB-	1,577	71%	1,439	67%
	BB+ to B-	583	107%	525	97%
	Below B-	5	150%	0	0%
	No External Rating (2)	4,894	59%	5,674	66%
Total Public Sector Entities		**39,703**	**18%**	**47,301**	**19%**
Retail	No External Rating	5	100%	3	75%
Total Retail		**5**	**100%**	**3**	**75%**
Securitization	AAA to AA-	8	0%	4	0%
	A+ to A-	25	50%	13	50%
	BB+ to B-	0	0%	71	150%
Total Securitization		**33**	**38%**	**88**	**128%**
Sovereign	AAA to AA-	1,318	0%	1,449	0%
	A+ to A-	564	20%	653	20%
Total Sovereign		**1,882**	**6%**	**2,102**	**6%**
Others		2,406	46%	3,272	41%
Total Others		**2,406**	**46%**	**3,272**	**41%**
Total continued activities		**51,089**		**61,917**	
Total activities held for sale		**319**			

(1) Exposure on Central Counterparties (CCP)

(2) Preferential treatment

In case no external rating is available, standard risk weights can be applied based on national discretions or Basel III rules (reference to the sovereign rating depending on the exposure type).

3.5. Impairment, Past-Due and Related Provisions

3.5.1. Concepts and Implementation within Dexia

The concepts "default", "impairment", "non-performing assets/exposures", "Past Due" and "Provisions" are closely related to each other. Within Dexia, policies and procedures are in place to ensure that these concepts are clear throughout the entire organisation and also uniformly integrated. They have been aligned with the latest technical standards issued by the EBA.

3.5.1.1. Principles of Past-Due Exposure

A past due is defined as payment that has become due but has not been made according to the terms of the agreement. A past due is considered by contract. Even if a counterparty fails to pay only the required interests at due date, the entire loan exposure is considered as past due.

3.5.1.2. Principles of Default (Dexia), Non-Performing Exposure and Forbearance (EBA)

The concept of default includes counterparties that have (or that are likely to have in the future) difficulties meeting their commitments or counterparties where return to a normal situation seems difficult.

For counterparties that have or are likely to have financial difficulties, Dexia has identified situations described by the different criteria listed below:

- Non-observance of any of the contractual obligations that are material in terms of risk;
- Any significant difficulties of the debtor, repeated delay of payments (even if those payments are lower than the threshold) < 90 days (or a different delay decided for a specific market segment), repeated exceeding or incorrect use of line of credit without improvement prospect, justifying a specific follow-up;
- Deterioration of the credit, or significant downgrading of the external ratings, or situation which could lead, on a statistical basis, to a non-payment of the obligations;
- Significant devaluation (or the probability of devaluation), due to an increase of the risk on an active market, especially where the credit could be threatened, or there is a disappearance of the market including sale of the credit obligation resulting in a material loss due to credit risk;
- Any case of accelerated payment as defined by law, illegal financial operation, important fraud, misrepresentation, accounting's publishing with reservation of external auditors;
- A cross-default, termination of credits by other banks, "protêt", triggering of an accelerated payment clause, social or tax "past due";
- Total or partial extinction of risk mitigant considered as essential to the credit;
- Legal action against the debtor likely to significantly damage his solvency;
- The debt being classified as "doubtful";
- Any restructuring, including emergency restructuring, triggered by deterioration of the risk and with a disadvantageous character (reduction of the Net Present Value);
- These counterparties receive a credit rating of D1 on a case by case analysis;
- For counterparties where return to a normal situation seems difficult, Dexia has also identified situations described by the criteria listed below;
- The counterparty is "past due" for more than 90 days on any payment obligation (or a different delay decided for a specific market segment). For authorised overdrafts, the delay starts at the due date of the authorisation and for non-authorised overdrafts, as soon as they appear. Exceptions to this rule are:
  - 180th days of any delay in payment obligation for the French local public sector and assimilated counterparties;
  - Technical past dues, defined as the consequence of a mistake of the counterparty, (or by its accountant, or by its bank) that leads to a delayed payment of the debt;
  - Operational past dues, defined as a failure in the process, or in the internal system of Dexia. Operational past due also include the legal risk when the counterparty has the means to afford its payment but refuses to pay for it;
  - Immaterial amounts: Dexia's threshold for past due is a fixed amount established at EUR 2,500. The threshold takes into account nominal past due, past due on interests, penalties and commissions.
- Any case of judicial settlement, unwinding, bankruptcy, concordat, Chapters 7, 9 or 11 or any similar legal status;
- Termination of the loan, due to any type of incident;
- The loan being subject to a legal procedure of "recovery";
- For these counterparties, a credit rating of D2 is given.

Non-Performing Exposure and Forbearance (EBA)

To facilitate monitoring and comparison between the different European banks, the European Banking Authority harmonised the definition of Non-Performing Exposure (NPE) and Forbearance.

Non-performing exposure amounts to outstanding unpaid for more than 90 days for which the Group thinks that the counterparty is unable to repay without the implementation of guarantees. The Dexia Group has identified exposures corresponding to the said EBA definition and published the amount of its non-performing exposure.

The definition of forbearance groups together facilities granted by banks to counterparties experiencing or about to experience financial difficulties in dealing with their commitments (facilities which banks would not otherwise have granted). Forbearance is applied on healthy or safe assets or on non-performing assets. As at 31 December 2014, 133 contracts, corresponding to 43 counterparties, were considered forborne, for an amount of outstanding at EUR 1 billion.

3.5.1.3. Impairments

In line with the impairment tests defined by IAS 39, Dexia has defined two types of impairments:

Specific impairments

The scope of application of specific impairments is determined by individual impairment tests conducted on the whole portfolio. A specific impairment aims at covering assets in default on an individual basis, following IFRS principles and based on the valuation of the net risk of the counterparty. The necessity of a specific impairment is assessed on every exposure classified "in default". Individual impairment test is the result of the application of the "Quarterly Review and Watch-list" process and of the default process on individual counterparties.

The amount of impairment to be set for the asset is equal to the difference between the net accounting value and the net present value of expected free cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (EIR), or EIR at reclassification date for AFS bonds that have been reclassified to Loans and Receivables.

This net present value is determined on a case by case basis by the credit expertise centres. The following indicators are taken into account for proposing the level of specific impairment to the Impairment Committee:

- The existence of guarantees and credit risk mitigants attached to the facility;
- The use, for some sectors, of external valuations on which to base its judgment;
- The use, for ABS, of a free cash flow model to estimate recovery rate at the end of the contract;
- Internal estimates, in some other cases, of recovery opportunities (according to objective factor and subjective factors resulting from its knowledge of the counterparty).

Collective impairments

Collective impairment tests are based on objective indicators of impairment on a portfolio basis. These impairments are compliant with IAS 39 allowing banks "to determine impairment losses in a group of financial assets".

Dexia's collective impairment model is based on two types of impairments:

- Statistical impairments which correspond to the provisioning until maturity of the exposures of a sub-portfolio composed of counterparties presenting objective evidence of deterioration in terms of risk quality without requiring a specific impairment;
- Sector impairments / or asset class impairments based on expert judgment taking into account in-depth knowledge on its portfolio in order:
  - To adjust its historical loss experiences taking into account the circumstances at the moment of the set-up of the impairment if these circumstances were not taken into account in the period during which the historical loss experience has been observed;
  - To cover the risks observed on a segment of counterparties / types of financing / country risk which present advanced deterioration evidence of risk without requiring the constitution of a specific impairment (for example, a change in legislation can represent a risk and does not necessary require a specific impairment).

3.5.2. Overview of Past-Due Exposure and Impairments

A financial asset is past due when the counterparty has failed to make a payment when contractually due. If a counterparty fails to pay the required interest at due date, the entire loan is considered as past due.
The following tables show the situation of past due and impaired assets at the end of 2013 and 2014.

	31/12/2013				31/12/2014			
	Past-due but not impaired financial assets			Carrying amount of individually impaired financial assets, before deducting any impairment loss	Past-due but not impaired financial assets			Carrying amount of individually impaired financial assets, before deducting any impairment loss
	Less than 90 days	90 days to 180 days	Over 180 days		Less than 90 days	90 days to 180 days	Over 180 days	
Financial assets available for sale (excluding variable income securities)	0	0	0	69	0	0	0	72
Loans and advances (at amortised cost)	199	52	478	1,391	183	28	474	1,161
Other financial instruments	0	0	110	9	0	0	188	2
TOTAL	**199**	**52**	**588**	**1,469**	**183**	**28**	**663**	**1,235**

	31/12/2013							
	As at 1 Jan.	Additions	Reversals	Utilisation	Other adjust-ments [1]	As at 31 Dec.	Recoveries directly recognised in profit or loss	Charge-offs directly recognised in profit or oss
Specific impairment	**(568)**	**(286)**	**170**	**43**	**16**	**(624)**	**12**	**(130)**
Customer loans and advances	(395)	(279)	112	4	13	(545)	9	(55)
Available for sale securities	(155)	(5)	49	39	2	(70)	0	(76)
Fixed revenue instruments	*(121)*	*0*	*49*	*37*	*1*	*(32)*	*0*	*(76)*
Variable revenue instruments	*(34)*	*(5)*	*0*	*2*	*1*	*(38)*	*0*	*0*
Other accounts and receivables	(18)	(2)	9	0	2	(9)	3	0
Collective impairment	**(422)**	**(212)**	**213**	**0**	**3**	**(419)**		
Interbank loans and advances	(6)	(5)	7	0	0	(5)		
Customer loans and advances	(416)	(207)	206	0	3	(414)		
TOTAL	**(990)**	**(498)**	**383**	**43**	**19**	**(1,043)**	**12**	**(130)**

(1) Other adjustments include notably the impact of changes in exchange rates and the scope of consolidation during the year.

	31/12/2014							
	As at 1 Jan.	Additions	Reversals	Utilisation	Other adjust-ments [1]	As at 31 Dec.	Recoveries directly recognised in profit or loss	Charge-offs directly recognized in profit or loss
Specific impairment	**(624)**	**(135)**	**366**	**31**	**(28)**	**(391)**	**1**	**(249)**
Customer loans and advances	(545)	(118)	357	20	(24)	(309)	0	(248)
Available for sale securities	(70)	(17)	0	11	(4)	(80)	0	0
Fixed revenue instruments	*(32)*	*(9)*	*0*	*0*	*(2)*	*(43)*	*0*	*0*
Variable revenue instruments	*(38)*	*(8)*	*0*	*11*	*(2)*	*(38)*	*0*	0
Other accounts and receivables	(9)	0	8	0	(1)	(2)	1	(1)
Collective impairment	**(419)**	**(155)**	**80**	**0**	**(9)**	**(503)**		
Interbank loans and advances	(5)	(11)	2	0	0	(14)		
Customer loans and advances	(414)	(144)	78	0	(9)	(490)		
TOTAL	**(1,043)**	**(290)**	**446**	**31**	**(38)**	**(894)**	**1**	**(249)**

(1) Other adjustments include notably the impact of changes in exchange rates and the scope of consolidation during the year.

In 2014, impaired loans and advances to customers fell by 16.5% to EUR 1,161 million. This fall was accompanied by a reduction of 43.9% in specific impairments on loans and advances to customers, which amounted to EUR 309 million. This downward trend is explained in particular by:

- Sales, accompanied by reversals of impairments, on the US local public sector (particularly on the City of Detroit and the Commonwealth of Puerto Rico) as well as the securitisation portfolio;
- Restructuring and sales of "corporate" and project finance assets in the United States, Italy and the United Kingdom, also resulting in a reduction of impairments and provisions;
- A return to healthy debt of several counterparties in Spain and the United States, in the project finance and corporate sectors.

This decrease is nonetheless tempered by an increase in impairments on certain files associated with corporates and project finance in France, Australia and Portugal.

These sales of highly impaired exposure mechanically resulted in a fall of the coverage ratio, which was at 26.6% at the end of December 2014.

Collective impairments on loans and advances to customers increased to EUR 490 million in 2014, mainly due to new collective impairments on renewable energy and banking sectors.

3.6. Credit Risk Mitigation Techniques

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

Credit Risk Mitigants (CRM) are used by a bank to reduce the credit risk associated with an exposure. CRM are one of the "risk" components used to determine the regulatory capital. CRM can be classified into two main categories:

- Funded credit protection, gathered under the generic name "collaterals";
- Unfunded credit protection, gathered under the generic name "guarantees and credit derivatives".

Funded Credit Protection: Collaterals

From a regulatory point of view, funded credit protection represents a technique for mitigating credit risk whereby the credit risk associated with the bank's exposure is reduced by the institution's right — in the event of a default by the counterparty or the occurrence of other predetermined events involving the counterparty — to liquidate certain amounts or assets, to have them transferred, to seize or hold them, or to reduce the amount of the exposure by the difference between this exposure and the amount of a claim that would be held on the bank, or to replace it by the balance of this difference.

Funded credit protection can adopt several sub-forms:
Financial collateral (securities portfolio under ratings conditions, cash, gold, precious materials, etc…)
Netting agreements: banks have legally enforceable netting arrangements 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.
Physical collaterals:
- Residential or commercial real estate collateral;
- Receivables (eligible only under Advanced Approach);
- Other types of physical collaterals…

Unfunded Credit Protection: Guarantees and Credit Derivatives

From a regulatory point of view, unfunded credit protection represents a technique for mitigating credit risk whereby the credit risk associated with the bank is reduced by the commitment of a third party to pay an amount in the event of a default by the borrower or in the event that other predetermined events should occur.

They include for example:
- Guarantees: guarantees refer to personal guarantees, first demand guarantees, support commitments and "tri-party conventions";
- Credit derivatives. The following types of credit derivatives are eligible for recognition:
  - Credit default swaps provide credit protection equivalent to guarantees. "Credit default swap" means a contract according to which one party to the contract undertakes to make a payment to the other party to the contract on the occurrence of a specified event or events relating to the creditworthiness of a third party. The making of such payment does not in itself give rise to a legal entitlement in the protection provider against the third party.
  - Total return swaps provide credit protection equivalent to guarantees. "Total return swap" means a contract according to which one party to the contract undertakes to make payments to the other party to the contract of all cash flows arising from a specified asset (or assets) plus any increase in the market value of the asset (or assets) since the last payment date or the commencement date of the contract, whichever is the most recent, and according to which the recipient of these amounts undertakes to pay to the first party an interest rate related flow plus any decrease in the market value of the asset (or assets) since the last payment date or the commencement date, whichever is the most recent.
  - Credit derivatives treated as cash collateral. A "Credit linked note" is a cash funded debt instrument which is redeemable by the issuer in accordance with the terms of the instrument, or the terms of redemption of which are altered, on the occurrence of a specified event or events related to the creditworthiness of a third party.
- Other credit commitments received from a third-party.

3.6.2. Policies and Processes

Institutions should use robust procedures and processes to control risks arising from the use of collateral, including in particular strategy, consideration of the underlying credit, valuation, policies and procedures, systems, control of roll-off risks, and management of concentration risk arising from the institution's use of collateral and its interaction with the institution's overall credit risk profile.

Collateral and Guarantees/Credit Derivatives

Within the Dexia Group, managing the CRMs involves the following tasks:
- Analysis of the eligibility of all CRMs under the Standard and Advanced approaches. To summarise, only financial collaterals, guarantees, credit derivatives, real estate assets and leased real estate assets are eligible under the Standard approach (provided they respect the related requirements). The scope of eligible CRMs is significantly broader under the Advanced approach than under the Standard approach: in addition to CRMs eligible under the Standard approach, receivables and other types of collaterals can also be considered as eligible provided they respect the related requirements;

- 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 regulatory 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. The following derivative products are eligible to netting agreements: swap, contracts forward, options, etc… covering the following underlying risks:

- Interest rate contracts;
- Exchange rate or gold contracts;
- Contracts on ownership titles;
- Contracts on precious metals except gold;
- Commodities other than precious metals;
- Credit derivative contracts.

For these products, internal policies document the eligibility criteria and minimum requirements that netting agreements need to fulfil in order to be recognised for regulatory purposes. Eligibility criteria are different for on-balance-sheet netting agreements and off-balance-sheet netting agreements. 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.

3.6.3. Basel Treatment

For netting agreements (and subject to eligibility conditions), Dexia recognises 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 recognises 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 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.
- Standard exposures: eligible CRMs (after regulatory haircuts) are directly taken into account in the EAD.

3.6.4. Exposure Covered by Credit Risk Mitigants by Exposure Class

This chart shows the amount of exposure per class of original counterparty, for which the guarantees is eligible, i.e. the guaranteed exposure has a lower risk weight than the exposure with the original counterparty (substitution principle).

2014	
	Eligible guarantee
ABS	229
Corporate	8,175
Financial institutions	2,059
Project finance	307
Public sector	6,303
Retail	1,084
Sovereign	183
Total	18,340

3.7. Counterparty Credit Risk

3.7.1. Management of the Risk

Dexia enters into derivative contracts primarily to protect cash flows and the fair value of financial assets and liabilities from market fluctuations. Derivative transactions are mainly concluded to reduce risk exposure with regard to interest rate risk and foreign exchange risk.

Even though it is the objective of the bank to enter into risk reducing strategies, only some of the derivative transactions can be classified as hedge accounting. In the event a strategy applied by the bank does not fulfil the stringent requirements defined under IAS 39, transactions are classified as derivatives "held for trading" notwithstanding their risk reducing character.

3.7.2. Counterparty Credit Risk – Basel III

Counterparty or replacement risk corresponds to the market value of transactions with counterparties. It represents the current cost of replacing transactions with a positive value should the counterparty default.

Calculation of Exposure at Default within the Regulatory Framework

The EAD relative to the counterparty's risk is determined by aggregating the positive market values of all transactions (replacement cost) and increasing the sum with a regulatory add-on. This add-on, which is calculated in line with the CRD (Capital Requirement Directive) guidelines, is a fixed percentage according to the type of transaction (complexity), the underlying and the residual maturity, which is applied to the transaction's nominal value. In both cases, the effects of netting agreements and collateral are factored in by applying the netting rules as defined by the mark-to-market method and subtracting guarantees or collateral.

Dexia is engaged in two types of transactions presenting counterparty credit risks:

- Derivatives: counterparties' exposure arises as a result of positive market valuation of derivative contracts. A positive market value represents Dexia's claim on the counterparty. Since market values fluctuate during the term to maturity, the uncertainty of future market conditions is taken into account by means of an 'add-on' to the current market value reflecting potential market movements for the specific contract. The total credit exposure on the counterparty, the credit risk equivalent, is the sum of the market value of the contract and the add-on.

- Repurchase agreements and securities lending or borrowing: given Dexia is cash taker, most of repo transactions record a positive transactional haircut (difference between received cash and posted collateral). This difference represents a Dexia risk on the counterparty. Bond prices fluctuate during the term to maturity and with the uncertainty of future markets. This explains why, as for derivatives, add-ons are included to obtain an economic view of counterparty risk.

To reduce the counterparty risk, Dexia OTC derivatives and Dexia repos are in most cases concluded within the framework of a master agreement (i.e. the International Swap and Derivative Association – ISDA or Global Master Repurchase Agreement – GMRA) taking account of the general rules and procedures set out in the Dexia credit risk policies. These framework agreements reduce Dexia's credit exposure through:

- The use of close-out netting agreements where all positive and negative market values (haircut for repos) under the same agreement can be netted on a counterparty level;
- The netting agreement is supplemented with a collateral agreement where the net market value exposure (net positive variation in haircut for repos) is reduced further by the reception of margin calls. Margin calls are regulated by the terms and rules stipulated in the Credit Support Annex (CSA) for derivatives and GMRA negotiated with the counterparty.

Dexia complies with the EMIR regulation and has been admitted by a central counterparty (clearing house) to net the allowed derivative transactions. Dexia also uses General Collateral Pooling with a central counterparty for funding via repos.

Counterparty credit risk is taken into account in the calculation of credit risk on financial institutions.

Credit Valuation Adjustment

The Credit Valuation Adjustment (CVA) corresponds to the difference between:

- A risk-free valuation; and
- The valuation that takes into account the possibility of a counterparty's default.

When applied to an OTC derivative portfolio, it corresponds to the market value of the counterparty credit risk. It is a fair value adjustment that reflects the expected losses due to a counterparty's default.

This derivative fair value component is now considered by banks as a standard market practice. The credit and liquidity crisis highlighted the need for a better measurement of this risk arising on derivative portfolios. The widening of credit spreads over past years has emphasised the significance of counterparty credit risk and CVA measurement.

From an accounting standard point of view, and with the release of IFRS 13, in spite of the changes in the fair value definition, calculation of CVA becomes a clear requirement.

As CVA measures the expected losses due to a counterparty's default, the method for calculating CVA is similar to the Basel regulatory capital loan loss provisioning methodology whereby CVA is equal to expected exposure (called in Basel texts Exposure at Default or EAD) multiplied by the probability of default (PD) and the loss given default (LGD).

CVA Capital Charge

Since the implementation of the Basel III framework, Dexia is subject to a capital charge for potential mark-to-market losses associated with deterioration in the creditworthiness of its counterparties.

Basel III aims at applying to CVA risk an approach equivalent to the one used for market risk capital charge measurement (based on Value at Risk): the CVA capital charge corresponds to a Value at Risk (VaR) applied to CVA.

Capital charge is computed in accordance with EBA guidelines.

Dexia has EUR 6,093 million of weighted risks on counterparty credit risk, of which EUR 3,473 million related to CVA capital charge.

3.7.3. Accounting Treatment of Derivatives

The accounting treatment of Dexia's derivative strategies is described in notes 1.1.10. and notes to 1.1.11. to the consolidated financial statements in Dexia's annual report 2014, on pages 87-88.

3.7.4. Derivative portfolio

Detailed information is provided in note 4.1. to the consolidated financial statements in Dexia's annual report 2014, on pages 119-120.

3.8. Focus on Equity Exposure

3.8.1. Accounting Rules

Detailed information is provided in the notes to the consolidated financial statements in Dexia's annual report 2014, on page 85.

3.8.2. Equity Exposure

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 2013 and 2014.

	2013		2014	
Type of asset	**Accounting value**	**Fair value**	**Accounting value**	**Fair value**
Financial assets designated at fair value	1	1	1	1
Available-for-sale financial assets	368	368	260	260
Total continued activities	**369**	**369**	**261**	**261**
Available-for-sale financial assets	193	193	-	-
Total activities held for sale	**193**	**193**	**-**	**-**
TOTAL	**562**	**562**	**261**	**261**

The reasons for the decrease of the equity value are:

- In 2014, Dexia sold its participation in Dexia Asset Management Group and consequently the "held for sale" equities held by Dexia Asset Management in 2013 disappeared in 2014 (decrease by EUR 193 million compared to 2013).
- Regarding continued activities, the main reason is that the accounting value of an Italian exposure was revised downwards by EUR 135 million.

The majority of equity exposures is classified as available-for-sale financial assets.

3.9. Focus on Securitisation Activities

3.9.1. Objectives and Roles of Dexia[5]

Dexia is managing in run-off a portfolio of senior ABS bonds. Dexia also manages a synthetic securitisation (WISE) with Public Finance and Utility assets as underlying.

Dexia has not originated any securitisation transactions since 2011. The same goes for new investments or acting as sponsor for providing liquidity facilities in Dexia securitisation transactions or third parties.

3.9.2. Management of the Risk

Dexia's 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 organised as follows:

- Depending on the level of risk of each position, an annual or semi-annual full review is realised analysing both the market on which the underlying assets are based (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.

- On a quarterly basis, the most sensitive exposures classified in the Watchlist or Quarterly Review List are reviewed by a dedicated Risk committee, which 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 characterised by static pools of assets, limiting the risk of cash-flow mismatches between assets and liabilities.

- 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 mismatch between the assets.

3.9.3. Basel III Treatment and Accounting Rules

3.9.3.1. Basel III Treatment

Dexia applies the Rating-Based Approach (RBA – advanced approach) to calculate the weighted risks corresponding to securitisation/re-securitisation exposures. This method determines the Risk Weight percentage applicable as a function of the external rating of the securitisation 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 securitisation position is deducted from capital.

For both securitisation originations and calculating weighted risks in relation to its investments in securitisation 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 securitisation transactions, their valuation and accounting treatment are pursuant to IAS 39 relating to Financial Instrument Recognition and Measurement.
For consolidation purposes, a Securitisation Structured Entity is consolidated in accordance with IFRS 10 relating to consolidation as described in Note 1.1.3 to the consolidated financial statements in Dexia's annual report 2014, page 81.

3.9.4. Securitisation Activity as Originator

All of Dexia's origination operations, except WISE 2006-1 and the DRECM originations, were carried out with a view to obtaining long term funding or establishing a liquidity buffer. The risk was not transferred out of the Group. No new transaction was closed in 2014 (nor in 2013). No new securitisation transaction is scheduled for the future, and subsequently there is no asset on the balance sheet awaiting securitisation or that can be identified as such.

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

(5) For more detailed information on securitisation concepts, please refer to Appendix 3 – Basics on Securitisation

The DRECM securitisation transactions were made following a standardised and recurrent format (all loans are sold, no securitisation position is retained, no credit risk is retained) with full risk transfer and regulatory capital relief.

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

The following tables show the outstanding notional amounts of reference obligations in the securitised pool, by nature of securitisation and type of underlying assets. The names of corresponding Dexia originations are shown in the last row.

Variations between 2013 and 2014 are due to the amortisation of the securitisation portfolios.

	Exposure at year-end 2013			
	Public sector	**Corporate exposures**	**Other**	**Total**
Traditional securitisations	410	209	178	797
Synthetic securitisations	0	980	277	1,257
	Triplus	**Tevere s3**	**Tevere s2**	
		Wise	**Wise**	

	Exposure at year-end 2014			
	Public sector	**Corporate exposures**	**Other**	**Total**
Traditional securitisations	385	176	162	723
Synthetic securitisations	0	1,050	290	1,341
	Triplus	**Tevere s3**	**Tevere s2**	
		Wise	**Wise**	

No exposure retained at origination is outstanding in Dexia's balance sheet. Dexia has purchased some of its originations on the secondary market; they are listed in the following chart (in EAD).

RW Bucket	2013	2014
1250%	22	14
]106% - 1250%[	0	10

Refer to Appendix 4 for more details regarding Dexia originations.

3.9.5. Securitisation Activity as Investor

3.9.5.1. Dexia Portfolios

The following tables show the Exposure At Default (EAD) of securitisation positions[6] retained or purchased in the banking book, broken down by type of securitisation and risk-weight class at year-end 2013 and 2014.

2013

Type of securitisation	[0 - 8%]	]8% - 16%]	]16% - 106%]	]106% - 1250%[	1250%	Grand Total
ABS	3,615	229	48	288	36	4,216
CDO		41		94	22	157
MBS	137	576	241	613	277	1,844
Other ABS					16	16
GRAND TOTAL	**3,752**	**846**	**289**	**996**	**351**	**6,233**

2014

Type of securitisation	[0 - 8%]	]8% - 16%]	]16% - 106%]	]106% - 1250%[	1250%	Grand Total
ABS	3,906	402	0	133	1	4,442
CDO		47	10	33	14	104
MBS	229	449	199	431	119	1,428
Other ABS					13	13
GRAND TOTAL	**4,135**	**898**	**209**	**596**	**148**	**5,987**

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

(6) Guaranteed positions are included (see amounts in sections 3.3.3 and 3.4.3).

84% of the portfolio (risk weights below or equal to 16%) is within the A or above rating range as of end 2014, and 88% of the portfolio is Investment Grade (a risk weight of 106% corresponding to a BBB- rating), up from 78% as of year-end 2013 thanks to rating upgrades by external rating agencies over 2014 and to the sale of some low-rated positions.

The decrease of the outstanding amount of securitisation positions retained or purchased is mainly due to the natural amortisation and some deleveraging/de-risking transactions during 2014.

Out of the above amounts, EUR 28 million of MBS were re-securitisation, weighted in the interval]106%-1250%[(both as at year-end 2013 and 2014).

The following table shows the Exposure At Default (EAD) of securitisation positions retained or purchased, broken down by seniority.

SENIORITY	2014
SENIOR	5,973
MEZZANINE	12
FIRST LOSS	3
Total	**5,987**

The bulk of the exposure, as at 31 December 2014, was senior.

In addition, Dexia owns a position in trading on a senior ABS weighted 8%; its accounting value was EUR 81.1 million as at 31 December 2013 and EUR 62.5 million as at 31 December 2014.

3.9.5.2. Gains or Losses on Sales

The tables below show the recognised gains or losses by type of exposure in 2013 and 2014 arising from the sale of securitisation positions. Securitisation sales for the years 2013 and 2014 resulted respectively in a EUR 6 million loss and a EUR 17 million gain, before reversal of collective impairments. The gain recorded in 2014 is attributable to a small number of impaired positions (including a Private Student Loans ABS and a Greek RMBS) which Dexia eventually managed to sell at favourable prices.

Gains or losses in 2013

US Student Loans	Residential Mortgage Loans	Commercial Mortgage Loans	Public Sector	Corporate Exposures	Other ABS	Total
-	-	-	-	-	-6	-6

Gains or losses in 2014

US Student Loans	Residential Mortgage Loans	Commercial Mortgage Loans	Public Sector	Corporate Exposures	Other ABS	Total
11	6	-	-	-	-	17

4. Market Risk

To ensure that market risk is monitored effectively, Dexia has developed a framework based on the following components:
- A comprehensive system for risk measurement, built on historical and probability models;
- A structure of limits and procedures governing risk-taking, consistent with the end-to-end risk measurement and management process.

4.1. Market Risk Measures

4.1.1. Risk Measurement

The Dexia Group mainly assesses market risk using a combination of two measurement indicators, resulting in a limit-based risk management framework.
- Value at Risk (VaR) is a measure of the expected potential loss with a 99% confidence interval and for a holding period of ten days. Dexia uses a number of VaR approaches to measure the market risk inherent in its portfolios and activities:
  - Directional interest rate risk and foreign exchange risk are measured via a parametric VaR approach using a methodology based on the assumed normal distribution of yields relating to various risk factors.
  - Credit spread risk (also known as specific interest rate risk) and other risks in the trading portfolio are measured using a historical VaR approach. Historical VaR is a VaR whose distribution is constructed by applying historical scenarios for the relevant risk factors associated with the current portfolio.
- Limits in terms of position, maturity, market and authorised products are put in place for each type of activity, ensuring consistency between overall value limits and operational thresholds used by front office.

Stress testing completes the risk management system by exploring a range of events outside the probability framework of VaR measurement techniques. The assumptions underlying stress test scenarios are regularly revised and updated. The results of consolidated stress tests and the corresponding analysis are presented quarterly to the Market Risk Committee.

4.1.2. Exposure to Market Risk

4.1.2.1 Value at Risk

The table below shows the details of VaR used for market activities, not including the bond portfolio. At the end of December 2014, total VaR consumption stood at EUR 13.3 million, compared with EUR 12.2 million at the end of 2013, a level lower than the global limit of EUR 40 million.

The Dexia trading portfolio is composed of two groups of activity:
- Transactions initiated by financial instrument trading activities until the date on which the Group was placed in orderly resolution, mostly covered back-to-back;
- Transactions intended to hedge transformation risks on the balance sheet, and in particular the liquidity gap on currencies, but for which there is no documentation of an accounting hedge relationship under IFRS standards.

The main risk factors of the trading portfolio are:
- Cross currency basis swap risk;
- Basis risk BOR-OIS.

	Value at risk of market activities				
	2013				
VaR (10 days, 99%)	Interest and FX (Banking and Trading)	Shares (Trading)	Other risks	Total	Limit
Average	2.6	7.2	0.4	10.2	40
End period	6.4	5.6	0.3	12.2	
Maximum	7,8	8.4	0.7	14.9	
Minimum	0.7	5.6	0.2	8.2	

	2014				
VaR (10 days, 99%)	Interest and FX (Banking and Trading)	Shares (Trading)	Other risks	Total	Limit
Average	6.7	5.3	5.3	5.3	40
End period	8.3	4.7	4.7	4.7	
Maximum	8.3	5.8	5.8	5.8	
Minimum	5.4	4.7	4.7	4.7	

4.1.2.2 Sensitivity of Portfolios Classified as "Available for Sale" to the Evolution of Credit Spreads

The sensitivity of the AFS reserve for available-for-sale portfolios to an increase in credit spreads is closely monitored. At the end of 2014, this sensitivity was EUR -20 million for a one basis point increase in credit spreads. The reduction of sensitivity compared to the end of 2013 is essentially due to the reclassification of illiquid assets to the category "Loans and receivables" on 1 October 2014.
Conversely, since interest rate risk is hedged, sensitivity to interest rate fluctuations is very limited.

4.1.3. Regulatory Internal Model and Back Testing

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.

The Stressed VaR is calculated 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. Nevertheless, the National Bank of Belgium (NBB) requires Dexia to apply a floor of 2.5 times the VaR while calculating the SVaR.

Standard Approach

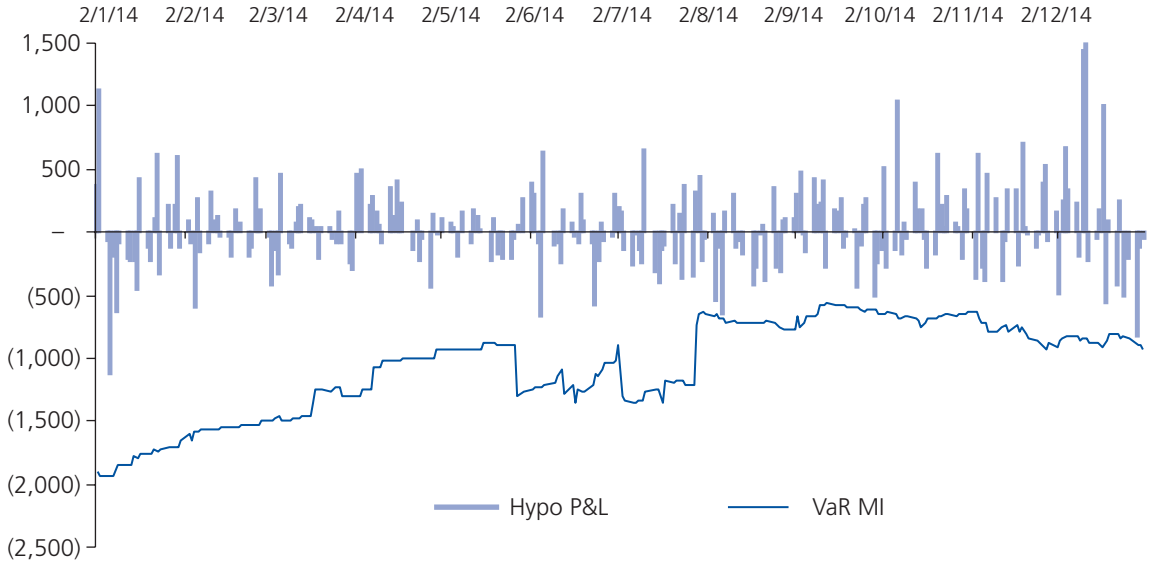
The other market risks (spread, equity) are treated under the Basel standard approach.

Back Testing

Back testing is performed on a daily basis on the trading scope. The result of the back testing is the number of losses exceeding their corresponding VaR figures (i.e. "the number of exceptions"). For back testing purposes, the VaR amounts need to be recalculated using a 1-day holding period. For VaR figures calculated under a parametric approach, rescaling is achieved through the application of a square root of 10 conversions. For any other VaR approach, a 1-day VaR figure is calculated. Risk reports are based on end-of-day positions meaning that risk figures refer to the maximum loss at the chosen confidence interval over the holding period of 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 income statement of the following business day, restated to exclude accounting elements that are not captured by the Value at Risk such as fees, in order to better challenge the robustness of the Dexia model.

Hypothetical back testing runs under the scenarios of change in interest rate alone, in change in exchange rate alone and change in both market data together. The back testing 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 2014, Dexia noticed 0 "downward" exceptions on its IR perimeter on internal models (as in 2013).

Back Testing Results for 2014



4.1.4. Validation

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

4.1.5. Systems and Controls

On a daily basis, the Product Control department, which is part of the Finance activity line, calculates, analyses and reports the risks and results at an entity and a consolidated level. On a monthly basis, the Market Risk Committee meets to analyse the risk and results, possibly to adjust 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 authorised products, sensitivity, VaR and/or outstanding limits. The systems and controls established within the Dexia Group are described in various procedures to ensure a complete and formal framework established to support all the market risk responsibilities.

As an example, the New Product Approval Procedure (NPAP) describes the approval process for 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, Market Risk analyses and proposes a valuation strategy for each product and presents 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 Valuation & Collateral Committee (VCC) and if necessary, this committee will put in place an action plan to improve the valuation strategies.

5. Transformation Risk

Dexia's asset and liability management policy aims to reduce liquidity risk as far as possible and limit exposure to interest rate and foreign exchange risk.

5.1. Management of Interest and Exchange Rate Risk

Dexia's balance sheet management policy aims to minimise volatility in the Group's results.

5.1.1 Measurement of Interest Rate Risk

Interest rate risk is measured via sensitivity. Risk sensitivity measures reflect balance sheet exposure to a 1% movement on the yield curve. The main indicator used to determine limits and to measure and monitor risk is the sensitivity of the net present value of accrued interest positions to interest rate fluctuations.
The overall and partial sensitivities by time bucket are the main risk indicators used by the ALM risk committees, organised within the Management Board, to manage risk. The Dexia Group's structural interest rate risk is mainly concentrated on European long-term interest rates, and arises from the imbalance between Dexia's assets and liabilities after hedging for interest rate risk.

The sensitivity of long-term ALM was EUR -14.2 million as at 31 December 2014, compared with EUR +10.5 million as at 31 December 2013. This is in line with the ALM strategy, which seeks to minimise P&L volatility.

	31/12/2013	31/12/2014
Sensitivity	+10.5	-14.2
Limit	+/- 96	+/- 80

5.1.2 Measurement of Foreign Exchange Risk

With regard to foreign exchange, the Management Board decides on the policy to hedge the foreign exchange risk generated by the existence of assets, liabilities, income and expenditure in currencies. Also subject to regular monitoring:
- The structural risks associated with the funding of holdings in foreign currencies;
- Elements liable to increase the volatility of the solvency ratios of the Group or its subsidiaries and branches.

Structural exchange positions are subject to strict limits below which a systematic hedge policy is applied.

5.2. Management of Liquidity Risk

5.2.1 Dexia's Policy on the Management of Liquidity Risk

Dexia's main objective is to manage the liquidity risk in euro and in foreign currencies for the Group, as well as to monitor the cost of funding so as to minimise volatility in the Group's results.
The liquidity management process aims to optimise the coverage of the Group's funding requirements taking into account the constraints to which it is exposed. Funding requirements are assessed prudently, taking into account existing transactions as well as planned on- and off-balance-sheet forecasts.
The Group's liquidity reserves consist of assets eligible for the central bank refinancing facilities to which Dexia has access.
To manage the Group's liquidity situation, the Management Board regularly monitors the conditions for funding transactions on the market segments on which Dexia operates. It also guarantees proper execution of the programmes put in place. To that end, a specific and regular mode of information has been introduced:
- Daily and weekly reports are provided to members of the Management Board, the State shareholders and guarantors and the regulatory authorities. This information is also used by all parties involved in managing the Dexia Group's liquidity position – namely the Finance and Risk teams in charge of these topics, and the Funding and Markets activity line;
- The 12-month funding plan is sent monthly to the State shareholders and guarantors, central banks and regulatory authorities;
- Twice-per-week conference calls are held with the European, French and Belgian regulatory authorities and central banks.

5.2.2 Measurement of Liquidity Risk

Liquidity indicators have evolved to take into account the constraints affecting Dexia's liquidity position. The four-week liquidity ratio, comparing the liquidity reserves with the Group's liquidity requirements under various scenarios, is supplemented by the maximum authorised amount of guaranteed issues and the maximum limit set by Banque de France on its emergency liquidity assistance (ELA).

Dexia's liquidity risk is also managed via the liquidity ratios monitored by its various regulators – the National Bank of Belgium (NBB) for Dexia and the French Autorité de Contrôle Prudentiel et de Résolution (ACPR) for Dexia Crédit Local:

- The NBB ratio to which Dexia is subject, establishes an institution's liquidity position by comparing required liquidity with available liquidity at one week and one month. Monitoring of this ratio was discontinued in June 2014.
- The ACPR ratio to which Dexia Crédit Local is subject is defined as the ratio of cash to liabilities over a forecast one-month period; the ratio thus calculated must always be above 100%[7].

Over 2014, the Dexia Group respected the various liquidity ratios to which it is subject.

Since June 2014, the Dexia Group has provided the National Bank of Belgium with a monthly estimate of the Liquidity Coverage Ratio (LCR). This ratio is scheduled to enter into force in October 2015.

Further information on liquidity is provided in the chapter entitled "Information on capital and liquidity" in Dexia's annual report 2014, on page 38.

(7) Instruction no. 2009-05 of 29 June 2009 relative to the standard approach of liquidity risk.

6. Operational Risk

Dexia's policy regarding operational risk management consists of regularly identifying and assessing the various risks and existing controls to check that the predefined level of tolerance for each activity is respected. If predetermined limits are exceeded, the governance in place must ensure that corrective action is quickly taken or that improvements are put in place to bring the situation back within acceptable parameters. This system is supplemented by a prevention policy covering in particular information security, business continuity and, when necessary, the transfer of certain risks via insurance.

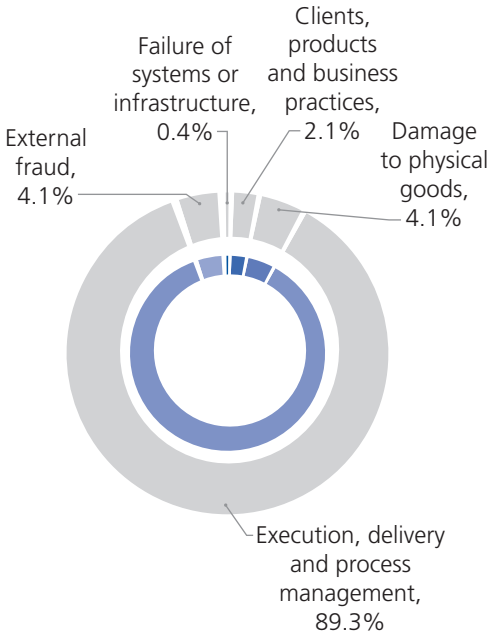
6.1. Risk Measurement and Management

The company project identifies operational risk management as one of the pillars of Dexia' strategy in the context of its orderly resolution.

The monitoring of operational risk is done within the framework of the standard approach determined by the Basel regulatory methodology. Under this methodology, information relating to the operational risk must be transferred to the managers in charge of monitoring this risk, and the tasks identified as critical must be monitored.

The operational risk management system relies on the following components.

- Operational risk database: the systematic capture and monitoring of operational incidents is one of the most important requirements of the Basel Committee. Fulfilling its regulatory obligations, Dexia has put a system in place to list operational incidents and to gather specific data. The information gathered enables it to improve the quality of its internal control system;
  Over the last three years, the breakdown of total losses between the standard categories of incidents is as follows:



  The classification of the various categories of operational incidents was modified as a result of the reduction of the scope of the Dexia Group.
  For example, internal fraud, which is more typical for retail and private banking activities, has almost disappeared following the disposal of the Group's retail banking businesses. "Execution, delivery and process management" remains the most dominant category, though there have been very few major events since 2010.
  The other categories account for few events and represent low loss levels. The main incidents are subject to corrective actions approved by the Group's management bodies.
- Risk self-assessment and control: as well as building a history of losses, Dexia's exposure to key risks is determined via an annual risk mapping exercise. All Dexia Group entities conduct risk self-assessment exercises that take into account existing controls, thus providing senior management with an overall view of most areas of risk within the Group's various entities and businesses. Actions to limit risk may be defined where applicable.

- Definition and monitoring of action plans: actions are defined in response to major incidents, deficient controls or important risks identified. Regular monitoring is carried out by the operational risk management function. This process allows the internal control system to be constantly improved and risks to be reduced appropriately over time.
- Scenario analysis and Key Risk Indicators (KRI): two specific elements of the operational risk management mechanism were developed in 2014: scenario analysis relating to internal fraud by the misappropriation of means of payment and the introduction of Key Risk Indicators (KRI) on the main risks identified in the operational risk mapping.
- Management of information security and business continuity: the information security policy and associated instructions, standards and practices are intended to ensure that Dexia's information assets are secure. All activities take place in a secure environment. The various activity lines establish impact analyses for vital activities in the case of disaster or interruption. They define plans for the recovery. Updating of activity continuity processes takes place at least once a year. On the basis of regular reports, the Management Board signs off recovery strategies, residual risks and action plans with the aim of delivering continuous improvement.

Dexia applies the Basel standard approach to calculate regulatory capital for operational risk management.
The table below shows the capital requirements determined by the standard approach computation with a conservative buffer for 2014:

	2013	2014
Capital requirement	202	80

6.2. Management of Operational Risk during the Resolution Period

In 2014, the Dexia Group continued to adjust its structure and its operational processes in line with its orderly resolution plan. This phase is by nature liable to give rise to operational risks, particularly as a result of factors such as the departure of key staff members, potential staff demotivation, and process changes when applications need to be replaced or duplicated.

The key components of the management system described above continue to be applied during this period. Specifically with regard to self-assessment of risks and controls, Dexia was called upon to assess the risk of discontinuity associated with the factors referred to above.

Furthermore, the separation of Dexia from Société de Financement Local (SFIL), finalised in 2014, is subject to specific analysis and monitoring, particularly concerning the duplication of applications and the management of access.

Finally, Dexia has taken action to prevent psycho-social risks and provide staff with support in connection with such risks.

7. Compensation Policies and Practices

Dexia's compensation policy has been established by the Human Resources department in collaboration with the Audit, Risk and General Secretariat, Legal and Compliance support lines.

Dexia has adopted one overall compensation policy for all its entities. It has been submitted, after approval by the Board of Directors, to the subsidiaries and branches, for formal approval by the competent bodies based on the rules and procedures provided in the company's articles of association.

Dexia modified its compensation policy in March 2013 in order to take into account the commitments made by the Belgian and French states regarding compensation during their discussion with the European Commission.

In order to guarantee attractive and competitive compensation, Dexia may use internal and external consultants, to verify the positioning of its compensation policy in comparison to any given reference market.

Depending on the activity and seniority level in the organisation, Dexia positions the compensation of its staff members and executives in relation to their peers. The Appointment and Compensation Committee analyses the levels of compensation of members of the Management Board with regard to compensation granted in other companies in the sector. The compensation of members of the Management Board is set by the Board of Directors of Dexia following proposals from the Appointment and Compensation Committee.

7.1. Fixed and Variable Compensation

The compensation of staff members whose professional activities have a significant impact on the risk profile may be composed of a fixed part and a variable part.

7.1.1. Fixed Compensation

Basic Compensation

Basic compensation is determined considering the nature and importance of the responsibilities assumed by each staff member (and taking into account the market benchmarks for comparable functions).

Function Premium

The Board of Directors decided to reduce the variable compensation dependent on the performance in order to reduce the potential incentive to take excessive risks. As a consequence, the Board decided to grant a lump sum, not affected by performance.

As a result, and in accordance with Article 7.I. of the Belgian Royal Decree of 22 February 2011, the Board is increasing the compensation not linked to performance which must be a significant proportion of the entire compensation.

Since July 2012, the compensation decided for the new members of the Management Board does not include a function premium and is only constituted with a fixed salary.

7.1.2. Variable Compensation

The member of the Management Board, Executive Committee and Group Committee have no contractual right to perceive a variable compensation.

For the other population and in order to discourage excessive risk-taking and to allow a sufficiently flexible policy of granting variable compensation, the maximum ratios observed between fixed and variable compensation is 1 (fixed remuneration) for 0.3 (variable compensation).

Taking the ratios set out above into account, the variable compensation paid to an employee will not be subject, except where there is an exception, of payment spread over several years. Nevertheless, the company reserves the right to apply the clawback mechanism in specific cases.

7.1.3. Clawback

Payment of variable compensation is based on the premise that, as long as the employee is working within the Group, the beneficiary fully observes the law and the rules specific to the company as well as the values of the Dexia Group.

In case fraud is observed after the attribution of variable compensation, and in cases where the variable compensation might have been granted on the basis of intentionally erroneous information, the Board of Directors reserves the right to consider the bringing of a civil action with a view to recovering the part of the variable compensation which might already have been paid, or at least equivalent damages and interest, in cases where the company might have suffered significant harm.

7.2. Link between Performance and Variable Compensation

All variable compensation is influenced by the company's situation and may fluctuate in function of the results of the Group, of the entity and the individual performance. Depending on the legal constraints and obligations, variable compensation may thus be reduced to nil, by decision of the Board of Directors.

The link between the variable compensation and employee performance is assessed with regard to former targets and subsequent expected results based on the activity carried out in the past.

Subsequently, the targets cascaded down to lower levels of the organisation will take into account the risk factors specific to the activity line concerned.

When monitoring performance, targets that are specifically risk-oriented will be subject to the same monitoring as other performance targets.

All groups which receive variable compensation are assessed on the basis of quantitative and qualitative, financial and non-financial criteria.

Professional performance, although taken into account when determining variable compensation, is but one element among others.

7.3. Quantitative Information

The information regarding the compensation of the Management Board is disclosed in chapter "Terms of office and compensation paid to directors and officers" of Dexia Crédit Local's registration document 2014, on pages 52-55, as well as in the Declaration of corporate governance published in Dexia 's annual report 2014, on pages 57-60.

In addition and based on the compensation policy, Dexia publishes on its corporate site the information regarding the compensation of all the risk takers. http://www.dexia.com/FR/actionnaires_investisseurs/information_reglementee/Documents/Politiquederémunération.pdf

Appendix 1
Glossary

Concept	Definition
ABS Asset-Backed Security	Securities issued by a vehicle created for the purpose of buying assets from a bank, a company or a state, like trade receivables or inventories, and to provide the seller with cash and the buyer with a financial product characterised by a certain risk profile and a rate of return.
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 Advanced 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 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.
AVC Asset Value Correlation	The AVC parameter is a means by which the framework captures the extent to which defaults across firms will cluster together. A multiplier of 1.25 is applied to the correlation parameter of all exposures to financial institutions meeting defined criteria (see LFI/UFI)
BIS Bank for International Settlements	"Bank for International Settlements" ("BIS") designates the international financial institution which acts as the central bank of the national central banks and of some supranational organisations, such as the European Central Bank (ECB). BIS receives deposits from, and makes loans to, these entities. BIS is also a forum to discuss co-ordination of macroeconomic policies in general, with a focus on monetary policies, such as the evolution of interest rates and currency exchange rates. The organisation's prime objective is the overall stability of the world's financial system. In that context, capital adequacy ratios applicable to banks are set up by the Basel Committee which is part of BIS.
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.
CMBS Commercial Mortgage-Backed Securities	CMBS are securities where the primary source of payments is a mortgage loan or a pool of mortgage loans secured mostly on commercial real property. Investors receive payments of interest and principal that are derived from payments received on the underlying mortgage loans.
CRD Capital Requirement Directive	The Capital Requirement Directive (CRD) for the financial services industry introduces a supervisory framework in the EU which reflects the Basel III rules on capital measurement and capital standards.
CRE Credit Risk Exposure	Each bank has developed an internal credit risk measure of calculation. Regarding the Dexia situation, the CRE is used to determine the credit risk vision for Dexia by extension of the regulatory scope for credit reporting and part of the credit limits monitoring purposes
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).
CVA capital charge	Under the Basel III the banks are subject to a "CVA" capital charge for potential mark to market losses associated with a deterioration in the creditworthiness of a counterparty. The CVA capital charge corresponds to a Value At Risk (VaR) applied to CVA.

Concept	Definition
CVA Credit Valuation Adjustment	The Credit Valuation Adjustment (CVA) is one of the components of the fair value (FV) of the derivatives. CVA adjusts FV in order to take counterparty risks into account. CVA was implemented by banks 10 years ago and is included in the IFRS 13 accounting framework. The CVA applied to OTC derivatives corresponds to the difference between the risk-free valuation and the valuation that takes into account the possibility of a counterparty's default (reflects the expected losses due to a counterparty's default).
DVA Debit Valuation Adjustment	The Debit Valuation Adjustment (DVA) is the measure of a bank's possibility of not fulfilling its own obligations based on its probability of default.
EAD Exposure at Default	Exposure at Default (EAD) is one of the parameters used to calculate regulatory capital requirement under the Basel III framework. EAD is Dexia best estimate of its credit risk exposure value in case of default of its counterparty. Definition of EAD depends on the approach taken into account by Dexia: both Standard and IRB approaches (Basel III regulation) are used by Dexia.
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 recognise 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.
Forbearance	Forborne exposures are restructured contracts in respect of which forbearance measures have been extended. Forbearance measures consist of concessions towards a debtor facing or about to face difficulties in meeting its financial commitments (in other words, forbearance bears upon counterparties which are in "financial difficulties"). Restructured contracts are transactions renegotiated (modification of the previous terms and conditions) or refinanced (use of debt contracts to ensure the total or partial payment of other debt). Concession refers to either of the following actions: (a) a modification of the previous terms and conditions of a contract the debtor is considered unable to comply with due to its financial difficulties ("troubled debt") to allow for sufficient debt service ability, that would not have been granted had the debtor not been in financial difficulties; (b) a total or partial refinancing of a troubled debt contract, that would not have been granted had the debtor not been in financial difficulties.The concept of forbearance applies to all loans and debt securities on balance sheet. "Debt" includes loans, debt securities and revocable and irrevocable loan commitments given, but excludes exposures held for trading.
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 Capital Adequacy Assessment 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.
IRB Approach	Internal Rating-Based Approach. Institutions using the IRB approach are allowed to determine borrowers' probabilities of default. Two IRB approaches exist: the Advanced Approach (AIRBA) and the Foundation Approach.
ISDA International Swap and Derivative Association	Trade organisation of participants in the market for over-the-counter derivatives. Its headquarters are in New York, and it has created a standard contract (the ISDA Master Agreement) to enter into derivative 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.
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.

Concept	Definition
LCR Liquidity Coverage Ratio	A 30 days liquidity coverage ratio set up by the new Capital Requirement Regulation (CRR) designed to ensure short-term resilience to liquidity disruption. The stock of high liquid assets in stressed conditions is compared to the total expected cash inflows minus outflows. Observation ratio until 1 January 2015.
LFI Large Financial Institution	A Large Financial Institution is a regulated financial institution (defined as an institution that provides financial services to its clients or acts as an intermediary in providing such services) whose total assets, on the level of that individual firm or on the consolidated level of the group, are greater than or equal to EUR 70 billion.
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.
Master scale	For reporting purposes, a "master scale" has been set up. This master scale is structured in grades ranging from AAA to CCC and the modifiers plus, flat and minus (except for both extremes of the scale). The two default classes D1 and D2 are also reported. Each rating corresponds to a bucket of PD set up according to the one-year average default rate of rating agencies. This rating is obtained by mapping its probability of default as estimated by the relevant IRS (Internal Rating System) into the master scale bucket. Rating classes provided in the present document stem from the master scale.
MBS Mortgage-Backed Securities	Asset-backed securities or debt obligations representing claims on the cash flows from mortgage loans.
MCRE	MCRE is one of the two credit risk metrics (with EAD) used to be the regulatory calculation communicated to authorities and is quarterly reconciled with accounting figures.
NBB National Bank of Belgium	The National Bank of Belgium is the Belgian Financial Institutions regulator.
NPE Non-Performing Exposure	Non performing exposures satisfy at least one of the following criteria : (i) material exposures which are more than 90 days past-due (quantitative criterion); (ii) the debtor is assessed as unlikely to pay its credit obligations in full without realisation of collateral, regardless of the existence of any past-due amount or of the number of past due days (qualitative criterion). The concept of non performing exposure applies to all debt instruments (loans & advances and debt securities) and off-balance sheet exposures (loan commitments given, financial guarantees given, and other commitments given). This definition does not include equities, derivatives, repos and exposures held for trading.
NSFR Net Stable Funding Ratio	Long-term structural liquidity ratio set up by the new Capital Requirement Regulation (CRR) designed to address liquidity mismatches and promote the use of stable funding (the amount of available stable funding is compared to the amount of required stable funding).
P/L Profit and Loss	The income statement is a document showing all wealth-creating revenues and wealth-destroying charges. There are two major income statement formats: the by-nature income statement format and the by-function income statement format. Also called profit and loss account (or P&L).
PD Probability of Default	The probability of default of a counterparty over a one-year period.
RCSA Risk & Control Self-Assessment	Annual self-assessment exercise that consists of identifying and evaluating Dexia's most significant risk areas in a coherent way across entities and activities. RSCA also includes the identification, challenging and description of key controls and indicators and eventually define action plans that will allow for an improvement of the risk mitigation.
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. Also named Weighted Risks.
UFI Unregulated Financial Institution	From a regulatory standpoint, unregulated financial institutions are defined as non-regulated financial entities that perform, as their main business, one or more of the activities performed by regulated financial entities. The following entities can be included in the UFI list: unregulated non-equity funds (may include funds involved in credit intermediation and operating with some degree of maturity and/or liquidity transformation) and unregulated structured finance vehicles (securitisation vehicles created for the purpose of warehousing assets and issuing ABS).
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 risk 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 back testing when applicable. The number of ratings on each scale depends on the characteristics of the underlying portfolio (the number of counterparties, their homogeneity, whether it is a low default portfolio or not) and varies between 6 and 17 non-default classes. In addition, each scale has been attributed two default classes (named D1 and D2).

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

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

CCF models estimate the part of off-balance-sheet commitments that would be drawn should a counterparty go into default. The regulation authorises 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.

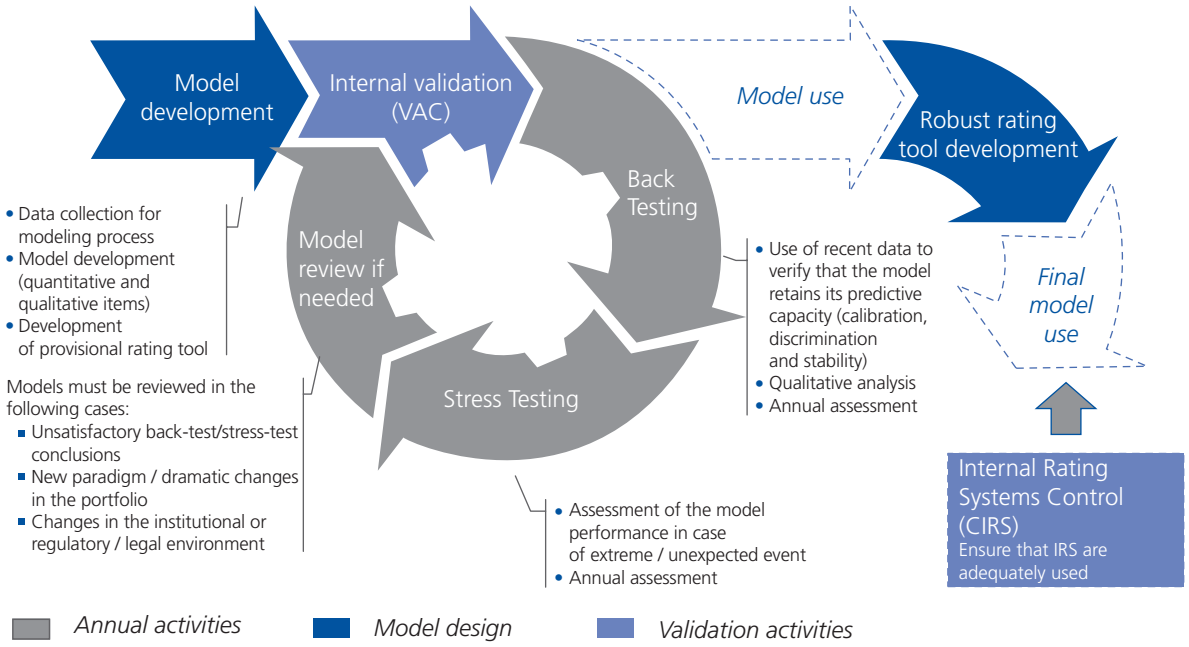
The relation between the outcomes of internal rating systems and external agency ratings is at two levels.

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

2. Description of the Internal Rating Process

General Organisation of the Internal Rating Process

The internal rating process is organised in three stages: the model development, the maintenance and the control of the internal rating. The model management division 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, credit internal rating systems control…).



Development and/or Review of the Models

The different steps of models development are:

- Defining or reviewing the scope of the counterparties concerned;
- Identifying, updating 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 determining the counterparty (or exposure) PD, LGD or CCF based on its characteristics. The score functions are established by the modelling team on the basis of statistical analysis and modelling techniques and are challenged by the model management division responsible for making sure that they will meet end user requirements; after they are constructed, the score functions are segmented into homogeneous risk classes and rating respecting optimal discrimination and stable through-the-cycle rating migration behaviour. 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;
- Testing the score function;
- Developing IT tools;
- Validating and implementing the model;
- Adjusting risk policies;
- Documenting the model use and certification process: user guide, documentation for the regulator, notes describing the building of the model etc..

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 the very low number of defaults for instance);
- Models based on a derivation approach stem from an existing model and those based on an assimilation approach have specific development processes. Counterparties treated by assimilation inherit the rating of their "master" counterparty. Assimilations and derivations are applied when it is neither financially intuitive nor statistically relevant to develop, adapt or use an existing model. Such cases occur typically for low default portfolios with a low number of observations, limited data availability (both for design and for model use) and for portfolios where strong relations exist between the "master" counterparty and the "assimilated" or "derived" counterparty. These relations can be legally bound or based upon long-term past experience and practice.

Maintenance of the Models

As mentioned above, the model management division is responsible for the entire process linked to the model review, including the maintenance of the model. The main model maintenance steps encompass:

- Centralisation, analysis and storage of default data;
- Coordination of the various quantitative and qualitative analyses required throughout the model life cycle;
- Gathering information and feed-back from the credit analysis and rating teams to update risk analysis techniques, and identify models' weaknesses;
- Conducing developments, reviews and back tests of models;
- Validating business requirements for IT developments (rating tools);
- Updating model documentation and user guides;
- Preparing model certification documents.

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 which they are assimilated (usually local authorities or sovereigns). They are consequently assimilated to these "master" counterparties and benefit from the same PD and LGD as their "master" counterparties.

Project Finance (Specialised 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 specialised 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.

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, 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 organisation 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 Models)

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 Securitisation Transactions

No internal models have been developed specifically for equity or securitisation transactions which follow a different regulatory approach under the Basel framework: securitisation risk weighting is based on external and not internal ratings; equities do not require the development of specific models.

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 harmonised from the beginning of the Basel 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 that of potential loss (for instance, a loan may present unpaid terms but may be totally collateralised and consequently present a nil expected loss) or to the notion of denunciation (which is decided on the basis of the interest Dexia may have to do so).

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

Main Principles Used for Estimating the PD

Types of counterparties	Through The Cycle (TTC) models	Default Definition	Time Series Used	Internal/ External Data
Sovereigns	Models are forward looking and Through The Cycle (TTC). They are designated to be optimally discriminative over the long term. The TTC aspect of the rating is also addressed in a conservative calibration of the PD	Default at 1st day	> 10 years	External
Banks		Default at 1st day	> 10 years	External and internal
		Default at 90 days (except for French: 180 days)	Cf. following table	Internal and/or external
Corporates		Default at 90 days	> 10 years	External
Specialised Lending		Default at 90 days	> 10 years	Internal
Equity	Specific approach: PD/LGD	N/A	N/A	N/A
Securitisation	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

(*) Western Europe Local Authorities, US Local Authorities, French "Groupements à Fiscalité Propre" and Social Housing

Main Principles Used for Estimating the LGD

Types of counterparties	Main hypotheses	Time Series Used	Internal/ External Data
Sovereigns	Expert score function based upon Fitch country loss risk methodology and internal expert knowledge to discriminate between high and low risk	> 10 years	**Internal + External**
Banks	Statistical model based on external rating agencies and internal loss data	> 10 years	**Internal + External**
Corporates	Statistical model based on external rating agencies loss data	> 10 years	**External**
Local Public Sector	Cf. next table		
Specialised lending	Statistical model based on internal loss data	> 10 years	**Internal**
Equity	Specific approach: PD/LGD	N/A	N/A
Securitisation	Rating-based approach	N/A	N/A

Overview of the Local Public Sector

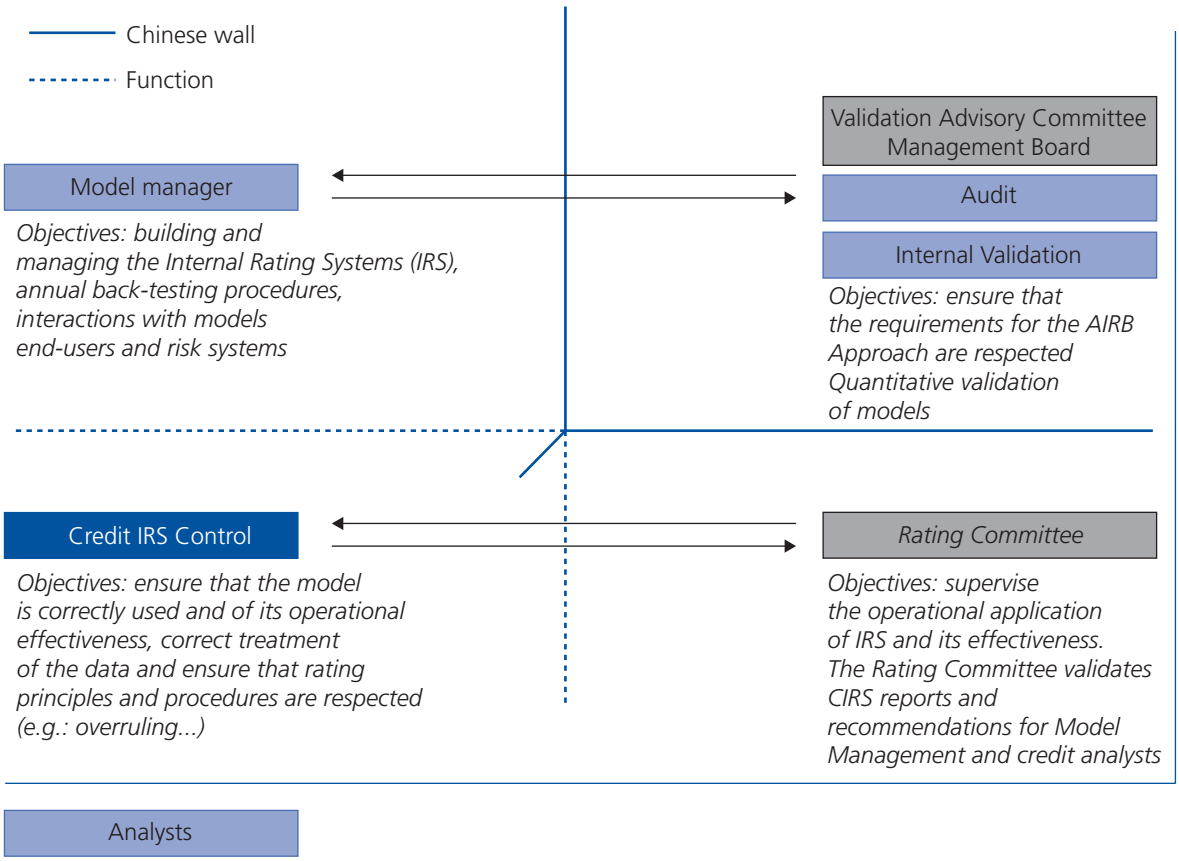
Types of counterparties	Main hypotheses	Time Series Used	Internal/ External Data
Western Europe Local Authorities	Statistical model based on the internal existing default cases observed on our portfolio. Final LGD are segmented on both socio-economic criteria and indicator reflecting the financial flexibility	> 10 years	**Internal**
US Municipalities	The Muni US LGD model is an expert model guided by external recovery rate factors and estimates. The final segmentation is based on business sectors	N/A	**External**
Groupements à fiscalité propre	A mixed analytical - expert model was chosen and constructed based on available observations to determine LGD and quantify potential loss related to a default in this sector	4 years	**Internal**
Social Housing	Expert model based on a global evaluation of security/credit risk mitigant. Segmentation is based on the number of houses and on a performance ratio	9 years	**Internal + External**

Main Principles Used for Estimating CCF

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

3. Control Mechanisms for Rating Systems

The BCBS 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 organised in 3 levels:

- Credit Internal Rating Systems Control (CIRS) is responsible for the monitoring of the models' use and environment review, pertaining to the second level controls of IRS (model scope, model input quality, overruling, audit trail);
- Market and Credit Validation are responsible for the overall assessment of the IRS (model set-up, model 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 CIRS department.

CIRS is integrated in the Risk Governance and Reporting department. Chinese walls between Model manager and Validation, Model management and Rating Committee (RC) and CIRS and Audit ensure the control system independence.

Credit Internal Risk Systems Control

Purpose

Credit Internal Rating Systems 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 organisation 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. 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 and procedures (mother support/BE, country ceilings, re-rating, piercing of LCCC & FCCC, country/mother company downgrade impacts, rating inheritances on counterparties etc.)

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

Process: Parties Involved
Key Stakeholders and Functions
The organisation 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.

Rating Committee
The key role of the Rating Committee is to monitor the appropriate use of internal rating systems within the Group as a whole and to ensure that these IRS are effective. For these reasons, the Rating Committee:
- Validates overrides above tolerance threshold, proposed by analysts;
- Reviews CIRS reports on the use 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 Validation Advisory Committee (VAC).

Processes and Guarantee of Independence
Fully aware of the importance of preserving the neutrality of the control process, a Chinese wall has been set between the development departments, model management, sales functions, analysis functions and the CIRS function.
These walls ensure a high credibility of the final control outcomes. This way any potential conflict of interest is fully avoided:
- The CIRS control function is independent from the credit analysis function (model users);
- The CIRS control function submit their proposals to the Rating Committee;
- The CIRS control function informs the Validation function 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 Pillar 1 credit rating models, ALM models and 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 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, methodology and requirements 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, using appropriate information sources, reviewing the consistency of control processes, performing sufficient testing (including stressed scenarios), evaluating the documentation and model risks;
- To assess input relevance and reliability (frequency and availability of data, consistency with corroborative data information, transparency of data, timeliness, maturity and liquidity);
- To bring and defend their works before the VAC in order to obtain a pre-approval;
- To present these pre-approvals for final approval to the Management Board.

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 Management Board. The validation approval process is formalised in a set of policies. The output of the validation is formalised in a validation report also including an executive summary,

strengths and weaknesses and a list of recommendations. These reports are presented to the VAC and are sent to the Regulators upon request. The Management Board has ultimate authority at Dexia Group level on all risk related decisions. In terms of sequence, all elements presented in Management Board are previously discussed within the VAC. The Management Board can either confirm or modify the initial VAC decision.

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;
- Following-up the recommendations issued.

Sub Validation Advisory Committees have been processing the Validation outcomes:

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

The VAC is composed by the Head of department of the stakeholders in the model development process and by the Head of department of the users. Audit and Compliance also attend the VAC. In terms of decision making, The VAC endorses the validation status proposed by the model validation team. An escalation procedure via the Management Board and information to the Audit Committee has been put in place.

Validation Scope

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

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

The validation scope includes a review of conceptual framework or mathematical monetisation or theoretical approach related to calculations:

- Model validation is not limited to back testing, but also includes tests demonstrating that assumptions made within the internal model are appropriate and do not underestimate risks;
- Testing for model validation uses additional assessments including for example testing carried out over long time periods (improving the power of back testing) or using hypothetical changes in portfolio value that would occur were end-of-day positions remain unchanged;
- Validation covers tests of assumptions ensuring that the model testing captures concentration risk in an undiversified portfolio;
- Assessment of potential linkages to counterparty credit risk.

Audit

According to the CRR art. 191 "Internal audit or another comparable independent auditing unit shall review at least annually the institution's rating systems and its operations, including the operations of the credit function and the estimation of PDs, LGDs, ELs and conversion factors. Areas of review shall include adherence to all applicable requirements".

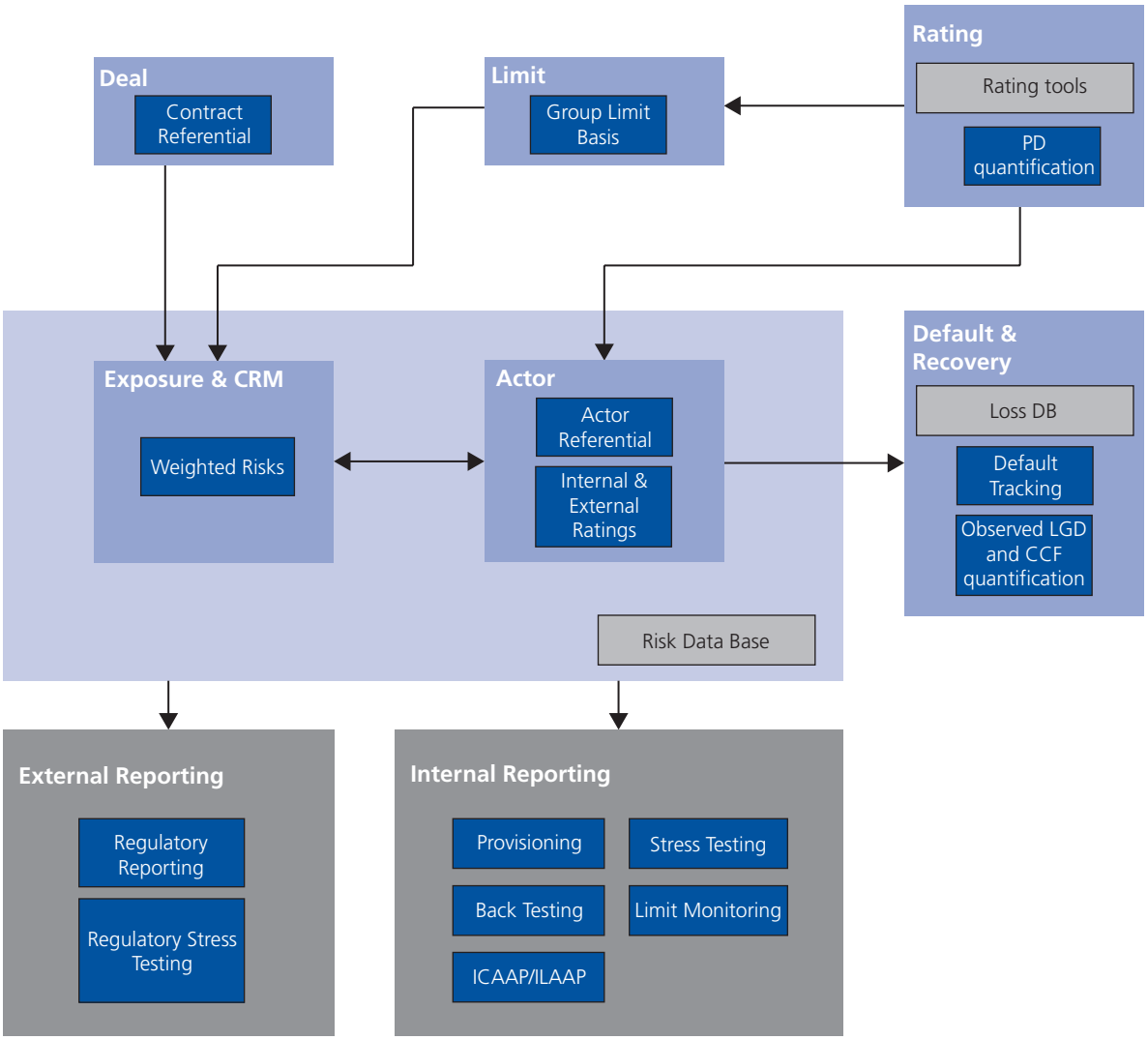
At Dexia, this annual verification has been delegated to the CIRS department. Audit acts as an additional level of control, included in its audit plan.

The Management Board can delegate application modalities for their decisions to other specialist Risk Committees (within the limits and rules defined).

4. Credit Risk IT Systems

Dexia Credit Risk IT Systems is centralised with all group exposure and counterparties for all Dexia entities.
Since March 2014, Credit Risk Systems was adapted to Basel III requirements.

The following chart provides a global view of the functional architecture of the credit risk information system within Dexia Group as at 31 December 2014.



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, and so on);
- 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 centres. 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, and so on) are joined with the credit risk mitigants (collateral and guarantees) to have an 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 back test Dexia internal rating systems.

Dexia's centralised IT systems are linked to a centralised by a reporting infrastructure allowing to produce credit risk reports based on the information gathered at different levels. All these IT and reporting systems support the general risk monitoring for both internal and external purposes as there are:

- External Reporting
  - Regulatory Reporting
  - Pillar 3
  - Regulatory Stress Testing

- Internal Risk Reporting
  - Cost of risk calculations and provisioning
  - Required reporting by current regulations with regards to ICAAP (Internal Capital Adequacy Assessment Process) and ILAAP (Internal Liquidity Assessment Process)
  - AIRB model back testing
  - Stress testing
  - 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 of 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 Securitisation

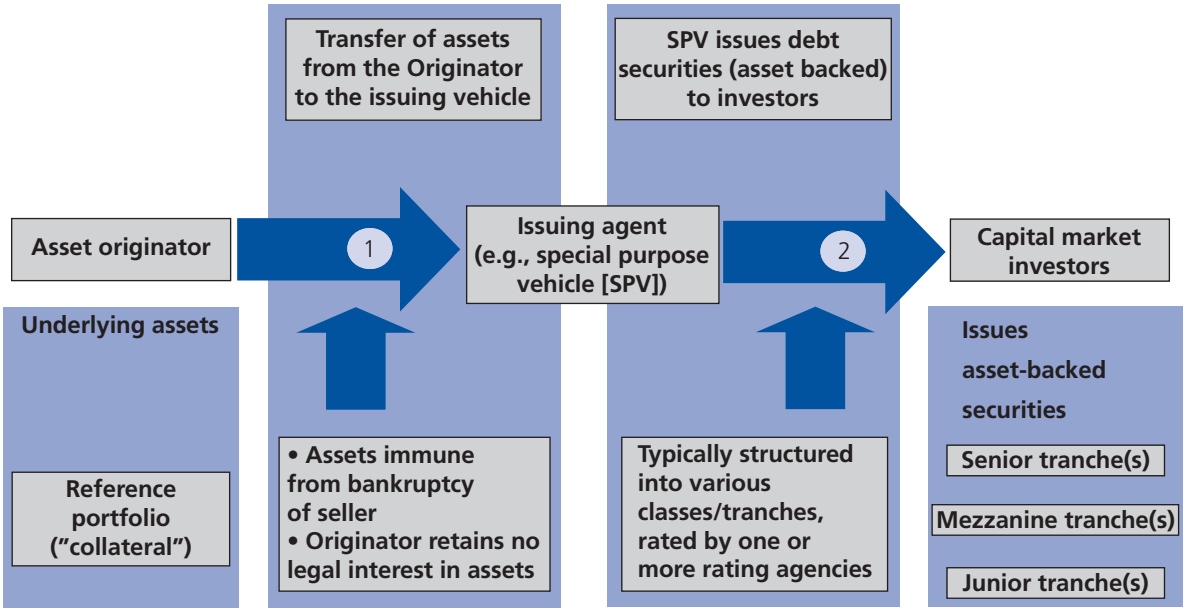
Securitisation is the financial practice of pooling various types of contractual debt such as residential mortgages, commercial mortgages, auto loans or credit card debt obligations and selling said debt as bonds to various investors. The principal and interest on the debt, underlying the security, is 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 collateralised 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 only to those necessary to complete the issuance of securities.

Tranching

Securities issued are often split into tranches, or categorised into varying degrees of subordination. Each tranche has a different level of credit protection or risk exposure to 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 been 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 securitisation process is performed:



Credit Enhancement

Tranching in a securitisation 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 securitisations use external credit enhancement provided by third parties, such as monoliners 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 securitisation, and it continues to do so after the assets have been securitised. It receives a small, ongoing servicing fee for doing so. Whoever actually performs servicing is called the servicing agent.

Appendix 4
Dexia Originations

Traditional securitisations of Dexia as originator

Dexia Crediop and Dexia Crédit Local have securitisation vehicles:

- Two for Dexia Crediop (DCC and Tevere Finance);
- One for DCL (Triplus).

Dexia Crediop per la Cartolarizzazione (DCC) (Type of underlying assets: public sector)

Dexia Crediop arranged an issuance programme composed of three transactions in order to securitise local public sector assets. The underlying assets were bonds issued by local authorities and held by Dexia Crediop. Issuance of notes by DCC occurred in 2004, 2005 and 2008.

The three note issuances were early redeemed in the 4th quarter of 2013. DCC was liquidated on 19 March 2014.

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 securitisations (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 was closed during the last quarter of 2010 and all the underlying bonds were 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 BBB (S&P) while class B is unrated. As at 31 December 2014 the outstanding commitments amounted to EUR 166.8 million and EUR 1 million respectively for class A and class B.

During the first quarter of 2010 Dexia Crediop issued a further Series of Tevere Finance i.e. Tevere Finance series III, the underlying assets of which are corporate loans. Like in the previous Series, two classes of notes have been issued: Class A (senior Tranche for an initial amount of EUR 472.7 million) and Class B (junior/subordinated tranche for an initial amount of EUR 2.6 million). As at 31 December 2014 the outstanding commitments amounted to EUR 185.1 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 securitised JPY 70.2 billion of Japanese municipal loans with the intention of providing funding with the placement of senior tranches (JPY 65.5 billion) to Investors.
The equity tranche (class B note) was retained by DCL Paris.

DCL Tokyo 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-backed loans, Loans A1 through A4, with the limited recourse assets of the respective Class A1 through A4 beneficial interests, to purchase each of the Class A beneficial interests. These notes are rated Aa2 by Moody's.
Each of the beneficial interests is secured by way of transfer ("joto tampo"). The entrustment and the transfer were perfected against relevant obligors and third parties by obtaining the approval of the trustee of the First Trust in writing with a certified date pursuant to the rules under Article 94 of Japan's Trust Law. The proceeds from the dividends and the redemption of the principal of the Class A1 through A4 beneficial interests are being used for the payment of interest and principal of Loans A1 through A4, respectively.

The transaction was arranged by Mitsubishi UFJ Securities Co., Ltd. The final maturity (corresponding to the maturity of the Class B note) is 20 May 2039.

As at 4 November 2014, the outstanding amount is JPY 55.96 billion (EUR 416 million) and is composed as follows:
Class B note: JPY 4.7 billion (EUR 41 million) – non rated note retained by DCL Paris;
Class A1 note: fully redeemed – note placed on the market;
Class A2 note: JPY 33.26 billion (EUR 247.5 million) – note placed on the market;
Class A3 note: JPY 5.7 billion (EUR 42.4 million) – note placed on the market;
Class A4 note: JPY 12.3billion (EUR 91.5 million) – note placed on the market.

Amortisations are allocated to each note one by one: A1, then A2, etc. This explains why only A1 notes are fully redeemed, and why only the A2 notes have amortised during 2014.

Synthetic Securitisations of Dexia as Originator

WISE 2006-1 (Type of underlying assets: corporate and other)

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

Dexia is transferring the credit risk related to the wrapped infrastructure portfolio to external parties by means of two credit default swaps: a non-funded super senior credit default swap with an OECD Bank and a junior credit default swap with WISE 2006-1 Plc, a special purpose company registered in Ireland. WISE 2006-1 has issued 3 tranches of credit linked notes (CLNs) to transfer the risk to the market, ranging from AAA/Aaa to AA-/Aa3 (S&P and Moody's respectively) at inception. As at 31 December 2014 the rating of the Class A notes was BB+/Ba3, the rating of Class B notes was B+/B3 and the rating of the Class C notes was CCC/Caa2 (S&P and Moody's respectively). The tranches were 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 1,042 million (EUR 1,388 million) as at 31 December 2014.

Appendix 5
Complements on Subsidiaries

Based on local GAAP figures.

1. Dexia Kommunalbank Deutschland (DKD)

1. Accounting and Regulatory Equity Figures

	31/12/2014		
	Financial Statements	Regulatory purposes	Difference
Equity, DKD solo	748	745	3
of which share capital and related reserves	*433*	*433*	*0*
of which reserves	*349*	*349*	*0*
of which gains and losses directly recognised in equity	*(36)*	*(36)*	*0*
of which net result of the period	*3*	*0*	*3*
Other intangible assets	0	0	0
Minority interests	0	0	0
TOTAL EQUITY			
Common Equity Tier I	748	745	3
Tier II	119	63	56
TOTAL CAPITAL	**867**	**808**	**59**

2. Capital Requirements by Type of Risk

			31/12/2014	
Type of risk	Basel III treatment	Exposure class	Weighted risks	Capital requirements
Credit risk	Advanced	Central governments or central banks	1,269	102
		Corporates - Specialised Lending	10	1
		Institutions	784	63
		Public sector entities		
		Regional governments or local authorities		
		Other non credit-obligation assets	18	1
		Total	***2,082***	***167***
	Risk exposure amount for contributions to the default fund of a CCP		***1***	***0***
	Standard	Central governments or central banks	42	3
		Corporate	365	29
		Institutions [(1)]	364	29
		Public sector entities	231	18
		Regional governments or local authorities	14	1
		Other items	232	19
		Total	***1,247***	***100***

(1) Credit Risk / Standard / Institutions: of which CVA: EUR 352 million of weighted risks and EUR 28 million of capital requirements.

			31/12/2014	
Type of risk	**Basel III treatment**	**Exposure class**	**Weighted risks**	**Capital requirements**
Market risk	Internal Model	Interest rate & foreign exchange risk		
		Position risk on equities		
		Other market risks		
		Total		
	Standard	Interest rate risk		
		Foreign exchange risk	36	3
		Position risk on equities		
		Other market risks		
		Total	***36***	***3***
Operational risk	Standard		**55**	**4**
Total			**3,420**	**274**

3. Capital Adequacy

	Basel II 31/12/2013	**Basel III 31/12/2014**
Common Equity Tier 1	740	745
Total Capital	859	808
Total Weighted Risks	2,946	3,420
Common Equity Tier 1 ratio	25	22
Total Capital Ratio	29	24

4. Geographic Distribution of Credit Risk Exposure

	31/12/2014							
	Central governments or central banks	**Corporate**	**Institutions**	**Multilateral development banks**	**Other items**	**Public sector entities**	**Regional governments or local authorities**	**Total**
Austria	1,355						192	1,547
Belgium	3,330		39					3,369
Finland	26							26
France	913		2,819	15	63			3,810
Germany	15,321	286	4,982		232	778	1,238	22,838
Hungary	157							157
Italy	3,152		604				70	3,825
Japan	613							613
Luxembourg	90		41	124				255
Netherlands			68					68
Poland	257							257
Portugal	262	100	50			75	327	815
Spain	19		877					896
Sweden	141							141
Switzerland			83					83
Turkey		11						11
United Kingdom			389	63				451
United States			387	105				491
Total	**25,636**	**398**	**10,339**	**307**	**295**	**853**	**1,827**	**39,654**

5. Credit risk Exposure per Economic Sector

31/12/2014		
Economic sector		Exposure value pre adjustments
Industry		
Construction		76
Trade-Tourism		0
Services	Transportation and storage	485
	Information and communication	76
	Financial and insurance activities	14,505
	Real estate activities	1,741
	Professional, scientific and technical activities	0
	Administrative and support service activities	1,931
	Public administration and defence- compulsory social security	19,189
	Human health and social work activities	373
	Arts, entertainment and recreation	41
	Other service activities	87
	Other Services	1,150
Others		0
Total		**39,654**

6. Exposure Covered by Credit Risk Mitigants by Exposure Class

	31/12/2014	
	Financial and physical collateral	Guarantees and credit derivates
Central governments or central banks		
Corporates		1,403
Institutions	6,795	3, 523
Public sector entities		1, 057
Regional governments or local authorities		
Retail		1,084
Other items		
Total	**6,795**	**7,067**

7. Compensation

	MB Supervisory function	MB Management function	Commercial Banking	of which: Independent control functions
Number of members (Headcount)	6	2		
Total number of staff in FTE (full time equivalents)			76	19
Total compensation (in EUR)	57,550	640,205	5,145,709	1,357,664
Of which: variable compensation (in EUR)	0	60,000	387,658	99,187

	MB Supervisory function	MB Management function	Commercial Banking	of which: Independent control functions
Members (Headcount)	6	2		
Number of identified staff (staff whose professional activities have a material impact on the institution's risk profile according to Article 92(2) of Directive 2013/36/EU; year-end numbers) **in full time equivalents**			24	8
Total fixed compensation (in EUR)	57,550	5,351,411	1,947,863	654,693
Of which: fixed in cash	57,550	5,351,411	1,947,863	654,693
Total variable compensation (in EUR)	0	60,000	257,570	79,930
Of which: variable in cash	0	60,000	257,570	79,930
Total amount of variable compensation which has been deferred (in EUR)	0	0	0	0

	Commercial Banking	of which: Independent control functions
Number of natural persons within the category identified staff remunerated EUR 1 million or more per financial year	0	0

2. Dexia Crediop

1. Accounting and Regulatory Equity Figures

	31/12/2014		
	Financial Statements	Regulatory purposes	Difference
Equity, Crediop solo	952	952	0
of which share capital and related reserves	*1,170*	*1,170*	*0*
of which gains and losses directly recognised in equity	*(155)*	*(155)*	*0*
of which net result of the period	*(63)*	*(63)*	*0*
Minority interests	0	0	0
TOTAL EQUITY	**952**	**952**	**0**
Prudential filters	0	55	55
Common Equity Tier I	952	1,007	55
Tier II	0	217	217
TOTAL CAPITAL	**952**	**1,224**	**272**

2. Capital Requirements by Type of Risk

			31/12/2014	
Type of risk	Basel III treatment	Exposure class	Weighted risks	Capital requirements
Credit risk	Advanced	Corporate	353	28
		Financial institutions	1,254	100
		Project finance	212	17
		Securitisation	51	4
		Sovereign	1,957	157
		Total	***3,827***	***306***
	Standard	Corporate	443	35
		Equities	2	0
		Financial Institutions	754	60
		Public sector entities	134	11
		Total	***1,333***	***107***
Market risk	Standard	Interest rate risk	293	23
		Total	***293***	***23***
Operational risk	Basic		**59**	**5**
Total			**5,512**	**441**

3. Capital Adequacy

	Basel II 31/12/2013	Basel III 31/12/2014
Common Equity Tier 1	1,079	1,007
Total Capital	1,322	1,224
Total Weighted Risks	4,442	5,512
Common Equity Tier 1 Ratio	24.2%	18.3%
Total Capital Ratio	29.8%	22.2%

4. Geographic Distribution of the Credit risk Exposure

	31/12/2014						
	Sovereign	Local Public Sector	Corporate	Project Finance	Financial Institutions	ABS/MBS	Total
Italy	8,053	10,402	966	488	488	92	20,488
France	3,262	38	0	0	427	0	3,726
United Kingdom	0	0	0	0	245	0	245
Germany	0	0	0	0	49	0	49
United States	0	0	0	0	5	0	5
Others	3,907	9	0	0	68	0	3,984
Total	**15,222**	**10,449**	**966**	**488**	**1,283**	**92**	**28,499**

5. Credit risk Exposure per Exposure Class and Economic Sector

		31/12/2014							
Economic sector		Corporate	Financial Institutions	Monolines	Project Finance	Public Sector Entities	Securitization	Sovereign	Total
Industry		526	0	0	287	0	0	0	813
Construction		0	0	0	64	0	0	0	64
Services	Transportation and storage	16	0	0	58	24	0	0	99
	Financial and insurance activities	0	1,116	167	0	0	11	11	1,305
	Real estate activities	265	0	0	78	0	80	0	423
	Public administration and defence-compulsory social security	0	0	0	0	10,111	0	15,211	25,322
	Human health and social work activities	0	0	0	0	298	0	0	298
	Other Services	159	0	0	0	16	0	0	175
Total		**966**	**1,116**	**167**	**488**	**10,449**	**92**	**15,222**	**28,500**

6. Overview of Past-Due Exposure and Impairments

	31/12/2013							
	As at 1 Jan.	Additions	Reversals	Utilisation	Other adjust-ments [1]	As at 31 Dec.	Recoveries directly recognised in profit or loss	Charge-offs directly recognised in profit or oss
Specific impairment	**28**	**0**	**0**	**(27)**	**0**	**1**	**0**	**0**
Interbank loans and advances (*)	6	0	0	(6)	0	0	0	0
Customer loans and advances	22	0	0	(20)	0	1	0	0
Other accounts and receivables	0	0	0	0	0	0	0	0
Collective impairment	**22**	**4**	**0**	**0**	**0**	**26**	**0**	**0**
Customer loans and advances	22	4	0	0	0	26	0	0
Total	**50**	**4**	**0**	**(27)**	**0**	**27**	**0**	**0**

(*) Specific impairment on Lehman Brothers International Europe.

	31/12/2014			
	Past-due but not impaired financial assets			Carrying amount of individually impaired financial assets, before deducting any impairment loss
	Less than 90 days	90 days to 180 days	Over 180 days	
Loans and advances (at amortized cost) (*)	7.0	0	19	1
Financial assets held to maturity	0	0	0	0
Other financial instruments (**)	15	0	65	0
Total	**22**	**0**	**84**	**1**

(*) Of which EUR 7 million of technical past-dues.
(**) Unpaid nettings on derivatives affected by litigations (operational default).

7. Exposure Covered by Credit Risk Mitigants by Exposure Class

	31/12/2014	
	Financial and physical collateral	Guarantees and credit derivates
Central governments or central banks	0	7,193
Corporates	23	193
Institutions	4,399	239
Regional governments or local authorities	0	1,128
Total	**4,422**	**8,753**

Excluding amortisation in charge of the Italian government and other subjects.