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Conference Call Transcript

DEXB.BR - Q2 2010 Dexia Earnings Conference Call

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PRESENTATION

Operator

Good day and welcome to the Dexia second quarter 2010 earnings release conference call. Today's conference is being recorded. At this time, I would like to turn the conference over to Mr. Pierre Mariani, CEO of Dexia. Please go ahead, sir.

Pierre Mariani - Dexia - CEO

Good morning, everybody. I'm here to comment -- give you some update on the results of Dexia during the second quarter of 2010.

A few, maybe, highlights first; of course, it's been a quarter of very high volatility in the market, very high tensions also on the monetary market and inter-banking market. And it was also a very important period for Dexia, because in the meantime, we had to exit from the State guarantee four months ahead of the schedule. And in the meantime, maybe, also pay back a huge amount of Central Bank facilities that we were granted in June 2009.

For the sixth time in a row, we delivered a positive result in the second quarter result. Net profit is EUR248 million. It's a consequence of a number of elements, the first one, a very recurrent one, and confirms the commercial dynamic of Retail and Commercial Banking activity. The second one is also a very strong improvement in the cost of risk, supported not only by the core businesses, of course, with a strong decrease in cost of risk in Retail Banking activities, and a very low cost of risk in all the PWB businesses. But also, for the first time since the beginning of the crisis a decrease of the estimation of the losses on the financial product portfolio; I will come back, of course, in more details about that.

Second significant element is, of course, the strong improvement of the liquidity situation of the Group. It's a result of a very cautious financing policy, and we decided, of course, in the first quarter, as I told you in -- when I commented the results, to accelerate our funding program for 2010. We have raised to date more than EUR40 billion long-term funding, EUR37 billion on the market and EUR3 billion in the Retail networks.

So we have fully accomplished our program for 2010 at the end of the first semester of 2010. And it gives us a lot of comfort for future funding policy because we have no need to come back on the markets, especially on the unsecured funding in 2010 and probably in 2011, thanks to the very quick pace of deleveraging.

The second element is the deleveraging, which remained a very high priority for us, as I told you when I gave you some update on our policies for 2010, and the target was EUR15 billion for 2010. At the end of July, we have sold more than EUR20.3 billion of assets at a very modest loss rate between 0.6% and 0.7%, which, of course, a situation which is very positive, on our capability to deleverage the balance sheet.

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And the results of this funding policy on one side, and deleveraging policy on the other side, is a reduction of our short-term funding need. It's been reduced by EUR22 billion in the first half of 2010. And it's, of course, a very significant evolution. We are ahead of schedule in this area. Since the summer 2008, we've been -- we've reduced the funding need by EUR120 billion.

We maintain in the quarter, of course, a very strong solvency, with a ratio of 12.2% and a core Tier 1 of 11.3%. The CEBS stress, of course, but you are all aware of that, confirm that we were with 10.9% Tier 1 ratio aftershock in the most adverse scenario, still very solid, and one of the highest ratio in the industry. Even if the solvency, of course, has been packaged this quarter by the exchange rate and the value of euro against dollar, which has been completely reversed during the month of July.

And we comment all these elements in more details beginning with the reported statement. I just remind you that in the first half of 2009, we still had in our accounts FSA 'til the end of the first half of 2009, because we've closed, of course, a deal in the first days of July 2009.

Income are down 8% quarter-to-quarter, mainly due to a number of elements, because we higher capital gains in the first quarter, compared to the second quarter. We had a good cost control overall in the quarter. Costs are down 1% quarter-to-quarter in the first half of 2010 versus first half of 2009.

If we appreciate that at constant exchange rate, the cost control is even higher; it would represent 2.5% decrease at constant exchange rate, quarter-to-quarter and half-to-half, which is, of course, a significant element, even if we consider that we have, in the meantime, invested a lot in the refurbishment of our Belgian network on one the side, opening new branches in Turkey and recruiting close to 1,000 in Turkey in the meantime.

One very important element of the quarter is the reduction in the cost of risk. It could be observed in the three main areas, the first one is Retail and Commercial Banking with a stable cost of risk in Belgium and Luxembourg at a very low level; a strong decrease in Turkey, where the cost of risk is divided by two since June 2009.

But also for the first time since the beginning of the crisis, we have a decrease in the cost of the financial products. And more important than the direct provisioning, is the estimation of losses for the first time, are decreasing, which leaves us with a comfortable amount of additional provision available on this portfolio.

One key element, maybe not complete fully understood and underline is that, of course, we had a positive one-off element with the sale of a number of assets in the portfolio with SPE, Dexia Epargne Pension and a number of other divestments.

But we have also a very significant negative one-off because we have decided to fully provision litigation in Slovakia that represents a provision of EUR138 million, which of course, should be taken as a one-off element, and an element that, of course, we are strongly opposing. And we still consider that the claim is groundless, but for safety and cautious provision policy, we have decided to provision it during the second quarter of 2010.

After all these elements, the pre-tax income -- the net income of the Group is EUR248 million, up 15% compared to last year, and down 13% compared to the first half of 2009.

On top of that, just as a general comment, I would like to underline that, of course, except the positive and negative one-offs, the quality of these revenues and its results are much better that it used to be in the past because, of course, there is normalization in the cost of funding and in the structural situation of the balance sheet.

And a number of exceptional result that helped in the first half of 2009 disappear, especially on the Treasury side. Of course, because of our unbalanced funding structure, we benefited of the very abnormal level of Treasury revenues in the first half of 2009 that there are progressively reduced. Just to give you an idea of that impact, it was representing more than EUR250 million of results of the Treasury division in the first half of 2009 that has been considerably reduced since -- with the progressive improvement of our liquidity situation.

When we try to analyze the results, splitting the analysis between Core and LPM divisions, the revenues of the Core division are up 11% quarter-to-quarter. And 3% increasing revenues in the first quarter, excluding the capital gains on the sale of SPE and on the sale of Dexia Epargne Pension booked in the second quarter of 2010. But in the first quarter, we also had exceptional revenues with EUR153 million of capital gains on the sales of Assured Guaranty which was booked in the LPM division.

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The expenses are down 1.1%; this reduction quarter-to-quarter is, in fact, a combination of a strong decrease in Belgium and Luxembourg, compensated by the fixed rate impact on DenizBank, due to the valuation of the Turkish lira versus euro. Gross operating income is up 43%. Cost of risk is decreasing, 48% on the Core division. And even after the provision for litigation in Slovakia, pre-tax income is up 36%, which is, of course, very significant.

On the LPM division we had a combined effect, a decrease of 80% quarter-to-quarter. First of all, because we had booked a EUR153 million gain on the sale of our short guarantee shares in the first quarter of 2010. But also, because we have a decrease in the Treasury result due to the other contraction of the liquidity gap and, of course, a higher impact of the deleverage on the quarter.

The cost on deleverage weighing on the Legacy division is EUR62 million compared to EUR48 million in the first quarter, so a difference of EUR16 million quarter-to-quarter which represents a very moderate loss rate, I will come back later on that for 0.6%.

The decrease of the cost of risk is supported by the reduced impairment of the financial product portfolio, but also the reversal of ABS provision, mainly driven by the sales of the portfolio which, of course, had an impact on the general provision built over time against this ABS portfolio.

Overall, pre-tax income is EUR236 million and net income after the recognition of deferred tax assets linked to the timing difference, excess provisions on the financial portfolio is EUR248 million, up 15% quarter-to-quarter and down from EUR283 million for the second quarter of 2009.

Coming back now to the results, the analysis of the results division-by-division; Retail and Commercial Banking revenues are up 1%. It's, of course, a combination of very good growth and favorable volume growth and deposit mix of Retail Banking activities in Belgium and Luxembourg on the one side, and a decrease of margins in Turkey.

This decrease of margin is really something that could be of service throughout the industry. It's the symptom and a very good sign in my view, because it's certainly something that reflects the improvement of the economy in Turkey. I remind you that last year the same period we had a very sharp increase of the interest margin in Turkey, but also very sharp increase in the cost of risk.

Now, of course, it's back to normal and it's normal to see a decreasing margin and also a decrease in the cost of risk. It's due also by policy in which we still cap the amount of the bond portfolio in DenizBank balance sheet on one side, but also with a policy which, hence, of course, had increasingly significantly the deposit base and conquering new customers and deposits in this activity.

PWB revenues are up 21.5%, but they include the sale of the stake we had in SPE in Belgium that was sold in the second quarter. And if we neutralize that it's really closely stable.

Insurance, Asset Management and Services are impacted by the performance in the Insurance business for two reasons. The first one is a very tough winter in Belgium that led to a high level of compensations. And also, because we accounted in the second quarter in the Life Insurance business not only the impact on the market valuation on the equity portfolio, but also we counted a provision for profit sharing of EUR58 million in the second quarter of 2010.

The Group Centers are up; they are supported mainly by profit on foreign exchange results and also with a capital gain on the revenues, on the sale of the Dexia Epargne Pension in the second quarter.

The overall costs are stable in Retail Banking. Once again there is the stronger discrepancy between Belgium and Luxembourg where costs are down 3% and we observe an increase in Turkey driven on one side by Turkish lira versus euro exchange rate. But also, because we have opened 15 branches and we are also building the workforce in the network over the quarter.

Public and Wholesale Banking costs are slightly decreasing and in terms of costs once again, like in Retail and Commercial Banking if we neutralize exchange rates, costs are down overall 2.5% in these two businesses.

Asset Management and Services the costs are up, mainly driven by the investment in investor services and the consolidation of costs for UBI Banca in the accounts of Dexia and an exchange rate impact.

And in the Group Center costs are down 22%, maybe because we were able to take into account the fact that we've been able to re-rent, building we freed with restructuring during the previous quarter and helped us to reduce the cost of real estate to our provision in the previous quarter.

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On the cost of risk, of course, it's one of the major impacts in the quarter. In Retail activities the overall cost has been reduced by 14% compared to the end of the year and compared to the top of the crisis in December the cost of risk has been high in Turkey coming from 331 basis points to 153 basis points. And it's pretty stable compared to last year in Retail and Commercial Banking activities in Belgium and Luxembourg.

In PWB costs of risk came back to its very low level after a few quarters of provisioning. It's really stable around a few basis point and we see absolutely no increase and no tension on the financial situation of our PWB customers all over our footprint.

On pre-tax income the results of all of these elements is an increase of 10% in Retail and Commercial Banking even taking into account the provisioning of the Slovakian litigation in the Group's center.

Public and Wholesale Banking results are up 88%, mainly driven by the SPE. But if we neutralize the SPE its revenues are stable. And I think it's probably the best estimate we can make on the recurrent level of activities, because I remind you but education is also repeating the elements, sorry for that, that when you compare the 2000 result to 2009 you don't compare exactly the same thing, because we are now in the 2000 level of the Public and Wholesale Banking income with the financial structure, which is a target for the business determined with the European Commission for 2014. It means with a very low level of transformation and less than 10% short-term funding.

Asset Management and Services Income are down, mainly as I told you because of the Insurance activities and the profit sharing provision billed in the second quarter of 2010. And the Group Center pretax income is stable.

When we come to a portfolio, the Legacy division, once again in the first quarter we accounted EUR153 million capital gains on the sale of the shares of Assured Guaranty. Of course, it was an exceptional result. We had in the second quarter a high level of cost of deleverage compared to the first quarter, EUR62 million compared to EUR46 million.

And the Treasury also allocated to the Legacy division is down 46% compared to the first quarter, mainly because we have reduced of course our liquidity gap and so it means that we have less the opportunity to use the benefit from the very specific interest rate situation and low level of interest rate.

The decrease of the cost of risk could be observed also in the Legacy division, mainly because of reduced impairment on the financial products. In the first quarter of 2010 which shows an improvement of EUR40 million and the reversal also on the ABS provisioning of EUR40 million mainly due to the sale and the natural run off of this portfolio quarter-to-quarter.

When we come to business I think it's important we have a very strong and very good commercial performance in most of the businesses, especially in Belgium and Luxembourg where the product mix is very favorable. We collected EUR1.6 billion additional deposits in the second quarter, close to EUR5.7 billion year-on-year. We have a very good deposit mix and we have, of course, concentrated these deposits on the saving accounts with a growth of 20% year-on-year.

Life insurance shows a very significant improvement with a campaign launched in Belgium, very good performance also in Luxembourg in this area. And loans are up 4% year-on-year mainly driven by mortgages and SME activities.

The transformation plan of the Retail network is still going on. We have deployed the new distribution model and we have observed this quarter and that's one of the most positive results in my view, a very significant increase and improvement of Dexia customer satisfaction in the Retail Banking in Belgium.

Last element, in Luxembourg we have a positive organic growth in Private Banking and SME, of course partially offset by market effects, but an overall increase of the deposit of EUR0.4 billion in Luxembourg. So it's an increase of close to 3% quarter-on-quarter.

In Turkey commercial activity is still very robust and it's in line with the recovery of the Turkish economy. We have now a total amount of deposit of EUR16.6 billion Turkish lira, up 5.7% quarter-on-quarter and 25% year-on-year. It's mainly driven by Retail, and PWB and Commercial activities.

Loan growth is also very robust, 7% quarter-on-quarter and 18% year-on-year. The loan to deposit ratio has improved year-on-year and it's stable in the first half compared to last December.

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We have increased our customer base by close to 12% and we have also increased our presence, both compared to last year with the opening of 15 branches and some additional ones to come in the second half of 2010. But also, with the deployment of our ATM, because our ATM park has been increased by 30% year-on-year with 171 ATM open or implemented in Turkey compared to last year.

In terms of P&L revenues are stable, up 3% in Belgium and Luxembourg mitigated by pressure on margins in Turkey. Compared to the first half of 2009 they are up 4% with very favorable volume and growth and deposit mix in Belgium and Luxembourg and increased businesses in Turkey.

Costs are slightly reduced in Belgium and Luxembourg, but this decrease has been offset by the impact of exchange rate. And compared to last year at constant exchange rate they are down 2.5%.

Cost of risk is, of course, down 16% and it's supported mainly by drop of credit risk in Turkey minus 92 basis point quarter-on-quarter and 178 basis point between the end of June and the peak of December 2009. Overall, pre-tax income is 10% up compared to last year and 20% up versus the first half of 2009, which shows a very solid improvement of our core businesses during the quarter in the Retail and Commercial Banking business.

As far as PWB is concerned, of course, we have a determined an objective for 2010, which is close to the figures of last year of a EUR10 billion production. We have produced EUR5 billion in the first half of 2010, 3% higher than last year of which EUR2.8 billion in the second quarter mainly contracts originated in France, Belgium and Iberia.

Total long-term commitments are stable quarter-on-quarter and down 2% year-on-year and that's a result, of course, of the refocus of the business line on core geographies. Deposits are up 5% and the project finance is still very active with a new mandate in infrastructure and renewable energies. And we have given a few examples of the projects we advised during the first half of 2010.

In terms of P&L of PWB the income is stable compared to the first quarter. They are down compared to last year but, once again, I would like to insist on the fact that it's due to higher allocated cost of funding in the first quarter of 2010, following the agreement with the European Commission. So it means that the future -- there will be no impact on the increase of the funding proportion in the financing of this business in the future. So it will be a constant future and so it will be, of course, a significant change compared to the way it was accounted before.

Costs are flat or slightly decreasing compared to last year, but we had a lot of one-off reversals last year. The cost of risk is also down, and -- because the first half of 2009 was impacted by collective provisions. And we had also a one-off write-back on the fine in Australia.

And we had a total pre-tax income of EUR149 million the second quarter and EUR228 million in the first half of 2010, which shows that PWB is still a very significant contributor to the Group results.

Asset management and services had a very contracted performance between the different areas. Assets under management are up 7% year-on-year but, of course, with the decrease in the second quarter, mainly linked to the negative market impact. Insurance gross written premiums are up 90% year-on-year, supported by commercial focus on life insurance in Luxembourg and Belgium. And we have launched a very successful campaign second quarter in Belgium with more than EUR600 million new premium raised in the quarter.

Investor Services, we had very positive impact of the euro dollar exchange with, of course, assets flat or slightly decreasing in dollar, but with a very positive impact on the valuation in terms of euros. So Asset Management's income are up 3% and costs are stable and pre-tax income is EUR18 million.

Insurance costs and revenues are down, as non-Life loss ratio was of course, impacted the revenues, but also with the impact on portfolio on one side and the profit sharing provision on the other side. Costs are slightly increasing and pre-tax income is only EUR23 million on the quarter.

Investor Services, revenues are strongly up thanks to ForEx impact. Costs are up 8% and pre-tax income shows a significant recovery with an increase of 61% quarter-on-quarter and a very significant growth also compared to the level where it was last year.

On the Legacy division the volatility of the quarter had an impact on the bond portfolio in run off. Portfolio in run off is down EUR2.9 billion quarter-on-quarter with the impact of deleverage and amortization of close to EUR8 billion. But this impact was partially offset by the FX effect of EUR4.9 billion on this portfolio which is, of course, very, very significant and nearly completely reversed since the beginning of the month of July with the recovery of the euro against dollars and other currency.

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The average life of the portfolio is 11.6 years. The portfolio is still 95% investment grade and the main impact and change in the quarter is the rating migration from A to BBB range, linked to the Greek Sovereign downgrading.

The stock of impairment remains at EUR938 million compared to EUR975 million at the end of March 2010, thanks to a reversal of EUR40 million of impairments on ABS which, of course, has been reduced over time with the sale and the natural amortization of these portfolios.

The second component of the Legacy division is the financial product portfolio. The nominal value of this portfolio is now USD 14.6 billion. Of course, it's been reduced every quarter with amortization and realized losses also. Average life is unchanged at 9.4 years. The significant element is that we have a total of provisions of \$2.02 billion (excluding the already realized cash losses) on this portfolio. On top of that provision, total losses are \$433 million of which \$128 million accounted in the second quarter of 2010.

I think for the first time since the beginning of the crisis we've seen significant changes in the situation of this activity in this portfolio; first of all, because despite a remaining uncertainty regarding future direction of US real estate market, we have observed since the beginning of the year the first sign of stabilization. They are, of course, partially driven by the government programs to help troubled homeowners. And so, we are not sure that the impact of these measures will last for longer time. But it had a significant impact on the market.

And second also we have observed a reduction of the delinquent loans in the pool of mortgages on the FP portfolio. The estimation we can do with the best of our knowledge of the market, and in the present market conditions, shows an improvement of the future cash shortfalls and losses on this portfolio, who are down \$80 million in the second quarter versus first quarter.

And the present estimation of the losses on the portfolio is \$1.239 billion. That's the first time we are giving this figure. And nevertheless we had to account for new specific impairments in the application of IAS 39, which is pretty different. And they are offset by release of collective provision.

But on total, we have a total amount of provision available today of \$2 billion in excess of US dollar, USD781 million versus a discounted -- versus the discounted expected cash shortfall on this portfolio. So we have an excess provision of USD 800 million that will have to be reversed over time if the effective losses are observed in the future.

On this portfolio we have also a stock of own credit risk of \$334 million. That's why we have taken into account this \$800 million excess provision, and minus this \$334 million own credit risk, deferred tax assets of \$157 million posted in the second quarter of 2010.

The third element of the Legacy division in the PWB run off commitments, the loans are down 31% compared to the end of 2008. This decrease is, of course, mainly led by the active deleveraging of loans in Japan, and of course, amortization of loans in the rest of the portfolio.

But also, it had an impact in the second quarter of exchange rate, because the change euro/dollar had offset part of the deleverage and the amortization effect in the second quarter.

But we are also observing a significant decrease of the liquidity line we used to have in the US with commitments going down from \$47.8 billion at the end of 2008 to \$29 billion which, of course, has very positive implications also in terms of reduction of the liquidity risk for the Group.

In terms of conclusion I think we've gone through a very challenging period; a very challenging period impacted by volatility of foreign exchange interest rates, and also a lot of tension in the inter-bank market. In spite of this uncertainty, we've been able to exit the State guarantee, reduce the portfolio, improve our liquidity situation, raise long-term funding.

Nevertheless, this volatility has an impact on the balance sheet. First of all because it, of course, changes the valuation of our asset denominated in dollars and other currencies. Just to remind you that euro/dollar change was close to 15% versus December '09; close to 10% change in the second quarter; same thing for Turkish lira.

And of course, with the decrease of the investment rate we had a strong impact on the valuation of our derivative and the level of collateral we have to post in front of that. So the impact of the deleveraging measures have been more than offset by these impacts of interest rate valuation on the fair value adjustment on one side; the cash collateral variation on the other side and, of course, the non-euro denominated assets finally.

One of the most significant impacts was, of course, the impact on the AFS reserves, so the variation of the AFS reserves is the result of many different impacts. First of all, currency impact; second, change in the accounting resulting from a global assessment of outstanding DTAs according to the new rules of the IFRIC released in May 2010, which had an impact of close to EUR400 million on the valuation of our reserve;

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and, of course, because of the valuation, the impact on the bonds and mainly due to the crisis of the Sovereign and the widening of the spread on the Sovereign in our portfolio.

So, of course, we know that part of this impact will be reversed, and has already been reversed in the first weeks of the third quarter. We have between the end of June and the end of July more than EUR1.1 billion net improvement of the AFS reserve due to the foreign exchange changes and also the tightening of credit spread. But we are not yet back to the situation of the end of March 2010.

The quarter shows also a very strong improvement in the Group's liquidity profile. As I told you, we have fully exited the State guarantee since June -- we've been exiting since June 30. We have improved our short-term -- reduced our short-term funding need; a EUR12 billion reduction in the second quarter on top of the EUR10 billion in the first quarter. So it's a reduction of EUR120 billion since the beginning of the fall 2008.

It means also that we are ahead of our objective in this area. I remember you that I said at the end of 2008 that the target was a reduction of EUR100 billion before the end of 2010. And so we are presently at EUR120 billion reduction 18 months, with six months in advance to the target. So I think it's a very important achievement.

In the meantime we have not reduced at all our available liquidity buffer. We have EUR123 billion of eligible assets compared to EUR78 billion effectively used in repo and Central Bank collateral in June 2010.

In the meantime we have also considerably reduced our financing by the Central Bank. We are now at the level which is much lower than the pre-crisis levels, so that level was reached in 2007 by Dexia. And we'll reduce it further in the coming months following the improvement of our financial structure.

That's very good news compared to the peak. Just to give you an idea, at the peak of the crisis in February 2009 we had more than EUR122 billion outstanding with the Central Bank. We are now really lower than the level at which we were at the end of 2007.

Long-term resources, our long-term financing program is also far ahead of objectives. It's fully booked since the end of June more or less. We have raised EUR37.9 billion total medium and long-term wholesale funding since the beginning of the year. On top of that we had EUR3 billion of retail long-term funding raised through the networks.

We have raised EUR23 billion with the State guarantee which, of course, had an impact on the account, because everything has a price. And because we've accomplished, and fully made our program -- long-term funding program on the first half of 2010, instead of splitting it all over the year, it has an impact on the cost of funding of the first half.

But we have also raised EUR9.9 billion on covered bonds issued by DMA and DKD, which is, of course, ahead of the level we reached last year at the same period of time. And we have still some room to increase our funding program on top of what we were. But it's also reducing significantly our dependency on the evolution of the unsecured long-term funding market.

I told you one of the main objectives of the Group was the deleveraging, and once again in this area we are far ahead of our objectives. We agreed with the Commission that we should sell more than EUR15 billion of assets this year. We had, at the end of July, sold more than EUR20.5 billion; EUR16.8 billion of bonds have been sold.

And I must underline that we have sold not only bonds in the Legacy division, but also, as was anticipated and I send you back to the presentation we've made in the 2009 accounts with the presentation of the European Commission agreement, we have also to sell part of the ALM portfolio and reduce also the ALM portfolio. So it's combined between the two elements.

The overall portfolios sold reflect the average rating of our bond portfolio, and the maturity of the bonds sold is 5.6 years. So it's under the average duration of our bond portfolio, but still with a significant impact.

We have been also able to sell and to reduce significantly the exposure and the assets of the DCL Tokyo branch, not only selling bonds but also loans. And we have sold EUR3.5 billion of loans as of today, of which EUR2.4 billion in the second quarter of 2010. The P&L impact of course, because it's very long-term loans and very long-term commitments is slightly proportionally higher than in the bond portfolio.

But, overall, losses on these divestments is still very moderate, between 0.6% and 0.7%, and it shows that costs of deleveraging, were overestimated by many people that have a look at us. Even if I don't make any commitment on the future losses on the divestments, we are, of course, in that area highly dependent on the market situation. But it's very interesting to show that we've been able also to divest very

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aggressively this portfolio even in the very difficult market conditions in May, June and even July, where we have also reduced our overall exposure to Sovereign risk.

In terms of solvency, the weighted assets are slightly up this month mainly due to exchange rate effect; that will be, of course, reversed fully at the end of July. But solvency remains extremely high at 12.2%. And of course, it's another confirmation that the level of our solvency gives us a very significant buffer to resist very adverse conditions, as shown by the CEBS stress test result, that helps us to weather very nicely this exercise and show that really we have the ways and means to weather any very adverse scenario.

That's all for the details. I'm now ready to answer your questions. But once again, it's a quarter of very strong restructuring, with results with positive one-offs, negative one-offs on the other side, with retro financing. And overall, we've been able to deliver a constant and a consistent profitability, mainly due to the improvement of the quality of our revenues in the Group.

Thank you very much.

QUESTION AND ANSWER

Operator

(Operator Instructions). Alex Koagne from Natixis.

Alex Koagne - Natixis Securities - Analyst

Good morning everybody. My name is Alex Koagne from Natixis Securities. I have five questions from my side.

The first one, is it possible for you to give us your liquidity gap as of today?

Secondly, on the cost of risk, let's say, on the Core Banking, can we consider it -- the level in Q2 as a run-rate?

On your FP portfolio, as I remember you were anticipating a kind of provision for EUR500 million. Do you stick on this target?

On your cost base, I think that for 2010 you were anticipating a level globally, stable or higher than 2009. Do you stick also on this target?

And on your AFS, I just have one very specific question. On the reclassified asset you have an increase on the unrealized gain on AFS. I was just wondering how do you see those unrealized gains evolving by 2011, considering that this is the main drag on your core Tier 1 ratio under Basel III. Thank you.

Pierre Mariani - Dexia - CEO

Well, the first one is liquidity gap. The liquidity gap, you have the figures in the presentation; it's EUR144 billion compared to EUR260 billion at the end of August 2008.

Alex Koagne - Natixis Securities - Analyst

Okay, thank you.

Pierre Mariani - Dexia - CEO

So the cost of risk on Core, in terms of evolution on PWB, I don't see a very significant change. Consider that 4 basis points is the run-rate on this portfolio. The main cost of risk on Retail and Commercial Banking in Belgium and Luxembourg is very low. We will be probably between 15 and 22/23 basis points.

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And so the main question remains whether the situation in Turkey is still improving. We are seeing very good sign in terms of evolution of NPL, ratios all over the portfolio. And so, I think it's something where we could reasonably expect improvements in the future.

I can't tell you what will be the precise pace of deleveraging and evolution of cost of risk on Turkey, but there will be, of course, an increase. And we are not yet on a long-term run rate in Turkey. We are still in a post-crisis situation from that point of view.

The last point is, of course, Financial Product portfolio. As I told you, we were anticipating an increase of the provisions on the portfolio not linked to the real cost -- on the provisions, sorry, not because of an increase of potential losses, but due to the accounting treatment of the rules of IAS 39, and the necessity to account not only for the real estimation of losses, but also on the mark-to-market for newly impaired assets. So this is still a rule that is effective.

The change we have observed this quarter is, clearly, a very significant change; first of all, because we had change in the estimation of losses. To add the second element is also because we are now convinced that we have an excess provision that will be reversed over time. And this allows us to account for deferred tax asset in front of these future provisions.

So we know that the future provision will be partially offset by deferred tax asset, not completely, but that will reduce significantly the impact on the account going forward if there is no deterioration of the realistic market in the US. So the overall impact will be probably significantly lower in the second half than it has been in the first half.

So the AFS reserve is, of course, something that is the consequence of three elements. The first one is a change in the rules that has been defined by the FX. So, it's a permanent change on the way we account for the deferred tax assets in the AFS reserve.

And second element is, of course, a temporary one, but it's linked to the exchange rate on the asset. And the third one is spread, and we have, of course, a huge portfolio. Even if it's not risky, it's a spread-sensitive portfolio, and this spread is reflected in the valuation.

So we know that we've observed already, without the tax impact, a reduction of EUR1.5 billion of the AFS reserve since the end of June, which leads to EUR1.1 billion net of deferred taxability, and so it's a net valuation of EUR1.1 billion.

I don't know what will be the evolution of this spread before the end of the third quarter, but if the present market situation improves, certainly, we will follow, certainly, the spread improvement with the improvement of the AFS reserve.

What is the treatment under Basel III? It's still a point and it's not clear, and nothing has been said about that in the precision. I think it will be a point that will be treated later in the process. It's not been discussed by the regulators yet. And we don't know yet if what kind of grandfathering measures could be implemented as far as AFS reserve treatment is concerned.

Alex Koagne - Natixis Securities - Analyst

Okay. And the last question is on your operating expense.

Pierre Mariani - Dexia - CEO

Yes, on the operating expenses, once again, I always said that last year we had reduced the costs; we were already ahead of the program in terms of cost reduction with a cost reduction of EUR360 million. I say publicly that we should not anticipate a strong decrease of cost in 2010, and on the first quarter it's a reduction of 1% compared to last year, and at constant exchange rate, it's a reduction of 2.5%.

Alex Koagne - Natixis Securities - Analyst

Okay. Thank you.

Operator

Ivan Lathouders from Bank Degroof.

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Ivan Lathouders - Bank Degroof - Analyst

Hello, this is Ivan Lathouders of Bank Degroof. I have one question on the profit-sharing provision in Belgium. You've taken the EUR52 million, which you call additional profit-sharing provisions in Belgium, could you please explain what you mean by additional? And should we be expecting similar amounts in future quarters? Thank you.

Pierre Mariani - Dexia - CEO

The life insurance contracts implies, of course, some part of profit-sharing between the Insurance company and the policyholders. I think it's certainly not a recurrent charge.

Ivan Lathouders - Bank Degroof - Analyst

Okay. Could you tell us how this 50 --

Pierre Mariani - Dexia - CEO

Yes, and it's not, of course, a commitment to pay it. It's just a provision at this stage.

Ivan Lathouders - Bank Degroof - Analyst

Okay, thank you.

Pierre Mariani - Dexia - CEO

It should be considered more than a one-off than a recurrent, and it's not yet a charge provision.

Ivan Lathouders - Bank Degroof - Analyst

Okay, thank you.

Operator

Matthias De Wit from Petercam.

Matthias De Wit - Petercam - Analyst

Yes, good afternoon. I've got one question left, please. With regard to the speed of the deleveraging, do you believe it is sustainable around current levels of 20 billion sales in seven months? Of course, it depends on market environment, but let's assume that they remain stable as now. Would that be a run rate going forward? Yes, that's it. Thank you.

Pierre Mariani - Dexia - CEO

I can't answer this question. We'll do whatever is possible to increase the leverage. I think we have seized any market opportunity, and clearly, if the market liquidity improve will certainly speed up the process and try to keep the same pace.

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But the first seven months are more active, usually, than the rest of the year. First of all, because usually August is weaker, even if the first week, from the figures I've seen, has still been very active. And usually we consider that it's not possible to sell significant amounts of assets after the end of November. So we have four months, four to five months left only.

Matthias De Wit - Petercam - Analyst

Okay. And with regard to the deleveraging loss rates, do you expect them to go up, as the bulk of sales have been focused on AAA-rated bonds?

Pierre Mariani - Dexia - CEO

We've sold, really, a mix of bonds which reflects the average rating of the portfolio. So until now, we've been able to be at a very low level, probably at level lower than at I was fearing, even myself, at the beginning of the year.

I think the loss rate depends, really, on the kind of assets we sell, especially in terms of duration more than risk. So it depends whether we deleverage long-term assets or more short-term assets. So I can't tell you what kind of loss rate we can anticipate. It's really highly dependent on market conditions.

Matthias De Wit - Petercam - Analyst

Okay. Thank you.

Operator

Brice Vandamme for Deutsche Bank.

Brice Vandamme - Deutsche Bank Securities - Analyst

Hi. Good morning, Brice Vandamme from Deutsche Bank. Just one question related to PWB. Could you tell us -- could you -- when I have look at the revenue quarter on quarter, if I take out this one of capital gains, the revenue is slightly down. In this decrease, could you tell us what is a proportion coming from actually a decrease of your trading revenue in PWB?

Pierre Mariani - Dexia - CEO

We have no trading revenues -- nearly no trading revenues in PWB. So it doesn't have a very significant impact.

Brice Vandamme - Deutsche Bank Securities - Analyst

Thank you.

Operator

Britta Schmidt from Autonomous Research.

Britta Schmidt - Autonomous Research - Analyst

Yes, hi, I've got three quick questions, if I may. The first one is on the AFS and the deleveraging again. You're selling maturities that are slightly lower than the average maturity of the book, I guess. Do you expect that further deleveraging, once you start selling longer-dated bonds out of the book that the losses might, then, pop up a little bit?

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And the other question related to that is whether at some point in time you're going to see an increased spend, which sensitivity of the AFS book if then the average duration of the book changes. That is the first question.

The second question is just a clarification, because the question was asked as to whether you still expect losses from the RMBS also from the FP Portfolio --

Pierre Mariani - Dexia - CEO

Excuse me, I didn't get your first question, so if you -- because the sound is not very good, so if you could repeat your question a little more slowly?

Britta Schmidt - Autonomous Research - Analyst

Okay, sure.

Pierre Mariani - Dexia - CEO

Sorry to interrupt you.

Britta Schmidt - Autonomous Research - Analyst

Sure. It was related to the AFS reserve and the deleveraging. You're selling some maturities that are, I guess, slightly shorter than the average maturity of the book, and I guess in this spread environment, that makes sense.

But do you see a point where, perhaps, the average maturity of the remaining book will come down? And that could mean that, for example, the spread sensitivity increases. Do you have an eye on that in your management of the deleveraging?

And the other point related to that is, if you wanted to avoid that -- some longer-dated bonds, would there be a risk of higher losses on that? So that's with regards to the deleveraging.

The second question was just a clarification. I think something was communicated once that there was a risk that some of the interest rate reset dates in some of the sub-prime RMBS are going to lead to higher charges in 2010. So I was just wondering whether that is something that you still see.

And just on the third one, on the deferred tax asset that you've booked on there. Am I right in understanding that you have not used the full kind of excess provision for calculating the deferred tax asset, but only partial -- only a part of that provision?

Pierre Mariani - Dexia - CEO

So on AFS, it's true that we are selling assets which, on average, are shorter than the average duration of the portfolio. The average bond portfolio sold so should be -- I don't -- we have given, of course, the duration of the legacy division portfolio, even if we sell assets in the ALM portfolio, which are, of course -- which are a much shorter duration. So we'll give you the complete split of that if you want.

But it's true that because of this difference, we are decreasing considerably the portfolio, but there will be, definitely, an increase in the average life of the remaining portfolio, probably at the end of the story if we don't change the policy over time.

But we don't know precisely what will be the evolution of the spread and the possibility to sell assets. It means that in present conditions, of course, we will be in a position to -- if we would decide to sell these long-term assets, it would mean higher level of losses on the deleverage.

But the issue we have on the other side is, of course, these very-long-term assets are not risky, and probably the best quality in the portfolio, I think, the most risky part of the portfolio is, of course, the short-term or the shorter-term assets, especially on the ABS, on RMBS portfolios.

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Britta Schmidt - *Autonomous Research - Analyst*

So, I guess --

Pierre Mariani - *Dexia - CEO*

So I think I'm not ready, for the time being, to accept a very high level of losses on these longer-term assets. And we have still a lot of assets that could be sold to respect the commitments with the European Commission, not having to observe and to account very high level of losses.

Britta Schmidt - *Autonomous Research - Analyst*

Okay, that's [very good].

Pierre Mariani - *Dexia - CEO*

But I don't expect an impact on the risk profile of the Group, at least in terms of credit risk, but not very high impact to the overall rating of the portfolio.

Britta Schmidt - *Autonomous Research - Analyst*

Okay. Thanks.

Pierre Mariani - *Dexia - CEO*

On the RMBS, I think we have taken, of course, this risk in the simulation of the cash flow, but we don't expect any major risk from that point of view. And we have not observed -- we were fearing, especially in the US, a risk of increase of duration, etc., but we didn't see any materialization of this risk, neither in the financial product portfolio, nor in the other RMBS we have.

Britta Schmidt - *Autonomous Research - Analyst*

Okay. So at the moment, you see no technical factors leading to some sort of higher charges on the SP portfolio --

Pierre Mariani - *Dexia - CEO*

No. No.

Britta Schmidt - *Autonomous Research - Analyst*

Okay. Great.

Pierre Mariani - *Dexia - CEO*

On the DTA, of course, on the DTA -- not -- of course, we don't use the excess provision, but only part of it, because we took the excess provision. But on the other side, we have also own credit risk, so we deducted the own credit risk from the excess provision, and we took a deferred tax asset only on the difference between the excess provision and the own credit risk.

Britta Schmidt - *Autonomous Research - Analyst*

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And is there any sort of -- has this been signed off with auditors and is a stable number? Or could it be that we see some sort of variation in the tax line due to the reevaluation of that?

Pierre Mariani - Dexia - CEO

Well, I think if there is no material change in the estimation of the losses, there will be no change on that or on the own credit risk.

But for the future, it means also that any additional provision at constant estimation of loss rate of the financial portfolio will be also followed by an increase of deferred tax assets on future provisions on the financial product portfolio.

Britta Schmidt - Autonomous Research - Analyst

Yes, very clear. Thank you.

Pierre Mariani - Dexia - CEO

And we have taken a tax rate of 35%.

Britta Schmidt - Autonomous Research - Analyst

Thanks.

Operator

As we have no further questions, I would like to hand the call back over to Mr. Pierre Mariani.

Pierre Mariani - Dexia - CEO

Well, thank you very much for all those who are -- still hope to take some vacation in this shaky environment, I hope you a nice vacation, and give you a next appointment in September. Thank you very much.

Operator

That will conclude today's conference call. Thank you for your participation, ladies and gentlemen. You may now disconnect.

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