



2017

RISK REPORT

PILLAR 3 OF BASEL III

DEXIA

Contents

Introduction	3
Basel framework	3
Dexia Management Board	4
Dexia's key figures and risk profile	5
Recognition of Dexia's specific and unique situation	5
1. Risk management objectives and policies	7
1.1. Risk organisation and governance	8
1.2. Accounting and prudential consolidation scope	10
1.3. Own funds and capital adequacy	11
1.4. Risk-weighted asset by type of risk	14
1.5. Capital adequacy	15
1.6. Leverage ratio	18
1.7. Significant banking subsidiary: Dexia Crédit Local	19
2. Credit risk	21
2.1. Credit risk management	21
2.2. Credit risk exposure	21
2.3. AIRB approaches	28
2.4. Standard approach	34
2.5. Impairment, past-due and related provisions	35
2.6. Credit risk mitigation techniques	39
2.7. Counterparty credit risk	41
2.8. Focus on equity exposure	43
2.9. Focus on securitisation activities	43
3. Market risk	46
3.1. Market risk measures	46
4. Transformation risk	49
4.1. Management of interest and exchange rate risk	49
4.2. Management of liquidity risk	49
5. Operational risk	52
5.1. Risk measurement and management	52
5.2. Management of operational risk during the resolution period	52
6. Remuneration policies and practices	54
6.1. Fixed and variable remuneration	54
6.2. Link between performance and remuneration	55
6.3. Quantitative information	55
Appendix 1 – Glossary	56
Appendix 2 – Internal rating systems	59
1. Structure of internal rating systems	59
2. Description of the internal rating process	59
3. Control mechanisms for rating systems	63
4. Credit risk IT system	66
Appendix 3 – Basics on securitisation	68
Appendix 4 – Dexia originations	70
Traditional securitisations of Dexia as originator	70
Appendix 5 – Complement on subsidiaries	71
1. Dexia Kommunalbank Deutschland (DKD)	71
2. Dexia Crediop	74

Introduction

Basel framework

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 the appropriate measurement of 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 the 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, was 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 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 was 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 2017.

In terms of market risk, Dexia calculates its capital requirements both on the basis of the Internal Model Approach and the Standard Approach for general interest rate risk and the Standard Approach for specific interest rate risk and foreign exchange risk.

For operational risk, Dexia applies the Standard Approach. In this regard, an information file was submitted to the supervisor in June 2007. Incident collection and reporting take place 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 Pillar 2 internal processes as recalled by the EBA 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:

- The Internal Capital Adequacy Assessment Process (ICAAP) aimed at establishing 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 Dexia's risk profile, as well as robust governance and internal control arrangements.
- The Supervisory Review and Evaluation Process (SREP). The purpose of the SREP is to ensure that Dexia has adequate arrangements, strategies, processes and mechanisms as well as capital and liquidity to ensure a sound management and coverage of its risks, to which it is or might be exposed, including those revealed by stress-testing.

Dexia has developed adapted and proportionate capabilities to address all Pillar 2 requirements under its orderly resolution plan and keeps its supervisors closely informed of all related developments undertaken.

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.

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 in this report.

Dexia's annual report 2017 is available on:

http://www.dexia.com/EN/journalist/publications/annual_reports/Documents/RA%20Dexia%202017_GB.pdf

An internal validation process at the level of Dexia guarantees the quality of the information provided.

The Pillar 3 report is a joint publication by the Risk Management and Communication departments. The Management Board is responsible for the final validation of the Pillar 3 disclosure. Statutory Auditors' approval is not required. Information is not disclosed if considered non-material, proprietary or confidential.

Dexia Crédit Local, as an institution controlled by a EU parent financial holding company, has to comply with the obligations laid down in Part Eight of the CRR in the framework of Pillar 3 disclosure requirements under the 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, Place du Champ de Mars 5, B-1050 Brussels, Belgium.

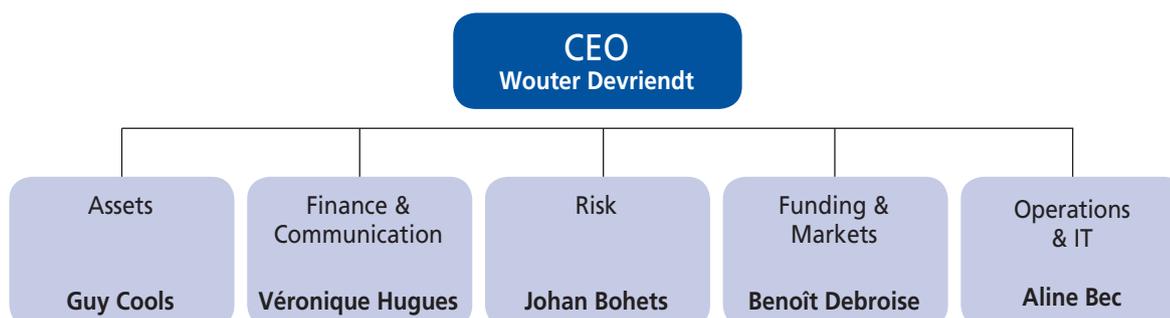
The Pillar 3 report has been published since 2008. The disclosure is organised on an annual basis together with the publication of the annual report.

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.

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

The requirements of the third Pillar are met by this publication.

Dexia Management Board



Dexia's key figures and risk profile

After significant efforts made on disposing of its main commercial activities, splitting large sections of its activities and then reconstructing operating platforms, in 2017 Dexia actively continued to simplify its structure. Indeed, in May 2017 Dexia Crédit Local signed an agreement with Cognizant to outsource its IT and back office activities in France.

In 2017, the Risks activity line continued Dexia's active risk management, in particular with the introduction of weekly production of indicators for the Risk Appetite Framework (RAF) mechanism. This mechanism was enhanced during the year and includes operational risk and activity continuity indicators associated with the transitional phase of the outsourcing of IT and back office services. Its task is to define the principles for assessing any difference in the risk profile compared to the strategic plan approved by the Group's executive bodies.

Since the end of 2011, the Dexia Group has been managed under an orderly resolution plan, approved by the European Commission in December 2012. As a consequence, Dexia's residual assets are managed in run-off and 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 2017:

- Total Capital ratio stood at 20.4%.
- Total risk-weighted assets amounted to EUR 33,351 billion.
- Credit risk
 - Dexia's Exposure at Default (EAD) amounted to EUR 141.9 billion, a decrease of 14% in comparison with 2016, explained by natural portfolio amortisation as well as asset disposals and early redemptions. Exposure was for EUR 73 billion in loans and EUR 58 billion in bonds. It is for the most part concentrated in the European Union (76%) and the United States (12%);
 - As at 31 December 2017 the majority of exposures remained concentrated on the local public sector and sovereigns (74%), taking account of Dexia's historical activity;
 - The portfolio comprises high quality assets that are 90% investment grade; non-investment grade exposures are predominantly situated in the 'BB' range;
 - Total impairments amounted to EUR 877 million, of which EUR 331 million of collective impairments, and EUR 257 million of specific impairments;
 - Credit risk-weighted assets (EUR 31.4 billion) are mostly on Public Sector Entities (29%), Financial Institutions (19%), Corporate & Project Finance (22%), and Sovereigns (24%);
 - Counterparty credit risk on derivatives and repo is included in the figure for credit risk-weighted assets and amounted to EUR 3.9 billion.
- Market risk (including interest rate and FX risk)
 - The end-of-period value at risk amounted to EUR 3.8 million mostly concentrated on interest and FX rate (EUR 1.5 million) and spread (EUR 1.8 million);
 - Market risk-weighted assets amounted to EUR 980 million.
- Operational risk-weighted assets amounted to EUR 1 billion.

Recognition of Dexia's specific and unique situation

Since the introduction of the Single Supervisory Mechanism (SSM), Dexia has been under the direct prudential supervision of the ECB. As such, the implementation of the resolution plan has been the subject of prolonged discussions with the supervisor, especially in the past year.

Considering Dexia's specific and unique situation as a bank in orderly resolution, the public nature of its shareholder structure and the liquidity guarantee put in place by the Belgian, French and Luxembourg governments, and in order to maintain financial stability, an objective of the orderly resolution plan, in 2015 the European Central Bank decided to apply a tailored, pragmatic and proportionate prudential supervisory approach to Dexia. This approach was extended in 2016 and 2017.

The ECB also informed Dexia that this approach would be renewed in 2018. Nevertheless, that renewal is accompanied by a convergence towards the general supervisory framework applied by the ECB, reflected by the strengthening of certain requirements:

- The requirement applicable by virtue of the Liquidity Coverage Ratio (LCR) amounts, as at 1 January 2018, to a minimum of 100% at company and consolidated levels. If this minimum level is not kept, Dexia Crédit Local will have to guarantee observance of a threshold of 80% at a consolidated level over the year 2018 and to inform the ECB thereof by submitting to it new LCR projections as well as a remediation plan.

- Dexia Crédit Local must nonetheless deduct from its CET1 regulatory capital the economic impact which might be generated by remediation on a failure to observe the constraint regarding large exposures. As at 1 January 2018, this related to one exposure and the deduction from regulatory capital is estimated at EUR 185 million for Dexia Crédit Local⁽¹⁾.
- Finally, the ECB states that it expects Dexia Crédit Local to observe the leverage ratio. As at 31 December 2017, the leverage ratio of Dexia Credit Local amounted to 3.8%, above the regulatory minimum of 3%.

(1) Based on a calculation of own funds taking account of the estimated impact of the IFRS 9 first-time adoption.

1. Risk management objectives and policies

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

The role of the risk activity line is to implement the Group's strategy on monitoring and managing risk and to put independent and integrated risk measures in place. 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:

- Define and control the bank's risk appetite and provide relevant independent information, analyses and expert judgement on risk exposures, and advice on proposals and risk decisions made by the management bodies, other business divisions or support units as to whether they are consistent with the risk tolerance and appetite;
- Set up risk policies, guidelines, calculation methodologies and limits to constrain risk generated by the bank activities;
- Ensure each key or emerging risk is identified and properly managed by the relevant units in the institution and that a comprehensive overview of all relevant risks is submitted to the management body;
- 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;
- Maintain the IRBA advanced status, e.g. design / review internal models and carry out model performance assessment, including calibration of model buffers when needed;
- Anticipate negative risk evolution so that action can be taken by the bank to mitigate such risk;
- Manage strategic and regulatory projects proactively and evaluate the potential impact of regulatory evolutions;
- Set frameworks for the better identification of 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 the risk units of subsidiaries and branches;
- Recommend improvements to the risk management framework and options to remedy breaches of risk policies, procedures and limits.

Information flow on risk to the management body (Management Board, Board of Directors or Risk Committee) is organised through regular presentations including:

- The Quarterly Risk Report and sector annual reviews;
- The risk appetite framework monitoring (half yearly);
- Presentations on the status of IRB models related works and changes, as well as significant issues or changes to the model use if any;
- New and /or updates of risk policies;
- Annual disclosures in regulatory risk related reports, including ICAAP/LAAP reports and outcomes of Pillar 2 related analyses;
- Presentations on expected changes in the regulatory and prudential framework impacting the bank's models and systems;
- Recommendations on the risk monitoring framework and operational management of Group risks under the supervision of the Transaction committee.

The terms of office of Directors and members of the Management Board are detailed in the chapter "Declaration of Corporate Governance" of Dexia's Annual Report 2017.

1.1. Risk organisation and governance

1.1.1. Organisation

1.1.1.1. Role of the Risk Committee, the Management Board, the ALCO and the Transaction Committee

The Risk Committee, created within the Dexia Board of Directors is responsible for monitoring aspects relating to risk strategy and level of tolerance of both current and future risk, as defined by the Board of Directors. It assists the Board of Directors in its supervision of the implementation of that strategy.

The Management Board is responsible for implementation of 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 related to certain assets, liabilities and / or derivatives to a Transaction Committee;
- To balance sheet management to an ALCO Committee;
- To market operations to a Market Risk Committee.

The Risk activity line establishes risk policies and submits its recommendations to the Management Board and to the sub-committees. It deals with the monitoring and operational management of Group risks under the supervision of those committees.

More detailed information on the Risk Committee, the Management Board, the ALCO and the Transaction Committee is provided in the section of Dexia's Annual Report entitled "Declaration of Corporate Governance".

1.1.1.2. Organisation of the Risk activity line

The decision-taking body of the Risk activity line is its Executive Committee.

As at 31 December 2017, this committee consists of the Chief Risk Officer and the six heads of:

- The credit risk department,
- The market risk department,
- The operational risk and IT system department,
- The strategic and regulatory risk department,
- The risk and capital adequacy department,
- The governance, reporting and risk systems department.

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.

In particular, the Executive Committee of the Risk activity line is responsible for monitoring models (developments, reviews, back-testing, stress-testing) on proposals from the teams responsible for the management of risk models, quantification and monitoring defaults and the market risks team. It regularly informs the Management Board and the Risk Committee of the use of models and, as the case may be, developments and/or difficulties.

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, defined in relation to the nature of the risks to which the Group is exposed.



Risk appetite framework

The Risk Appetite Framework (RAF) is a regulatory requirement which defines Dexia's level of risk tolerance and falls within the implementation of Dexia strategy. It defines the Group's risk profile, and qualifies the types of risk which Dexia is inclined to hold, minimise, attenuate or transfer in order to achieve its strategic objectives. The RAF considers Dexia's significant risks and relies on Dexia's strategy and capital forecasts.

The RAF was introduced in Dexia in 2016. It includes a declaration of risk appetite, qualitative and quantitative risk limits and an overview of the roles and responsibilities of bodies and functions which supervise implementation and monitoring. It is subject to regular monitoring and an annual review in order to integrate any new regulatory, strategic or operational development. A half-yearly schedule is presented by Risk Management to the Risk Committee and to the Board of Directors, with the aim of close and in-depth monitoring of the main risk indicators and of informing the Group's decision-making bodies. In 2017 this annual review was reflected by the integration of activity continuity indicators associated with the transition phase of the IT and back office outsourcing project, in order to assess and to analyse the operational risks associated with the implementation of such projects. It also allowed definition of the principles of assessment and integration in the RAF of any difference in the risk profile compared to the approved strategic plan.

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 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 when the accounts are drawn up.

Along with the Risk Committee, the Management Board and the Transaction Committee, the following three committees meet on a quarterly basis:

- The Watch-list 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 internal 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 general 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 interest rate and foreign exchange risk of the positions within the banking portfolio are part of the transformation risk.

Market risk policy and management are in the hands of the Management Board. To facilitate operational management, a system of delegated authority has been put in place:

- 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, analyses risk results and positions and approves risk measurement methods. It meets on a monthly basis.
- The Valuation and Collateral Monitoring Committee meets quarterly to analyse indicators relating to collateral management and valuation models performance, to decide on action plans for significant valuation differences and to monitor the valuation of structured products.

Under the aegis of the Management Board and specialized risk committees, the market risk department identifies, analyses and monitors risks and results (including financial instrument valuations) associated with market activities.

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 of the Group's environment, on the basis of a range of stress scenarios.

Within the Risk activity line, a dedicated ALM Risk team is in charge of defining the risk framework within which management may be placed in the hands of the Financial Strategy team within the Finance activity line, of validating the models used actually to 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.

Operational risk and IT system 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.

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. 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, which examine and decide on actions to be taken to guarantee activity continuity and the implementation of a policy for IT systems security.

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 operational continuity management.

Regulatory risk

To ensure a proactive response to the various regulatory requirements, the Regulatory Watch Committee is responsible for defining Dexia's general approach to prudential problems and ensuring exhaustive cover for the various regulatory topics. It informs the different managements of the main regulatory developments, asks for and organises the various impact analyses and liaises with the various international entities on the implementation of new reforms.

ICAAP/ILAAP

In 2017, Dexia established the Stress-Tests and Pillar II Committee under the joint responsibility of the Finance and Risk activity lines in order to guarantee governance and consistency in the measurement of the risks of deviation from strategic plans, internal ICAAP and ILAAP processes and to ensure observance of the requirements formulated within the framework of the SREP. This committee approves all of these subjects prior to their submission to the Management Board, the Risk Committee and the Board of Directors.

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 the section entitled "Declaration of corporate governance" of Dexia Crédit Local's registration document 2017, as well as, if needed at a Dexia level, in the "Declaration of corporate governance" published in Dexia's annual report 2017.

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. Dexia Group policy on risks is defined and supervised by the Board of Directors. The role of the Risk activity line is to implement the Group's strategy on monitoring and managing risk and to put independent and integrated risk measures in place. The Risk activity line identifies and monitors the risks to which the Group is exposed. 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 provisions deemed necessary to cover the risks to which the Group is exposed.

1.2. Accounting and prudential consolidation scope

There is no difference between the consolidation scope for accounting and prudential purposes. The Dexia Group applies all rules with regard to the consolidation scope resulting from:

- IFRS 10 on the preparation and presentation of consolidated financial statements;
- IFRS 3 on business combinations and the impact of accounting methods on the consolidated accounts;
- IAS 28 (revised) on Investments in associates and joint ventures;
- IFRS 11 on Joint Arrangements.

The policies laid down by these standards imply that all companies over which the Group exercises exclusive or joint control or notable influence must be consolidated.

Consequently, all companies exclusively or jointly controlled, or over which the Group holds a notable influence, are consolidated.

Pursuant to the principle of a true and fair view of the financial statements of the Group, any companies whose contribution to the consolidated financial statements is not material shall not be included in the consolidation scope.

Entities are considered as non-significant when, at consolidated level, the aggregate of their total assets, liabilities, equity and net income does not exceed 1% of the total of consolidated balance sheet and net income (respectively EUR 1.81 billion and EUR 3.28 million (average on 3 years) in 2017).

As at 31 December 2017, the sum of the total balance sheet and net income of unconsolidated entities does not exceed this threshold.

The list of subsidiaries by method of consolidation is available in the Note 1.2 to the consolidated financial statements of Dexia's Annual Report 2017.

No participation is deducted from the regulatory own funds as at 31 December 2017.

1.3. Own funds and capital adequacy

Dexia monitors its solvency using rules established by the Basel Committee on Banking Supervision and European Directive CRD IV. On the other hand, the Group ensures observance of the capital requirements imposed by the European Central Bank (ECB), within the framework of Pillar 2 of Basel III, following the Supervisory Review and Evaluation Process (SREP).

The year 2017 was marked by the 80% deduction of the AFS reserve, compared to 60% in 2016, in accordance with the calendar defined by the CRD IV Directive.

The European Central Bank has informed Dexia of the qualitative and quantitative regulatory capital requirements which are applicable to Dexia and certain of its subsidiaries as from 1 January 2018, in accordance with Regulation (EU) No 1024/2013 of the Council dated 15 October 2013.

In this regard, the level of total SREP capital requirement applicable to Dexia SA in 2018 has been set at 10.25% on a consolidated basis. This level includes a minimum own funds requirement of 8% (Pillar 1) and an additional own funds requirement of 2.25% (P2R – Pillar 2 Requirement). By including the capital conservation buffer, of 1.875% in 2018, this brings the capital requirement to 12.125%.

These levels are also applicable to Dexia Crédit Local, on a consolidated basis, as well as Dexia Kommunalbank Deutschland and Dexia Crediop.

1.3.1. Accounting and regulatory equity figures

(in EUR million)	31/12/2016			31/12/2017		
	Financial statements	Regulatory purposes	Difference	Financial statements	Regulatory purposes	Difference
Equity, Group share, of which :	4,147	7,180	3,033	4,992	6,466	(1, 474)
<i>Share capital and related reserves</i>	2,486	2,446	(40)	2,489	2,449	40
<i>Consolidated reserves</i>	7,017	7,017	0	7,228	7,228	0
<i>Gains & losses directly recognised in equity</i>	(5,710)	(2,637)	3,073	(4,263)	(2,748)	(1,515)
<i>Net result of the period</i>	353	353	0	(462)	(462)	0
Minority interests	427	259	(168)	410	197	213
TOTAL EQUITY	4,574	7,439	2,865	5,402	6,663	(1,261)
Prudential filters		(428)			(167)	
Common Equity Tier 1		7,011			6,496	
Additional Tier 1		50			48	
Tier 2		244			267	
TOTAL CAPITAL		7,305			6,811	

Share capital and related reserves

The residual outstanding of Deeply Subordinated Non-Cumulative Notes issued on October 2006 by Dexia Funding Luxembourg (DFL) amounted to EUR 40 million. Following the merger of DFL with Dexia, this amount is booked in equity, Group share. However, for regulatory purposes and taking into account the transitional dispositions of Basel III, this amount has to be considered partly as Additional Tier 1 and as Tier 2.

Gains and losses directly recognised in equity - breakdown

(in EUR million)	31/12/2016			31/12/2017		
	Financial statements	Regulatory purposes	Difference	Financial statements	Regulatory purposes	Difference
Gains and losses directly recognised in equity	(5,710)	(2,637)	(3,073)	(4,263)	(2,748)	(1,515)
Available for sale reserve on debt instruments, loans and receivables and equities	(4,525)	(2,715)	(1,810)	(3,495)	(2,796)	(699)
Cash flow hedge reserve	(1,339)	(76)	(1,263)	(922)	(25)	(897)
Non realised performance - own credit risk on liabilities designated at fair value through profit or loss	na	na		81	0	81
Actuarial gains and losses on defined benefit plans	(3)	(3)	0	(1)	(1)	0
Cumulative translation adjustments	157	157	0	45	45	0
Gains and losses directly recognised in equity of non current assets held for sale	0	0	0	29	29	0

The difference between the booked amount of available for sale reserve and the amount recognised as regulatory own funds is explained by the calendar defined by the CRD IV Directive: the transitional provisions imposed to recognise 80% of the booked amount of the AFS reserve in prudential own funds in 2017 (60% in 2016).

In application of the Article 33.1 (a) of Regulation (EU) 575/2013, only the amount of cash flow hedge reserve related to financial instruments at fair value is taken into account in regulatory own funds. This represented an amount of EUR -25 million as at 31 December 2017 (EUR -76 million as at 31 December 2016).

Regarding own credit risk on financial liabilities at fair value through profit and loss, as allowed by the standard IFRS 9, since 1 January 2017, Dexia has recognised the own credit risk of those financial liabilities in gains and losses directly recognised in equity. In application of Article 33.1 (b) in the CRR 575/2013, this amount is not recognised in regulatory own funds.

Following the application of the standard IFRS 5 to Dexia Israel, its gains and losses directly recognised in equity were presented separately in own funds. The amount mainly represented cumulative translation adjustments (EUR 29 million).

1.3.2. Regulatory capital

Total capital can be broken down as follows:

- Common Equity Tier 1 capital, including in particular:
 - share capital, premiums, retained earnings,
 - profits for the year,
 - gains and losses directly recognised in equity (revaluation of financial assets available for sale or reclassified, revaluation of cash flow hedge derivatives and translation adjustments),
 - the eligible amount of non-controlling interests,
 - after deduction of 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, Additional Valuation Adjustment).
- Additional Tier 1 including Tier 1 subordinated debt (hybrid);
- Tier 2 Capital which includes the eligible portion of Tier 2 subordinated debt as well as surplus provisions at 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 sovereign and non-sovereign bonds and shares 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, i.e. 80% in 2017.
- Non-controlling interests are partially eligible for Tier 1 capital; their limited inclusion is the object of transitional provisions;
- Certain adjustments on subordinated and hybrid debt must be taken into consideration in the calculation of capital in order to reflect the loss-absorption characteristics of these instruments.

As at 31 December 2017, Dexia's Total Capital was EUR 6.8 billion, against EUR 7.3 billion as at 31 December 2016. This decrease is principally explained by the negative net result for the financial year.

Gains and losses recognised directly in equity stood at EUR -4.3 billion as at 31 December 2017, a strong improvement of EUR +1.4 billion over the year, principally as a result of the tightening of credit spreads on sovereign bonds, in particular from Italy and Portugal, and the appreciation of the euro. The amount deducted from regulatory capital for the AFS reserve was EUR -2.8 billion as at 31 December 2017, whilst the amount was EUR -2.8 billion as at 31 December 2016, despite the phased deduction (80% in 2017 against 60% in 2016, in accordance with the schedule defined by the CRD IV Directive).

Dexia's Common Equity Tier 1 capital followed a similar trend and was at EUR 6.5 billion as at 31 December 2017, against EUR 7.0 billion as at 31 December 2016.

(in EUR million)	Regulatory Capital	
	31/12/2016	31/12/2017
TOTAL CAPITAL	7,305	6,811
Common Equity Tier 1 Capital	7,011	6,496
Core shareholders' equity	9,817	9,214
Eligible gains or losses directly recognised in equity	(2,791)	(2,792)
Cumulative translation adjustments (Group share)	157	45
Actuarial differences on defined benefit plans	(3)	(1)
Non-controlling interests eligible in Tier 1	259	197
Items to be deducted:		
<i>Intangible assets</i>	(32)	(35)
<i>Ownership of CET 1 instruments in financial institutions (>10%)</i>	(2)	0
<i>Own credit risk</i>	(148)	0
<i>Debit Valuation Adjustment</i>	(80)	(48)
<i>Additional Valuation Adjustment</i>	(166)	(84)
Additional Tier 1 Capital	50	48
Subordinated debt	58	48
Items to be deducted:		
<i>Ownership of Tier 1 instruments in financial institutions (>10%)</i>	(8)	0
Tier 2 Capital	244	267
Subordinated debt	54	52
<i>of which additional Tier 1 reclassified</i>	38	48
IRB provision excess (+); IRB provision shortfall 50% (-)	247	215
Items to be deducted:		
<i>Ownership of Tier 2 instruments in financial institutions (>10%)</i>	(58)	0

As at 31 December 2017, the Group's Tier 1 hybrid capital securities represented a nominal total of EUR 96 million, including EUR 48 million eligible as additional Tier 1 and EUR 48 million as Tier 2 capital, as allowed by the transitional provisions of the implementation of Basel 3 regulation. No hybrid debt buyback operations were carried out in 2017. The Group's hybrid 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.

Taking account of the eligible part of Tier 2 subordinated debts (EUR 4 million), the additional Tier 1 reclassified (EUR 48 million) and the IRB provision excess (EUR 215 million), the Tier 2 Capital amounted to EUR 267 million.

Prudential filters

As a consequence of the application of Article 33 of the Regulation (EU) No. 575/2013 (Capital Requirements Regulation – CRR) on cash flow hedges and changes in the value of own liabilities, Dexia shall not include the following items in any element of own funds:

- The fair value reserves related to gains or losses on cash flow hedges of financial instruments not valued at fair value, including projected cash flows. Out of the amount of EUR -922 million of CFH reserve as at 31 December 2017, EUR -897 million was filtered out. As a consequence, EUR -25 million was eligible as regulatory own funds. As at 31 December 2016, EUR -1,263 million was filtered out from the total CFH reserve, which amounted to EUR -1,339 million and EUR -76 million was eligible as regulatory own funds.
- The gains or losses on liabilities of the institution that are valued at fair value that result from changes in the own credit risk (OCR) of Dexia. In 2016 the OCR was part of the "Core Shareholders' Equity" and booked in P&L. As a consequence, it had to be deducted (EUR 148 million). As from 1 January 2017 onwards, as allowed by the standard IFRS 9, Dexia booked the OCR of those financial liabilities in "gains and losses directly recognised in equity". As a consequence, it was fully filtered out (EUR 81 million) of the regulatory own funds.
- Fair value gains and losses arising from Dexia's own credit risk related to derivative liabilities. The Debit Valuation Adjustment (DVA) amounted to EUR 48 million as at 31 December 2017 (EUR 80 million as at 31 December 2016).

Also, in accordance with the regulation prudent valuation requirements are applied to all fair-valued positions regardless of whether they are held in the trading book or banking book.

The prudent valuation requirement (Additional Valuation Adjustment) was EUR -84 million as at 31 December 2017 (EUR -166 million as at 31 December 2016).

Deductions pursuant to Articles 36, 56 and 66 and items not deducted in accordance with Articles 47,48,56,66 and 79 of the CRR

As at 31 December 2017, the Dexia Group was concerned by the deductions under review only for the intangible assets.

- The amount of intangible assets (software acquired or internally developed) to be deducted represented EUR 35 million.
- The holdings in capital instruments of financial sector entities without representing a significant investment in those entities amounted to EUR 222 million as at 31 December 2017, far below the threshold (EUR 650 million) from which deductions have to be made.

The holdings of those capital instruments decreased during 2017 mainly due to the disposal of some positions (EUR -359 million) and to natural amortisation (EUR -170 million). As at 31 December 2016, the portfolio exceeded the threshold (EUR 701 million) and led to a deduction of EUR 68 million, allocated proportionally to the nature of the instruments held in CET1 for EUR 2 million, in AT1 for 8 million and in T2 for EUR 58 million.

- Regarding deferred taxes, the Group mainly had a position of unrecognised deferred tax assets, due to the losses resulting from the wind-down of its activities. The deferred tax assets on the face of the balance sheet represented an amount of EUR 29,6 million as at 31 December 2017 and arose from temporary differences. (EUR 32 million as at 31 December 2016).
- Significant investments in financial sector entities, at EUR 2 million, did not exceed the threshold for deduction. This limited amount, together with the amount of deferred tax assets arising from temporary differences did not exceed the second threshold required in article 48. They are included in the risk-weighted assets with a weight of 250 %.

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, 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.

1.4. Risk-weighted asset by type of risk

The following table shows the risk-weighted assets (RWA) and capital for each type of risk (and exposure class for credit risk) at year-end 2017. 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.

(in EUR million)		31/12/2016		31/12/2017		
Type of risk	Basel III treatment	Exposure class	RWA	Capital Requirements	RWA	Capital Requirements
Credit risk	Advanced	Corporate	3,715	297	3,204	256
		Equities	1	0	315	25
		Financial Institutions ⁽¹⁾	7,417	593	5 088	407
		Project Finance	3,303	264	2 729	218
		Public Sector Entities	3,429	274	2 941	235
		Securitisation	7	1	4	0
		Sovereign	7,96	1	7 353	588
		Total	25,832	2,067	21,633	1,731
		Standard	Corporate	1,32	0	537
	Equities		802	64	32	3
	Financial Institutions ⁽¹⁾		1,155	92	830	66
	Monolines		719	58	499	40
	Project Finance		620	50	511	41
	Public Sector Entities		8,029	642	6,215	497
	Retail (leasing)		0	0	0	0
	Securitisation ⁽²⁾		6	0	2	0
	Sovereign		149	12	198	16
Total	12,800	1,024	8,824	706		
RBA	Securitisation ⁽²⁾	2,356	188	915	73	
	Total	2,356	188	915	73	
Market risk	Internal Model	Interest Rate Risk	485	39	319	26
		Total	485	39	319	26
	Standard	Interest Rate Risk	577	46	445	36
		Foreign Exchange Risk	306	24	215	17
		Total	883	70	660	53
Operational risk	Basic	1,000	80	1,000	80	
TOTAL		43,356	3,468	33,351	2,669	

(1) In 2017: o/w RWA related to CVA Capital Charge: EUR 2,050 million in Advanced and EUR 373 million in Standard.

(2) Securitisation is in foundation method (RBA), unless it has a guarantor, in which case it is classified according to the guarantor approach in standard or advanced method.

At the end of 2017, risk-weighted assets stood at EUR 33.4 billion, of which EUR 31.4 billion for credit risk, EUR 980 million for market risk and EUR 1 billion for operational risk. To recall, at the end of 2016 they were at EUR 43.4 billion, of which EUR 41.0 billion for credit risk. The sharp EUR 9.6 billion decrease of credit risk-weighted assets was for the most part a result of the reduction of the asset portfolio, of a favourable exchange rate and of a reduction of the fair value of exposures.

(in EUR million)		Risk-weighted assets	
		31/12/2016	31/12/2017
Credit risk-weighted assets		40,988	31,371
Market risk-weighted assets		1,367	980
Operational risk-weighted risks		1,000	1,000
TOTAL		43,356	33,351

1.5. Capital adequacy

1.5.1. Regulatory solvency ratios

Dexia's Common Equity Tier 1 ratio was 19.5% as at 31 December 2017, against 16.2% at the end of 2016. The Total Capital ratio was 20.4%, against 16.8% at the end of 2016, a level higher than the threshold of 9.875% (including the capital conservation buffer of 1.250%) imposed for the year 2017 by the European Central Bank within the framework of the Supervisory Review and Evaluation Process (SREP).

(in EUR million)		Solvency ratios	
		31/12/2016	31/12/2017
Total Capital ratio		16.8%	20.4%
Common Equity Tier 1 ratio		16.2%	19.5%

1.5.2. Internal capital adequacy

In 2012 Dexia began an overhaul of its internal adequacy assessment process, taking account of its specific situation as a bank in orderly resolution and in line with the requirements of the CRR and the CRD IV.

Dexia in fact developed a “Risk and Capital Adequacy” approach which was inspected by the supervisory authorities. Within the framework of the Single Supervisory Mechanism (SSM), this approach is the Group’s response to the requirements of the European Central Bank (ECB) in relation to the Internal Capital Adequacy Assessment Process (ICAAP), the Internal Liquidity Adequacy Assessment Process (ILAAP) and the Supervisory Review and Evaluation Process (SREP).

This approach consists of establishing an exhaustive map of the qualitative and quantitative risks which might simultaneously affect the Group’s accounting and prudential situation as well as its liquidity. Such risk mapping aims primarily to measure the sensitivities and exposure to different risk factors impacting the bank. Secondly, the simultaneous impact of various unfavourable future risk scenarios is measured, particularly in terms of the evolution of the principal accounting and prudential indicators. In this regard, and within the same framework, multiple transversal stress-tests are performed. Possible departures from financial and strategic plans are thus identified, measured and analysed. These unfavourable scenarios simultaneously include scenarios of macroeconomic stress and scenarios which are simulated mathematically. Capital adequacy is thus analysed over horizons of from 3 to 5 years.

In accordance with the requirements of Pillar 2 and in line with best market practices, the conclusions from these processes are regularly submitted for the approval of the bank’s decision-taking bodies (Management Board and Board of Directors).

This internal approach was renewed for 2017, taking account of the evolution of risks, Dexia’s situation and the recommendations of the JST made in 2016, following their in-situ inspection of the processes. The interaction with Dexia’s supervisors continued in 2017.

The “Risk & Capital Adequacy” (RCA) approach builds upon key strengths of regular economic capital approaches, stress testing techniques and risk appetite frameworks. It aims at being fully integrated into the financial planning process, thus demonstrating the capital and liquidity adequacy as required by regulations.

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

- **An Integrated Risk Map (IRM):** this IRM is Dexia’s comprehensive risk taxonomy and cartography inter alia allowing assessments to measure the sensitivities of the financial and prudential statements to each major identified risk factor (default, rating migration, market spread indices, foreign exchange rates, 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 interest rates simultaneously on liquidity reserve, CVA, cash collateral, AFS reserve, hedge accounting, risk-weighted assets, etc. and eventually on available capital, capital ratios and funding sources. This risk map establishes a transparent link between a comprehensive and economic approach to risks and their impact on accounting and prudential measures. For illustration, Common Equity Tier 1 ratios under multiple macro-economic scenarios are estimated.
- **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. The adequacy between available financial and funding resources and the risks facing the bank for a variety of risk scenarios at different severity levels is assessed.
- **Reporting:** an integrated cascade of reporting is devised ranging from the most synthetic reports 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 into 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 run-off.

1.5.3. Stress-tests

The objective of the stress-test framework is to ensure that the Dexia Group’s financial position provides sufficient resilience to withstand the impact of severe economic and financial stress. The nature of the stress-tests takes into account the Dexia orderly resolution plan of October 2011, approved by the European Commission on 28 December 2012. Stress-test exercises are performed in a transversal and integrated way by the Dexia Group’s risk management teams.

These exercises used for the purposes of internal guidance also help ensure the observance of regulatory requirements in that regard, particularly those relating to Pillar 2 and the ICAAP and ILAAP processes defined by the European Central Bank and the EBA guidelines “Common procedures and methodology for Supervisory Review and Evaluation Process (SREP Guidelines)” and “EBA guidelines on institutions’ stress-testing”. In association with those requirements, a complete stress-test programme is implemented to guarantee consistent articulation between the various types of stress (particularly market, Pillar I credit and liquidity).

For ICAAP and ILAAP stresses, Dexia regularly makes a complete review of its vulnerabilities in order to cover all material risks, associated with its business model under stressed macroeconomic and financial conditions. This review documented by the ICAAP process is applied and completes the financial planning process. In addition, reverse stress-tests are also performed.

Crisis simulations for the purposes of ICAAP and ILAAP, described in detail in the following sections, are performed twice per annum and are the object of internal validation and verification. In accordance with regulatory requirements, the complete annual exercise for 2017 was forwarded to the ECB. These tests form an integral part of the Risk Appetite Framework (RAF) and are incorporated in the definition and review of global strategy. The link between risk tolerance, adaptations of the strategic resolution plan and ICAAP and ILAAP stress-tests is guaranteed by the specific capital consumption indicators which form a part of the RAF.

As in 2016 stress-tests in addition to those performed within the ICAAP / ILAAP framework were applied.

1.5.3.1. Stress-tests related to credit risk

In the context of Pillar 1 of Basel III, credit exposures covered by the internal rating based approach (IRBA) are regularly subject to sensitivity tests and scenario analyses based on macro-economic 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 risk-weighted assets, Expected Loss (EL) or direct losses.

A quantitative point-in-time modelling per credit sector has been developed, for the purpose of stress testing, financial planning and IFRS 9 multi-scenario Expected Credit Loss Calculations, to link the evolution of the credit risk parameters to the change of the main macro-economic 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 macro-economic 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.

The outcomes of the macro-economic stress and expert stress scenarios are benchmarked with historical scenarios and the Pillar 2 ICAAP Risk & Capital Adequacy credit risk results. A stress-test report is drafted for each credit sector, including data description, principles of methodology, results and conclusions of different sensitivity tests and scenarios, as well as possible management actions to face hypothetical and adverse situations. The results of the stress-test exercises are presented to the Risk Management Executive Committee. All stress-test reports are submitted for validation by the internal methodological validation team in charge of IRBA models.

1.5.3.2. Stress-tests related to market risk

The 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 results of these stress-tests 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 into three categories:

- Single risk factor (mono-factorial) stress-tests, including some stress-tests recommended by the banking supervisors.
- 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 Euro zone.
- Integrated hypothetical scenarios stress-tests.

1.5.3.3. 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 results of these stress-tests are reported to the Group Assets & Liabilities Committee.

1.5.3.4. 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 financial deterioration of Dexia;
- Combined scenario.

Stress scenarios are applied on balance sheet and off-balance sheet components of the residual gap that is the main liquidity driver. The residual gap is the difference between:

- Dynamic liquidity gap composed of the static liquidity gap profile adjusted for gap assumptions (new transactions, roll of repo, roll of short-term funding, etc.);
- Dynamic buffer of reserves composed of the static buffer of eligible reserves adjusted for reserve assumptions.

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

1.5.3.5. Integrated Pillar 2 stress-tests

As mentioned in 1.4 and following the Pillar 2 regulation recalled by the JST, in 2016 Dexia included in its ICAAP a comprehensive stress-testing framework, clearly distinct and independent from the ICAAP risk measurement, providing a challenging perspective to the latter, including of its underlying assumptions. The latter relies on the comprehensive risk map built in the ICAAP framework.

In order to enhance transparency and synergies between the multiple currently available stress-tests recalled above, a dedicated scenario analysis policy is part of the 2017 ICAAP file. It covers the articulations of multiple risk stresses (market, Credit Pillar 1 and liquidity) with the baseline scenarios used for the financial planning.

1.6. Leverage ratio

The Basel III /CRD IV Regulation introduced the leverage ratio, the main objective of which is to serve as a complementary measure on capital. This ratio is obtained dividing Tier 1 capital by exposures calculated using the balance sheet assets and off-balance sheet commitments, assessed according to a prudential approach. Derivatives and repurchase agreements are also adjusted.

The Delegated Act amending Regulation (EU) No. 575/2013 adopted by the European Commission on 10 October 2014, specifies the changes in the methods for calculating the ratio relative to the initial 2013 text. In November 2016, the European Commission published a draft of the CRR revision (CRR2). The CRR2 proposes a complete framework for Leverage ratio which will be binding in 2019. The proposal confirms a minimum level of 3% from that year onwards. However, banks have been required to publish their leverage ratio since 1 January 2015.

As at 31 December 2017, the Group ratio calculated according to the CRR/CRD IV rules as amended by the Delegated Act of October 2014 reached 4.59%, compared to 4.31% as at 31 December 2016. This improvement is explained by the decrease of exposure that offset a lower Tier1 capital.

Quarterly follow-up of the leverage ratio is performed both at Group and entity levels, in order to manage the risk of excessive leverage. This follow-up is included in the quarterly "Capital Management" report.

Summary comparison of accounting assets against leverage ratio exposure measure

LEVERAGE EXPOSURE : RECONCILIATION WITH TOTAL BALANCE SHEET (*)		
	31/12/2016	31/12/2017
TOTAL BALANCE SHEET	212,771	180,938
Neutralisation of the balance sheet value of items whose leverage exposure is different from that of the balance sheet	(62,816)	(50,462)
<i>Trading derivatives (assets)</i>	16,415	12,509
<i>Hedging derivatives (assets)</i>	6,830	4,985
<i>SFT (assets)</i>	2,939	2,980
<i>Cash collateral (paid)</i>	36,632	29,989
Leverage exposure of derivatives	6,811	5,427
Leverage exposure of reverse repo	0	0
Leverage exposure of repo (liabilities) counterparty credit risk	5,867	5,642
Leverage exposure of off-balance sheet items	1,476	1,020
Leverage exposure adjustment on assets deducted from CET1	(208)	(119)
<i>Intangible assets</i>	32	35
<i>Breach of threshold on deduction on CET1 of instruments from fin. institutions</i>	2	0
<i>Breach of threshold on deductions on AT1 of instruments from fin. institutions</i>	8	0
<i>Additional value adjustments</i>	166	84
TOTAL LEVERAGE EXPOSURE	163,900	142,447
TIER 1 capital, transitional provisions	7,061	6,544
LEVERAGE RATIO (*)	4.31%	4.59%

(*) Figures published have been modified for 2016 to take into account the positive net result of Year End 2016. However, figures published by the EBA for the transparency exercise for 2016 did not include this positive result

Leverage ratio common disclosure template

	31/12/2016	31/12/2017
On-balance sheet exposures		
1 On-balance sheet items (excluding derivatives and SFTs, but including collateral)	186,586	160,465
2 (Asset amounts deducted in determining Basel III Tier 1 capital transitional definition)	(208)	(119)
3 Total on-balance sheet exposures (excluding derivatives and SFTs) (sum of lines 1 and 2)	186,378	160,347
Derivative exposures		
4 Replacement cost associated with all derivatives transactions (where applicable net of eligible cash variation margin and/or with bilateral netting)	7,869	6,281
5 Add-on amounts for PFE associated with all derivatives transactions	2,194	1,924
6 Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the operative accounting framework	(36,632)	(29,989)
7 (Deductions of receivables assets for cash variation margin provided in derivatives transactions)	(3,252)	(2,778)
8 (Exempted CCP leg of client-cleared trade exposures)	0	0
9 Adjusted effective notional amount of written credit derivatives	0	0
10 (Adjusted effective notional offsets and add-on deductions for written credit derivatives)		
11 Total derivative exposures	6,811	5,427
Securities financing transaction exposures		
12 Gross SFT assets (with no recognition of netting), after adjusting for sale accounting transactions		
13 (Netted amounts of cash payables and cash receivables of gross SFT assets)		
14 CCR exposure for SFT assets	5,867	5,642
15 Agent transaction exposures		
16 Total securities financing transaction exposures (sum of lines 12 to 15)	5,867	5,642
Other off-balance sheet exposures		
17 Off-balance sheet exposure at gross notional amount	2,691	1,739
18 (Adjustments for conversion to credit equivalent amounts)	(1,215)	(719)
19 Off-balance sheet items (sum of lines 17 and 18)	1,476	1,020
Capital and total exposures		
20 Tier 1 capital – Transitional definition	7,061	6,544
21 Total exposures (sum of lines 3, 6, 11, 16 and 19)	163,900	142,447
Leverage ratio		
22 Basel III leverage ratio (*) – using a transitional definition of Tier 1 capital	4.31%	4.59%

(*) Figures published have been modified for 2016 to take into account the positive net result of Year End 2016. However, figures published by the EBA for the transparency exercise for 2016 did not include this positive result

1.7. 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.

	Solvency	
(in EUR million except where indicated)	31/12/2016	31/12/2017
Total capital	5,802	5,629
Common equity Tier 1	5,676	5,354
Risk-weighted assets	43,206	33,177
Total capital ratio	13.4%	17.0%

As at 31 December 2017, Dexia Crédit Local's Total Capital was EUR 5.6 billion, against EUR 5.8 billion as at 31 December 2016. This fall is principally explained by the negative net result for the financial year.

Gains and losses recognised directly in equity stood at EUR -4.0 billion as at 31 December 2017, a strong improvement of EUR +1.3 billion over the year, principally as a result of the tightening of credit spreads on sovereign bonds, in particular from Italy and Portugal, and the appreciation of the euro. The amount deducted from regulatory capital for the AFS reserve was EUR -2.6 billion as at 31 December 2017, whilst the amount was EUR -2.5 billion as at 31 December 2016, despite the phased deduction (80% in 2017 against 60% in 2016, in accordance with the schedule defined by the CRD IV Directive).

Dexia's Common Equity Tier 1 capital followed a similar trend and was at EUR 5.4 billion as at 31 December 2017, against EUR 5.7 billion as at 31 December 2016.

At the end of 2017, risk-weighted assets amounted to EUR 33.2 billion, against EUR 43.2 billion at year-end 2016. At a credit risk level, the sharp fall was for the most part a result of the reduction of the asset portfolio, of a favourable exchange rate and of a reduction of the fair value of exposures.

Dexia Crédit Local's Common Equity Tier 1 ratio⁽²⁾ was 16.1% as at 31 December 2017. As at 31 December 2017, Dexia Crédit local's Total Capital ratio was 17%.

(2) Ratio including net income for the financial year.

2. Credit risk

2.1. 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. This framework guides credit risk management in its functions of analysis, decision-making and risk surveillance.

Risk Management contributes to the process of credit by setting up a framework of credit limits mainly for banking activities (funding and derivatives) dedicated to the remaining portfolio. The rest of the transactions (restructuring, additional credit limits beyond the framework) have to be approved by the Transaction Committee.

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 by counterparty, setting the maximum exposure deemed acceptable. The risk management teams can also set limits per product: they proactively monitor limits, and may reduce them at any time depending on the evolution of associated risks.

2.2. Credit risk exposure

Dexia's credit risk exposure is expressed as Exposure at Default (EAD). It corresponds to the best estimate of credit risk exposure in the event of default. The Dexia Group uses both the standard and the advanced approach to calculating its risk-weighted assets. Thus the regulatory metric has been adapted to allow the treatment of impairments to be homogenised for comparability purposes.

- For financial assets measured at amortised cost, the EAD of a credit exposure on the balance sheet corresponds to the book value, gross of impairments, taking account of accrued interest and the impact of hedge accounting;
- For financial assets measured at fair value, the EAD of a credit exposure on the balance sheet corresponds to its book value, before impairments;
- For derivatives, the EAD is calculated using the mark-to-market valuation method under Article 274 of the Regulation (EU) No. 575/2013 and includes the replacement cost as well as the amount representing future potential exposure, obtained by the product of the notional amount and a coefficient depending on the type of derivative and its residual term;
- For off-balance-sheet commitments, the EAD represents the product of the (nominal) amounts of commitments and a Credit Conversion Factor (CCF). The Dexia Group applies the standard method (Article 111 of the Regulation (EU) No. 575/2013) to determine credit conversion factors, except for project finance transactions (advanced approach).

As at 31 December 2017, Dexia's credit risk exposure was EUR 141.9 billion, compared with EUR 164.7 billion at the end of December 2016, a fall of 14%, associated with natural portfolio amortization as well as asset disposals and early redemptions.

Exposure was EUR 73 billion in loans and EUR 58 billion in bonds. It is for the most part concentrated in the European Union (76%) and the United States (12%).

Exposure on France increased following the deposit of a significant part of the Group liquidity reserve with the Bank of France.

2.2.1. 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 2016 and 2017.

Exposure at year-end 2016 (EAD)					
	Eurozone ⁽¹⁾	Rest of Europe ⁽²⁾	US	Rest of the world	Total
Loans & advances	54,829	15,011	1,683	4,827	76,350
Debt securities	30,761	9,699	15,841	11,006	67,306
Repo	2,258	1,214	709	1,259	5,441
ABS	714	1,575	4,277	34	6,600
Derivatives	4,229	1,445	593	340	6,607
Given guarantees	1,143	386	794	34	2,356
Retail loans	4	0	0	0	4
Other assets	0	0	0	0	0
TOTAL	93,938	29,330	23,897	17,500	164,665

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

(2) Including Turkey.

Exposure at year-end 2017 (EAD)					
	Eurozone ⁽¹⁾	Rest of Europe ⁽²⁾	US	Rest of the world	Total
Loans & advances	54,526	13,567	839	3,751	72,681
Debt securities	24,993	6,866	12,293	8,848	53,000
Repo	2,378	559	1,102	1,157	5,196
ABS	553	1,471	2,399	2	4,424
Derivatives	2,906	1,370	436	252	4,964
Given guarantees	938	235	414	27	1,613
Retail loans	2	0	0	0	2
Other assets	0	0	0	0	0
TOTAL	86,296	24,067	17,483	14,036	141,881

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

(2) Including Turkey.

2.2.2. 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 2016 and 2017. 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.

Exposure at year-end 2016 (EAD)						
Rating	AAA+ to AA-	A+ to BBB-	NIG ⁽¹⁾	Default	Unrated	Total
Loans & advances	37,429	28,612	8,756	1,143	411	76,350
Debt securities	14,883	47,248	5,045	129	0	67,306
Repo	0	5,441				5,441
ABS	5,726	649	216		9	6,600
Derivatives	213	5,257	985	144	8	6,607
Given guarantees	1,059	1,074	185	26	12	2,356
Retail loans	0		2	3	0	4
Other assets	0	0	0	0	0	0
TOTAL	59,311	88,280	15,188	1,444	441	164,665

Exposure at year-end 2017 (EAD)						
Rating	AAA+ to AA-	A+ to BBB-	NIG ⁽¹⁾	Default	Unrated	Total
Loans & advances	37,065	27,379	6,724	936	578	72,681
Debt securities	9,290	39,275	4,404	28	2	53,000
Repo	0	5,196	0	0	0	5,196
ABS	3,717	585	117	0	5	4,424
Derivatives	179	4,084	583	118	0	4,964
Given guarantees	667	784	126	19	17	1,613
Retail loans	0	0	0	2	0	2
Other assets	0	0	0	0	0	0
TOTAL	50,917	77,304	11,955	1,104	602	141,881

(1) Non-investment grade.

As at 31 December 2017, 90% of the exposure was investment grade. Non-investment grade (NIG) files represented 8.4% of the portfolio, 0.4% were unrated and 0.8% were in default.

2.2.3. 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 2016 and 2017.

Exposure at year-end 2016 (EAD)									
Economic Sector	Corporate	Financial institutions	Financial guarantors	Project finance	Public sector entities	Retail	Securitisation	Sovereign	Total
Industry	6,306	91		2,537	2,729	0			11,663
Construction	50			6,659	370				7,079
Trade-tourism	3				41				43
Services	Transportation and storage	868		747	1,393			56	3,064
	Financial and insurance activities	0	20,029	2,062	0	1,708	12	4,376	28,186
	Real estate activities	300	3		3,573	7,200			11,076
	Professional, scientific and technical activities	0	0			44			44
	Administrative and support service activities	26				3,832			3,858
	Public administration and defense-compulsory social security	0	0			68,373	91	19,734	88,198
	Human health and social work activities	24				2,752			2,776
	Arts, entertainment and recreation					214			214
	Education	3				394			397
	Other services	-	-	-	-	248	-	-	1,293
Others	27	0				2	6,496	0	6,526
TOTAL	7,607	20,123	2,062	13,515	89,298	2	6,600	25,458	164,665
%	5%	12%	1%	8%	54%	0%	4%	15%	

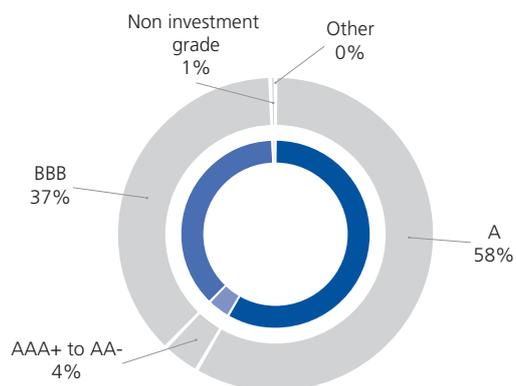
Exposure at year-end 2017 (EAD)									
Economic Sector	Corporate	Financial institutions	Financial guarantors	Project finance	Public sector entities	Retail	Securitisation	Sovereign	Total
Industry	4,906	79	-	2,010	1 979	0	-	-	8,974
Construction	27	-	-	6,098	387	-	-	-	6,512
Trade-tourism	2	-	-	-	34	-	-	-	35
Services	Transportation and storage	645	0	-	540	1,264	-	48	2,497
	Financial and insurance activities	0	13,093	1,500	0	1,309	-	4,377	11,562
	Real estate activities	161	3	-	3,005	6,132	-	-	9,300
	Professional, scientific and technical activities	0	0	-	-	41	-	-	41
	Administrative and support service activities	27	-	-	-	3,389	-	-	3,416
	Public administration and defense-compulsory social security	0	0	-	-	57,964	-	47	17,294
	Human health and social work activities	22	-	-	-	2,381	-	-	2,402
	Arts, entertainment and recreation	-	-	-	-	207	-	-	207
	Education	0	-	-	-	296	-	-	297
	Other services	-	-	-	-	238	-	-	797
Others	17	0	-	-	-	1	0	0	18
TOTAL	5 807	13 174	1 500	11 652	75 621	1	4 424	29 701	141 881
%	4%	9%	1%	8%	53%	0%	3%	21%	

As at 31 December 2017 the majority of exposures remained concentrated on the local public sector and sovereigns (74%), taking account of Dexia's historical activity.

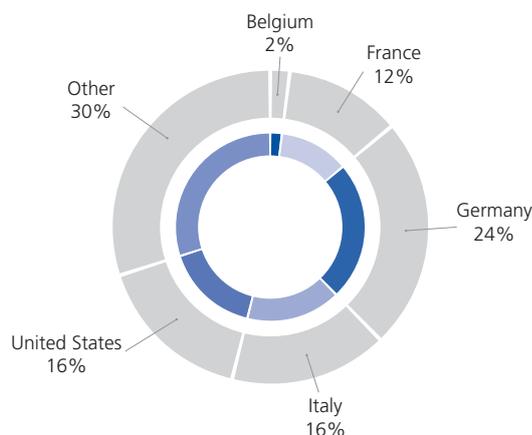
Exposure on Sovereigns from the "Financial and insurance activities" class increased in 2017 following the deposit of a significant part of the Group liquidity reserve with the Bank of France. All other exposures continued to decrease over the year.

Exposure to financial institutions decreased by 35%, and now represents 9% of total exposures. This decrease is mainly due to portfolio amortisation. 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.

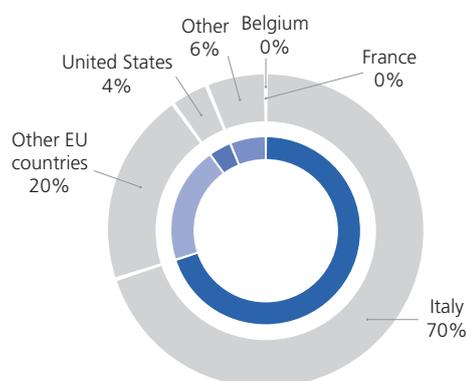
Financial institutions: split by rating class



Public administration / Public sector entities: split by country



Public administration / Sovereign: split by country



2.2.4. Fundamentals of Dexia's credit risk in 2017

2.2.4.1. Dexia Group commitments on sovereigns

	Sovereigns	
	2016	2017
Italy	13,415	12,247
France	2,661	10,233
Portugal	1,894	2,050
United States	1,477	1,144
Japan	845	585
Poland	1,159	486
Hungary	273	0
Others	3,733	2,955
TOTAL	25,458	29,701

Dexia Group commitments on sovereigns are concentrated essentially on Italy and France and to a lesser extent on Portugal and the United States.

Sovereign exposure on France, in an amount of EUR 10.2 billion as at 31 December 2017, includes a significant part of the Group liquidity reserve, on deposit with the Bank of France. In 2017, Dexia took advantage of favourable conditions to dispose of some of its sovereign exposure, in particular in Poland (EUR -672 million).

2.2.4.2. Dexia Group commitments on the local public sector

Considering Dexia's historical activity as a lender to local authorities, the local public sector represents a significant proportion of the Group's outstanding, principally concentrated in the countries of Western Europe (Germany, France, the United Kingdom, Italy, and Spain) and in North America.

	Local Public Sector	
	2016	2017
Germany	17,537	15,165
France	15,585	12,915
United Kingdom	11,952	11,038
Italy	10,750	9,739
United States	12,448	9,684
Spain	6,785	5,489
Portugal	1,794	1,698
Canada	1,466	1,087
Greece	50	3
Others	10,932	8,803
TOTAL	89,298	75,621

France

The quality of the Group's portfolio, consisting mainly of outstanding on local authorities and social housing, remains very good, with a very limited number of payment incidents observed.

Over the year, Dexia continued its policy of assisting French local authorities, in order to reduce its outstanding of sensitive structured credits, which appear on the Dexia balance sheet at EUR 616 million as at 31 December 2017.

Spain

The Spanish State's support to the regions and municipalities continued through the renewal of several financial support funds: EUR 31 billion was paid to the regions in 2017, particularly by the Autonomous Liquidity Fund (FLA). In consideration for such aid, the State control over regional or local finances was increased: the expected deficit of the regions should be reduced to -0.6% of GDP in 2017 (against a target of -0.7% of GDP in 2016).

Catalonia and Valencia are two large Spanish regions which are not major centres of economic attractiveness for Spain. Their financial situation remains tense and comparable (negative savings, heavy indebtedness, tight liquidity, dependence on short-term refinancing). Dexia Group's exposure to Catalonia and Valencia amounted to EUR 1.7 billion and EUR 0.7 billion respectively. The year 2017 was marked by political tensions between the Catalan regional government and the Spanish government. In mid-September, the Spanish State took over the region's treasury and guaranteed payments.

No payment incident was recorded on direct or indirect exposures to those two regions and their satellites.

United States

In 2017, Dexia remained extremely vigilant as to the evolution of the US public sector, in particular the Commonwealth of Puerto Rico, where the situation remains fragile. The federal board for the financial rehabilitation of the Commonwealth included the central government debt on Puerto Rico, the majority of the public service enterprises and civil servant retirement pension funds under Chapter III of the PROMESA Law, promulgated by Congress in 2016. These entities have ceased payments. When their obligations are subject to insurance by monolines, service of the debt is taken over by the latter.

In September 2017 the island was severely hit by Hurricane Maria. A first federal aid plan of USD 15 billion was passed in September, and emergency aid was paid in October.

Against that background, Dexia decided to dispose of certain positions on Puerto Rico, for a total of EUR 343 million (USD 412 million). The Dexia Group's residual exposure amounted to EUR 88 million as at 31 December 2017 and was limited to public enterprises associated with the Commonwealth of Puerto Rico. Although entirely covered by a monoline, certain distant redemption maturities without intermediary amortisation require careful attention. Total provisions amounted to EUR 35.7 million (USD 42.8 million) as at 31 December 2017.

Furthermore, Dexia is also closely monitoring the financial situation of the Chicago Board of Education (CBOE), in view of the very high debt level, the under-financing of pension funds and the ongoing decline of student registrations. These difficulties are amplified by the delay of the State of Illinois in paying subsidies to the CBOE. As a consequence, the latter increased its portion of short-term financing, the conditions of access to which have hardened. The year 2017 should close with a significant deficit as well as a relatively low liquidity level. The budget for 2018 was approved in an amount of USD 5.7 billion and in particular includes aid from the State of Illinois (USD 300 million), the city of Chicago (USD 269 million) and the proceeds of new real estate taxes. In view of the reaffirmed support of the State of Illinois, the credit profile of the CBOE has stabilised: it continues to meet its commitments and has pre-financed the service of its financial debt until March 2018. Dexia's exposure to the CBOE amounted to EUR 417 million and total provisions to EUR 33 million (USD 40 million) as at 31 December 2017.

2.2.4.3. Dexia Group commitments on project finance and corporates

	Corporate		Project finance	
	2016	2017	2016	2017
United Kingdom	5,352	4,277	4,268	3,943
France	1,072	864	2,678	2,200
Spain	60	45	1,943	1,733
Italy	551	229	293	170
United States	300	193	506	418
Canada	0	0	957	846
Germany	20	10	207	166
Portugal	0	0	115	86
Greece	0	0	78	85
Others	252	190	2,470	2,005
TOTAL	7,607	5,807	13,515	11,652

The project finance and corporate loans portfolio amounted to EUR 17.4 billion as at 31 December 2017, a 17% decrease in comparison with December 2016. Beyond natural amortisations and certain early redemptions, this portfolio contracted on the one hand as a result of opportunistic disposals and the decrease of the fair value component and, on the other hand, as a result of exchange rate effects (particularly in the UK Utilities sector).

This portfolio consists 67% of project finance, the balance being in finance to corporates, such as financing for acquisitions, commercial transactions or corporate bonds. Dexia is following a policy of disengagement vis-à-vis its counterparties, and in 2017 disposed of positions in the Utilities sector in an amount of EUR 2.5 billion.

The portfolio is of good quality: 76% project finance and 96% finance to corporates rated investment grade.

Furthermore, the diplomatic crisis between Qatar and its neighbours is being monitored carefully. The Dexia Group exposure to Qatar corresponds to the financing of nine projects for an exposure of EUR 283 million. They correspond either to desalination / electricity production plants or the production / transport of natural gas (LNG). All of these projects are of very good quality and do not appear to be impacted to date by the diplomatic crisis.

2.2.4.4. Dexia Group commitments on ABS

	ABS/MBS	
	2016	2017
United States	4,277	2,399
United Kingdom	1,575	1,471
Spain	441	395
Others	175	74
Portugal	85	75
Italy	47	9
TOTAL	6,600	4,424

In 2017, Dexia committed to a voluntary reduction of its ABS portfolio. Under favourable market conditions, the Group disposed of EUR 1.8 billion in assets over the year, in particular ABS on US government student loans. As a consequence, as at 31 December 2017, the Group's ABS portfolio was down 33%, to EUR 4.4 billion. The ABS portfolio on student loans still represents a major part of the portfolio (EUR 2.4 billion). These loans are guaranteed in an amount of EUR 2.3 billion by the US Federal State and present a rather long amortisation profile and a limited expected loss. The balance consists for the most part of residential mortgage-backed securities (RMBS) in an amount of EUR 0.6 billion, of which EUR 0.3 billion in Spain.

The quality of the portfolio remained stable overall with 97% of the portfolio rated investment grade at the end of December 2017, almost all of the tranches in which Dexia has invested being at a senior level.

2.2.4.5. Dexia Group commitments on financial institutions

	Financial institutions	
	2016	2017
Spain	4,360	2,067
United States	3,224	2,514
Germany	2,510	2,286
France	3,488	1,989
United Kingdom	1,854	1,019
Italy	457	609
Canada	232	139
Portugal	16	14
Greece	0	0
Others	3,982	2,538
TOTAL	20,123	13,175

Dexia Group commitments to financial institutions amounted to EUR 13.1 billion as at 31 December 2017, down by EUR 6.9 billion since December 2016. Commitments consist 72% of bonds, covered bonds and repo operations with financial institutions. The balance includes exposures associated with loans to financial institutions and derivatives.

Dexia exposures are concentrated 19% in the United States and 67% in Europe, principally in Spain (16%), Germany (17%), France (15%) and the United Kingdom (8%). The portfolio's credit remained stable overall in 2017.

In 2017, Dexia paid particular attention to the situation of Spanish banks, considering the tense political situation in Catalonia. The Group's exposure to the Spanish banking sector was principally concentrated on investment grade issuers and was composed of Spanish covered bonds with a limited exposure to Catalanian banks (EUR 126 million).

Finally the evolution of the Deutsche Bank Group, the situation of which stabilised in the spring by virtue of a recapitalisation of EUR 8 billion, was monitored carefully. Dexia's exposure to that Group amounted to EUR 0.9 billion as at 31 December 2017.

The first half of the year was marked by turbulence in the Italian banking sector. The EUR 609 million exposure on the Italian banking sector, mentioned in the above table, includes the exposure on clearing houses and on special purpose vehicles. The Group's exposure to Italian banks amounted to EUR 154 million as at 31 December 2017. It is overwhelmingly focused on banks with good credit quality. Exposure to non-investment grade banks amounted to EUR 0.6 million and consists of collateralised derivatives.

2.2.4.6. Dexia Group commitments on financial guarantors

Dexia is indirectly exposed to the quality of the signature of Financial Guarantors, through insurance contracts to cover the timely end of certain types of bonds issued in the form of securities or loans. Through their insurance policy, these FG irrevocably and unconditionally undertake to repay the principal and interest payable on credits in the case of the underlying counterparty defaulting. In certain cases this activity also results in a reduction of capital requirements.

Dexia carefully monitors the financial situation of Financial Guarantors which were particularly affected by the climatic events in the autumn of 2017, in particular in Puerto Rico.

As at 31 December 2017, EUR 13.9 billion of the Dexia portfolio was insured by Financial Guarantors, including 93% of assets insured by financial guarantors rated investment grade by one or more rating agencies. All but FGIC continue to pay all claims on time and in full.

2.3. AIRB approaches

2.3.1. Competent authority's acceptance of approach

By letter sent on 21 December 2007 by the Belgian supervisory 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.

2.3.2. 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, IFRS 9 models, ALM models, economic capital models;
- Audit is responsible for auditing the general consistency and compliance with the regulation (CRR). Audit then acts as an additional level of control, included in its audit plan.

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

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

The following tables show the total EAD (banking book), average EAD, average PD, LGD, average risk weights and average expected losses broken down by exposure class and obligor grade at year-end 2016 and 2017. The counterparties are the final counterparties, i.e. after taking into account the Basel III eligible guarantees (substitution principle). Financial guarantors' exposure is essentially an indirect exposure. Average EAD is the quarterly average figure.

Exposure class	Obligor grade	2016					
		EAD (banking book) ⁽¹⁾	Average EAD ⁽²⁾	Average PD	Average LGD	Average RW	Average EL
Corporate	AAA to AA-	0	0	-	-	-	-
	A+ to A-	1,812	1,480	0.07%	39.70%	37.06%	0.03%
	BBB+ to BBB-	4,101	5,075	0.21%	40.08%	60.88%	0.08%
	BB+ to B-	284	283	2.25%	45.60%	129.28%	1.10%
	No external rating	19	20	30.87%	66.29%	420.63%	20.46%
	Total	6,216	6,859	0.35%	40.30%	58.17%	0.18%
Financial institutions	AAA to AA-	1,568	1,626	0.12%	4.02%	4.90%	0.00%
	A+ to A-	9,177	11,514	0.18%	21.74%	18.34%	0.02%
	BBB+ to BBB-	5,830	5,784	1.43%	28.37%	42.98%	0.10%
	BB+ to B-	48	86	1.05%	62.13%	174.06%	0.65%
	No external rating	0	0	11.15%	66.97%	287.55%	7.41%
	Total	16,624	19,011	0.62%	22.51%	26.17%	0.05%
Project finance	AAA to AA-	0	0	-	-	-	-
	A+ to A-	2,721	2,721	0.07%	12.63%	11.15%	0.01%
	BBB+ to BBB-	6,649	6,836	0.31%	14.41%	25.97%	0.05%
	BB+ to B-	2,485	2,854	1.59%	17.16%	51.57%	0.28%
	Below B-	0	3	-	-	-	-
	No external rating	4	2	30.87%	12.12%	76.67%	3.74%
	Total	11,859	12,417	0.53%	14.58%	27.95%	0.09%
Public sector entities	AAA to AA-	17,896	18,557	0.03%	9.24%	4.73%	0.00%
	A+ to A-	9,795	10,607	0.08%	7.58%	6.20%	0.00%
	BBB+ to BBB-	9,197	9,431	0.31%	2.67%	4.51%	0.01%
	BB+ to B-	8,077	8,334	1.87%	4.16%	15.28%	0.15%
	No external rating	215	220	1.54%	4.04%	12.39%	0.06%
	Total	45,180	47,150	0.43%	6.61%	6.93%	0.03%
Securitisation	AAA to AA-	11	12	0.00%	5.00%	0.00%	0.00%
	BBB+ to BBB-	80	86	1.09%	3.00%	8.35%	0.03%
	BB+ to B-	0	6	-	-	-	-
	Below B-	0	0	-	-	-	-
	Total	91	103	0.96%	3.25%	7.32%	0.03%
Sovereign	AAA to AA-	4,987	5,886	0.00%	9.32%	0.09%	0.00%
	A+ to A-	2,004	2,567	0.08%	15.78%	14.76%	0.01%
	BBB+ to BBB-	16,452	16,905	0.24%	28.00%	45.20%	0.08%
	BB+ to B-	86	774	1.97%	50.00%	172.11%	0.98%
	No external rating	0	0	-	-	-	-
	Total	23,528	26,132	0.18%	23.08%	33.51%	0.06%
Equities	A+ to A-	0	0	-	-	-	-
	BBB+ to BBB-	0	0	0.32%	90.00%	174.46%	0.15%
	BB+ to B-	0	0	1.15%	90.00%	273.24%	0.52%
	No external rating	2	2	32.64%	11.11%	322.51%	0.23%
	Total	3	2	30.64%	16.09%	318.12%	0.24%
Default		906	989	-	-	-	-
TOTAL		104,408	112,663	-	-	-	-

(1) Trading exposures are not included in this chart.

(2) Average EAD is the quarterly average figure.

The decrease of EAD is mainly explained by sell-off, maturity, early repayment as well as fair value changes. These effects are offset by FX movements.

The majority of Dexia Group exposure in the AIRB approach (65% 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 below 1% (the average PD is 0.48%), 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.

		2017					
Exposure class	Obligor grade	EAD ⁽¹⁾	Average EAD ⁽²⁾	Average PD	Average LGD	Average RW	Average EL
Corporate	AAA to AA-	-	-	-	-	-	-
	A+ to A-	1,725	1,716	0.07%	39.80%	36.42%	0.03%
	BBB+ to BBB-	3,229	3,560	0.21%	39.50%	61.80%	0.08%
	BB+ to B-	128	112	2.18%	52.02%	148.06%	1.18%
	No external rating	17	13	30.87%	66.68%	423.25%	20.58%
	Total	5,100	5,401	0.31%	40.01%	56.61%	0.16%
Financial institutions	AAA to AA-	1	0	0.09%	11.11%	190.00%	0.80%
	A+ to A-	5,568	6,145	0.07%	25.20%	19.91%	0.02%
	BBB+ to BBB-	3,680	3,705	0.25%	37.50%	49.98%	0.11%
	BB+ to B-	1,367	1,939	4.47%	1.79%	7.93%	0.06%
	No external rating	0	0	11.15%	66.18%	333.32%	7.38%
	Total	10,616	11,790	0.70%	26.45%	28.82%	0.06%
Project finance	AAA to AA-	-	-	-	-	-	-
	A+ to A-	2,642	2,184	0.07%	12.48%	11.06%	0.01%
	BBB+ to BBB-	5,742	5,109	0.30%	14.42%	25.80%	0.05%
	BB+ to B-	1,837	1,802	1.75%	17.07%	52.29%	0.31%
	Below B-	0	0	-	-	-	-
	No external rating	0	-	-	-	-	-
	Total	10,222	9,094	0.50%	14.40%	26.75%	0.08%
Public sector entities	AAA to AA-	14,230	13,236	0.03%	9.36%	4.76%	0.00%
	A+ to A-	8,343	7,680	0.08%	7.06%	5.76%	0.00%
	BBB+ to BBB-	8,088	7,547	0.32%	2.64%	4.58%	0.01%
	BB+ to B-	6,866	5,939	1.87%	4.18%	15.36%	0.15%
	No external rating	378	265	1.96%	4.08%	12.71%	0.11%
	Total	37,905	34,667	0.45%	6.43%	6.94%	0.03%
Securitisation	AAA to AA-	10	11	0.00%	5.00%	0.00%	0.00%
	BBB+ to BBB-	-	22	-	-	-	-
	BB+ to B-	37	40	1.48%	3.00%	9.70%	0.04%
	Below B-	-	-	-	-	-	-
	Total	47	73	1.17%	3.43%	7.63%	0.03%
Sovereign	AAA to AA-	11,892	8,873	0.00%	9.84%	0.00%	0.00%
	A+ to A-	1,072	1,445	0.08%	17.27%	17.38%	0.01%
	BBB+ to BBB-	14,948	14,964	0.24%	27.85%	46.32%	0.08%
	BB+ to B-	80	83	3.40%	55.00%	212.18%	1.87%
	No external rating	-	-	-	-	-	-
	Total	27,991	25,366	0.14%	19.87%	26.01%	0.05%
Equities	AAA to AA-	53	13	0.09%	11.11%	190.00%	0.79%
	A+ to A-	4	1	0.11%	11.11%	198.38%	0.31%
	BBB+ to BBB-	29	8	0.52%	11.11%	190.25%	0.76%
	BB+ to B-	1	1	3.35%	11.11%	200.85%	0.36%
	Below B-	0	0	30.87%	11.11%	190.00%	0.00%
	No external rating	112	29	32.46%	12.85%	222.50%	0.59%
	Total	200	52	18.36%	12.09%	208.51%	0.66%
Default		749	577	-	-	-	-
TOTAL		92,830	99,509	-	-	-	-

(1) Trading exposures are not included in this chart.

(2) Average EAD is the quarterly average figure.

2.3.4. Average PD, LGD and risk weight by exposure class and geographic area

The following tables show the total EAD (banking book), average EAD, average PD, LGD, average risk weights and average expected losses broken down by exposure class and geographical location at year-end 2017.

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

Average EAD is the quarterly average figure.

Exposure class	Geographic area	2017					
		EAD ⁽¹⁾	Average EAD ⁽²⁾	Average PD	Average LGD	Average RW	Average EL
Corporate	France	826	870	0.41%	46.61%	68.50%	0.22%
	Italy	228	423	0.22%	39.92%	58.49%	0.09%
	United Kingdom	3,783	3,872	0.15%	38.54%	51.50%	0.06%
	Spain	45	46	1.41%	43.37%	122.66%	0.70%
	Portugal	-	-	-	-	-	-
	Germany	10	11	0.18%	34.93%	51.13%	0.06%
	Greece	-	-	-	-	-	-
	United States	180	222	0.23%	37.52%	56.40%	0.09%
	Canada	-	-	-	-	-	-
	Others Europe	17	18	30.85%	66.27%	420.44%	20.44%
	Other countries	12	55	0.46%	39.34%	61.09%	0.24%
	Total	5,100	5,518	0.31%	40.01%	56.61%	0.16%
Financial institutions	France	1,970	2,611	0.11%	28.16%	27.32%	0.06%
	Italy	154	161	0.51%	47.08%	102.51%	0.24%
	United Kingdom	409	728	0.11%	20.57%	26.61%	0.02%
	Spain	2,067	3,269	3.05%	6.14%	12.88%	0.05%
	Portugal	14	15	0.82%	60.75%	215.10%	0.50%
	Germany	1,473	1,579	0.17%	35.86%	36.37%	0.06%
	Greece	-	-	-	-	-	-
	United States	1,960	2,093	0.08%	24.61%	20.62%	0.02%
	Canada	139	179	0.07%	23.50%	16.78%	0.02%
	Others Europe	529	806	0.10%	27.12%	21.77%	0.03%
	Other countries	1,901	2,035	0.18%	40.73%	46.24%	0.10%
	Total	10,616	13,476	0.70%	26.45%	28.82%	0.06%
Project finance	France	2,084	2,161	0.35%	11.74%	23.10%	0.05%
	Italy	109	212	0.68%	17.80%	42.80%	0.13%
	United Kingdom	3,738	3,799	0.20%	13.76%	19.19%	0.03%
	Spain	1,263	1,333	1.23%	17.73%	49.50%	0.22%
	Portugal	58	64	0.75%	19.49%	38.95%	0.15%
	Germany	133	151	1.46%	19.49%	57.19%	0.28%
	Greece	-	-	-	-	-	-
	United States	107	126	0.98%	19.49%	40.66%	0.19%
	Canada	846	894	0.28%	13.77%	23.94%	0.04%
	Others Europe	110	114	0.90%	18.52%	46.50%	0.17%
	Other countries	1,775	2,035	0.73%	15.47%	26.43%	0.13%
	Total	10,222	10,889	0.50%	14.40%	26.75%	0.08%
Public sector entities	France	10,677	11,745	0.20%	2.22%	1.35%	0.01%
	Italy	9,243	9,555	0.81%	3.00%	6.90%	0.02%
	United Kingdom	3,375	3,495	0.04%	1.57%	1.00%	0.00%
	Spain	4,662	5,162	0.77%	3.00%	5.81%	0.02%
	Portugal	225	241	0.51%	3.00%	5.88%	0.02%
	Germany	-	-	-	-	-	-
	Greece	-	-	-	-	-	-
	United States	8,682	9,809	0.43%	19.19%	17.63%	0.09%
	Canada	-	-	-	-	-	-
	Others Europe	84	118	0.00%	10.00%	0.00%	0.00%
	Other countries	957	973	0.00%	5.00%	0.00%	0.00%
	Total	37,905	41,097	0.45%	6.43%	6.94%	0.03%
Securitisation	Italy	-	22	-	-	-	-
	Spain	37	40	1.48%	3.00%	9.70%	0.04%
	Other countries	10	11	0.00%	5.00%	0.00%	0.00%
	Total	47	73	1.17%	3.43%	7.63%	0.03%

Exposure class	Geographic area	2017					
		EAD ⁽¹⁾	Average EAD ⁽²⁾	Average PD	Average LGD	Average RW	Average EL
Sovereign	France	10,314	5,232	0.00%	10.00%	0.00%	0.00%
	Italy	12,269	12,556	0.16%	25.00%	34.68%	0.04%
	United Kingdom	61	62	0.00%	10.00%	0.00%	0.00%
	Spain	437	504	0.16%	25.00%	35.95%	0.04%
	Portugal	2,050	1,957	0.71%	45.00%	117.59%	0.32%
	Germany	135	137	0.00%	5.00%	0.00%	0.00%
	Greece	-	-	-	-	-	-
	United States	1,147	5,176	0.00%	10.00%	0.00%	0.00%
	Canada	-	-	-	-	-	-
	Others Europe	704	981	0.15%	20.15%	24.65%	0.05%
	Other countries	874	1,066	0.37%	18.63%	32.41%	0.18%
	Total	27,991	27,671	0.14%	19.87%	26.01%	0.05%
Equities	France	63	17	3.31%	11.11%	190.00%	0.73%
	Italy	29	7	7.35%	11.11%	199.41%	0.72%
	United Kingdom	21	6	29.76%	11.11%	216.83%	0.36%
	Spain	0	0	-	-	-	-
	Portugal	-	-	-	-	-	-
	Germany	0	0	-	-	-	-
	Greece	-	-	-	-	-	-
	United States	51	13	30.87%	11.11%	245.54%	0.61%
	Canada	-	-	-	-	-	-
	Others Europe	34	9	30.47%	16.87%	191.25%	0.80%
	Other countries	3	1	7.43%	11.11%	190.00%	0.10%
	Total	200	52	18.36%	12.09%	208.51%	0.66%
Default	749	733	-	-	-	-	
TOTAL	92,830	99,509	-	-	-	-	

(1) Trading exposures are not included in this chart.

(2) Average EAD is the quarterly average figure.

2.3.5. 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 aim, three properties in particular are 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 PD (or LGD or CCF) slightly exceeds 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 precisely to identify in advance all borrowers that subsequently default. In practice, however, such perfect rating systems do not exist. A rating system demonstrates a high discriminatory power if the "good" grades subsequently turn out to contain only a small percentage of defaulters and a large percentage of non-defaulters, with the converse applying to the "poor" grades. 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...).

Presentation of estimated losses versus actual losses

The analysis of the estimated compared to actual risk parameters (PD & LGD) is carried out on a basis per exposure class over a long period in the back-test reviews. The following table displays the statistical significance of the risk parameter of the 2017 back-testing.

	PD		LGD	
	p-value	BT period	p-value	BT period
Financials Institutions		1995-2016		1980-2016
Corporates		1983-2016		1980-2016
Sovereigns		1995-2016		1998-2016
Project Finance		2002-2016		1995-2016
Public Sector Entities		1995-2016		1995-2016

All results are displayed on the longest available period. The realized default rates and losses are in line with the estimated ones. Data used in the table:

- On Project Finance and Public Sector Entities, the results are displayed on internal data on the whole portfolio.
- On Banks, Corporates and Sovereigns, the results are displayed on external data (in line with the results of the yearly back-tests) on the Investment Grade (for PD) and Senior Unsecured (for LGD) positions as these positions are the more representative of the Dexia portfolio.

Back-Test policy:

	Indication that the observed values are significantly different from the expected values (calibration, discrimination, stability).
	Indication that the observed values are weakly significantly different from the expected values (calibration, discrimination, stability).
	Indication that the observed values are in line with the expected values (calibration, discrimination, stability). There is no significant difference, though this colour code is an early warning indicator.
	Indication that the observed values are perfectly in line with the expected values (calibration, discrimination, stability). There is no significant difference.
	Indication that the historically observed PD, LGD and CCF values are much lower than the calibrated values.

2.3.6. Model use

In addition to the calculation of risk-weighted exposures, the internal estimates of PD, LGD and CCF models are used in other areas such as lending policies (including the exposure limits), early warning systems or credit risk adjustments (provisioning policy).

Use of the A-IRB models is also expanded to the internal exercises of stress-tests, financial plan, ICAAP (Internal Capital Adequacy Assessment) as well as the internal and external reporting (notably the Quarterly Risk Report and the annual report).

The collection and recovery policies and processes are partially based on the risk parameters of the A-IRB models and will be enhanced in 2018.

Internal ratings, default and loss estimates used in capital requirements play an essential role in Dexia's risk management and decision-making process, in credit approval (limited to activities authorized in the context of the Orderly Resolution Plan), internal capital allocation, and corporate governance functions. An independent unit ensures that effective use of internal ratings and the resulting parameters is made across the risk management processes including: transaction committee files instruction, overall rating process consistency (country ceiling, state/mother support), limits set-up and update, credit watch, corporate governance and reporting.

In particular Dexia uses regulatory metrics (adjusted EAD, see § 2.2) and IRB parameters in its internal risk reporting and external reports. The current risk reporting system is leveraged on IRB risk parameters. Internal ratings, as well as ADV LGD and CCF values and the regulatory metric of Exposure at Default (used in the computation of own funds requirements) are used for the quarterly risk report (QRR) dedicated to the monitoring of credit risks. A new appendix has been included in the QRR that allows credit risk exposure mapping (internal reporting view) to the corresponding COREP portfolio.

The EAD metric has also been selected since 2015 to provide credit risk related information in the annual report, Pillar 3 report and internal control report. The internal IRB ratings' scales (as validated for each IRB models) are mapped to a "master scale" that is used for credit exposure reporting. This master scale is used for comparison purposes between sectors in the QRR – independently from the approach applied to compute the capital requirements – however IRB ratings and parameters are used in model related documentation, as well as in the financial plan long-term projections.

According to Dexia's Watch list policy, all the sensitive files (including counterparties in A-IRB) are followed up by the Watch-List Committee which is entitled to make recommendations of actions on credit issues. The criteria of the counterparties selected in the Watch-List process are based on ratings thresholds defined per sector in the risk policies and as a consequence of the IRB rating models for the IRB portfolio.

2.4. Standard approach

2.4.1. Introduction

Consecutively to the disposal of some entities and to the sharp decrease of some portfolios, Dexia presented an official request to the home supervisors to move some portfolios from advanced to standard approach. The portfolios involved had become non-material in terms of exposure and number of counterparties.

The switch from advanced to standard approach was implemented in June 2013 following official acceptance of the proposal by the National Bank of Belgium for the following types of counterparties:

- Insurance companies including financial guarantors;
- Belgian 'other' satellites;
- Belgian Region and Community expert models and assimilated counterparties;
- Mid-corporate counterparties.

2.4.2. Nominated external credit assessment institutions (ECAI)

The standard approach provides risk-weighted asset 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.

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.

Standard & Poor's	Credit rating agencies and credit quality step under the standard approach		Regulatory credit quality step
	Moody's	Fitch	
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.

2.4.3. Exposure at default and average risk weights

The following table shows the total exposure at default (banking book) and exposure to weighted-average risk weights broken down by exposure class and obligor grade at year-end 2016 and 2017.

Exposure Class	Obligor Grade	2016		2017	
		EAD (M)	Average RW	EAD (M)	Average RW
Corporate	AAA to AA-	14	20%	13	20%
	A+ to A-	446	50%	419	50%
	BBB+ to BBB-	151	100%	127	100%
	No external rating	72	102%	73	98%
<i>Total Corporate</i>		<i>683</i>	<i>66%</i>	<i>631</i>	<i>65%</i>
Equities	No external rating	577	150%	2	250%
<i>Total Equities</i>		<i>577</i>	<i>150%</i>	<i>2</i>	<i>250%</i>

Exposure Class	Obligor Grade	2016		2017	
		EAD (M)	Average RW	EAD (M)	Average RW
Financial institutions	AAA to AA-	36	15%	65	7%
	A+ to A-	564	33%	353	21%
	BBB+ to BBB-	39	34%	3	50%
	BB+ to B-	0	-	-	-
	No external rating ⁽¹⁾	2,073	37%	1,737	14%
Total Financial Institutions		2,713	27%	2,201	16%
Financial guarantors	AAA to AA-	1,022	20%	777	20%
	A+ to A-	1,040	50%	723	50%
Total Financial guarantors		2,062	35%	1,500	34%
Project Finance	AAA to AA-	203	20%	188	20%
	A+ to A-	29	50%	26	50%
	BBB+ to BBB-	5	100%	5	100%
	No external rating	562	100%	458	100%
Total Project Finance		800	78%	676	76%
Public Sector Entities	AAA to AA-	31,762	12%	28,030	12%
	A+ to A-	7,714	27%	5,558	27%
	BBB+ to BBB-	2,147	50%	1,900	28%
	BB+ to B-	1,620	47%	1,071	56%
	Below B-	50	100%	3	100%
	No external rating ⁽²⁾	603	38%	954	24%
Total Public Sector Entities		43,896	18%	37,516	17%
Retail	No External Rating	2	75%	1	75%
Total Retail		2	75%	1	75%
Securitisation	AAA to AA-	9	20%	5	20%
	Below B-	3	150%	0	150%
Total Securitisation		12	52%	6	29%
Sovereign	AAA to AA-	1,373	0%	877	0%
	A+ to A-	723	20%	974	20%
	BBB+ to BBB-	-	-	-	-
Total Sovereign		2,096	7%	1,851	11%
Others		2,684	34%	1,522	21%
Total Others		2,684	34%	1,522	21%
TOTAL		55,524	-	45,906	-

(1) Exposure on central counterparties (CCP) clearing houses.

(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).

2.5. Impairment, past-due and related provisions

2.5.1. Concepts and implementation within Dexia

2.5.1.1. Principles of past-due exposure

A past-due is defined as a 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.

2.5.1.2. Principles of default (Dexia), non-performing exposure and forbearance (EBA)

The concept of default includes counterparties that have (or are likely in the future to have) 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 significantly to 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:
 - In order to comply with Article 178(1) of Regulation (EU) No. 575/2013 on default of an obligor, on 31 December 2016, Dexia switched from a "more than 180 days past-due" default definition (linked to a specific Dexia exemption to a 'more than 90 days past-due' default definition for the categories of exposures specified in Article 178(1)(b) of Regulation (EU) No. 575/2013.
 - Technical past-dues, defined as the consequence of a mistake by 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-dues also include the legal risk when the counterparty has the means to afford its payment but refuses to pay it;
 - Immaterial amounts: Dexia's threshold for past-due is a fixed amount established at EUR 500 (from 1 January 2015). The threshold takes into account nominal past-due, past-due on interest, penalties and commissions.
- Any case of judicial settlement, unwinding, bankruptcy, composition, 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

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

According to the EBA, non-performing exposures on balance sheet are those that satisfy at least one of the following criteria (§ 145 ITS):

- Material exposures which are more than 90 days past-due (quantitative criterion);
- 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 days past-due (qualitative criterion).

The Dexia Group has identified exposures corresponding to the said EBA definition.

Non-performing and forbore exposures

	Gross carrying amount of performing and non-performing exposures							Accumulated impairment and provision and negative fair value adjustments due to credit risk			Collaterals and financial guarantees received		
	of which performing but past-due >30 days and <= 90 days	Of which performing forbore	of which non performing				On performing exposures	On non-performing exposures	On non-performing exposures	of which: forbore exposures			
			of which: defaulted	of which: impaired	of which: forbore	of which: forbore							
Debt securities	55,688	0	114	195	195	183	0	(138)		(64)			
Loans and advances	73,420	87	549	1,249	1,001	694	412	(193)	(28)	(193)	(112)	305	210
Off-balance sheet exposures	68,309		5	61	0		0	1		0			

Forbearance (EBA)

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. Forbearance is applied to healthy or safe assets or on non-performing assets. As at 31 December 2017, EUR 1.1 billion of outstanding on 57 counterparties were considered as forborne (compared to EUR 1.1 billion as at 31 December 2016).

2.5.1.3. 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". The 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 as 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 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 is based on two types of models:

- Statistical approach based impairments corresponding 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: the statistical provision, based on average parameters (LGD, PD).
 - Additional sector impairments, in order to take account of the current circumstances, by stressing calculation parameters.
- Expert approach based impairments covering risks observed on a segment of counterparties / types of financing / country risk presenting advanced deterioration evidence of risk without requiring the constitution of a specific impairment.

2.5.2. Overview of past-due exposure and impairments

Counterparties shall be considered as defaulted when:

- Dexia considers that the obligor is unlikely to pay its obligations towards the bank, or any of its subsidiaries in full, without recourse by the institution to actions such as realizing security. Identification of an unlikely to pay situation may rely on the following situations: allocation of specific credit risk adjustment, identification of material distressed restructuring, existence of a bankruptcy situation and other indications of unlikely to pay.
- The obligor has past-dues over EUR 500 that last for more than 90 days on any credit obligation.

By exceptions to this rule, not considered as defaulted are:

- Technical past-dues, defined as the consequence of a mistake by 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-dues also include the legal risk when the counterparty has the means to afford its payment but refuses to pay it.

	31/12/2016				31/12/2017			
	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	91 days to 180 days	Over 180 days		Less than 90 days	91 days to 180 days	Over 180 days	
Loans and advances (at amortised cost)	33	10	234	1,064	457	0	216	876
Other financial instruments	0	0	24	2	16	0	10	1
TOTAL	33	10	258	1,066	473	0	225	877

Dexia's stock of impaired assets amounted to EUR 877 million as at 31 December 2017, down EUR 188 million on the end of 2016. Specific impairments allocated amounted to EUR 257 million, down EUR 65 million on 31 December 2016.

This fall of impaired assets and specific impairments is essentially explained by the exposures to Spanish motorway projects and public enterprises associated with the Commonwealth of Puerto Rico as well as the latest Dexia outstanding on the city of Athens.

Furthermore, the restructuring of several impaired assets enabled provisions on those exposures to be reversed.

As a consequence, the coverage ratio was at 29.3% as at 31 December 2017.

In addition to specific impairments, Dexia has collective (statistical and sector) provisions in a total amount of EUR 331 million as at 31 December 2017, against EUR 416 million as at 31 December 2016.

The observed fall is principally due to the reduction of the calculation basis for collective provisions following disposals and redemptions.

	31/12/2017							
	As at 1 January	Additions ⁽¹⁾	Reversals ⁽¹⁾	Utilisation	Other adjustments	As at 31 December	Recoveries directly recognised in profit or loss	Charge-offs directly recognised ⁽¹⁾ in profit or loss
Specific impairment	(365)	(90)	141	1	15	(299)	0	(92)
Customer loans and advances	(321)	(89)	141		12	(257)	0	(92)
Available for sale securities	(42)	(1)	0	1	3	(41)	0	0
<i>Fixed revenue instruments</i>	0	0	0	0	0	0	0	0
<i>Variable revenue instruments</i>	(43)	(1)	0	1	3	(41)	0	0
Other accounts and receivables	(2)	0	0	0	0	(2)	0	0
Collective impairment	(416)	(65)	136	0	15	(331)	0	0
Interbank loans and advances	(37)	(3)	22			(19)	0	0
Customer loans and advances	(379)	(62)	114		15	(312)	0	0
TOTAL	(781)	(155)	277	1	30	(631)	0	(92)

(1) Following the disposal of some of the exposures on Puerto Rico, reversals of specific impairments have been booked for an amount of EUR 40 million and an amount of charge-offs has been recognised directly in profit or loss for an amount of EUR 60 million; also, an additional provision of EUR 38 million was booked on the residual exposures on public entities related to the Commonwealth of Puerto Rico.

Past-due overview displayed by cause and counterparty type

Counterparty type	Credit default	Operational default	Technical default	Short-term technical past-due	Past-due amounts (M€)
Sovereign	0	0	0	237	237
Local public sector	166	50	0	51	268
Project finance	39	1	2	1	43
Corporate	1	19	0	3	23
TOTAL	206	70	2	293	570

Short-term technical past-dues represent more than half of the past-dues (51%) followed by credit defaults (36%). By counterparty type, local public sector and sovereign represent 47% and 42% respectively.

Past-due overview displayed by countries and cause

Italy represents 51% of past-due amounts, followed by Portugal (21%) and France (13%).

Risk Country	Credit default	Operational default	Short-term technical past-due	Technical default	Past-due amount (M€)
Italy	8	10	272	0	290
Portugal	120	0	0	0	120
France	3	55	16	2	76
Brazil	39	0	0	0	39
Bulgaria	21	0	0	0	21
United States	12	0	0	0	12
Germany	0	4	0	0	4
Belgium	0	0	3	0	3
Spain	0	0	2	0	2
Serbia	2	0	0	0	2
TOTAL	206	70	293	2	570

The short-term technical past-dues represent 51%. By country Italy has the highest percentage (51%).

Past-due overview by country and bucket past-due date

Risk country	<6j	<90j	[90j - 180j]	>180j	Total past-due amount (M€)
Italy	273	0	0	17	290
Portugal	0	0	0	120	120
France	13	3	0	60	76
Brazil	0	0	39	0	39
Bulgaria	0	0	0	21	21
United States	0	0	0	12	12
Germany	0	0	0	4	4
Belgium	3	0	0	0	3
Spain	1	1	0	0	2
Serbia	0	0	0	2	2
Other	0	0	0	0	0
TOTAL	290	4	39	235	570

2.6. Credit risk mitigation techniques

2.6.1. 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 in 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 to 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 of 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.

2.6.2. 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. Dexia is indirectly exposed to the quality of the signature of:

- Financial Guarantors, through insurance contracts to cover the timely end of certain types of bonds issued in the form of securities or loans. As at 31 December 2017, EUR 13.9 billion of the Dexia portfolio was insured by Financial Guarantors (see section 2.2.4.6 above and section 2.6.4 below).
- Several southern Europe local authorities (Italy, Spain) that are natural guaranty providers for local public satellites or smaller public sector entities (see section 2.6.4 below).

2.6.3. 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 risk-weighted assets.

For guarantees and credit derivatives, Dexia recognises the impact by replacing, under the AIRB approach, 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. The same process of substitution is applied only to the risk weight under the standard approach.

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 approach exposures: eligible CRMs (after regulatory haircuts) are directly taken into account in the EAD.

2.6.4. Exposure covered by credit risk mitigants by exposure class

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

IRBA - Credit risk mitigation technique

	31/12/2017			
	Total exposure	Risk mitigation		
		Guarantees and credit derivatives	Collateral	Total guarantees and collateral
Corporate	5,125	606	18	624
Financial institutions	10,802	783	28,331	29,114
Project finance	10,740	0	645	645
Public sector entities	38,126	3,349	10	3,359
Central governments	27,991	670		670
ABS/MBS	47	47		47
TOTAL	92,830	5,455	29,003	34,458

STANDARD APPROACH - Credit risk mitigation technique

	31/12/2017			
	Total exposure	Risk mitigation		
		Guarantees and credit derivatives	Collateral	Total guarantees and collateral
Corporate	977		2	2
Financial institutions	3,366	18	7,253	7,272
Project finance	676			0
Public sector entities	37,516	2,628	8	2,636
Central governments	1,864			0
Individuals, SME & self employed	2			0
ABS/MBS	6	6		6
Financial guarantors	1,500	1,500		1,500
TOTAL	45,906	4,152	7,263	11,415

2.7. Counterparty credit risk

2.7.1. Definition

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 reduction strategies, only some of the derivative transactions can be classified as hedge accounting. In the event that a strategy applied by the bank does not meet the stringent requirements defined under IAS 39, transactions are classified as derivatives “held for trading” notwithstanding their risk reducing character.

2.7.2. 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 counterparty 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: counterparty 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 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 counterparty's default.

Banks now consider this derivative fair value component 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 since the release of IFRS 13, in spite of the changes in the fair value definition, calculation of CVA becomes a clear requirement.

The CVA is equal to expected exposure multiplied by the probability of default (PD) and the loss given default (LGD). Dexia computes the expected exposure by replicating a string of swaptions, or where not appropriate or too cumbersome, by applying the Basel exposure at default (net present value + add-on). Credit spreads are used for implying PDs.

For collateralised derivatives, Dexia uses a conservative 10-day margin period of risk.

CVA capital charge

Since the implementation of the Basel III framework, Dexia has been 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 that 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.

As at 31 December 2017, Dexia had EUR 3,939 million of risk-weighted assets on counterparty credit risk, of which EUR 2,377 million related to CVA capital charge.

Downgrade of Dexia's own credit rating – impact

Taking into account the current level of credit rating, no additional amount of collateral would have to be provided should Dexia Crédit Local incur a downgrade.

2.7.3. Accounting treatment of derivatives

The accounting treatment of Dexia's derivative strategies is described in note 1.1.10. and note 1.1.11. to the consolidated financial statements in Dexia's annual report 2017.

2.7.4. Derivative portfolio

Detailed information is provided in note 4.1 to the consolidated financial statements in Dexia's annual report 2017. The notional value of credit derivatives is provided in table 4.1.b of the notes to the consolidated financial statements. All credit derivatives are used for Dexia's own credit portfolio (no intermediation activities) as protections bought (however not designated as IFRS hedges).

2.8. Focus on equity exposure

2.8.1. Accounting rules

Detailed information is provided in note 1.1 to the consolidated financial statements in Dexia's annual report 2017.

2.8.2. 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 2016 and 2017.

Type of asset	2016		2017	
	Accounting value	Fair value	Accounting value	Fair value
Financial assets designated at fair value	1	1	1	1
Available-for-sale financial assets	210	210	188	188
TOTAL	211	211	189	189

2.9. Focus on securitisation activities

2.9.1. Objectives and roles of Dexia

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 to third parties.

2.9.2. Risk monitoring

The Credit Risk Management department monitors Dexia's ABS positions. 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 carried out 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 "Watch list" or "Quarterly review" lists are reviewed by a dedicated Watch-List Risk Committee, which also decides on impairments.

Analysis of rating migration related to external rating agencies is based on 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 on the notes issued, in case of a mismatch between the assets.

Securitisation exposures in the banking book

	2017	
	Bank acts as originator	Bank acts as investor
	Synthetic	Traditional
TOTAL RETAIL	0	2,950
of which residential mortgage	0	557
of which other retail exposures	0	2,372
of which re-securitisation ⁽¹⁾	0	21
TOTAL WHOLESALE	1,417	57
of which loans to corporates	0	45
of which commercial mortgage	0	12
of which other wholesale	1,417	0

(1) Re-securitisation exposure is purchased only.

2.9.3. Basel III treatment and accounting rules

2.9.3.1. Basel III treatment

Dexia applies the rating-based approach (RBA – advanced approach) to calculate the risk-weighted assets 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 risk-weighted assets in relation to its investments in securitisation positions, Dexia uses the services of the following rating agencies: Standard & Poor's, Moody's and Fitch.

2.9.3.2. Accounting rules

The recognition and de-recognition 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". Securitisation positions where the bank acts as an investor are classified in the IAS 39 category of "loans & receivables". See section 1.1.6.2 of Dexia's annual report. The valuation techniques for such assets are detailed in section 1.1.7.2 of Dexia's annual report.

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 2017.

Dexia has no assets awaiting securitisation.

2.9.4. Securitisation activity as originator

All of Dexia's origination operations, except WISE, 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.

DCL has not initiated any new securitisation transaction since 2010. Dexia Crediop securitisation TEVERE Finance SRL and Dexia Cr dit Local securitisation TRIPLUS – 2010 were sold/unwound in 2017.

Dexia has not securitised any revolving exposure or liquidity facilities that are shared between investors and Dexia as originator.

The following tables show the outstanding notional amounts of reference obligations in the securitised pool.

Variations between 2016 and 2017 are due to the amortisation of the securitisation portfolios.

(in EUR million)	EAD	
	31/12/2016	31/12/2017
Synthetic securitisation (Wise)	1,515	1,417

Securitisation exposures in the banking book and associated regulatory capital requirements - Bank acting as originator or as sponsor

	2017							
	Exposure values (by RW bands)		Exposure values (by regulatory approach)		RWA (by regulatory approach)		Capital charge after cap	
	≤ 20% RW	1250% RW	IRB RBA (incl. IAA)	1250%	IRB RBA (incl. IAA)	1250%	IRB RBA (incl. IAA)	1250%
TOTAL EXPOSURE	1,394	24	1,394	24	112	295	9	24
Synthetic securitisation (*)	1,394	24	1,394	24	112	295	9	24

(*) 100% Wholesale.

2.9.5. Securitisation activity as investor

2.9.5.1. Dexia portfolios

The following tables show the exposure at default (EAD) of securitisation positions retained or purchased in the banking book, broken down by type of securitisation and risk-weight class at year-end 2016 and 2017.

2016 – EAD						
Securitisation type	[0 - 8%]	8% - 16%	16% - 106%	106% - 1250%	1250%	Total
ABS	4,098	50	87	0	0	4,235
CDO	1,495	46	0	0	24	1,565
MBS	208	199	274	3	115	800
TOTAL	5,801	296	361	3	138	6,600

2017 – EAD						
Securitisation type	[0 - 8%]	8% - 16%	16% - 106%	106% - 1250%	1250%	Total
ABS	2,248	74	59	0	0	2,381
CDO	1,394	37	0	0	24	1,454
MBS	134	287	147	0	21	588
TOTAL	3,775	398	206	0	45	4,424

Dexia invested almost exclusively in originally AAA externally rated transactions, explaining the current low risk-weighted assets associated to this portfolio. 94% of the portfolio (risk weights below or equal to 16%) is within the A or above rating range as at the end of 2017, and 99% of the portfolio is investment grade (a risk weight of 106% corresponding to a BBB-rating), against 98% as at year-end 2016.

The following table shows the exposure at default (EAD) of securitisation positions retained or purchased, broken down by seniority.

Seniority	2016	2017
Senior	6,542	4,372
Mezzanine	38	37
First loss	20	15
TOTAL	6,600	4,424

Securitisation exposures in the banking book and associated regulatory capital requirements - Bank acting as investor

	Exposure values (by RW bands)				Exposure values (by regulatory approach)			RWA (by regulatory approach)		Capital charge after cap	
	≤ 20% RW	>20% to 50% RW	>50% to 100% RW	>100% to <1250% RW	1250% RW	IRB RBA (including IAA)	1250%	IRB RBA (including IAA)	1250%	IRB RBA (including IAA)	1250%
TOTAL EXPOSURE 2017	2,868	101	16		21	2,986	21	304	210	24	17
Traditional securitisation	2,868	101	16		21	2,986	21	304	210	24	17
of which securitisation	2,863	101	16		0	2,981	0	303	0	24	0
of which retail underlying	2,806	101	16		0	2,924	0	297	0	24	0
of which wholesale	57	0	0		0	57	0	6	0	0	0
Of which re-securitisation (*)	5	0	0		21	5	21	1	210	0	17

(*) Senior only.

2.9.5.2. Gains or losses on sales

The tables below show the recognised gains or losses by type of exposure in 2016 and 2017 arising from the sale of securitisation positions in line with Dexia deleveraging strategy. Securitisation sales for the years 2016 and 2017 resulted in EUR 17 million and EUR 7 million gain respectively. The gain recorded in 2017 is attributable to the sale of positions sold by Dexia at favourable conditions on residential mortgage loans.

	US student loans	Residential mortgage loans	Commercial mortgage loans	Total
Gains or losses in 2017		(8)	18	(3)
Gains or losses in 2016		11	6	0
				17

3. Market risk

3.1. Market risk measures

3.1.1. 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 to its portfolios and activities:
 - Directional interest rate risk is 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 the distribution of which 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 various 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 Risk Committee.

3.1.2. Exposure to market risk

3.1.2.1. Value at risk

The Dexia trading portfolio is composed of two groups of activity:

- Transactions initiated by trading activities until the date on which the Group was placed in orderly resolution, mostly covered back-to-back;
- Transactions intended to hedge risks arising from disinvestments and sales of assets within the framework of the orderly resolution plan.
- The main risk factors of the trading portfolio are:
 - Interest rate risk, in particular on the euro zone and the dollar zone,
 - Cross currency basis swap risk,
 - Basis risk BOR-OIS.

Value adjustments (CVA, DVA, FVA) and their variation are not included in the VaR model but are included in stress scenarios.

Value at risk (VaR)

The detail of the VaR from the market activities of the trading portfolios is presented in the following table. At the end of December 2017, total consumption in VaR was EUR 3.8 million, against EUR 8.2 million at the end of 2016.

(in EUR million)	2016				2017			
	IR	Spread	Other risks	Total	IR	Spread	Other risks	Total
VaR (10 days, 99%)								
Average	6.0	2.8	0.2	9.0	2.5	3.8	0.2	6.5
End of period	4.0	4.1	0.2	8.2	1.9	1.8	0.1	3.8
Maximum	10.4	4.1	0.2	14.0	3.8	4.2	0.2	8.2
Minimum	2.4	2.3	0.2	5.1	1.9	1.8	0.1	3.8

3.1.2.2. 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 2017, this sensitivity amounted to EUR -10 million for a one basis point increase in credit spreads, against EUR -13 million at the end of 2016. Sensitivity to interest rate fluctuations is extremely limited, as interest rate risk is hedged.

3.1.3. Regulatory internal model and back-testing

3.1.3.1. Basel treatment

Internal model

The parametric Value at Risk (VaR) model is the one used for the regulatory capital requirement calculation of general interest rate risk within the trading scope.

The Stressed VaR (SVaR) is calculated on a weekly basis using parameters from the period September 2008-September 2009. Regulatory capital is calculated as the sum of both a multiple of VaR and a multiple of SVaR. Nevertheless, the National Bank of Belgium requires Dexia to apply a floor of 2.5 times the VaR capital charge while calculating the SVaR capital charge.

The portfolios covered by the internal model are located in Dexia Crédit Local, in Paris and New York, and are exclusively composed of derivatives. As part of the independent price verification, their valuation is checked against external sources so as to assess the performance of the valuation models used.

Standard approach

Dexia uses the standard approach for the CVA hedge portfolio, foreign exchange and, specific interest Market Risk as well as Dexia Crediop's portfolio that were not covered by regulatory approval.

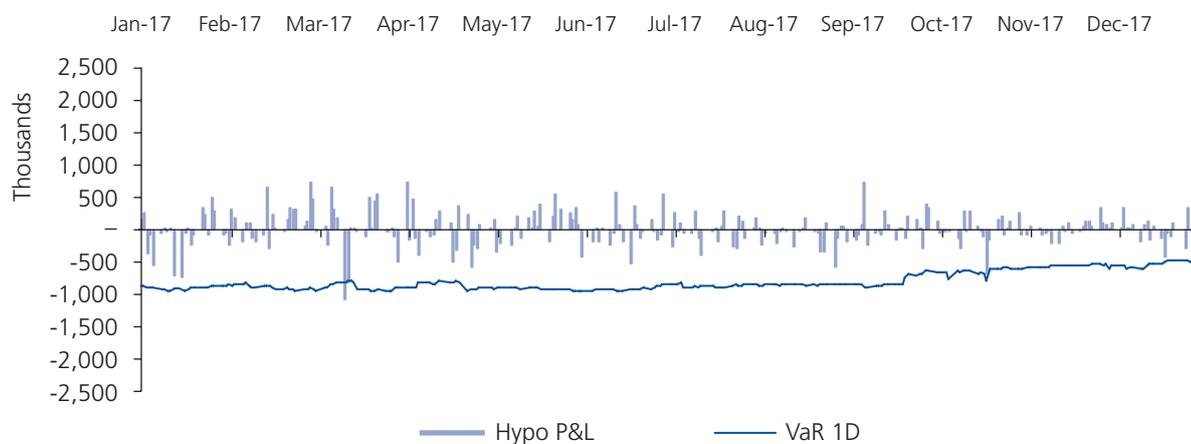
3.1.3.2. Back-testing

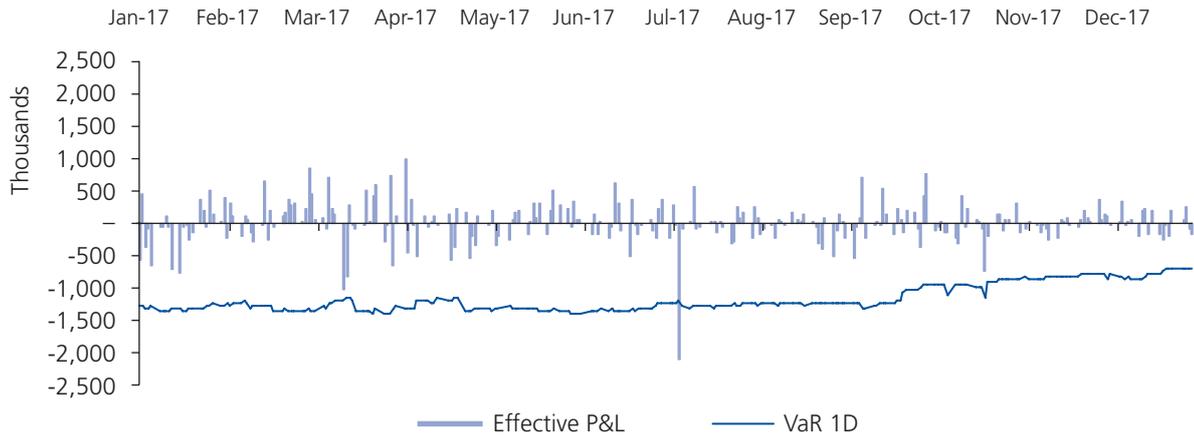
Back-testing is performed on a daily basis on the internal model perimeter. The result of the back-testing is the number of losses exceeding their corresponding VaR figures (i.e. “the number of exceptions”). For back-testing purposes, the VaR amounts need to be recalculated using a 1-day holding period. For VaR figures calculated under a parametric approach, rescaling is achieved through the application of a square root of 10 conversions. 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 challenge the robustness of the Dexia model better.

Back-testing is performed both on actual and hypothetical changes in the portfolio's value. Hypothetical back-tests are run under the scenarios of change in interest rate alone. 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 2017, Dexia noticed 3 “downward” exceptions on its IR perimeter on internal models (compared with six in 2016).

Back-testing results for 2017





3.1.4. 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.

3.1.5. 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 (MRC) meets to analyse the risk and results, possibly to adjust 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 of its capacity to deliver correct valuations. The results are discussed in the Valuation & Collateral Committee (VCC) and if necessary, this committee puts in place an action plan to improve the valuation strategies.

4. Transformation risk

Dexia's asset and liability management (ALM) aims to reduce liquidity risk as far as possible and to limit exposure to interest rate and foreign exchange risk of positions in the banking book

4.1. Management of interest and exchange rate risk

4.1.1. Measurement of interest rate risk

Interest rate risk is measured and monitored via two sets of indicators:

- Interest rates gaps between assets and liabilities;
- The sensitivity of the net present value of accrued interest positions to a 1% shift (upward / downward) of the interest rate curve.

The overall and partial sensitivities by time bucket are the main risk indicators used by the ALM risk committee, organised within the ALCO, 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 interest rate risk related to behaviour on loan prepayment and non-maturity deposits is non material considering Dexia's portfolio.

The sensitivity of long-term ALM was EUR +13.9 million as at 31 December 2017, compared with EUR +8.8 million as at 31 December 2016. This is in line with the ALM strategy, which seeks to minimise income statement volatility.

(in EUR million)	2016	2017
Sensitivity	+8.8	+13.9
Limit	+/-80	+/-80

4.1.2. Measurement of foreign exchange risk

With regard to foreign exchange, the ALCO decides on the policy to hedge foreign exchange risk generated by the existence of assets, liabilities, income and expenditure in currencies. The monitoring of the foreign exchange exposure stemming from highly likely income (notably accrued interest) is delegated to the local ALCOs, within strict limits defined by currency that are reviewed on a monthly basis.

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.

4.2. Management of liquidity risk

4.2.1. Dexia's policy on the management of liquidity risk

Dexia's main objective is to manage the liquidity risk in euros 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 existing transactions into account 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 funding 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 supervisory 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 matters, and the Funding and Markets activity line;
- The twelve-month funding plan is sent monthly to the State shareholders and guarantors, central banks and supervisory authorities;
- Twice-monthly conference calls are held with the European, French and Belgian supervisory authorities and central banks.

4.2.2. Liquidity risk measurement

In 2015, the European Central Bank (ECB) decided to apply a tailored, pragmatic and proportionate prudential supervisory approach to Dexia. This approach was extended in 2016 and 2017.

The ECB informed Dexia that this approach would be renewed in 2018⁽³⁾. Nevertheless, that renewal is accompanied by a convergence towards the general supervisory framework, reflected by the strengthening of certain requirements, in particular regarding observance of the Liquidity Coverage Ratio (LCR). Indeed the requirement applicable to Dexia by virtue of the Liquidity Coverage Ratio (LCR) amounted, as at 1 January 2018, to a minimum of 100% at company and consolidated levels. If this minimum level is not kept, Dexia will have to guarantee observance of a threshold of 80% at a consolidated level over the year 2018 and to inform the ECB thereof by submitting to it new LCR projections as well as a remediation plan.

The Dexia Group posted a consolidated LCR ratio of 111% as at 31 December 2017, against 80% as at 31 December 2016.

Further information on liquidity is provided in the section "Information on capital and liquidity" in Dexia's annual report 2017.

4.2.3. Asset encumbrance

Assets

	31 December 2017			
	Carrying amount of encumbered assets	Fair value of encumbered assets	Carrying amount of unencumbered assets	Fair value of unencumbered assets
Assets	98,618		82,320	
Equity instruments	0	0	189	189
Debt securities	41,387	40,098	14,778	13,252
Other assets	57,231		67,353	

	31 December 2016			
	Carrying amount of encumbered assets	Fair value of encumbered assets	Carrying amount of unencumbered assets	Fair value of unencumbered assets
Assets	116,172		96,599	
Equity instruments	0	0	211	211
Debt securities	48,257	45,520	24,458	24,132
Other assets	67,914		71,930	

Collateral received

	31 December 2016		31 December 2017	
	Fair value of encumbered collateral received or own debt securities issued	Fair value of collateral received or own debt securities issued available for encumbrance	Fair value of encumbered collateral received or own debt securities issued	Fair value of collateral received or own debt securities issued available for encumbrance
Collateral received	2,772	347	2,225	173
Equity instruments	0	0	0	0
Debt securities	106	138	0	0
Other collateral received	2,666	0	2,225	173
Own debt securities issued (*)	0	0	0	0

(*) Other than own covered bonds or ABS.

(3) Cf. Dexia Press Release dated 5 February 2018, available at www.dexia.com.

Encumbered assets/collateral received and associated liabilities

	31 December 2016		31 December 2017	
	Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued	Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued
Carrying amount of selected financial liabilities	125,350	117,402	97,901	99,643

5. Operational risk

Dexia's policy regarding operational risk management consists of regularly identifying and assessing the various risks and implementing corrective actions or improvements to reduce the most significant operational risks. This system is supplemented by a prevention policy in particular covering information security, business continuity and, when necessary, the transfer of certain risks via insurance.

5.1. Risk measurement and management

Operational risk management has been identified as one of the pillars of Dexia's strategy within the context of its orderly resolution.

This risk is monitored 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, almost 99% of losses under the Basel definition originated from the category "Execution, Deliveries and Process Management". The other categories ("External Fraud" and "Failure of Systems or IT Infrastructure") represent 12% of the total number of incidents but less than 1% of total losses. The principal incidents are subject to corrective actions approved by the 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. The overall mapping is presented each year to the Management Board. 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.
- Key Risk Indicators (KRI): KRI have been developed and enable the Operational Risk Committee to monitor the evolution of the principal 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 procedures 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.

5.2. Management of operational risk during the resolution period

The transformation of the Dexia Group within the context of its orderly resolution is by nature propitious to the development of operational risks. In 2017, the operational risk department developed several initiatives to strengthen the analysis, measurement and management of those risks:

- Definition and introduction of operational continuity risk indicators in particular enabling the Management Board and Board of Directors to monitor IT, HR and outsourcing risks.
- Development of a new more complete and granular methodology for analysis of the causes and consequences of operational incidents.
- Application of that risk analysis to the transformation of activities (outsourced activities and financial market activities) and to the main mapped critical processes of the Group and the definition and monitoring with the business lines of action plans to reduce and to limit the highest operational risks over the short and medium term.

6. Remuneration policies and practices

It has been decided since 12 March 2015, in order to take account of the transposition of the European banking directive, known as CRD IV, into Belgian law and French law, to split the Appointments and Remuneration Committee into an Appointments Committee, on the one hand, and a Remuneration Committee, on the other, both with powers relating to Dexia and Dexia Crédit Local.

Dexia's remuneration policy has been established by the Human Resources department in collaboration with the Audit, Risk and Compliance, Legal & Tax departments.

Dexia has adopted one overall remuneration policy for the whole of the Group. This policy has been submitted, after approval by the Board of Directors, to the entities for formal approval by their competent bodies, in accordance with the rules and procedures stated in the company's articles of association.

Dexia modified its remuneration policy in August 2017 in order to take into account the behavioural commitments made by the Belgian and French States to the European Commission regarding remuneration. In order to guarantee attractive and competitive remuneration, external remuneration consultancies may be used to obtain information about developments in pay on the employment market in the financial sector.

Taking the benchmarking analyses into account, the Remuneration Committee makes proposals to the Board of Directors regarding any adjustments in terms of the remuneration paid to the members of Dexia's Management Board. These adjustments would be justified by market developments, taking account of the company's situation.

6.1. Fixed and variable remuneration

The remuneration of staff whose professional activities have a significant impact on the risk profile is made up of a fixed part that may be accompanied by a variable part.

6.1.1. Fixed remuneration

Fixed remuneration may be made up of basic remuneration, determined considering the nature and importance of the responsibilities assumed by each staff member, plus a 'function bonus' or salary supplement that is not affected by performance, paid quarterly.

This supplement was introduced correlatively to the decision by the Board of Directors to reduce variable remuneration based on performance in order to reduce the potential incentive to take excessive risks. In this way the Board, in accordance with the statutory and regulatory provisions in the matter, has increased remuneration not linked to performance, which must represent a significant proportion of the whole of the remuneration.

Remuneration for Management Board members is based exclusively on a fixed element, with no performance conditions, and constitutes a whole from which, unless the Board of Directors decides otherwise on a proposal from the Remuneration Committee, a deduction is made of any director's fees or percentage paid to a Management Board member by a Dexia Group company or by a third party company in which an office is held in the name and on behalf of Dexia.

6.1.2. Variable remuneration

Members of the Management Board have no contractual right to receive variable remuneration.

As a rule, in order to discourage excessive risk-taking and to allow a sufficiently flexible policy of granting variable compensation, the maximum ratio observed between fixed and variable compensation is 1 (fixed compensation) to 0.3 (variable compensation).

Exceptionally, this ratio may reach 0.5 in case of premium having the goal to keep the necessary competencies to maintain the operational continuity. In any case, variable remuneration will not exceed EUR 75,000.

Given the ratios set out above, the variable remuneration paid to an employee will not be deferred over time, except where there is an exception such as keeping key competencies (cf. paragraph above). Nevertheless, the company reserves the right to apply a retrospective clawback adjustment in certain cases (See below).

6.1.3. Retrospective clawback adjustment of variable remuneration

Payment of variable remuneration is based on the premise that, as long as the employee is working within the Group, he or she fully observes the law and the rules that apply to the company, as well as its values. Variable remuneration may be the subject of retrospective clawback adjustments.

In the event of fraud being observed after the allocation of variable remuneration, and in cases where variable remuneration might have been granted on the basis of intentionally erroneous information, the Board of Directors of Dexia reserves the right to bring civil action with a view to recovering the part of the variable remuneration which might already have been paid, or at least damages to remedy the consequences of those actions.

6.2. Link between performance and remuneration

Performance may influence movements in fixed remuneration and the amount of any variable remuneration.

All variable remuneration is influenced by the company's situation and may fluctuate based on the results of the Group, of the entity and the individual performance. In compliance with statutory constraints and obligations, any variable remuneration that may have been granted may therefore be reduced to zero, by decision of the Board of Directors, if the Group's collective results are negative.

The link between the variable remuneration and employee performance is assessed with regard to former targets and results expected in the future, linked to past activity.

When being determined, the directors' targets, set by the Board of Directors, include the risk criteria. Subsequently, the targets streamed down to lower levels of the organisation will also take account of the risk factors specific to the business line in question.

When monitoring performance, targets that are specifically risk-oriented will be subject to the same monitoring as other performance targets. Performance is assessed on the basis of quantitative and qualitative, financial and non-financial criteria. Professional performance is therefore an element taken into account when determining variable remuneration, but is just one element among others.

6.3. Quantitative information

The information regarding the remuneration of the Management Board is disclosed in the chapter entitled "Terms of office and remuneration of directors and officers" of Dexia Crédit Local's registration document 2017, as well as in the chapter entitled "Declaration of corporate governance" published in Dexia's annual report 2017.

	Number of staff ⁽¹⁾	Compensation			Severance payments			A posteriori adjustment of variable compensation
		Fixed	Variable ⁽²⁾	Retention premium	Number of beneficiaries	Paid amounts	Highest paid amount	
Management Board members	6	2,95	0	0	0	0	0	0
Other staff ⁽¹⁾	37	7,87	1,12	0,03	5	1,90	0,95	0

(1) This table is related to executives and staff members whose activity has a significant material impact on the Group risk's profile.

(2) In light of the applicable ratios between fixed and variable pay, the payment of the variable remuneration will not be deferred.

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 evolution 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). The BIS receives deposits from, and makes loans to, these entities. The 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 the BIS.
CCF Credit Conversion Factor	The ratio of the currently undrawn amount of a commitment that will be drawn and outstanding at default to the currently undrawn amount of the commitment. The extent of the commitment will be determined by the advised limit, unless the unadvised limit is higher.
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.
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 Credit Valuation Adjustment	The Credit Valuation Adjustment (CVA) is one of the components of the fair value (FV) of derivatives. CVA adjusts FV in order to take counterparty risk into account.
CVA capital charge	Under Basel III, banks are subject to a "CVA" capital charge for potential mark-to-market losses associated with any deterioration in the creditworthiness of a counterparty. The CVA capital charge corresponds to a Value At Risk (VaR) applied to CVA.
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.

Concept	Definition
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 a 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 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 with which the debtor is considered unable to comply 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 that will be more sensitive to an institution’s individual risk profile. This is to be achieved by introducing 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. 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 on 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.
LCR Liquidity Coverage Ratio	A 30-day 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.

Concept	Definition
Leverage Ratio	The leverage ratio is defined as the “capital measure” (the numerator) divided by the “exposure measure” (the denominator) and is expressed as a percentage. The capital measure is currently defined as Tier 1 capital and the minimum leverage ratio is 3%. The leverage ratio is intended to (i) restrict the build-up of leverage in the banking sector to avoid destabilising deleveraging processes that can damage the broader financial system and the economy and (ii) reinforce the risk-based requirements with a simple, non-risk based “backstop” measure.
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) the total assets of which, 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.
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 and advances as well as 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 to 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 the most significant risk areas in a coherent way across entities and activities. RCSA also includes the identification, challenging and description of key controls and indicators and eventually defines action plans that will allow for an improvement of 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.
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.
Asset Encumbrance	An asset will be treated as encumbered if it has been pledged or if it is subject to any form of arrangement to secure, collateralise or credit enhance any transaction from which it cannot be freely withdrawn.

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 Risk Models, Quantification & Defaults 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...).

Model development and/or review

The different steps of models development are:

- The major stages for model design process are the following: Defining the scope of the model application;
- Identifying and gathering the most pertinent available data like financial data, data on defaults and recoveries (internal and/or external data), institutional and legal framework...;

- Building a database for the purpose of modelling, calibration of risk parameters (internal and/or external default, financial and qualitative information, internal data on recovery process, etc.); the database source depends on the case at hand, with a preference for objective above subjective data and a long data history. The data source varies by model. The data quality is checked by RMQD analysts before launching the testing phase;
- Defining the methodology: expert, statistical or mixed statistical and expert approaches, definition of a broad list of financial ratios or / and qualitative criteria, definition of material risk drivers for discrimination, computation of quantitative and qualitative criteria according to the type of model chosen;
- Model construction
 - Testing ratios methods and/or material risk driver for discrimination in an interactive way between quantitative analysts from RMQD and qualitative analysts from CEC teams when necessary. Testing ratios, methods and/or material risk driver for discrimination in an interactive way between quantitative analysts from RMQD and qualitative analysts from CEC teams when necessary.
 - Segmentation (per homogeneous group or segment) and calibration (through-the-cycle average and conservative margin) steps:
- Model Evaluation: Expert evaluation, Formal backtest, Statistical performance, Criteria to rank models;
- Documentation writing: Model documentation and documentation to be disclosed to the Supervisor;
- Validation: Internal validation (validation team and internal audit, ad hoc committees (COTEC, VAC, Risk EXCOM));
- Information to the Supervisor;
- Model Implementation in IT systems;
- Adapting risk policies and tools to take IRSs into account.

Nevertheless, some steps in the development process detailed above are not applied.

- 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 Risk Models, Quantification & Defaults division is responsible for the entire process linked to the model review, including the maintenance of the model. The main model maintenance steps encompass:

- Centralising, analysing and storing of default data;
- Coordinating 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;
- Conducting 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 at present are 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 those 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 company or a listed publicly owned company with total annual revenues higher than EUR 50 million or belonging to a Group with total annual revenues 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 in 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 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, and public facility lease. Every local government or public authority generally has one or more 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. In particular, this field is 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 that 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 may or may not eventually lead to a provision). See above in section 3.5

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 90 days	> 10 years	External
Banks		Default at 90 days	> 10 years	External and internal
Local public sector		Default at 90 days (except for French: 180 days until Dec 31, 2016)	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

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

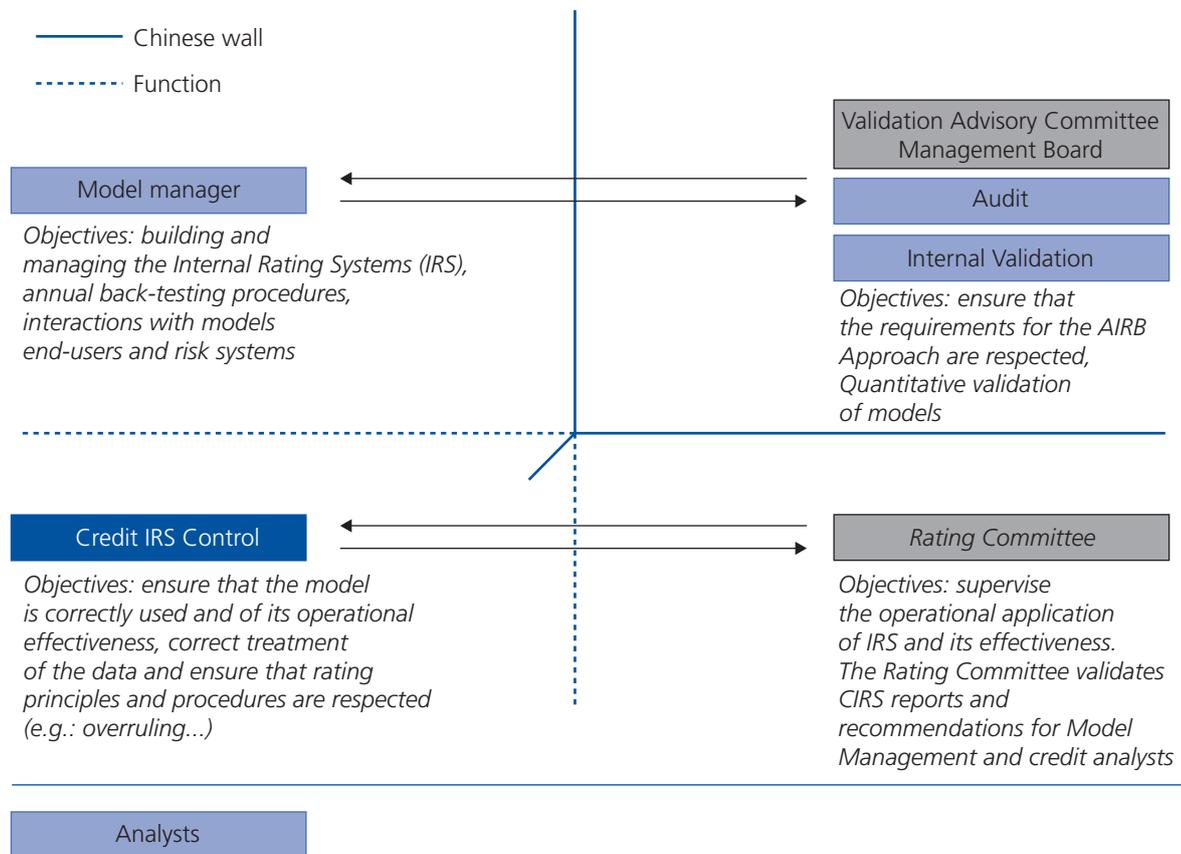
Types of counterparties	Main hypotheses	Time series used	Internal/ external data
Western Europe local authorities	Statistical model based on the internal existing default cases observed on our portfolio. Final LGD are segmented on both socio-economic criteria and indicator reflecting the financial flexibility	> 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, the 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, Reporting & Risks Systems department. Chinese walls are built between Model manager and Validation,

Risk Models, Quantification & Defaults (RMQD) and Rating Committee (RC) and CIRS and Audit ensure 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 to explain 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 on the model) reflect the monitoring of existing issues related to the model in question. These controls encompass:

- Monitoring the models' use and environment changes;
- Monitoring the models' scope (in/out, grey zones);
- Overruling (when human judgment overrides model outputs) ;
- Verifying the correct application of the rating guidelines and procedures (mother support/Branch Equivalency, country ceilings, re-rating, piercing of LCCC & FCCC, country/mother company downgrade impacts, rating inheritances on counterparties etc.);
- Correcting the data input of the internal IT system (ratings, LGD, CCF) and data recording;
- Consistency tests on past-dues files and the exhaustiveness of the default files on the period under review
- Additional tests on the default qualification process based on documentation.
- Sample controls on counterparties under review to check the exhaustiveness of the defaults
- Maintaining the audit trail of the rating process;
- Reporting malfunctions and monitoring remedial actions.
- Having up to date documentation of the rating system controls processes

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 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 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 these are validated by the Validation Advisory Committee (VAC).

In case of disagreement between the Credit IRS Control and the Credit Expertise Centres (CEC) or Risk Models, Quantification & Defaults divisions (on a recommendation or a rating reviewed), the Committee has a veto right and the possibility to escalate to the Risk Management Executive Committee and/or to the Internal Control Committee.

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, Risk Models, Quantification & Defaults, 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, as the CIRS control function:

- Is independent from the credit analysis function (model users);
- Submits their proposals to the Rating Committee;
- Informs the Validation function on any subject concerning IRS or modes of applying the IRS within the Group.

Model validation department

Dexia monitors its solvency using rules and ratios established by the Basel Committee on Banking Supervision and the European Capital Requirements Directive. The application of this approach requires a validation process to ensure that the internal models are conceptually sound while adequately capturing all material risks.

Formally a model is defined as a quantitative method, system, or approach that applies statistical, economic, financial, or mathematical theories, techniques, and assumptions to process input data into quantitative estimates:

- Models based on observations of historical data and some statistical assumptions. This kind of model is fully statistics-driven.
- Models based on some assumptions of behaviour of agents in the market. These models try to use a system of equations to simulate the market and thus to calculate the risks.
- Models that share the characteristics of the two previous categories.

Model validation department

All the models used within Dexia, either market risk models, pricing models, Basel Pillar 1 credit rating models, IFRS 9 models, ALM models and economic capital models have to be validated by an independent entity.

The Validation department ensures 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 department 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 Validation Advisory Committee (VAC) in order to obtain an approval;
- To inform the Management Board and the Audit Committee frequently of the model validation status

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 regulatory requirements through the work-out of proposals by the Validation department, an approval of those proposals by the VAC. 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 and IFRS 9 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 and 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

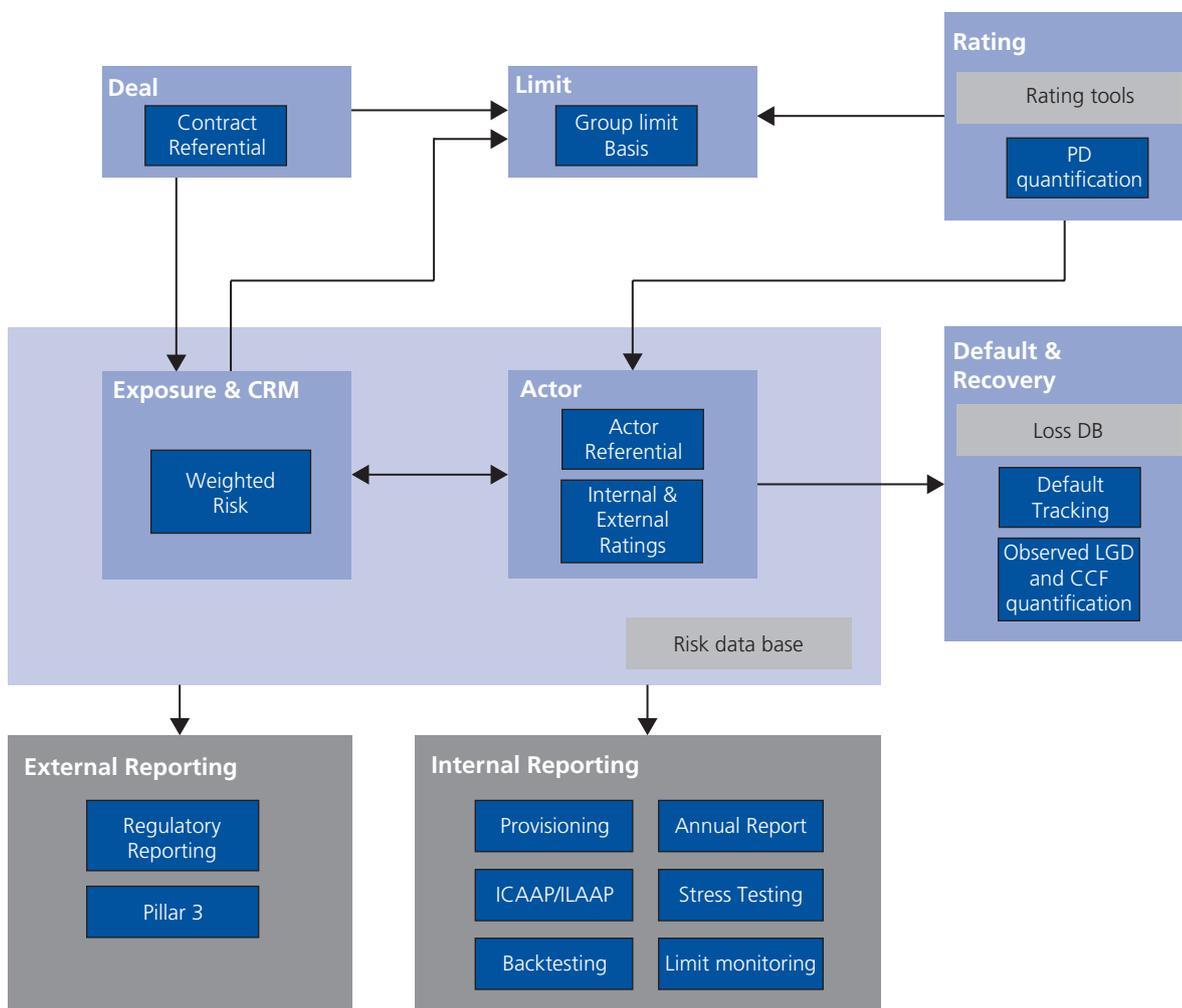
According to Article 191 of the CRR, “Internal audit or another comparable independent auditing unit shall review at least annually the institution's rating systems and its operations, including the operations of the credit function and the estimation of PDs, LGDs, ELs and conversion factors. Areas at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

At Dexia the CIRS Control division performs this annual verification. Internal Audit operates as an additional control layer and periodically verifies that the overall credit model processes are followed in accordance with the applicable regulation and internal guidelines and procedures.

4. Credit risk IT system

Dexia Credit Risk IT Systems is centralised with all Group exposure and counterparties for all Dexia entities. Since March 2014, Credit Risk Systems has been 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



The core of credit risk IT systems is built around actor and exposure information. Both concepts are united in 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 counterpart (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 actors' database.

The second component of the central risk database is the exposure and CRM universe. A precise view of the exposure with significant amount valuations (nominal, outstanding, mark-to-market, accrued interests, and so on) are combined with the credit risk mitigants (collateral and guarantees) to provide an integrated risk view of the positions taken by the Group.

Around central risk, three other data sets are situated for different purposes.

- The contract referential databases containing (product type, seniority level, maturity...).
- In limit databases current limits on any credit counterpart (limit database) are defined using the counterpart 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 system is linked to a reporting infrastructure allowing credit risk reports to be produced on the basis of the information gathered at different levels. All these IT and reporting systems support general risk monitoring for both internal and external purposes as there are:

- External reporting: regulatory reporting (CoRep, LE, LR, STE, EBA Benchmarking), Pillar 3;
- Internal risk reporting: cost of risk calculations and provisioning, reporting in relation to the risk appetite framework, the ICAAP (Internal Capital Adequacy Assessment Process) and ILAAP (Internal Liquidity Assessment Process), AIRB model back-testing and stress-testing, limit monitoring, annual report.

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.

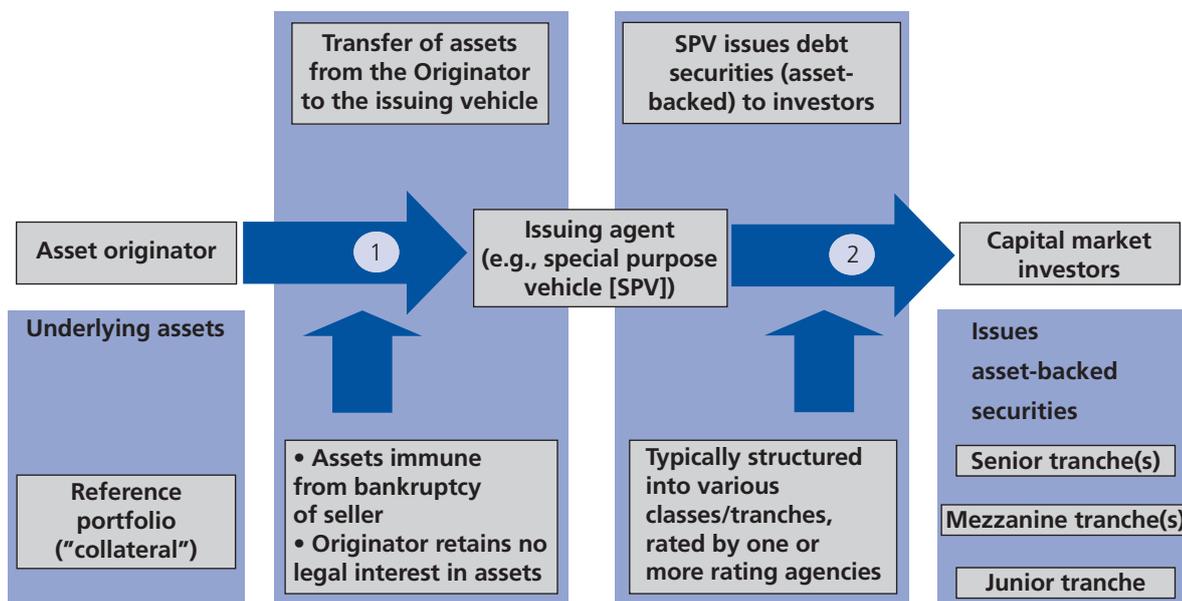
The originator initially owns the assets engaged in the deal. This is typically a company looking to seek financing or to raise capital.

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 financial guarantors 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

In the past Dexia Group entities Dexia Crédit Local and Dexia Crediop issued securitisation transactions to obtain long-term funding or constitute a liquidity buffer. The risk was not transferred outside the Group. DCL has not initiated new securitisation transaction since 2010. Dexia Crediop securitisation TEVERE Finance SRL and Dexia Crédit Local securitization TRIPLUS – 2010 have been sold/unwind in 2017.

Synthetic securitisations of Dexia as originator

Wise transaction

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.

The vehicle 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 2017 the rating of the Class A notes was BB-/B2, the rating of Class B notes was B-/Caa1 and the rating of the Class C notes was CCC/Caa3 (S&P and Moody's respectively).

The tranches were placed with several investors.

The bonds (underlying assets) remain on the Dexia Crédit Local Dublin Branch balance sheet and will continue to be administered by the company.

The portfolio amounted to an outstanding notional of GBP 891 million (EUR 1,003 million) as at 31 December 2017.

DCL credit risk teams are responsible for the credit risk follow-up of the underlying portfolio; a monthly and quarterly report is sent to the investors in the CLN notes and the super senior CDS counterparty.

Appendix 5

Complement on subsidiaries

1. Dexia Kommunalbank Deutschland (DKD)

1.1. Accounting and regulatory equity figures

(in EUR million)	31/12/2016			31/12/2017		
	Financial statements	Regulatory purposes	Variation	Financial statements	Regulatory purposes	Variation
Equity, DKD solo	663	654	9	665	663	2
<i>of which share capital and related reserves</i>	433	433	0	433	433	0
<i>of which reserves</i>	349	349	0	349	349	0
<i>of which gains and losses directly recognised in equity</i>	(118)	(123)	5	(116)	(118)	2
<i>of which net result of the period</i>	0	(4)	4	0	0	0
Other intangible assets	0	0	0	0	0	0
Minority interests	0	0	0	0	0	0
TOTAL EQUITY			0			0
Common Equity Tier 1	663	654	9	665	662	2
Tier 2	64	27	36	34	19	15
TOTAL CAPITAL	727	681	46	699	681	17

1.2. Capital requirements by type of risk

(in EUR million)			31/12/2016		31/12/2017	
Type of risk	Basel III treatment	Exposure class	Weighted risks	Capital requirements	Weighted risks	Capital requirements
Credit risk	Advanced	Central governments or central banks	1,504	120	1,429	114
		Corporates - Specialised lending	9	1	8	1
		Corporates - Other	8	1	5	0
		Institutions	393	31	269	22
		Other non credit-obligation assets	11	1	8	1
		Total	1,925	154	1,719	137
		Risk exposure amount for contributions to the default fund of a CCP	0	0	2	0
	Standard	Central governments or central banks	49	4	45	4
		Corporate	160	13	116	9
		Institutions	285	23	229	18
		<i>of which CVA</i>	262	21	203	16
		Public sector entities	177	14	158	13
		Regional governments or local authorities	12	1	11	1
Other items		220	18	191	15	
Total	903	72	750	60		
Market risk	Standard	Interest rate risk	0	0	0	0
		Foreign exchange risk	36	3	33	3
		Total	36	3	33	3
Operational risk	Standard		76	6	62	5
TOTAL			2,940	235	2,566	205

1.3. Capital adequacy

(in EUR million)	31/12/2016	31/12/2017
Total Capital	681	681
Common Equity Tier 1	653	662
Total Weighted Risks	2,941	2,566
Total Capital Ratio	23,1%	26.6%
Common Equity Tier 1 ratio	22,2%	25.8%

1.4. Exposure at default by geographic distribution

(in EUR million)	31/12/2017								31/12/2016	
	Central governments or central banks	Corporate	Exposures in default	Institutions	Multilateral development banks	Other items	Public sector entities	Regional governments or local authorities	Total	Total
Austria	1,024	0		10	0	0	0	0	1,034	1,087
Belgium	179	251		30	0	4	786	0	1,250	1,416
Finland	21	0		0	0	0	0	0	21	23
France	0	0		1,775	15	47	0	0	1,838	1,209
Germany	10,876	766		1,717	0	196	330	191	14,075	15,795
Hungary									0	90
Italy	3,099	0		466	0	0	0	57	3,622	3,671
Japan	224	0		0	0	0	0	0	224	245
Luxembourg	0	0		0	85	0	0	0	85	85
Netherlands	0	0		25	0	0	0	0	25	68
Poland									0	110
Portugal	589	100		0	0	0	125	0	814	815
Spain	19	0		0	0	0	0	0	19	450
Sweden	36	0		0	0	0	0	0	36	79
United Kingdom	0	0		256	63	0	0	0	319	376
United States	0	0		253	105	0	0	0	358	478
TOTAL	16,067	1,117	0	4,533	268	247	1,241	247	23,720	25,996

1.5. Exposure at default by economic sector

(in EUR million) Economic sector	31/12/2017								31/12/2016	
	Exposure value pre adjustments								Total	Total
	Central governments or central banks	Corporate	Institutions	Multilateral development banks	Other items	Public sector entities	Regional governments or local authorities			
Trade tourism	0	0	0	0	0	0	20	0	20	25
Transportation and storage	0	22	0	0	0	0	6	0	28	46
Information and communication	0	8	0	0	0	0	0	0	8	76
Financial and insurance activities	63	1	4,041	268	0	0	0	139	4,511	4,505
Real estate activities	192	139	0	0	0	0	3	0	334	1,455
Professional, scientific and technical activities	6	14	0	0	0	0	0	0	20	0
Administrative and support service activities	13	3	0	0	0	0	0	0	16	1,333
Public administration and defense-compulsory social security	14,118	605	492	0	5	878	109	0	16,207	16,783
Electricity, gas, steam and air conditioning supply	27	204	0	0	0	17	0	0	247	0
Water supply, sewerage, waste management and remediation activities	643	23	0	0	0	233	0	0	899	0
Human health and social work activities	6	49	0	0	0	63	0	0	118	389
Arts, entertainment and recreation	2	42	0	0	0	2	0	0	46	5
Education	0	2	0	0	0	0	0	0	2	0
Other service activities	51	5	0	0	0	0	0	0	56	62
Other services	946	0	0	0	242	19	0	0	1,207	1239
TOTAL	16,067	1,117	4,533	268	247	1,241	247	247	23,720	25,996

1.6. Exposure covered by credit risk mitigants by exposure class

(in EUR million)	31/12/2016		31/12/2017	
	Financial and physical collateral	Guarantees and credit derivatives	Financial and physical collateral	Guarantees and credit derivatives
Corporates	356	900	300	668
Institutions	2,049	403	3,035	341
Public sector entities	0	1,014	0	860
Retail	0	997	0	946
TOTAL	2,405	3,314	3,335	2,815

1.7. Overview of impairments

(in EUR million)	As at 1 January 2017	Additions	Reversals	Other adjustments	As at 31 December 2017
General credit risk adjustments	20	14	0	0	34
Specific credit risk adjustments	11	0	0	(5)	6
TOTAL	31	14	0	(5)	40

1.8. Overview of impaired and defaulted financial assets

Nil

1.9. Remuneration

	MB Supervisory function	MB Management function	Commercial Banking	of which: independent control functions
Members (Headcount)	6	2		
Total number of staff in FTE (full time equivalents)			71,39	14,00
Total remuneration (in EUR)	24,000	686,458	5,193,085	1,177,398
Of which: variable remuneration (in EUR)	0	50,000	322,000	72,027

	MB Supervisory function	MB Management function	Commercial Banking	of which: independent control functions
Members (Headcount)	3	2		
Number of identified staff ⁽¹⁾ in full time equivalents			17,00	5,00
Total fixed compensation (in EUR)	24,000	636,458	1,389,142	459,340
Of which: fixed in cash	24,000	636,458	1,389,142	459,340
Total variable compensation (in EUR)	0	50,000	145,418	36,858
Of which: variable in cash	0	50,000	145,418	36,858
Total amount of variable remuneration which has been deferred (in EUR)	0	0	0	0

(1) Staff whose professional activities have a material impact on the institutions risk profile according to Article 92(2) of Directive 2013/36/EU; year-end numbers.

1.10. Leverage ratio

As at 31 December 2017, the leverage ratio calculated at DKD level reached 3.18%.

Summary comparison of accounting assets against leverage ratio exposure measure

LEVERAGE EXPOSURE: RECONCILIATION WITH TOTAL BALANCE SHEET	31/12/2016	31/12/2017
TOTAL BALANCE SHEET	28,809.79	24,624.98
Neutralisation of the balance sheet value of items whose leverage exposure is different from that of the balance sheet		
Trading derivatives (assets)		
Hedging derivatives (assets)		
SFT (assets)		
Cash collateral (paid)		
Adjustments for derivative financial instruments	(4,717.99)	(3,898.27)
Adjustment for securities financing transactions (SFTs)	31.12	33.40
Adjustment for off-balance sheet items	43.05	16.42
Other adjustments	29.94	32.05
TOTAL LEVERAGE EXPOSURE	24,195.90	20,808.59

Leverage ratio common disclosure template

	2016	2017
On-balance sheet exposures		
1 On-balance sheet items (excluding derivatives and SFTs, but including collateral)	28,574.08	24,472.68
2 (Asset amounts deducted in determining CRR Tier 1 capital)	(0.36)	(0.45)
3 Total on-balance sheet exposures (excluding derivatives and SFTs) (sum of lines 1 and 2)	28,573.73	24,472.23
Derivative exposures		
4 Replacement cost associated with all derivatives transactions (where applicable net of eligible cash variation margin and/or with bilateral netting)	33.77	1.73
5 Add-on amounts for PFE associated with all derivatives transactions	294.26	247.22
6 Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the operative accounting framework	0.00	0.00
7 (Deductions of receivables assets for cash variation margin provided in derivatives transactions)	(5,046.02)	(4,147.22)
8 (Exempted CCP leg of client-cleared trade exposures)	0.00	0.00
9 Adjusted effective notional amount of written credit derivatives	0.00	0.00
10 (Adjusted effective notional offsets and add-on deductions for written credit derivatives)	0.00	0.00
11 Total derivative exposures (sum of lines 4 to 10)	(4,717.99)	(3,998.27)
Securities financing transaction exposures		
12 Gross SFT assets (with no recognition of netting), after adjusting for sale accounting transactions	266.00	184.80
13 (Netted amounts of cash payables and cash receivables of gross SFT assets)	0.00	0.00
14 CCR exposure for SFT assets	31.12	33.40
15 Agent transaction exposures	0.00	0.00
16 Total securities financing transaction exposures (sum of lines 12 to 15)	297.12	218.21
Other off-balance sheet exposures		
17 Off-balance sheet exposure at gross notional amount	43.05	16.42
18 (Adjustments for conversion to credit equivalent amounts)	0.00	0.00
19 Off-balance sheet items (sum of lines 17 and 18)	43.05	16.42
Capital and total exposures		
20 Tier 1 capital	653.46	662.38
21 Total exposures (sum of lines 3, 11, 16 and 19)	24,195.90	20,808.59
Leverage ratio		
22 CRR leverage ratio according to Delegated Act	2.70%	3.18%

2. Dexia Crediop

2.1. Accounting and regulatory equity figures

(in EUR million)	31/12/2016			31/12/2017		
	Financial statements	Regulatory purposes	Difference	Financial statements	Regulatory purposes	Difference
Equity, Crediop solo	946	946	0	942	942	0
<i>of which share capital and related reserves</i>	1,083	1,083	0	969	969	0
<i>of which gains and losses directly recognised in equity</i>	(143)	(143)	0	(29)	(29)	0
<i>of which net result of the period</i>	5	5	0	2	2	0
Minority interests	0	0	0	0,00	0,00	0
TOTAL EQUITY	946	946	0	942	942	0
Prudential filters	0	39	39	0	(16)	(16)
Common Equity Tier I	946	984	39	942	926	(16)
Tier II	0	58	58	0	19	19
TOTAL CAPITAL	946	1,042	97	942	945	3

2.2. Capital requirements by type of risk

(in EUR million)			31/12/2016		31/12/2017		
Type of risk	Basel III treatment	Exposure class	Weighted risks	Capital requirements	Weighted risks	Capital requirements	
Credit risk	Advanced	Corporate	91	7	72	6	
		Financial Institutions	1,038	83	880	70	
		Project Finance	169	14	46	4	
		Equities			49	4	
		Securitisation			-	-	
		Sovereign	2,411	193	2,123	170	
			Total	3,709	297	3,170	254
	Standard	Corporate	171	14	173	14	
		Equities	1	0	-	-	
		Financial Institutions	396	32	336	27	
Public sector entities		109	9	93	7		
		Total	677	54	602	48	
Market risk	Standard	Interest rate risk	204	16	175	14	
		Total	204	16	175	14	
Operational risk	Basic		87	7	113	9	
TOTAL			4,677	374	4,060	325	

2.3. Capital adequacy

(in EUR million)		31/12/2016	31/12/2017
Total Capital		962	945
Common Equity Tier 1		905	926
Total Weighted Risks		4,682	4,060
Total Capital Ratio		20.56%	23.28%
Common Equity Tier 1 Ratio		19.32%	22.81%

2.4. Exposure at default by geographic distribution

(in EUR million)	31/12/2017							31/12/2016
	Sovereign	Local Public Sector	Corporate	Project Finance	Financial Institutions	ABS/MBS	Total	Total
Italy	6,323	8,936	306	170	724	0	16,460	18,356
France	0	29	0	0	347	0	377	412
United Kingdom	0	0	99	0	58	0	157	177
Germany	0	0	0	0	44	0	44	45
United States	0	0	0	0	10	0	10	9
Others	0	2	0	0	48	0	50	62
TOTAL	6,323	8,967	405	170	1,232	0	17,098	19,061

2.5. Exposure at default by exposure class and economic sector

(in EUR million)	31/12/2017							31/12/2016		
	Corporate	Financial Institutions	Financial Guarantors	Project Finance	Public Sector Entities	Securitisation	Sovereign	Total	Total	
Industry	76	-	-	82	-	-	-	158	315	
Construction	-	-	-	26	-	-	-	26	28	
Services	Transportation and storage	2	-	2	15	-	-	19	24	
	Financial and insurance activities	-	1,341	99	-	-	7	1,447	1,331	
	Real estate activities	79	-	-	60	-	-	139	146	
	Public administration and defense-compulsory social security	-	-	-	-	8,686	-	6,205	14,891	16,761
	Human health and social work activities	-	-	-	-	224	-	-	224	251
Other services	149	3	-	-	42	-	-	193	205	
TOTAL	306	1,344	99	170	8,967	-	6,212	17,098	19,061	

2.6. Overview of past-due exposure and impairments

(in EUR million)	31/12/2017					
	As at 1 January	Additions	Reversals	As at 31 December	Recoveries directly recognised in profit or loss	Charge-offs directly recognised in profit or loss
Specific impairments	6	17	0	23	0	0
Customer loans and advances	1	16	0	17	0	0
Other accounts and receivables	5	1	0	6	0	0
Collective impairments	27	0	6	21	0	0
Customer loans and advances	27	0	6	21	0	0
TOTAL	33	17	6	44	0	0

(in EUR million)	31/12/2017				Carrying amount of individually impaired financial assets, before deducting any impairment loss
	Past-due but not impaired financial assets			Over 180 days	
	Less than 90 days	91 days to 180 days	Over 180 days		
Loans and advances (at amortized cost) ^{(1) (2)}	272	0	4	17	
Other financial instruments ^{(3) (4)}	1	0	12	0	
TOTAL	273	0	16	17	

(1) Of which EUR 7 million are technical past-dues.

(2) Of which EUR 271.83 million are technical past-dues ("Less than 90 days") and EUR 1.16 million (out of EUR 17.32 million) are also past-dues.

(3) Of which EUR 12.33 million unpaid nettings on derivatives affected by litigation (operational default).

(4) Unpaid nettings on derivatives affected by litigation (operational default).

2.7. Exposure covered by credit risk mitigants by exposure class

(in EUR million)	31/12/2016		31/12/2017	
	Financial and physical collateral	Guarantees and credit derivatives	Financial and physical collateral	Guarantees and credit derivatives
Central governments or central banks	0	8	0	7
Institutions	3,732	216	4,984	199
Regional governments or local authorities	0	1,120	0	972
TOTAL	3,732	1,344	4,984	1,178

2.8. Leverage ratio

As at 31 December 2017, the leverage ratio calculated at Dexia Crediop level reached 5.53%, against 4.29% as at 31 December 2016. This 1.24% increase is due to the exposures decrease.

Summary comparison of accounting assets against leverage ratio exposure measures

LEVERAGE EXPOSURE: RECONCILIATION WITH TOTAL BALANCE SHEET	31/12/2016	31/12/2017
TOTAL BALANCE SHEET	23,402	20,531
Neutralisation of the balance sheet value of items whose leverage exposure is different from that of the balance sheet	6,447	5,266
<i>Trading derivatives (assets)</i>	1,919	1,306
<i>Hedging derivatives (assets)</i>	259	223
<i>SFT (assets)</i>	0	0
<i>Cash collateral (paid)</i>	4,269	3,738
Leverage exposure of derivatives	1,721	1,066
Leverage exposure of reverse repos	0	0
Leverage exposure of repo (liabilities) counterparty credit risk	3,756	371
Leverage exposure of off-balance sheet items	79	63
Leverage exposure adjustment on assets deducted from capital CET1	(41)	(22)
<i>Intangible assets</i>	(3)	(3)
<i>Breach of threshold on deduction on CET1 of instruments from financial institutions</i>	(18)	(10)
<i>Breach of threshold on deductions on AT1 of instruments from financial institutions</i>	(20)	(10)
<i>Additional Value Adjustments</i>	0	0
TOTAL LEVERAGE EXPOSURE	22,472	16,743
Tier 1 Capital, transitional provisions	905	926
Leverage ratio	4.03%	5.53%

Leverage ratio common disclosure template

	31/12/2016	31/12/2017
On-balance sheet exposures		
1 On-balance sheet items (excluding derivatives and SFTs, but including collateral)	21,224	19,003
2 (Asset amounts deducted in determining CRR Tier 1 capital)	(41)	(22)
3 Total on-balance sheet exposures (excluding derivatives and SFTs) (sum of lines 1 and 2)	21,183	18,981
Derivative exposures		
4 Replacement cost associated with all derivatives transactions (where applicable net of eligible cash variation margin and/or with bilateral netting)	1,460	848
5 Add-on amounts for PFE associated with all derivatives transactions	262	218
6 Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the operative accounting framework	0	0
7 (Deductions of receivables assets for cash variation margin provided in derivatives transactions)	0	0
8 (Exempted CCP leg of client-cleared trade exposures)	0	0
9 Adjusted effective notional amount of written credit derivatives	0	0
10 (Adjusted effective notional offsets and add-on deductions for written credit derivatives)	0	0
11 Total derivative exposures (sum of lines 4 to 10)	1,721	1,066
Securities financing transaction exposures		
12 Gross SFT assets (with no recognition of netting), after adjusting for sale accounting transactions	3,756	5,120
13 (Netted amounts of cash payables and cash receivables of gross SFT assets)	(3,485)	(4,749)
14 CCR exposure for SFT assets	0	0
15 Agent transaction exposures	0	0
16 Total securities financing transaction exposures (sum of lines 12 to 15)	271	371
Other off-balance sheet exposures		
17 Off-balance sheet exposure at gross notional amount	122	100
18 (Adjustments for conversion to credit equivalent amounts)	(43)	(38)
19 Off-balance sheet items (sum of lines 17 and 18)	79	63
Capital and total exposures		
20 Tier 1 capital	905	926
21 Total exposures (sum of lines 3, 11, 16 and 19)	23,255	20,481
Leverage ratio		
22 CRR leverage ratio according to Delegated Act	3.89%	4.52%