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KBC Group

Risk Report 2010

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Introduction: highlights in 2010 and disclosure policy

KBC is an integrated bancassurance group, with main focus on retail customers, small and medium-sized enterprises and private banking clientele. It occupies leading positions on its home markets of Belgium and Central and Eastern Europe, where it specialises in retail bancassurance and asset management activities. Elsewhere around the globe, the group has established a presence in selected countries and regions.

Highlights

In the wake of the global financial crisis, 2010 was a year in which there were many internal and external changes and challenges for KBC.

Firmly embedding risk management

Continuing where it left off in 2009, KBC reshaped its risk management governance and structure in 2010 and embedded it more firmly throughout the group. More information in this regard can be found in the 'Risk governance' section of this report.

Concerns regarding sovereign debt

Market concerns regarding the sovereign debt of Southern European countries and Ireland, amongst other countries, dominated the financial sector in 2010. More information on 'sovereign exposure' can be found in the 'Credit risk' section of this report, as well as in the 'Risk Management' section of the 2010 annual report of KBC Group NV (see www.kbc.com).

Stress testing on European level

To assess the resilience of a significant sample of European financial institutions, the Committee of European Banking Supervisors (CEBS) – now known as the European Banking Authority (EBA) – conducted stress tests during the first half of 2010. KBC's results under the CEBS stress scenarios illustrated its ability to meet legal and market requirements with regard to solvency. The EBA will conduct a stress test in the first half of 2011. For more information on the results of the 2010 stress tests, see the 'Capital adequacy' section of this report.

Regulatory challenges

Basel III will gradually introduce more stringent capital and liquidity requirements for banks from 2013 onwards. As regards the current Basel III proposal, KBC will – based on estimates and barring any unforeseen circumstances – be compliant with the new capital and liquidity standards as currently contemplated. For more information, see the section on 'Capital adequacy' in this report.

Solvency II, which is the successor to the Solvency I capital requirements for insurance undertakings, will establish new capital requirements and risk management standards across the industry (in Europe) from 2013 onwards. Based on the most recent estimates, the KBC Insurance group largely meets the targets set by Solvency II. For more information, see the section on 'Capital adequacy' in this report.

Credit portfolios under stress

Given the specific economic situation in Ireland and Hungary, more information on KBC's credit portfolios in these countries can be found in the 'Credit risk' section of the 2010 annual report of KBC Group NV (see *www.kbc.com*).

Disclosure policy

In line with its general communication policy, KBC aims to be as open as possible when communicating to the market about its exposure to risk. Risk management information is therefore provided in a separate section of the 2010 annual report and – more extensively – in this publication.

The most important regulations governing risk and capital management are the Basel II capital requirements applying to banking entities, and the Solvency I capital framework applying to insurance entities. In the coming years, the Basel II capital requirements will be altered or complemented by the Basel III framework. Solvency I will be replaced by the fundamentally reformed Solvency II framework, which is based on Basel II principles. Both changes will come into effect from 2013 onwards (at once for Solvency II and gradually for Basel III).

This risk report is based on Basel II's third pillar and the resulting disclosure requirements of the Capital Requirements Directive (as transposed into Belgian law). Although the disclosures are set up according to the first Basel II pillar and focus on banking entities, KBC – as a *bancassurance* company looking ahead to the disclosure requirements of Solvency II – decided to extend the scope for the insurance activities in order to provide an overall view of the KBC group's risk exposure and risk management activities.

To ensure that a comprehensive view is provided, the credit risk inherent to KBC Insurance has also been included in the section on credit risk management. Furthermore, as they are managed in an overarching group-wide fashion, the disclosures on structured credit products, market risks (non-trading-related, i.e. Asset and Liability Management), liquidity risk and non-financial risks have been drawn up to include detailed information at KBC group level (banking and insurance combined). Detailed information on the technical insurance risk borne by KBC Insurance has also been included.
Disclosures required under Pillar 3 are only incorporated if they are deemed relevant for KBC.

Information is disclosed at the highest consolidated level. Additional information, specifically on the material entities, is confined to the capital information in the section on 'Capital adequacy'. For more detailed information, please refer to the local capital disclosures of the entity concerned (for instance, those provided on their websites).

Unless otherwise stated, 2010 data for KBL EPB (including VITIS Life), which has been recognised as a discontinued operation under IFRS 5, have been excluded from the various tables (but are provided separately in a footnote) in order to maintain consistency with the treatment of discontinued operations in the 'Risk management' section, and in the balance sheet and income statement of the 2010 annual report. It should be noted that at mid-March 2011, it was announced that the sale of KBL EPB (including VITIS Life) to the Hinduja Group would not go through. As can be seen from the various footnotes containing data on KBL EPB, its impact on the different risk indicators is relatively limited.

KBC ensures that a representative picture is given at all times in its disclosures. The scope of the reported information – which can differ according to the matter being dealt with – is clearly indicated.

A comparison with the previous year is provided unless this is not possible due to differences in scope and/or methodology.

The information provided in this document has not been subject to an external audit. However, the disclosures have been checked for consistency with other existing risk reports and were subjected to a final screening by authorised risk management representatives to ensure quality.

Information disclosed under IFRS 7, which has been audited, is presented in KBC's annual report. Broadly speaking, the information in the annual report coincides with the information in this risk report, but a one-to-one comparison cannot always be made due to the different risk concepts used under IFRS and Basel II. In order not to compromise on the readability of this document, relevant parts of the annual report have been reproduced here.

This risk report is available in English on the KBC website and is updated on a yearly basis. KBC's next update is scheduled for the beginning of April 2012. Depending on market requirements, KBC may however decide to provide more frequent updates.

Risk management governance

General risk governance model

During 2010, KBC's risk management underwent significant changes with regard to governance and structure. The ultimate goal of these changes was to further improve the group's ability to deal decisively with major economic events in the future by creating an adjusted and comprehensive integrated model that aligns all dimensions of risk, capital and value management.

The risk governance model is characterised primarily by:

- the Board of Directors (assisted by the Audit, Risk and Compliance Committee) which sets the risk appetite each year;
- an integrated, Executive-Committee-centred architecture that links risk appetite, strategy and performance goal setting via capital allocation to limits and targets. Along with a consequential monitoring process, this creates the parameters for the business to take risks autonomously within the overall strategic choices of the group;
- the Group Risk and Capital Oversight Committee and the Group Risk Management Committee (see below), two risk committees that leverage the time of the Executive Committee;
- a single, independent, group-wide risk function that comprises the Group Chief Risk Officer (Group CRO who sits on the Executive Committee), local CROs, and group and local risk functions;
- risk-oriented business people, who have the awareness and skill to make the right risk-return trade-offs and who act as the first line of defence for conducting sound risk management in the group. The Risk, Finance and Compliance functions act as the second line of defence, while Internal Audit is the third line.

To achieve the above objectives:

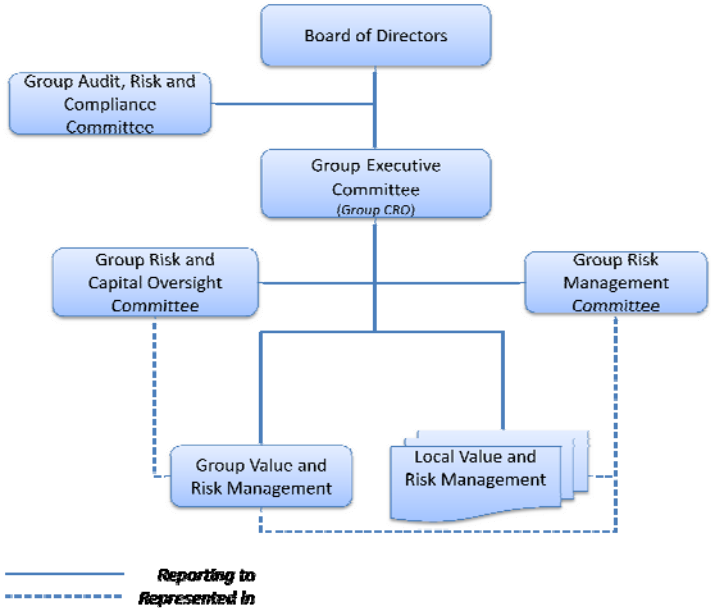
- KBC put forward the *Group Executive Committee (Group ExCo)* as a single integrating committee for risk and capital management, entrusting it with major tasks such as:
    - making proposals to the Board of Directors about risk and capital strategy, and about risk appetite;
    - agreeing on the risk and capital governance framework to be implemented throughout the group;
    - allocating capital to activities in order to maximise the risk-adjusted return;
    - monitoring the group's major risk exposure to ensure conformity with the risk appetite.

- KBC set up a *Group Risk and Capital Oversight Committee (GRCOC)* which, among other things:
    - monitors the integrated risk profile (combining, for instance, market context, solvency, liquidity, performance) to ensure consistency with risk limits and risk appetite, and identifies hidden risks;
    - if risk exposure exceeds limits, recommends mitigating actions to the Group ExCo to bring the risk exposure back in line;
    - advises the Group ExCo on all decisions/matters that (may) involve material risks and takes autonomous decisions on less material risks.
    - The permanent committee members are the Group CRO and Group Chief Finance Officer (both members of the Group ExCo), the senior general managers of the Group Value and Risk Management Directorate and Group Finance, the Group Treasurer and the general manager of the Group Strategy Unit. The committee also provides a platform for the business entities by inviting the relevant senior business managers to attend meetings dealing with topics in their field of expertise.

- KBC set up a *Group Risk Management Committee (GRMC)* which, among other things:
    - monitors and ensures the adequacy of risk and capital governance, and informs the Group ExCo on gaps and inefficiencies;
    - makes recommendations to the Group ExCo about material changes to the risk and capital governance frameworks, and decides on non-material changes to these frameworks on an autonomous basis;
    - actively promotes risk governance throughout the group (by means of education, communication, etc.);
    - manages and supervises model frameworks and their implementation;
    - The permanent members of this committee are the Group CRO, the senior general manager of the Group Value and Risk Management Directorate and local CROs. Here too, the voice of the business is heard via the local CROs or by inviting the relevant senior managers themselves to provide input on all topics and/or frameworks that affect them.

- KBC installed *Local Chief Risk Officers* (LCROs) throughout the group according to a logical segmentation based on entity and/or business unit. Close collaboration with the business is assured since they take part in the local decision-making process. Independence of the LCROs is achieved through a direct reporting line to the Group CRO. The LCROs have a number of responsibilities, including:
    - assisting the business on a day-to-day basis to identify, quantify and manage risks within their organisation;
    - monitoring the local integrated risk profile and compliance with local limits;
    - assuring a direct flow of information to the group on locally emerging risks;
    - making recommendations and advising the group risk function on *inter alia* frameworks to support a fit at local level.

- KBC abolished its specific risk committees (including the group credit risk committee, group trading risk committee, group ALCO) which were organised as *risk silos*. All responsibilities and open to-dos were transferred to the new committees at group level or moved to the local level (via the LCRO). The process of abolishing the former specific risk committees on local level is still ongoing.



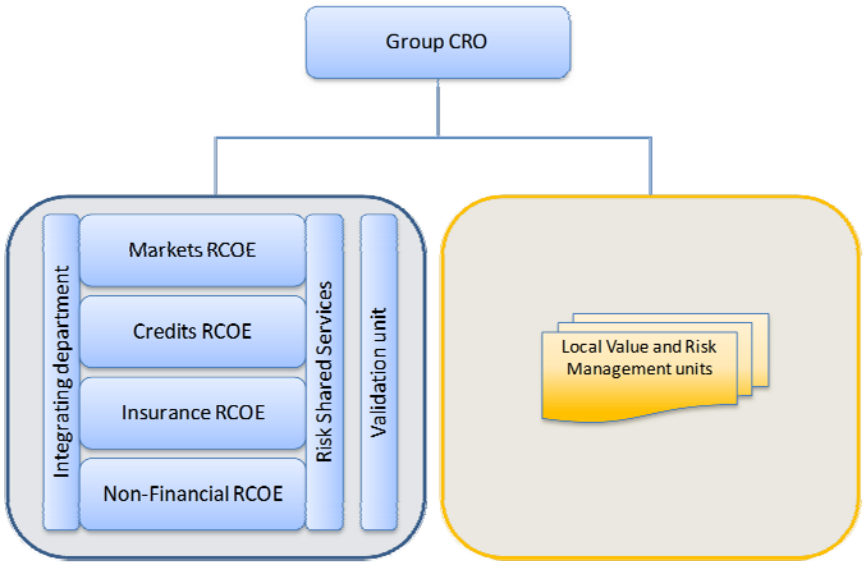
The new model has not changed:

- the role of the group internal audit division. It is still responsible for audit planning and thus audits the compliance of the risk management framework with legal and regulatory requirements, the efficiency and the effectiveness of the risk management system and its compliance with the risk management framework, as well as the way in which line mangement handles risks outside this formal framework.

- the role of the group risk function (the Group Value and Risk Management Directorate or GVRM), which among other things monitors risks and capital at an overarching group-wide level, develops risk models (while business models are developed by business), performs independent (thus segregated from the modelling staff) validations of all the risk and business models developed, develops group-wide frameworks and advises/reports on issues handled by the Group ExCo and the risk committees.

  Although, the role of GVRM did not change the structure was significantly reformed to assure a more integrated view and approach towards risk management (incl. measuring and monitoring) - see picture below. Where up until 2010 GVRM was organised according to risk silos, the overall change to the risk governance resulted in Risk Centres of Excellence (RCOEs) which group together all knowledge with regard to market risks (trading and non-trading), credit risks, non-financial risks and insurance risks. In addition to this, an integrating section was created to focus on aggregating risk measures (e.g., economic capital), overarching reports for management or the public and setting up general risk frameworks. Next to these, Shared Services units are responsible for overall model and process development.

  The above structure was copied at local level when deemed necessary.



Capital adequacy

Capital adequacy measures the financial strength of an institution. It relates to the level of capital a financial institution needs to implement its business plans, taking into consideration the risks that threaten the realisation of such plans.

Strategy and Processes

In order to assess capital adequacy within the group, KBC uses a multi-dimensional approach where the capital situation is assessed and set off against minimum targets

- from a regulatory (i.e. pillar 1 of Basel II) and an economic (i.e. pillar 2 of Basel II) point of view
- in the current situation and over a 3-year time horizon
- under different economic scenarios: base case, alternative and internally defined stress scenarios

The purpose of this assessment is to make sure that KBC holds enough capital to cover the risks that it takes on. It also gives KBC the opportunity to manage capital in a pro-active way. Taking into account the multi-dimensional approach, this broad capital picture allows top management to assess whether business plans are in line with the capital that is available in the group and – when necessary – to take action in a timely manner. In order to maximise the impact of the capital adequacy assessment on decision processes, it is embedded in the planning process. As a result, the planning process also qualifies as an Internal Capital Adequacy Assessment Process (ICAAP), as required under pillar 2 of the Basel II accord.

The outcome of the ICAAP is discussed by KBC's Group Executive Committee, its Audit Risk and Compliance Committee and its Board of Directors.

KBC focuses on the group situation when assessing its capital adequacy, since the sound capital situation at group level provides adequate assurance that the group will be able to support local entities if necessary. Nevertheless, KBC also established ICAAPs in significant banking subsidiaries.

Within the limits of regulatory constraints, KBC has no current or foreseen material or legal obstacles to the transfer of capital or the repayment of debts among parent companies and their subsidiaries.

Further on in this chapter, a distinction is made between regulatory solvency disclosures – linked to Basel II pillar 1 – and economic capital disclosures– linked to Basel II pillar 2. Short reference is also made to the expected impact of regulatory adjustments.

Regulatory solvency disclosures

Scope of solvency disclosures

The capital profile is disclosed for KBC Group as a whole, i.e. fully consolidated, as well as for the major activities of the group, i.e. banking (KBC Bank consolidated) and insurance (KBC Insurance consolidated). In addition, the solvency information is also disclosed for a number of significant banking subsidiaries (see further).

KBC calculates its solvency position on the basis of IFRS figures and the relevant guidelines issued by the Belgian regulator.

Solvency in 2010, group overview

For group solvency, the so-called 'building block' method is used. This entails comparing the available regulatory group capital with the sum of the separate minimum regulatory solvency requirements for KBC Bank, KBL EPB, the holding company (after deduction of intercompany transactions between these entities) and KBC Insurance. The total risk-weighted volume of KBC Insurance is calculated as the required solvency margin under Solvency I divided by 8%.

Regulatory minimum solvency requirements were amply exceeded in 2010, not only at year-end, but also throughout the entire year.

In its risk appetite statement KBC defined internal targets versus the risk-weighted volume which are largely above the regulatory minimum requirements:

In-house solvency target at group level (Basel II) – 2010	Target
Tier-1 ratio	10%
Core tier-1 ratio	8%

Solvency at group level (consolidated, including KBL EPB, Basel II) (in millions of EUR)	31-12-2009	31-12-2010
Total regulatory capital, after profit appropriation	20 414	21 726
Tier-1 capital[1]	15 426	16 656
Parent shareholders' equity	9 662	11 147
Non-voting core-capital securities	7 000	7 000
Intangible fixed assets (-)	-398	-429
Goodwill on consolidation (-)	-2 918	-2 517
Innovative hybrid tier-1 instruments	554	598
Non-innovative hybrid tier-1 instruments	1 642	1 689
Minority interests	159	161
Equity guarantee (Belgian State)	601	446
Revaluation reserve, available-for-sale assets (-)	-457	-66
Hedging reserve, cashflow hedges (-)	374	443
Valuation differences in financial liabilities at fair value – own credit risk (-)	-151	-190
Minority interests in available-for-sale reserve and hedging reserve, cashflow hedges (-)	-1	-3
Equalisation reserves (-)	-131	-128
Dividend payout (-)[2]	0	-854
IRB provision shortfall (50%) (-)[4]	-77	0
Limitation of deferred tax assets	0	-243
Items to be deducted (-)[3]	-433	-397
Tier-2 and tier-3 capital	4 988	5 069
Perpetuals (including hybrid tier-1 instruments not used in tier-1 capital)	321	30
Revaluation reserve, available-for-sale shares (at 90%)	348	392
Minority interests in revaluation reserve, available-for-sale shares (at 90%)	0	0
IRB provision shortfall (50%) (-)[4]	-77	0
IRB provision excess (+)[4]	0	132
Subordinated liabilities	4 685	4 730
Tier-3 capital	145	182
Items to be deducted (-)[3]	-433	-397
Total weighted risks	143 359	132 034
Banking	128 303	116 129
Insurance[5]	15 022	15 676
Holding-company activities	86	264
Elimination of intercompany transactions between banking and holding-company activities	-52	-34
Solvency ratios		
Tier-1 ratio	10.8%	12.6%
Core tier-1 ratio	9.2%	10.9%
CAD ratio	14.2%	16.5%

1 Audited figures.
2 Includes the dividend on ordinary shares and the coupon on non-voting core-capital securities sold to the Belgian State and Flemish Region.
3 Items to be deducted, which are split 50/50 over tier-1 and tier-2 capital, include mainly participations in and subordinated claims against financial institutions in which KBC has between a 10% and 50% share (primarily NLB).
4 Excess/shortfall is defined as the (positive/negative) difference between the actual loan loss impairment recognised and the 'expected loss' calculation.
5 Weighted risks for insurance are calculated by multiplying capital under Solvency I by a factor 12.5 (8% rule similar to the relationship between RWA and capital for banking, i.e. Basel II).

Next to the Parent Shareholders' Equity, the major component of the Tier 1 capital of the group consists of non-voting core-capital securities. These originated from the capital-strenghthening measures which were taken in 2008 and 2009, whereby non-voting core-capital securities were issued to the Belgian State and the Flemish Regional Government. In addition a Guarantee Agreement was signed with the Belgian State for the remaining CDO risks (see the 'Additional information' section in the 2010 annual report for more details).

The Tier 1 capital of KBC Group also incorporates hybrid instruments. As these are all issued by KBC Bank, more detail is provided in the caption on the Solvency of KBC Bank consolidated.

On 31 December 2010, new rules entered into effect with respect to the characteristics and proportions of hybrid instruments that can be included in pillar I tier-I capital ('CRD II'). The instruments issued by KBC are not yet fully compliant with these new requirements. The European Directive and the Belgian regulation allow for a transition period, during which instruments that are no longer compliant could still be included in tier-I capital. During the first ten years, there would be no additional cap on these grandfathered instruments. However, the implementation of the Basel III regime will affect this grandfathering regime. Non-compliant government-subscribed instruments will be fully grandfathered in a first phase. Starting 2018, they will no longer qualify.The amount of other non-compliant hybrid instruments that can be taken into account will decrease from 90% of the outstanding amount in 2014 to 0% of the outstanding amount in 2023.

Solvency, KBC Bank Consolidated

The table shows the tier-1 and CAD ratios calculated under Basel II. It should be noted that Basel II rules have been implemented throughout the group since 2008. Basel II IRB Foundation is the primary approach (used for about 75% of the weighted risks), while the remainder weighted risks (roughly 25%) are calculated according to the Standardised method.

Solvency, KBC Bank consolidated In millions of EUR	31-12-2009 Basel II	31-12-2010 Basel II
Total regulatory capital, after profit appropriation	17 760	18 552
Tier-1 capital	13 440	13 809
Parent shareholders' equity	12 168	13 193
Intangible fixed assets (-)	-109	-100
Goodwill on consolidation (-)	-1 665	-1 611
Innovative hybrid tier-1 instruments	402	414
Non-innovative hybrid tier-1 instruments	1 945	1 689
Minority interests	492	584
Equity guarantee (Belgian State)	462	354
Revaluation reserve available-for-sale assets (-)	17	386
Hedging reserve, cashflow hedges (-)	374	446
Valuation diff. in fin. liabilities at fair value - own credit risk (-)	-151	-190
Minority interest in AFS reserve & hedging reserve, cashflow hedges (-)	0	-5
Dividend payout (-)	0	-623
IRB provision shortfall (50%) (-)	-77	0
Limitation of deferred tax assets	0	-379
Items to be deducted (-)	-418	-349
Tier-2 and tier-3 capital	4 320	4 743
Perpetuals (including hybrid tier-1 instruments not used in tier-1 capital)	250	250
Revaluation reserve, available-for-sale shares (at 90%)	109	82
Minority interests in revaluation reserve, available-for-sale shares (at 90%)	-1	1
IRB provision shortfall (50%) (-)	-77	0
IRB provision excess (+)	0	132
Subordinated liabilities	4 313	4 445
Tier-3 capital	145	182
Items to be deducted (-)	-418	-349
Total weighted risks[1]	123 074	111 711
Credit risk	107 133	97 683
Market risk	5 062	3 279
Operational risk	10 879	10 749
Solvency ratios		
tier-1 ratio	10.9%	12.4%
of which core tier-1 ratio	9.0%	10.5%
CAD ratio	14.4%	16.6%

1 Counterparty risk was retroactively shifted from market risk to credit risk.

The regulatory minimum under Basel II for the CAD ratio amounts to 8%. During a transition period capital requirements are still calculated according to Basel I rules as well, with the intention to limit the decrease in capital requirements between Basel I and Basel II. In 2011 a floor of 80% applies, which means that the capital required under Basel II should not be less than 80% of the capital required under Basel I. In case the floor is not respected, the regulator may increase the minimum capital ratio of 8% to cover the capital requirements below 80%. Currently, the Basel II capital requirements for KBC Bank at consolidated level are slighted above 80% of Basel I.

In Belgium, banks may issue both innovative and non-innovative hybrid capital instruments which qualify for a maximum 25% of tier-1 capital (with additional limits for the innovative hybrid component). To be classified as non-innovative, the instrument must have a number of features, viz. it needs to be subordinated, should not provide for any step-up in dividends, should be perpetual (no general redemption right for investors) and may be converted to ordinary shares subject to certain limits and approvals.

In order to strengthen the solvency ratios of KBC Bank and with a view to optimising the use of hybrid instruments allowed by the regulator, KBC Bank issued so-called non-innovative hybrid tier-1 capital instruments in 2008. Since then no new hybrid instruments were issued in view a.o. of the uncertainty

regarding future regulations related to hybrids. The table below gives an overview of the main hybrid Tier 1 instruments.

Overview of main hybrid tier-1 instruments

Issuer	Description	Original nominal amount	Nominal amount at 31-12-2010	Start date	First call date
KBC Bank	directly issued perpetual debt securities	525 million GBP *(200+175+150)*	45 million GBP	December 2003	December 2019
KBC Bank	directly issued perpetual debt securities	1 250 million EUR	1 250 million EUR	May 2008	May 2013
KBC Bank	directly issued perpetual debt securities	700 million EUR	700 million EUR	June 2008	June 2013
KBC Bank Funding Trust II	perpetual non-callable 10-yr preferred securities	280 million EUR	119 million EUR	June 1999	June 2009
KBC Bank Funding Trust III	non-cumulative guaranteed trust preferred securities	600 million USD	173 million USD	November 1999	November 2009
KBC Bank Funding Trust IV	non-cumulative guaranteed trust preferred securities	300 million EUR	121 million EUR	November 1999	November 2009

Solvency in 2010, significant banking subsidiaries

Solvency information is also disclosed for the significant banking subsidiaries. Significance in this respect is defined by KBC as set out in the EBA guidelines on co-operation between consolidating supervisors and home supervisors. It therefore takes into account:

- from a KBC group perspective: the contribution to earnings and overall risk of the group, and
- from a local perspective: the importance of the KBC entity to the local banking system as expressed in terms of e.g., market share, for instance.

Absolut Bank, CBC Banque, Centea, ČSOB (Czech Republic), ČSOB (Slovak Republic), KBC Bank (Ireland), KBL EPB, Kredyt Bank and K&H Bank have been identified as significant banking subsidiaries.

A summary of the solvency information for significant entities is provided in the table below. The reported figures are calculated according to IFRS or Belgian GAAP, and on a consolidated basis (except for CBC and Centea). For details on the capital profile of significant banking subsidiaries please refer to the capital disclosures in the annual reports of the relevant entities.

Solvency, significant banking subsidiaries
In millions of EUR

		31-12-2009			31-12-2010		
		Total regulatory capital	Total weighted risks	CAD ratio	Total regulatory capital	Total weighted risks	CAD ratio
Absolut Bank	IFRS	459	2 980	15,41%	485	2 589	18,74%
CBC Banque	Belgian GAAP	520	2 934	17,72%	544	2 674	20,36%
Centea	Belgian GAAP	484	4 360	11,10%	612	4 535	13,50%
ČSOB (Czech Republic)	IFRS	2 081	13 907	14,96%	2 295	12 819	17,91%
ČSOB (Slovak Republic)	IFRS	606	3 994	15,17%	593	3 966	14,94%
KBL EPB	IFRS	1 179	6 055	19,47%	1 092	5 021	21,74%
KBC Bank Ireland	IFRS	1 107	10 765	10,28%	915	7 234	12,65%
Kredyt Bank	IFRS	812	6 592	12,32%	904	7 030	12,85%
K&H Bank	IFRS	722	5 863	12,32%	720	5 717	12,60%

Solvency, KBC Insurance Consolidated

KBC Insurance applies the rules for the calculation of the solvency ratio, in accordance with the regulator's guidelines. Some specific elements in the calculation are:

- The equalisation reserve – calculated under Belgian GAAP – is deducted from available capital
- The available capital includes:
  - 90% of the *net positive* revaluation reserve for shares and 100% of the *net positive* revaluation reserve for bonds.
  - Unrealised gains on property and equipment, investment property and held-to-maturity instruments.

  The combined amount of the above two items cannot exceed a formula-based maximum, equalling the total net amount of unrealised gains/losses in respect of all investments (i.e. the revaluation reserves for AFS investments – including the negative figures – and the unrealised gains/losses on property and equipment, investment property and held-to-maturity instruments).

In millions of EUR	31-12-2009	31-12-2010
Available capital	3 130	2 712
Parent shareholders' equity	3 331	3 904
Dividend payout (-)	0	-923
Minority interests	74	57
Subordinated liabilities	0	10
Intangible fixed assets (-)	-20	-17
Goodwill on consolidation (-)	-401	-393
Revaluation reserve available-for-sale investments (-)	-540	-482
Equalization reserve (-)	-131	-128
Equity guarantee (Belgian State)	139	92
Cash flow hedge reserve	0	-3
90% of positive revaluation reserve, available-for-sale shares	264	304
Latent gains on bonds	346	210
Latent gains on real estate	67	83
Limitation of latent gains on shares and real estate	0	0
Required solvency margin	1 202	1 254
Non-life and industrial accident (legal lines)	322	315
Annuities	8	9
Subtotal, non-life insurance	330	324
Class-21 life insurance	845	901
Class-23 life insurance	16	15
Subtotal, life insurance	861	916
Other	10	14
Solvency ratio and surplus		
Solvency ratio (%)	260%	216%
Solvency surplus (in millions of EUR)	1 928	1 458

The current solvency requirements (Solvency I) are purely volume-based (maximum of a percentage of the premium and a percentage of the claims cost) and do not take into account the asset mix and asset quality. In order to improve the capital regulations, a new EU solvency regime for (re-)insurance companies (Solvency II) will be implemented (target date 31 October 2012). The Solvency II capital requirements will be based on the real risk exposure of the (re-)insurance company.

Economic Capital

KBC uses economic capital as a major building block for its Internal Capital Adequacy Assessment Process where the required Economic Capital is set off versus the Available Financial Resources (AFR). In addition Economic Capital provides essential input for internal valuation models, such as the Market Consistent Embedded Value model.

Economic capital (ECap) is an internal risk measure adapted to specific activities and portfolios of KBC Group. KBC's ECap is defined as the unexpected loss in the fair value of the Group over a one-year time horizon and measured at a defined confidence level of 99.93%. It represents the minimum amount of capital which has to be available in order to protect the group against economic insolvency.

Economic capital is calculated for all material risks (credit, market, ALM, insurance, operational, business & funding cost risk) and is modelled on the specific features of the KBC portfolios. By using a common denominator across risk types (the same time horizon and the same confidence interval) it allows for an aggregated view. Since it is extremely unlikely that all risks will materialise at the same time, an allowance is made for diversification benefits when aggregating the individual risks.

The breakdown of KBC's economic capital per risk type is provided in the table. The difference in the distribution of economic capital across the different risk types is partly related to changes in risk exposures, but also from changes being made to the economic capital model. Indeed, the model – which is the result of an internal assessment – is reviewed on a regular basis.

Economic capital distribution, KBC group*	2009	2010
Credit risk	64%	69%
Market risk in non-trading activities	14%	12%
Market risk in trading activities	3%	3%
Business risk	8%	6%
Operational risk	6%	5%
Insurance risk	3%	3%
Funding cost risk	2%	2%
Total	100%	100%

* All percentages relate to figures at the end of September 2009.

Economic Capital is reported on a quarterly basis to KBC group's Executive Committee, Audit, Risk and Compliance Committee and Board of Directors.

Regulatory environment

European stress tests

The results of the EU stress tests were published on 23 July 2010. These tests were co-ordinated by the Committee of European Banking Supervisors (CEBS), in co-operation with the European Central Bank, the CBFA (Belgian supervisory authority) and the National Bank of Belgium. As regards KBC, the stress test focused on KBC Bank at the consolidated level. The exercise was conducted using the scenarios, methodology and key assumptions provided by CEBS (see the aggregate report published at www.eba.europa.eu).

As a result of the assumed shocks under the adverse scenario, the estimated consolidated tier-1 capital ratio would drop to 9.8% in 2011 compared with 10.9% at the end of 2009. KBC is satisfied that the outcome of the stress test proves that, even under these stress scenarios, the bank adequately meets the legal and market requirements in terms of solvency. More information in this regard is provided in the press release of 23 July 2010, which is available at www.kbc.com. The European Banking Authority (EBA), the newly established European authority that officially took over the tasks of CEBS on 1 January 2011, has planned to conduct new stress tests in 2011.

Basel III

The so-called Basel III agreement, which introduces new, more stringent capital requirements for financial institutions, was published on 16 December 2010. Under this agreement, the regulatory minimum tier-1 ratio, which stood at 4% under Basel II, will be increased first to 4.5% in 2013, and gradually further to 6% in 2015 (with a minimum common equity ratio of 4.5%). On top of this, a so-called 'conservation buffer' (0% in 2013, gradually rising to 2.5% in 2019), a 'countercyclical buffer' (between 0% and 2.5%, to be determined by the national regulatory authority) and an extra charge for global systemic banks will be applied.

Under Basel III certain elements used in the calculation of regulatory available capital will be gradually phased out or changed. The capital injections received from the government (for KBC, the 7 billion euro's core capital securities sold to the Belgian State and Flemish Regional Government in 2008 and 2009) will be classified as additional tier-1 capital and will be grandfathered until the end of 2018.

As regards the current Basel III proposals, KBC will, based on estimates and barring unforeseen circumstances, be compliant with the new capital and liquidity standards as currently contemplated.

Solvency II

As the regulatory framework is not yet stable, KBC continuously follows up changes to align with the most current view on Solvency II. In this respect KBC also participated in the fifth Quantitative Impact Study (QIS 5) undertaken by the Committee of European Insurance and Occupational Pension Supervisors (CEIOPS) – currently transformed into the European Insurance and Occupational Pension Authority (EIOPA) – and for which the overall results were published on 14 March 2011 on eiopa.europa.eu. Based on QIS 5 KBC Insurance Group largely meets the targets set by Solvency II.

In line with the ICAAP in Basel II, Solvency II introduces a Pillar 2 internal view on capital adequacy, namely ORSA (Own Risk and Solvency Assessment). Since the KBC ICAAP is group-overarching (i.e. including insurance activities), KBC plans to align ORSA with the existing ICAAP process..

Overview of capital transactions with the government

In 2008 and 2009, a number of capital-strenghthening measures were taken, whereby non-voting core-capital securities were issued to the Belgian State and the Flemish Regional Government, and a Guarantee Agreement signed with the Belgian State for the remaining CDO risks (see the 'Additional information' section in the 2010 annual report for more details).

Liquidity risk management

Liquidity risk is the risk that an organisation may not be able to fund increases in assets or meet obligations as they fall due, unless at an unreasonable cost.

Strategy and processes

The principal objective of KBC's liquidity management is to be able to fund the group and to enable the core business activities of the group to continue to generate revenue, even under adverse circumstances. Since the financial crisis, there has been a greater focus on liquidity risk management throughout the industry, and this has been intensified by the minimum liquidity standards defined by the Basel Committee. At industry level, increased demand for long-term wholesale or retail funding is expected to create upward pressure on financial institutions' funding costs.

KBC is preparing for the Basel III era by gradually incorporating Basel III concepts into its liquidity and funding framework, as well as into its financial planning. Awareness of liquidity risk throughout the organisation is ensured not only through limit setting, but also through incorporating liquidity costs into the group's funds transfer pricing mechanism.

The liquidity management framework and group liquidity limits are set by the Board of Directors. Liquidity management is organised within the Group Treasury unit, which centralises collateral management and the acquisition of long-term funding. Primary responsibility for operational liquidity management lies with the respective group companies, since they know best the specific features of their local products and markets and deal directly with local regulators and other officials. However, the liquidity contingency plan requires all significant local liquidity problems to be escalated to group level. The group-wide operational liquidity risks are also aggregated and monitored centrally on a daily basis and are reported periodically to the GRCOC, Group Exco and the Audit, Risk and Compliance Committee.

KBC's liquidity framework is based on the following pillars:

- *Contingency liquidity risk*. This risk is assessed on the basis of liquidity stress tests, which measure how the liquidity buffer of the group's bank entities changes under extreme stressed scenarios. This buffer is based on assumptions regarding liquidity outflows (retail customer behaviour, professional client behaviour, drawing of committed credit lines, etc.) and liquidity inflows resulting from actions to increase liquidity ('repoing' the bond portfolio, reducing unsecured interbank lending, etc.).
  The liquidity buffer has to be sufficient to cover liquidity needs (net cash and collateral outflows) over (i) a period that is required to restore market confidence in the group following a KBC-specific event, (ii) a period that is required for markets to stabilise after a general market event and (iii) a combined scenario, which takes a KBC-specific event and a general market event into account. The overall aim of the liquidity framework is to remain sufficiently liquid in stress situations, without resorting to liquidity-enhancing actions which would entail significant costs or which would interfere with the core banking business of the group.
- *Structural liquidity risk*. The group's funding structure is managed so as to maintain substantial diversification, to minimise funding concentrations in time buckets, and to limit the level of reliance on wholesale funding. Therefore, the forecasted structure of the balance sheet is reviewed regularly and the appropriate funding strategies and options developed and implemented. Measures comparable to the Basel III concepts have been monitored since the end of 2009.
- *Operational liquidity risk.* Operational liquidity management is conducted in the treasury departments, based on estimated funding requirements. The most volatile components of the balance sheet are monitored on a daily basis by the Group Treasury unit, ensuring that a sufficient buffer is available at all times to deal with extreme liquidity events in which no wholesale funding can be rolled over.

Scope of liquidity risk management

This liquidity risk report covers most material entities of KBC group that carry out banking activity, i.e. KBC Bank NV, CBC Banque SA, Centea, KBC Lease, Antwerp Diamond Bank, KBC Financial Products, ČSOB Czech Republic, ČSOB Slovakia, KBC Ireland, K&H, Kredyt Bank and Absolut Bank. KBC Insurance entities are not included since insurance entities are generally liquidity providers and not liquidity users.

Structural liquidity risk

The table below illustrates structural liquidity risk by grouping the assets and liabilities according to the remaining term to maturity (contractual maturity date). The difference between the cash inflows and outflows is referred to as the 'net liquidity gap'. At year-end 2010, KBC had attracted 44 billion euros' worth of funding from the professional market. Netted with interbank lending, funding attracted through the professional market fell to 18 billion euros.

Liquidity risk at year-end (excluding intercompany deals)[1] (in billions of EUR)	<= 1 month	1-3 months	3-12 months	1-5 years	5-10 years	> 10 years	not defined	Total
31-12-2009								
Total inflows	55	13	23	70	42	40	45	288
Total outflows[2]	69	22	23	29	7	3	136	288
Professional funding	34	9	13	1	0	1	0	59
Customer funding	22	7	7	6	1	1	91	135
Debt certificates	9	6	3	21	6	1	0	46
Other[3]	4	0	0	0	0	0	45	49
Liquidity gap (excl. undrawn commitments)	-14	-8	-1	41	35	37	-91	0
Undrawn commitments	–	–	–	–	–	–	-34	–
Financial guarantees	–	–	–	–	–	–	-17	–
Net liquidity gap (incl. undrawn commitments)	-14	-8	-1	41	35	37	-142	-51
31-12-2010[4]								
Total inflows	49	12	23	64	44	46	37	276
Total outflows[2]	65	16	14	31	6	2	141	276
Professional funding	36	5	1	1	0	0	0	44
Customer funding	17	8	8	13	3	2	99	149
Debt certificates	8	4	5	17	3	0	0	36
Other[3]	4	0	0	0	0	0	43	47
Liquidity gap (excl. undrawn commitments)	-16	-4	9	34	38	44	-105	0
Undrawn commitments	–	–	–	–	–	–	-34	–
Financial guarantees	–	–	–	–	–	–	-12	–
Net liquidity gap (incl. undrawn commitments)	-16	-4	9	34	38	44	-151	-46

1 Cash flows are excluding interest rate flows consistent with internal and regulatory liquidity reporting. No inflows/outflows are reported arising from margin calls posted for / received for MtM positions of derivatives. The aim of the table is to present contractually determined flows while potential flows arising from margin calls depend on future MtM evolutions.
2 'Professional funding' includes all deposits from credit institutions and investment firms, as well as all repos.
3 MtM derivatives are reported in the 'not defined' bucket.
4 Excluding KBL EPB. Because of its private banking activities, KBL EPB attracts high volumes of short term customer deposits and grants low volumes of customer loans (an LTD of 17%).

Typical for a banking group, funding sources generally have a shorter maturity than the assets that are funded, leading to a negative net liquidity gap in the shorter time buckets and positive net liquidity gap in the longer term buckets. This creates liquidity risk i.e. if KBC would be unable to renew maturing short-term funding. The KBC liquidity framework imposes a funding strategy to ensure that the liquidity risk remains within the group's risk appetite.

Credit risk management

Credit risk is the potential negative deviation from the expected value of a financial instrument consequent on non-payment or non-performance by a borrower (of a loan), an issuer (of a debt instrument), a guarantor or re-insurer, or a counterparty (to a professional transaction), due to that party's insolvency or lack of willingness to pay or perform, or to events or measures taken by the political or monetary authorities of a particular country. Credit risk thus encompasses default risk and country risk, but also includes migration risk which is the risk for adverse variances in transitions between credit ratings.

Credit risk is confined mainly to the banking entities of KBC group, but also arises at its insurance entities. Most of this stems from the investment portfolios, which – for instance – includes substantial investments in debt securities. Furthermore, credit risk also ensues from insurance and reinsurance contracts concluded by KBC Insurance.

Credit risk, including counterparty credit risk, arising at the banking entities is dealt with under the Basel II (regulatory capital) requirements directive and presented as such in this risk report.
Credit risk exposure related to KBC Insurance is reported separately at the end of this section (see 'Credit risk related to KBC Insurance'). This means that, up to and including the 'Internal modelling' section, all disclosures deal with credit risk at KBC's banking entities.

Strategy and processes

Credit risk is managed at both transactional and portfolio level. Managing credit risk at the transactional level means that there are sound procedures, processes and applications (systems, tools) in place to identify and measure the risks before and after accepting individual credit exposures. Limits are set to determine the maximum credit exposure allowed. Managing the risk at portfolio level encompasses *inter alia* periodic measuring of and reporting on risk embedded in the consolidated loan and investment portfolios, monitoring limit discipline, conducting stress tests under different scenarios, taking risk mitigating measures and optimising the overall credit risk profile.

Credit risk management at transactional level

Acceptance. Sound acceptance policies and procedures are in place for all kinds of credit risk exposure. The description here is limited to exposures related to traditional loans to businesses and to lending to individuals, as these account for the largest part of the group's credit risk exposure.

As regards lending to businesses, unless a small amount or a low risk is involved, a proposal submitted by a commercial entity is accompanied by a recommendation made by a loan adviser. In principle, significant decisions are then taken jointly by two or more managers. The level at which decisions should be taken is determined by matrices that take account of such parameters as the group risk total (the total risk run by the entire KBC group vis-à-vis the group the counterparty belongs to), the risk class (determined primarily on the basis of internally developed rating models) and the type of counterparty (financial institutions, sovereign entities, corporate entities, etc.).

Lending to individuals (e.g., mortgages) is subject to a standardised process, during which the output of scoring models plays an important role in the acceptance procedure. Credit to individuals is generally granted in the local currency, except in some Central and Eastern European countries and Russia, where credit in foreign currency is often provided on account of the significant gap between interest rates in the local currency and interest rates in other currencies. In recent years, there has been a growing awareness of the inherent risk stemming from fluctuations in exchange rates, resulting in a very cautious approach towards this particular type of lending.

Supervision and monitoring. For most types of credit risk exposure, monitoring is determined primarily by the *risk class*, with a distinction being made based on the Probability of Default (PD) and the Loss Given Default (LGD). The latter reflects the estimated loss that would be incurred if an obligor defaults, the likelihood of which is estimated as the PD.

In order to determine the risk class, KBC has developed various rating models for measuring how creditworthy borrowers are and to estimate the expected loss of various types of transactions. A number of uniform models are used throughout the group (models for governments, banks, large companies, project finance, etc.), while others have been designed for specific geographic markets (SMEs, private individuals, etc.). The same internal rating scale is used throughout the group.

The output generated by these models is used to split the normal loan portfolio into internal rating classes ranging from 1 (lowest risk) to 9 (highest risk) for the PD. A defaulted obligor is assigned an internal rating ranging from PD 10 to PD 12. PD class 12 is assigned when either one of the obligor's credit facilities is terminated by the bank, or when a court order is passed instructing repossession of the collateral. Class 11 groups obligors that are more than 90 days past due (in arrears or overdrawn), but that do not meet PD 12

criteria. PD class 10 is assigned to obligors for which there is reason to believe that they are unlikely to pay (on time), yet are still performing and do not meet the criteria for classification as PD 11 or PD 12. For the larger loans, an overview of all obligors in default is submitted to the Group Executive Committee every quarter.

Loans to large corporations are reviewed at least once a year, with the internal rating being updated, as a minimum. If ratings are not updated in good time, a penalty is incurred. Reviews of loans to small and medium-sized enterprises are based primarily on risk signals (such as a significant change in the risk class). Loans to individuals are screened periodically at aggregate level for review purposes.

Credit decisions are also monitored, with a member of a credit committee checking decisions taken at the decision level immediately below to see if they are consistent with the lending policy.

Impairment. For credit linked to borrowers in PD classes 10, 11 and 12 (impaired loans), KBC records impairment losses based on an estimate of the net present value of the recoverable amount. This is done on a case-by-case basis (and on a statistical basis for smaller credit facilities). In addition, for credit in PD classes 1 to 9, impairment losses are recorded on a 'portfolio basis', using a formula based on the IRB Advanced models used internally (or an alternative method if an IRB Advanced model is not yet available).

In order to avoid a situation where an obligor facing financial difficulties ends up defaulting, a decision can be taken to renegotiate its loans. Renegotiation may involve changing the contractual repayment schedule, lowering or postponing interest or fee payments, or some other appropriate measure. If a renegotiation stems from a deterioration in the obligor's financial situation and the payment terms are altered, a PD class 9 or higher will be assigned. In cases where renegotiation includes a (full or partial) charge-off of the financial asset, a PD class of at least 10 will be assigned. For the retail portfolio, the assigned PD class is determined on the basis of the behavioural score. In such cases, the resulting PD may be lower than 9. After renegotiation, the obligor's situation will be re-assessed one year later (in principle) and the obligor can return to a better class than PD 9 if the assessment turns out to be positive. In this case, the obligor is no longer considered as being in 'renegotiated status'.

At the end of 2009, loans that were renegotiated to avoid impairment accounted for some 2.2% of the total loan portfolio (amount outstanding). This figure had risen to 2.5% by the end of 2010 (see table below for a further breakdown). As regards the Merchant Banking Business Unit, most of the renegotiated exposure is accounted for by KBC Bank Ireland where nearly 9.0% of its total portfolio was renegotiated at the end of 2010 (5.8% at the end of 2009).

Renegotiated loans avoiding impairment (as a % of the total portfolio of renegotiated loans)*	31-12-2009	31-12-2010
Belgium Business Unit	16%	16%
CEE Business Unit	23%	20%
Czech Republic	3%	4%
Slovakia	3%	2%
Hungary	10%	10%
Poland	1%	1%
Bulgaria	7%	3%
Merchant Banking Business Unit	53%	61%
Group Centre (including planned divestments)	7%	3%
Total	100%	100%
In billions of EUR	3.7	4.0

* KBL EPB accounts for approximately 0.1% of the total portfolio of renegotiated loans.

Credit risk management at portfolio level

Monitoring is also conducted on a portfolio basis, *inter alia* by means of quarterly reports on the consolidated credit portfolio in order to ensure that lending policy and limits are being respected. The largest risk concentrations are, in addition, monitored via periodic and *ad hoc* reports. Limits are in place at borrower/guarantor, issuer or counterparty level, at sector level and for specific activities or geographic areas. Moreover, stress tests are performed on certain types of credit (for instance, mortgages, loans provided to specific business sectors), as well as on the full scope of credit risk.

Whereas some limits are still in notional terms, concepts such as 'expected loss' and 'loss given default' are being used as well. Together with the 'probability of default', these concepts form the building blocks for calculating the regulatory capital requirements for credit risk, as KBC has opted to use the Basel II Internal Rating Based (IRB) Approach.

The switch to the Basel II IRB approach is taking place in stages, with KBC Bank NV and most of its main subsidiaries having already switched over to the IRB Foundation approach in 2007. Of the material group companies, K&H Bank switched to the Basel II standardised approach in 2008 and will adopt the IRB Foundation approach in 2011, while others – such as Kredyt Bank and ČSOB Slovakia – will adopt it at a later date (subject to regulatory approval). The non-material entities of the KBC group adopted the Basel II standardised approach in 2008 and will continue to use it. Further moves to adopt the IRB Advanced approach are envisaged, starting in 2012.

Scope of credit risk disclosures

The scope of the disclosures for credit risk is based on the implementation of Basel II at KBC, and can be inferred from the roll-out plan below.

With regard to the timing of and approach to implementing Basel II, KBC has opted for a phased roll-out of the IRB approach at all its material entities. A material entity in this respect is defined as any subsidiary that accounts for more than 1% of the risk-weighted assets for credit risk at KBC Group NV. Compliance with this criterion is checked at least twice a year. The first set of material entities started adopting the IRB Foundation approach at the beginning of 2007. The internal target dates for the other material entities to adopt this approach are shown in the table below. Any switchover is of course subject to regulatory approval.

Material entities that had not yet adopted the IRB Foundation approach in 2010 are following the Basel II Standardised approach for the time being. This approach will also be adhered to until further notice by the other (non-material) entities of KBC group.

For its material entities, KBC envisages a phased roll-out of the IRB Advanced approach. For a first set of entities, the switch from the IRB Foundation approach to the IRB Advanced approach is planned to start in 2012. Other entities will follow suit from 2013 on.

The scope is limited to these material entities, which accounted for roughly 97% of the total credit risk weighted assets of KBC group in 2010.

Because of this limitation in scope, and also because another definition of exposure[1] is used in the accounting figures, a one-to-one comparison cannot be made with similar disclosures in KBC Bank's 2010 annual report.

Roll-out of Basel II pillar 1 approach	2010	2011	2012
IRB Advanced approach			KBC Bank CBC Banque ČSOB Czech Republic KBC Credit Investments KBC Finance Ireland KBC Real Estate[1] KBC Lease Belgium
IRB Foundation approach	KBC Bank CBC Banque ČSOB Czech Republic KBC Bank Ireland[2] KBC Credit Investments KBC Financial Products KBC Finance Ireland KBC Bank Deutschland[3] KBC Real Estate[1] KBC Lease Belgium Antwerp Diamond Bank[3]	KBC Bank CBC Banque ČSOB Czech Republic KBC Bank Ireland[2] KBC Credit Investments KBC Financial Products KBC Finance Ireland KBC Bank Deutschland[3] KBC Real Estate[1] KBC Lease Belgium Antwerp Diamond Bank[3] K&H Bank	KBC Bank Ireland[2] KBC Financial Products KBC Bank Deutschland[3] Antwerp Diamond Bank[3] Kredyt Bank K&H Bank
Standardised approach	Kredyt Bank K&H Bank Centea[3] KBL EPB[3] ČSOB Slovak Republic Absolut Bank[3] Non-material entities	Kredyt Bank Centea[3] KBL EPB[3] ČSOB Slovak Republic Absolut Bank[3] Non-material entities	Centea[3] KBL EPB[5] ČSOB Slovak Republic Absolut Bank[3] Non-material entities

1 Although KBC Real Estate is not a material entity according to KBC's definition above, it also uses the IRB Foundation approach as it operates on a shared IT platform.
2 KBC Bank Ireland includes the former KBC Homeloans entity, which merged with KBC Bank Ireland in 2009.
3 Centea, Antwerp Diamond Bank, KBC Bank Deutschland, KBL EPB and Absolut Bank have been targeted for divestment under the KBC strategic plan approved by the EU. In this respect, KBL EPB and Centea will no longer be switching to the IRB Foundation approach, but will continue to apply the Standardised approach instead.

[1] In this report, credit exposure – where possible – is expressed as EAD (Exposure At Default), while it is expressed as an amount granted or an amount outstanding in the annual report. EAD is a typical measure for exposure within the context of Basel II, pillar I.

Exposure to credit risk

The tables in this section provide an overview of the overall credit risk expressed in terms of Exposure At Default (EAD) and are based on the figures for the end of December 2010. Exposure to securities in the trading book and to structured credit products is excluded. Information on securities in the trading book is reported in the credit risk section of KBC's annual report and the related risks are taken up in the trading market risk VAR. For structured credit exposure, reference is made to the detailed information in the 'Structured credit products' section in this document.

Detailed information is given separately in the following sections: (i) a general aggregate overview of the total credit risk in scope, (ii) a general (IRB Foundation and Standardised) overview of the lending portfolio, (iii) overviews of concentration in the lending portfolio (including a quality analysis), (iv) overviews of impaired credit in the lending portfolio, (v) breakdowns of the counterparty credit risk, (vi) credit risk mitigation and exposure to repo-like transactions and (vii) information on internal modelling.

In the lending portfolio, EAD is the amount that KBC expects to be outstanding if and when an obligor were to default. For lending exposure treated under the IRB approach, EAD is composed of the amount outstanding at the time of the calculation (without taking provisions into account), plus a weighted part of the off-balance-sheet portion of the exposure. For non-retail exposures, this weight is determined on a regulatory basis according to the IRB Foundation approach. For retail exposures, the weight is determined via internal models, in line with the IRB Advanced approach for this asset class. For lending exposures treated under the Standardised approach, EAD is not defined as such, but can be regarded as the amount outstanding at the time of the calculation minus the provisions set aside plus a weighted part of the off-balance-sheet portion of the exposure. EAD can be stated with or without application of eligible collateral, i.e. net or gross.

For the portfolio of derivatives, EAD (actually, pre-settlement counterparty credit risk) is calculated as the sum of the (positive) current replacement value (marked-to-market) of a transaction and the potential risk as captured by the applicable add-on (= current exposure method). Credit Default Swaps (CDS) in the banking book (protection bought or sold) are an exception to this calculation, since they are considered guarantees (obtained or given) and treated as such in this report.

For the portfolio of repo-like instruments, the EAD is determined based on the lending leg in the transaction, which means that for reverse-repos, including tri-party repos, this is based on the nominal amount of the cash that was provided by KBC, and that for repos it is based on the market value of the securities received.

The EAD is used as a basis to determine the Risk-Weighted Assets (RWA), which in turn are used to calculate the capital required for the exposure. RWA can be regarded as an exposure weighted according to its 'riskiness'. This 'riskiness' depends on such factors as the amount of collateral or guarantees, the maturity of the exposure and the probability of default (PD) of the obligor.

Total and average aggregate exposure to credit risk

In the table below, exposures are broken down according to types of credit exposure. These types are equal for exposures subject to the Standardised or the IRB Foundation approach.

- *On-balance-sheet assets (On-balance)*: this category contains assets, including equities in the banking book, whose contract is booked on the balance sheet of the entities in scope excluding securities in the trading book, repo-like instruments and – in the case of this publication – securitisation-related assets. On-balance-sheet asset are dealt with in the 'lending portfolio' sections.

  Off-balance-sheet assets (Off-balance): this category contains assets whose contract is not booked on the balance sheet of the entities in scope. The category excludes most derivative instruments, repo-like instruments and – in the case of this publication – securitisation-related assets. Derivative instruments related to selling credit protection, i.e. CDS that have been sold are included as off-balance-sheet assets when they do not relate to trading activity. Off-balance-sheet assets are dealt with in the 'lending portfolio' sections.

- *Derivatives:* this category contains all credit exposure arising from derivative transactions, such as Interest Rate Swaps (IRS), Forex deals, etc. (excluding CDS in banking book, which are treated as an Off-balance instrument). Derivatives are dealt with in the section on 'Counterparty credit risk' and not in the 'lending portfolio' sections.

- *Repo-like transactions (Repo-like):* this category contains all credit exposure arising from repo-, reverse repo and tri-party repo transactions in scope. More details on these transactions can be found in the section on 'Credit risk mitigation'.

Average exposure is determined by aggregating the total exposure at the end of every quarter and dividing the sum by four. The gross EAD is the Exposure At Default after application of the credit conversion factor and substitution due to guarantees, but before the application of eligible collateral. The net EAD is the gross EAD after application of all eligible collateral.

In billions of EUR – 31-12-2009

Exposure [EAD]	On-balance	Off-balance	Derivatives	Repo-like	Total
Gross total	216	24	18	38	296
Gross average	217	27	21	37	302
Net total	208	23	16	5	250
Net average	209	25	17	6	258
Total RWA	77	12	6	0	96

In billions of EUR – 31-12-2010*

Exposure [EAD]	On-balance	Off-balance	Derivatives	Repo-like	Total
Gross total	226	20	11	36	292
Gross average	220	20	14	41	296
Net total	218	19	9	5	251
Net average	212	19	11	6	248
Total RWA	70	10	4	0	83

* KBL EPB has been excluded from the 2010 figures. Per end of 2010, KBL EPB's gross exposure totals 13 billion euros (of which 6.5 billion euros for on-balance and 5.5 billion euros for repo-like transactions), net exposure totals 8 billion euros and RWA amounts to 3 billion euros.

Referring to the group-wide framework for dealing with model uncertainty, as mentioned in the section on internal modelling further on, KBC takes into account (and reports under pillar1) as of mid 2010 additional RWA for known deficiencies and avoidable uncertainties regarding its PD models. Per end of 2010 this additional RWA amounted to 204 million euros.

Credit risk in the lending portfolio

The lending portfolio excludes all derivatives (except for CDS in banking book) and any repo-like exposure as these are dealt with in the 'Counterparty credit risk' and 'Credit risk mitigation' sections. As mentioned above, exposure to securities in the trading book is also excluded. The securities in trading book carry issuer risk, and total 0.4 billion euros per end of 2010 (the contribution of KBC FP to this amount has become negligible). In light of the capital calculations this risk is included in trading market risk.

In millions of EUR – 31-12-2009

Lending portfolio [EAD]	Gross EAD of main categories	'Other'[1]	Total Gross EAD
Subject to IRB approach	178 590	12 608	191 197
Subject to Standardised approach	46 280	1 601	47 881
Total	224 870	14 208	239 078

In millions of EUR – 31-12-2010

Lending portfolio [EAD]	Gross EAD of main categories	'Other'[1]	Total Gross EAD
Subject to IRB approach	178 080	24 603	202 683
Subject to Standardised approach[2]	41 391	1 277	42 668
Total	219 471	25 880	245 351

1 Exposure to 'Other' is given separately and not included in the disclosures on concentrations and impaired exposure, since the data required to create the breakdowns is often missing. This category contains mostly 'other assets' (e.g., property and equipment, non-assignable accruals). The significant year-to-year increase for IRB entities is mainly due to cash balances with central banks.
2 As mentioned , KBL EPB has been excluded from the 2010 figures (for Standardized approach). KBL's gross EAD of main categories amounts to 6 778 million euros, while the other assets amount to 439 million euros.

Overall information on the lending portfolio is divided into two tables below. One for a total overview of the exposure subject to the IRB approach and one for the overview of the exposure treated via the Standardised approach. Each approach has its own (regulatory) breakdown by type of exposure/asset class.
In the tables relating to concentrations, both are aggregated to provide a total overview of concentrations in the lending portfolio. This is done at the expense of best-efforts mapping into the mainstream asset classes. As regards the quality analysis, however, both the IRB and Standardised approaches are presented separately again, since the manner for indicating quality is not equal.

Credit exposure subject to the IRB approach

The table below shows the total exposure calculated via the IRB approach broken down per asset class. The asset classes are those defined for the purpose of regulatory reporting according to the IRB approach, viz.:

- *Sovereign*: this category includes claims on public sector entities, regional governments and local authorities as long as they are qualified as 'Sovereign' by the local regulator. Multilateral development banks attracting a 0% risk weighting are included.
- *Institutions:* this category relates mainly to bank exposure. Claims on public sector entities, regional governments and local authorities that do not qualify as 'Sovereign' are also included in this category.
- *Corporates*: besides ordinary corporate exposure, this category includes specialised lending exposure (project finance and commercial real estate).
- *SME (treated as) Corporates*: these are exposures fulfilling the necessary conditions (total annual sales of under 50 million euros) for determining the minimum capital requirements according to the capital weighting formula for corporate SMEs.
- *Retail*: this includes all types of retail exposure, such as mortgage loans, personal loans and commercial credit to retail SMEs, for which the total exposure of the counterparty (or related group of the counterparty) does not exceed a threshold of one million euros. Note, that the IRB Foundation approach for retail exposure is non-existing and that for this asset class IRB Advanced is the only approach.
- *Other*: besides 'other assets', this category includes the residual value of leasing transactions.

In millions of EUR - 31-12-2009

IRB exposure [EAD]	Sovereign	Institutions	Corporates	SME Corporates	Retail[1]	(sub)Total[3]	Other	Total
Gross Exposure	45 877	7 339	47 422	16 037	61 913	178 590	12 608	191 197
Net Exposure	45 675	7 361	43 044	11 495	61 913	169 489	12 608	182 097
RWA	1 328	1 978	34 997	11 303	12 182	61 787	3 631	65 418

In millions of EUR - 31-12-2010

IRB exposure [EAD]	Sovereign	Institutions	Corporates	SME Corporates	Retail[2]	(sub)Total[3]	Other	Total
Gross Exposure	47 739	6 549	42 547	16 076	65 169	178 080	24 603	202 683
Net Exposure	47 646	6 534	39 020	11 897	65 168	170 265	24 603	194 868
RWA	1 245	1 865	29 568	11 012	10 189	53 879	3 960	57 839

1 In 2009 the EAD of the retail class consisted of 45 419 million euros in mortgages and 16 494 million euros in other retail. The related RWA amounted to 8 899 million euros and 3 283 million euros respectively.
2 In 2010 the EAD of the retail class consists of 48 221 million euros in mortgages and 16 948 million euros in other retail. The related RWA amounts to 7 243 million euros and 2 946 million euros respectively.
3 The (sub)Total is accounted for in the section on concentrations in the lending portfolio.

Above table already clearly shows the impact of KBC's revised focus, i.e. reduction in corporate exposure and increase in retail (mortgages) exposure. Next to refinements in PD and LGD models, the above decrease of retail RWA is mainly linked to the increased provisioning for retail portfolios (e.g., KBC Bank Ireland).

Note that the determination of RWA is not the same for exposure subject to IRB Foundation and exposure subject to the IRB Advanced approach. The difference is situated in the portfolio of defaulted exposure.

In line with the Basel II regulation, no RWA are defined for defaulted exposure calculated via the IRB Foundation approach. A capital impact for this exposure is determined at the level of KBC by a global comparison (i.e. the whole IRB portfolio) between the total Expected Loss and the provisions set aside to cover losses. 50% of any shortage in provisions must be deducted from tier-1 capital and 50% from tier-2 capital.

For defaulted exposures calculated via the IRB Advanced approach, relevant RWA, and thus required capital, are determined via the difference between the 'modelled loss given default' (*default* LGD, which includes the notion of downturn) and the 'best estimate expected loss' (EL, which is based on the provisions for these exposures). At KBC, this is currently only applicable for exposures in the retail asset class.

Credit exposure subject to the Standardised approach

The table below shows the exposure calculated via the Standardised approach broken down per exposure type. The exposure types are those defined for the purpose of regulatory reporting according to the Standardised approach, viz.:

- *Sovereign:* claims on central authorities and governments.
- *RGLA:* claims on Regional Governments and Local Authorities independently if these qualify as 'Sovereign' under the IRB approach.
- *PSE:* claims on Public Sector Entities.
- *MDB:* claims on Multilateral Development Banks independently if these qualify as 'Sovereign' under the IRB approach.
- *International Org.:* claims on a specific list of organisations (e.g., International Monetary Fund, European Central Bank).
- *Institutions:* claims on all remaining banks.
- *Corporates:* claims on all corporate exposure, including small and medium-sized enterprises that are treated as corporate clients.
- *Retail:* claims on retail clients (including SMEs not qualifying for treatment as corporate clients). Most of these claims are related to mortgages and categorised under 'secured by real estate'.
- *Secured by real estate:* claims that are (fully) covered by real estate collateral via mortgages and including real estate leasing. These are extracted from the above categories (mostly retail or corporate).
- *Past Due:* all exposure which is past due, meaning that it is more than 90 days in arrears. All past due exposure is extracted from all the other categories.
- *CIU:* claims on Collective Investment Undertakings.
- *High Risk:* exposure that is not collateralised and/or not rated, attracting a risk-weighting equal to or higher than 150% and therefore considered 'high risk'. Past due and equity exposure are excluded.

- *Covered bonds:* exposure for which the credit risk is mitigated by risk positions on very highly rated governments, authorities or institutions. Past due, equity and high-risk claims are excluded.
- *Short term:* exposure (to institutions or to corporates) which is rated and has a maturity less than three months. Past due, equity and high-risk claims are excluded. This exposure has been assigned to its respective exposure type, namely 'Institutions' or 'Corporates'.
- *Other*: all other claims (e.g., other assets).

In millions of EUR – 31-12-2009

Standardised exposure [EAD]	gross Exposure	net Exposure	RWA
Sovereign	13 253	13 253	330
RGLA	499	499	274
PSE	51	51	31
MDB	122	122	1
International Organisations	0	0	0
Institutions	2 205	2 205	698
Corporates	9 259	9 095	8 911
Retail	7 098	7 080	5 352
Secured by real estate	12 849	12 353	5 967
Past due	724	694	703
CIU	220	220	220
(sub)Total[1]	46 280	45 572	22 486
High risk	123	123	184
Covered bonds	0	0	0
Other	1 478	1 478	1 034
Total	47 881	47 173	23 704

In millions of EUR – 31-12-2010[2]

Standardised exposure [EAD]	gross Exposure	net Exposure	RWA
Sovereign	12 397	12 397	170
RGLA	511	510	460
PSE	35	34	27
MDB	13	13	1
International Organisations	0	0	0
Institutions	921	921	388
Corporates	7 302	7 139	7 133
Retail	7 696	7 677	5 758
Secured by real estate	11 747	11 257	5 654
Past due	755	726	658
CIU	14	14	14
(sub)Total[1]	41 391	40 688	20 265
High risk	14	14	22
Covered bonds	0	0	0
Short term	28	28	6
Other	1 235	1 235	887
Total	42 668	41 965	21 180

1 The (sub)Total is accounted for in the section on concentrations in the lending portfolio.
2 The portfolio of KBL EPB (not in scope of the 2010 figures) is mostly concentrated in sovereign (2 278 million euros), institutions (1 539 million euros) and corporate exposure (1 402 million euros).

Concentrations to credit risk in the lending portfolio

In order to portray an overall picture of the lending portfolio, the exposure calculated according to the Standardised approach and the IRB approach is aggregated based on the most material asset classes from the IRB approach. KBC believes this leads to a more transparent and uniform presentation of the concentrations to credit risk in the lending portfolio.

The exposure types under the Standardised approach are therefore mapped to the most applicable types/asset classes under IRB Foundation, viz.:

- *Secured by real estate:* this type of exposure is mapped according to the asset class of the underlying client from which the exposure originated, mostly retail, corporate or SME corporates.
- *Corporates:* this type of exposure is mapped to 'corporates' or 'SME corporates' depending on the internally used segmentation.
- *Past due:* this type of exposure is mapped according to the asset class of the underlying client from which the exposure originated.
- *RGLA, PSE, International organisations and MDB:* these exposure types are mapped mostly to the 'Institutions' asset class, or when distinguishable as eligible sovereign exposure to the asset class 'Sovereigns'.
- *CIU:* this exposure is mapped to the 'Institutions' asset class.

The Standardised exposure types of 'High risk', 'Covered bonds' and 'Short term' are all mapped to the 'Other' asset class due to their immateriality. The other mappings are rather straightforward.

For reasons of relevancy/materiality/data availability the 'Other' category is not included in the following tables.

Unless otherwise stated, all the results presented in this section are stated gross (i.e. without collateral benefits), and exposure is attributed to the asset class after PD substitution. This implies that if PD substitution is applied to a certain exposure to a borrower guaranteed by another party, the exposure will shift to the region, sector and exposure class of the guaranteeing party in the breakdowns below. For example, when a corporate entity is guaranteed by a bank and PD substitution is applied, this exposure will be incorporated under 'Institutions' in the breakdowns provided.

Total credit exposure in the lending portfolio per geographic region

In millions of EUR – 31-12-2009

Gross exposure [EAD]	Sovereign	Institutions	Corporates	SME Corporates	Retail	Total
Africa	12	106	76	15	11	220
Asia	400	1 069	1 895	116	3	3 484
Central and Eastern Europe & Russia	16 115	3 034	11 967	6 577	19 258	56 950
Latin America	167	128	303	0	7	605
Middle East	27	477	485	0	1	990
North America	2 801	780	5 989	99	7	9 675
Oceania	0	135	746	0	7	889
Western Europe	40 246	4 070	34 461	12 528	60 752	152 057
Total	59 767	9 799	55 922	19 336	80 045	224 870

In millions of EUR – 31-12-2010*

Gross exposure [EAD]	Sovereign	Institutions	Corporates	SME Corporates	Retail	Total
Africa	11	164	137	1	1	314
Asia	382	1 364	1 529	84	0	3 360
Central and Eastern Europe & Russia	18 719	1 633	9 289	6 777	21 696	58 114
Latin America	72	163	161	0	0	397
Middle East	0	514	455	6	0	976
North America	2 072	610	5 051	83	2	7 817
Oceania	0	77	799	1	0	877
Western Europe	39 382	3 000	30 608	12 535	62 091	147 616
Total	60 637	7 527	48 029	19 487	83 791	219 471

* KBL EPB (not in scope of the 2010 figures) mainly focuses on Western Europe.

The geographic regions in the above table are those where each borrower (or guarantor) is situated. The predominance of Western Europe reflects KBC's focus on its Belgian home market, along with its sizeable exposures to Ireland and – to a lesser extent – the UK, France and Germany. The importance of the second home market, Central and Eastern Europe, also stands out.

Total credit exposure in the lending portfolio per sector

In millions of EUR – 31-12-2009

Gross exposure [EAD]	Sovereign	Institutions	Corporates	SME Corporates	Retail	Total
Agriculture, Farming & Fishing	0	1	596	919	2 357	3 873
Authorities	59 514	66	19	0	0	59 599
Automotive	0	0	2 011	962	726	3 699
Building & Construction	0	0	3 497	1 234	1 458	6 189
Chemicals	0	0	2 305	657	67	3 029
Commercial Real Estate	0	0	8 837	3 052	954	12 844
Distribution	0	0	5 296	3 746	2 909	11 951
Electricity	0	0	3 287	123	5	3 415
Finance & Insurance	252	9 648	6 353	160	407	16 820
Food Producers	0	0	1 966	493	246	2 706
Metals	0	0	1 598	512	256	2 366
Oil, Gas & Other Fuels	0	0	1 801	93	2	1 896
Private Persons	0	0	575	82	65 485	66 142
Services	0	15	6 869	3 915	3 600	14 400
Shipping	0	0	1 157	497	101	1 755
Other[1]	0	68	9 755	2 889	1 472	14 185
Total	59 767	9 799	55 922	19 336	80 045	224 870

In millions of EUR – 31-12-2010[2]

Gross exposure [EAD]	Sovereign	Institutions	Corporates	SME Corporates	Retail	Total
Agriculture, Farming & Fishing	0	0	494	970	2 289	3 753
Authorities	60 397	38	338	0	0	60 773
Automotive	0	0	1 598	884	582	3 064
Building & Construction	0	0	3 307	1 209	1 460	5 976
Chemicals	0	0	2 328	602	60	2 990
Commercial Real Estate	0	0	8 135	2 616	926	11 677
Distribution	0	0	4 366	4 009	2 891	11 265
Electricity	0	0	2 637	161	4	2 803
Finance & Insurance	239	7 404	4 764	135	361	12 903
Food Producers	0	0	1 741	484	220	2 445
Metals	0	0	1 726	580	271	2 577
Oil, Gas & Other Fuels	0	0	1 784	91	5	1 880
Private Persons	0	0	26	86	69 484	69 595
Services	0	15	6 141	4 028	3 572	13 757
Other[1]	0	70	8 645	3 630	1 668	14 013
Total	60 637	7 527	48 029	19 487	83 791	219 471

1 All sectors with a concentration of less than 0.75% of the total EAD are aggregated into the other category.
2 The largest part of the exposure attributed to KBL EPB is situated in the sectors Sovereign and Institutions.

In view of KBC's substantial retail activities in most markets, 'private persons' represent a large share of this sector distribution. Moreover, the large percentage of 'authorities' is accounted for predominantly by investments in government bonds.

Maturity analysis of the total credit exposure in the lending portfolio

In millions of EUR – 31-12-2009

Residual maturity	Sovereign	Institutions	Corporates	SME Corporates	Retail	Total
<1 year	7 773	3 681	23 765	6 680	3 882	45 781
=>1 to <5 years	29 548	3 771	17 571	3 855	7 632	62 377
=>5 to <10 years	8 848	1 456	5 479	2 851	22 893	41 527
=>10 years	10 908	505	5 978	4 887	42 582	64 860
Until Further Notice[1]	2 689	386	3 130	1 063	3 057	10 323
Total	59 767	9 799	55 922	19 336	80 045	224 870

In millions of EUR – 31-12-2010[2]

Residual maturity	Sovereign	Institutions	Corporates	SME Corporates	Retail	Total
<1 year	7 174	3 476	19 777	6 733	3 572	40 732
=>1 to <5 years	30 011	2 763	13 952	3 640	8 101	58 467
=>5 to <10 years	11 017	811	4 775	2 807	31 713	51 122
=>10 years	11 566	396	8 559	5 679	39 328	65 527
Until Further Notice[1]	870	82	966	628	1 078	3 624
Total	60 637	7 527	48 029	19 487	83 791	219 471

1 Exposure without a concrete end-date is assigned to the 'Until Further Notice' category.
2 At KBL EPB, which is not included in the table, 74% of the exposure matures within five years.

About 45% of the lending portfolio will mature within five years.The longest maturities are mainly found in the retail asset class and relate primarily to mortgage loans to private persons.

Total credit exposure in the lending portfolio per product type

In millions of EUR – 31-12-2009

Gross exposure [EAD]	Sovereign	Institutions	Corporates	SME Corporates	Retail	Total
Guarantee	849	566	4 608	1 130	311	7 464
Debt instrument	49 317	3 329	2 686	1	87	55 420
Equity	0	211	327	7	0	545
Leasing	12	6	1 947	1 013	1 583	4 561
Mortgage loans	12	4	376	400	59 164	59 956
Other lending	9 577	5 682	45 979	16 786	18 900	96 924
Total	59 767	9 799	55 922	19 336	80 045	224 870

In millions of EUR – 31-12-2010*

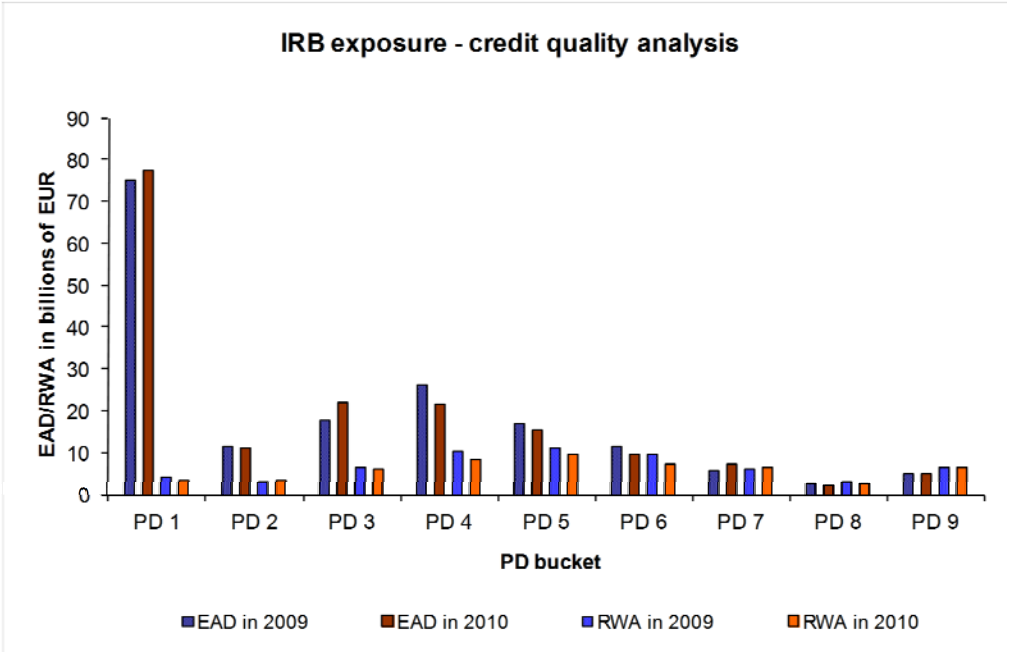
Gross exposure [EAD]	Sovereign	Institutions	Corporates	SME Corporates	Retail	Total
Guarantee	817	325	3 957	960	283	6 342
Debt instrument	50 461	2 742	1 580	3	0	54 786
Equity	0	10	160	14	0	185
Leasing	10	5	1 770	857	1 405	4 046
Mortgage loans	0	0	0	38	62 606	62 644
Other lending	9 349	4 444	40 562	17 614	19 498	91 467
Total	60 637	7 527	48 029	19 486	83 791	219 471

* KBL EPB (figures not included for 2010) is mainly active in product types debt instruments and other lending.

Quality analysis of the total credit exposure in the lending portfolio – IRB

The chart and table below show credit risk exposure per Probability of Default (PD) class in terms of EAD at year-end. Only the lending exposure subject to the IRB approach is captured in this table. A similar overview of the exposure subject to the Standardised approach appears in a subsequent table. The exposure (EAD) is presented together with the relevant RWA per PD rating.

Unlike the previous tables, the chart and table below show exposure before the application of guarantees. This means that there is no shift in asset class due to PD substitution. The RWA for the exposure, however, is presented after all collateral and guarantees have been applied. This allows an indication to be given of the mean residual RWA for a certain original exposure. The latter is also reflected in the 'weighted average' percentage.



As can be witnessed from the above graph, the rating distribution (in terms of EAD and RWA) was rather stable between 2009 and 2010. For more detailed figures, please refer to the table below.

Generally, the average weighting percentage increases as PD ratings worsen, which is in line with the principle that higher risks attract higher capital.

The PD scale presented is KBC's Masterscale for Probability of Default. For more information in this regard, please refer to the 'internal modelling' section.

In millions of EUR – 31-12-2009

PD Masterscale	gross Exposure [EAD] RWA Average in %	Sovereign	Institutions	Corporates	SME Corporates	Retail	Total
1 [0.00% - 0.10%]	Sum of EAD	42 404	5 073	6 863	562	20 368	75 271
	Sum of RWA	899	928	1 480	131	435	3 873
	weighted average	2%	18%	22%	23%	2%	5%
02 [0.10% - 0.20%]	Sum of EAD	142	617	5 860	1 123	3 814	11 556
	Sum of RWA	26	195	2 096	419	275	3 010
	weighted average	18%	32%	36%	37%	7%	26%
03 [0.20% - 0.40%]	Sum of EAD	156	621	7 859	2 771	6 202	17 609
	Sum of RWA	93	266	4 076	1 360	652	6 446
	weighted average	59%	43%	52%	49%	11%	37%
04 [0.40% - 0.80%]	Sum of EAD	8	244	7 863	3 103	15 099	26 317
	Sum of RWA	4	90	5 820	2 048	2 135	10 097
	weighted average	55%	37%	74%	66%	14%	38%
05 [0.80% - 1.60%]	Sum of EAD	110	571	7 504	3 081	5 524	16 790
	Sum of RWA	53	285	6 890	2 463	1 450	11 140
	weighted average	48%	50%	92%	80%	26%	66%
06 [1.60% - 3.20%]	Sum of EAD	106	85	4 999	2 234	4 176	11 599
	Sum of RWA	5	38	5 693	2 061	1 556	9 353
	weighted average	5%	45%	114%	92%	37%	81%
07[1] [3.20% - 6.40%]	Sum of EAD	165	87	2 932	1 193	1 228	5 605
	Sum of RWA	220	65	3 960	1 293	542	6 080
	weighted average	133%	75%	135%	108%	44%	108%
08 [6.40% - 12.80%]	Sum of EAD	9	21	906	438	1 226	2 602
	Sum of RWA	1	15	1 555	622	646	2 838
	weighted average	6%	68%	172%	142%	53%	109%
09 [12.80% - 100.00%]	Sum of EAD	0	40	1 824	751	2 376	4 991
	Sum of RWA	0	5	3 459	98	2 116	6 508
	weighted average	-	13%	190%	124%	89%	130%
Total gross exposure		43 100	7 360	46 611	15 256	60 013	172 340
Total risk-weighted assets		1 300	1 886	35 029	11 325	9 806	59 345
Total weighted average		3%	26%	75%	74%	16%	34%

1 Unrated exposure is assigned a PD% of 4.53% and allocated to PD bucket 7.

In millions of EUR – 31-12-2010

PD Masterscale	gross Exposure [EAD] RWA Average in %	Sovereign	Institutions	Corporates	SME Corporates	Retail	Total
1 [0.00% - 0.10%]	Sum of EAD	43 985	4 186	6 910	617	21 641	77 338
	Sum of RWA	625	685	1 433	141	405	3 290
	weighted average	1%	16%	21%	23%	2%	4%
02 [0.10% - 0.20%]	Sum of EAD	310	775	6 133	1 216	2 418	10 852
	Sum of RWA	81	188	2 304	424	169	3 166
	weighted average	26%	24%	38%	35%	7%	29%
03 [0.20% - 0.40%]	Sum of EAD	136	656	6 898	2 583	11 502	21 775
	Sum of RWA	72	294	3 603	1 244	949	6 162
	weighted average	53%	45%	52%	48%	8%	28%
04 [0.40% - 0.80%]	Sum of EAD	457	114	6 483	2 769	11 816	21 639
	Sum of RWA	357	57	4 601	1 772	1 729	8 515
	weighted average	78%	50%	71%	64%	15%	39%
05 [0.80% - 1.60%]	Sum of EAD	44	640	6 223	2 868	5 394	15 170
	Sum of RWA	3	394	5 658	2 277	1 283	9 614
	weighted average	7%	61%	91%	79%	24%	63%
06 [1.60% - 3.20%]	Sum of EAD	115	60	3 678	1 871	3 672	9 395
	Sum of RWA	11	33	4 118	1 743	1 303	7 208
	weighted average	10%	55%	112%	93%	35%	77%
07[1] [3.20% - 6.40%]	Sum of EAD	58	51	2 473	1 394	3 089	7 064
	Sum of RWA	4	37	3 481	1 523	1 415	6 460
	weighted average	7%	73%	141%	109%	46%	91%
08 [6.40% - 12.80%]	Sum of EAD	25	19	908	566	700	2 219
	Sum of RWA	42	13	1 559	775	336	2 725
	weighted average	167%	69%	172%	137%	48%	123%
09 [12.80% - 100.00%]	Sum of EAD	0	10	1 371	656	2 738	4 775
	Sum of RWA	0	22	2 973	1 137	2 415	6 547
	weighted average	0%	230%	217%	173%	88%	137%
Total gross exposure		45 130	6 511	41 077	14 539	62 970	170 227
Total risk-weighted assets		1 196	1 722	29 728	11 036	10 005	53 687
Total weighted average		3%	26%	72%	76%	16%	32%

1 Unrated exposure is assigned a PD% of 4.53% and allocated to PD bucket PD 7.

With reference to the retail exposure, which is treated according to the IRB Advanced approach, key data are shown in the table below (i.e., EAD, the outstanding amount, the undrawn amount, the EAD-weighted mean Credit Conversion Factor (CCF %) applicable to the undrawn amount and the EAD-weighted mean LGD percentages).

Further detailed quality information on retail exposure
In millions of EUR – 31-12-2009

PD	1	2	3	4	5	6	7	8	9	Total
EAD	20 305	3 880	6 254	15 254	5 468	4 383	1 196	1 207	2 347	60 293
Outstanding amount	19 722	3 507	5 857	14 859	5 228	4 040	1 100	1 182	2 321	57 816
Undrawn amount	947	638	691	656	414	437	148	46	41	4 018
Average CCF %	61.6%	58.5%	57.4%	60.1%	57.8%	78.5%	64.7%	54.8%	66.4%	61.7%
LGD %	14.1%	21.3%	19.6%	16.9%	20.9%	19.4%	20.7%	16.8%	20.3%	17.3%

In millions of EUR – 31-12-2010

PD	1	2	3	4	5	6	7	8	9	Total
EAD	21 641	2 418	11 502	11 816	5 394	3 672	3 089	700	2 738	62 970
Outstanding amount	20 998	2 070	11 070	11 439	5 101	3 438	2 823	666	2 710	60 315
Undrawn amount	1 087	650	732	612	501	339	333	59	45	4 359
Average CCF %	59.2%	53.5%	59.3%	61.7%	58.6%	68.9%	79.8%	57.6%	62.2%	60.9%
LGD %	14.4%	20.9%	15.3%	16.6%	19.1%	20.1%	17.4%	21.4%	17.1%	16.3%

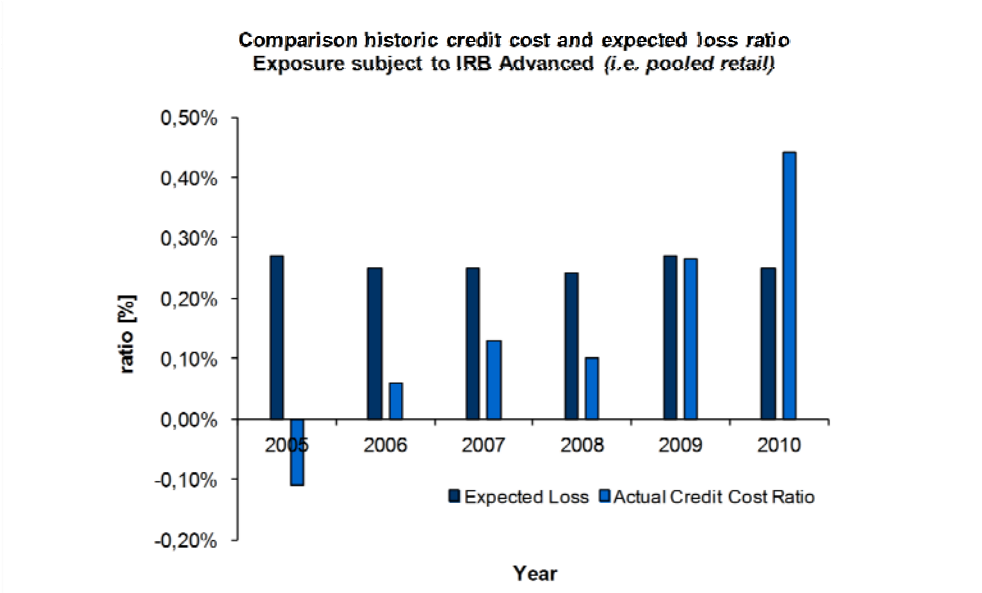
Strictly pursuant to Basel II pillar 3 rules, KBC should disclose a comparison of 'expected losses' with 'actual losses' over a longer period in time and broken down by asset class. KBC believes that this disclosure is less relevant for a portfolio that is largely made up of exposure subject to the IRB Foundation approach, since only one underlying parameter of the EL, namely PD, is subject to own estimates/models.

Therefore, KBC has chosen to disclose this comparison only for the retail portfolio which is subject to the IRB Advanced approach (see first graph below). As regards the exposure subject to the IRB Foundation approach, KBC discloses what it believes to be a valid alternative (see second graph below).

The first graph compares KBC's EL ratio (EL related to the outstanding amount) with the actual average credit cost percentage. Note that EL expresses the modelled expectations with a one-year time horizon and thus there is a time lag compared to the credit cost ratio.

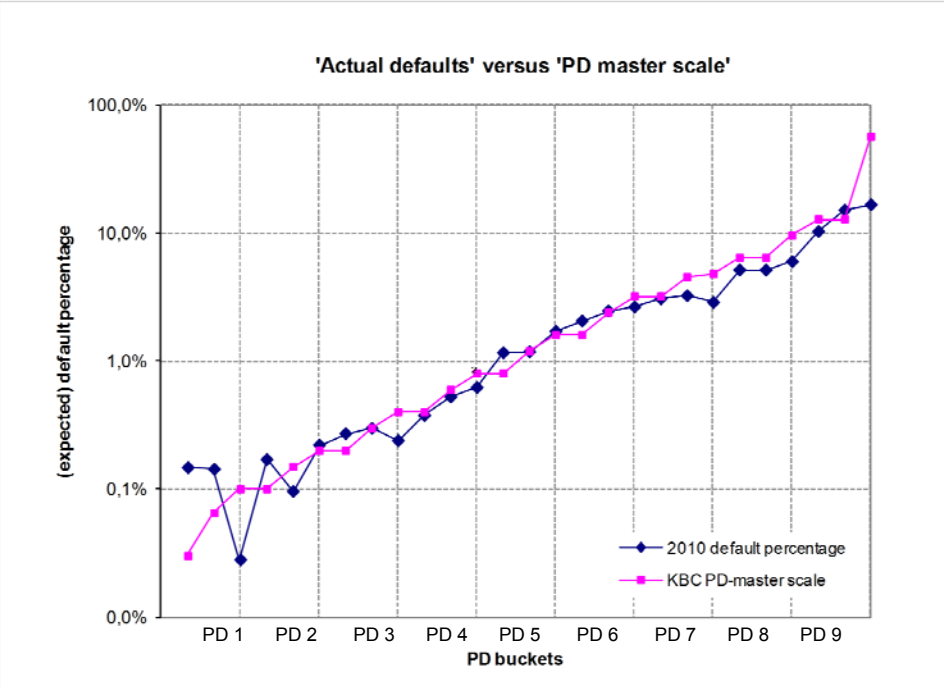
Only the normal (i.e. non-default) portfolio is taken into account.

KBC Homeloans only switched from the Standardised to the IRB approach halfway through 2008 and was thus only incorporated into the graph below for 2009 and 2010. The retail portfolio of ČSOB Czech Republic, which is also subject to the IRB approach, is not included in the scope of this graph.



The economic downturn of past years, especially in Ireland, is responsible for an increasing number of defaults and higher losses given these defaults, and is thus reflected by the fact that the credit cost ratio shown in the graph is now higher than the EL ratio. This is mainly linked to the mortgage portfolio of KBC Bank Ireland and the extra provisions that were set aside for it in 4Q 2010.

With reference to the portfolio subject to the IRB Foundation approach (i.e. non-retail), the predictiveness of KBC's models is presented via a comparison between the percentage of defaults expected at year-end 2009, according to KBC's PD-Masterscale and the actual outcome (measured in observed defaults over the past year devided by the number of non-defaults at the beginning of the year) in the table below. It should be noted that every bucket of the PD scale from PD 1 to PD 9 is further subdivided into three intervals resulting in a total of 27 data points. The IRB Foundation portfolio of ČSOB Czech Republic and KBC FP are not included in the scope of the graph below.



Overall, the actual default percentage closely follows the predicted one according to the masterscale.

In 2009, there was a downward spike in the PD 7 bucket, related to unrated and not timely re-rerated (i.e. more than 18 months) counterparts. For these counterparts KBC uses a penalising PD of 4.53%, corresponding to PD 7, which is higher than the observed default percentage for such unrated and not timely re-rated counterparts.
Thanks to increased focus during 2010 on reducing the unrated and not timely re-rated counterparts, this downward spike has significantly been reduced as compared to last year.

Quality analysis of the total credit exposure in the lending portfolio – Standardised

As mentioned above, only the lending exposure subject to the Standardised approach is dealt with in this section.

KBC uses the regulatory defined risk buckets to assess the quality and linked risk weight for all exposure calculated according to the Standardised approach. It uses external ratings from S&P, Fitch and Moody's to define the risk bucket of exposures.
The table below shows credit risk exposure calculated according to the Standardised approach broken down by type of exposure and risk bucket. Unlike previous indications, the gross exposure appearing in this table is not only before the application of eligible collateral, but also before the application of guarantees, which means that substitution effects are not taken into account.
Much of the exposure is assigned to the unrated bucket. This includes the 'secured by real estate' exposure, which does not require a rating. Obviously, the retail exposure is assigned to the unrated bucket.

In millions of EUR – 31-12-2009

Standardised exposure [EAD]		Quality steps							
		1	2	3	4	5	6	Unrated	Total
Sovereign	gross	3 198	2 497	4 748	27	3	0	2 780	13 253
	net	3 198	2 497	4 748	27	3	0	2 780	13 253
RGLA	gross	130	57	0	0	3	0	308	499
	net	130	57	0	0	3	0	308	499
PSE	gross	0	33	8	0	0	0	11	51
	net	0	33	8	0	0	0	10	51
MDB	gross	13	0	0	0	0	0	109	122
	net	13	0	0	0	0	0	109	122
International Org.	gross	0	0	0	0	0	0	0	0
	net	0	0	0	0	0	0	0	0
Institutions	gross	373	488	203	4	56	9	1 071	2 204
	net	373	488	203	4	56	9	1 071	2 204
Corporates	gross	44	333	283	42	0	1	8 557	9 260
	net	44	333	283	42	0	1	8 393	9 096
Retail	gross	0	0	0	0	0	0	7 098	7 098
	net	0	0	0	0	0	0	7 080	7 080
Secured by real estate	gross	0	6	0	0	0	0	12 843	12 849
	net	0	6	0	0	0	0	12 347	12 353
Past due	gross	0	0	0	0	0	0	724	724
	net	0	0	0	0	0	0	694	694
High risk	gross	0	0	0	0	0	0	122	123
	net	0	0	0	0	0	0	122	123
Covered bonds	gross	0	0	0	0	0	0	0	0
	net	0	0	0	0	0	0	0	0
CIU	gross	0	0	0	17	0	0	203	220
	net	0	0	0	17	0	0	203	220
Other	gross	0	0	0	0	0	0	1 478	1 478
	net	0	0	0	0	0	0	1 478	1 478
Total	gross	3 759	3 415	5 241	90	62	10	35 304	47 881
	net	3 759	3 416	5 241	90	62	10	34 596	47 173

In millions of EUR – 31-12-2010*

Standardised exposure [EAD]		Quality steps							
		1	2	3	4	5	6	Unrated	Total
Sovereign	gross	3 553	2 539	4 356	0	0	0	1 947	12 396
	net	3 553	2 539	4 356	0	0	0	1 947	12 396
RGLA	gross	0	38	6	0	0	0	467	511
	net	0	38	6	0	0	0	467	511
PSE	gross	0	34	0	0	0	0	1	35
	net	0	34	0	0	0	0	1	34
MDB	gross	12	0	1	0	0	0	0	13
	net	12	0	1	0	0	0	0	13
International Org.	gross	0	0	0	0	0	0	0	0
	net	0	0	0	0	0	0	0	0
Institutions	gross	205	319	144	26	50	3	173	921
	net	205	319	144	26	50	3	173	921
Corporates	gross	0	24	25	24	0	0	7 228	7 300
	net	0	26	25	24	0	0	7 063	7 137
Retail	gross	0	0	0	0	0	0	7 719	7 719
	net	0	0	0	0	0	0	7 700	7 700
Secured by real estate	gross	0	2	0	0	0	0	11 745	11 747
	net	0	2	0	0	0	0	11 254	11 256
Past due	gross	0	0	0	0	0	0	716	716
	net	0	0	0	0	0	0	686	686
High risk	gross	0	0	0	0	0	0	34	34
	net	0	0	0	0	0	0	34	34
Covered bonds	gross	0	0	0	0	0	0	0	0
	net	0	0	0	0	0	0	0	0
CIU	gross	0	0	0	14	0	0	0	14
	net	0	0	0	14	0	0	0	14
Short term	gross	28	0	0	0	0	0	0	28
	net	28	0	0	0	0	0	0	28
Other	gross	1	0	0	0	0	0	1 234	1 235
	net	1	0	0	0	0	0	1 234	1 235
Total	gross	3 800	2 955	4 533	63	50	3	31 264	42 668
	net	3 800	2 957	4 533	63	50	3	30 559	41 965

* KBL EPB: 35% of its gross EAD is top rated (quality step 1), 47% is unrated.

Impaired credit exposure in the lending portfolio

The tables show impaired credit risk exposure per geographic region and per sector.

The tables include all exposure in the lending portfolio, independently of the regulatory approach or the assigned exposure type or asset class. If exposure is treated according to the IRB approach, impairment is determined in the same way as for accounting purposes, i.e. the PD assigned to the obligor of the exposure is PD 10, 11 or 12. If exposure is treated according to the Standardised approach, impairment is determined by the fact that provisions were set for the exposure and/or as 'past due' in this section. It is worth mentioning that the EAD reported here and originated via the Standardised approach, already takes provisions for the exposure into account. For exposure calculated according to the IRB approach, this is not the case.

In millions of EUR

Impaired gross exposure per geographic region [EAD]	31-12-2009	31-12-2010*
Africa	0	0
Asia	139	138
Central and Eastern Europe & Russia	1 830	2 618
Latin America	43	30
Middle East	15	15
North America	474	285
Oceania	2	41
Western Europe	5 106	6 456
Total	7 609	9 582

* In 2010, KBL EPB's impaired gross exposure (not in scope of the 2010 figures) amounted to 43 million euros, mainly situated in Western Europe.

In millions of EUR

Impaired gross exposure per sector [EAD]	31-12-2009	31-12-2010
Agriculture, Farming & Fishing	157	182
Automotive	315	268
Building & Construction	279	571
Chemicals	160	205
Commercial Real Estate	1 206	2 048
Distribution	897	1 065
Electrotechnics	102	99
Finance & Insurance	278	134
Horeca	163	281
IT	137	130
Machinery & Heavy Equipment	184	129
Metals	115	200
Private Persons	2 047	2 252
Services	493	691
Shipping	135	176
Textile & Apparel	221	196
Other*	720	957
Total	7 609	9 582

* All sectors with a concentration of less than 1% of the total EAD in 2010 are aggregated into the other category.

For all data on impairment, provisions and value adjustments, reference is made to the consolidated annual accounts section of KBC's annual report for 2010 (Notes 14 and 21).

Counterparty credit risk

KBC defines counterparty credit risk as the credit risk resulting from over-the-counter transactions (i.e. where there is no formal Exchange), which are in the main Credit Default Swaps (CDS), interest-related transactions (e.g., Interest Rate Swaps), currency-related transactions (e.g., FX swap), equity-related transactions or commodity transactions. In principle, it includes repo-like transactions, which are measured in-house and managed like other over-the-counter transactions. However, in this report, repo-like transactions are not covered here, but instead are dealt with in the section on 'Credit risk mitigation', owing to the fact that repo-like transaction are precisely a way of reducing (mitigating) credit risk and risk mitigation is highlighted separately.
No distinction is made between counterparty credit risk arising from exposures subject to the IRB approach or to the Standardised approach, nor from the banking or trading book.

The tables show the counterparty credit risk for the entities referred to in the scope description of credit risk disclosures.

Counterparty limits are set for each individual counterparty, taking into account the general rules and procedures set out in a group-wide policy. Sub-limits can be put in place for each product type. The risk is monitored by a real-time limit control system, allowing dealers to check limit availability at any time. A pre-deal check occurs before the conclusion of each transaction using 'heavy' add-ons which are higher than the regulatory add-ons.

Close-out netting and collateral techniques are used wherever possible (subject to legal certainty about applicability). These techniques are discussed in the next section. The netting benefits and risk mitigation through collateral for OTC-derivative transactions are however already shown in the table below.

In millions of EUR – 31-12-2009

Transaction type	Marked-to-market	Add-on	Gross counterparty risk [EaD]	Notional value of contracts	Regulatory capital*
CDS bought -Trading	5 383	6 616	11 999	94 223	208
CDS sold - Trading	1 302	3 995	5 297	98 449	44
Other	1	3	4	29	0
Total credit derivatives	6 686	10 614	17 300	192 702	253
Interest Rate Swaps (IRS)	9 065	2 452	11 274	466 706	138
Caps/Floors	594	256	840	26 427	10
Other	293	344	594	39 417	11
Total interest-related transactions	9 950	3 053	12 708	532 551	160
FX forward	452	346	798	28 879	14
FX swap	530	549	1 030	51 746	5
Cross Currency IRS	1 518	4 964	6 164	94 499	54
Other	155	90	245	8 549	3
Total currency-related transactions	2 654	5 949	8 237	183 673	76
Equity swaps	2 925	2 238	5 155	66 353	22
Equity options	831	751	1 566	16 943	9
Total equity-related transactions	3 757	2 990	6 746	83 297	33
Total commodity transactions	42	49	90	420	0
Gross counterparty risk	23 089	22 655	45 081	992 642	
- Netting benefit			-27 478		
Total counterparty risk after netting			17 702		
- Collateral benefit			-1 647		
Total net Counterparty risk			16 055		523

* Based on the net counterparty risk of the transaction type

In millions of EUR – 31-12-2010

Transaction type	Marked-to-market	Add-on	Gross counterparty risk [EaD]	Notional value of contracts	Regulatory capital[1]
CDS bought -Trading	1 079	2 207	3 308	27 020	138
CDS sold - Trading	78	469	665	31 099	6
Other	0	1	2	15	0
Total credit derivatives	1 158	2 677	3 974	58 134	143
Interest Rate Swaps (IRS)	5 821	1 504	7 342	321 232	114
Caps/Floors	773	268	1 041	28 566	12
Other	303	331	634	38 617	9
Total interest-related transactions	6 898	2 103	9 017	388 415	135
FX forward	261	271	533	21 354	7
FX swap	830	769	1 599	73 207	6
Cross Currency IRS	1 274	1 081	2 355	65 723	18
Other	188	175	363	13 085	3
Total currency-related transactions	2 553	2 296	4 849	173 369	35
Equity swaps	2 402	2 044	4 445	60 380	17
Equity options	491	351	869	7 161	5
Total equity-related transactions	2 893	2 395	5 315	67 541	22
Total commodity transactions	46	55	101	491	0
Gross counterparty risk	13 548	9 525	23 257	687 950	
- Netting benefit			-12 390		
Total counterparty risk after netting			10 867		
- Collateral benefit			-1 407		
Total net Counterparty risk [2]			9 460		335

1 Based on the net counterparty risk of the transaction type.
2 KBL EPB's net counterparty credit risk (EAD) amounted to 186 million EUR at the end of 2010.

Below, a breakdown of the net counterparty risk is provided both by geographic region (i.e. where the counterparty is located) and by rating band (based on external ratings). This reveals that around 80% of the total counterparty credit risk is exposure to investment-grade counterparties.

In millions of EUR

Net derivative exposure per geographic region [EAD] [1]	31-12-2009	31-12-2010
Africa	5	4
Asia	294	216
Central and Eastern Europe & Russia	844	779
Latin America	4	2
Middle East	91	81
North America	2 668	1 170
Oceania	38	46
Western Europe	12 109	7 161
Total	16 055	9 460

Net derivative exposure per rating band[2] [EAD] [1]	31-12-2009	31-12-2010
AAA	350	650
AA	5 828	2 911
A	6 158	3 370
BBB	1 061	838
BB	718	1 080
B and below	317	396
No rating	1 622	215
Total	16 055	9 460

1 After collateral and netting benefits have been taken into consideration.
2 For instance, rating band AA incorporates ratings AA+, AA and AA-. If multiple ratings are available, the second best is used.

As mentioned earlier, the EAD is calculated as the sum of the (positive) current replacement value (marked-to-market) of a transaction and the applicable add-on (= current exposure method).

It is worthwhile mentioning that a PFE methodology (Potential Future Exposure) is also used in-house at KBC FP. This is a simulation-based methodology that takes the effect of collateral agreements in the counterparty exposure fully into account. Counterparty exposure is estimated conservatively via scenarios drawn from the historical distribution of the underlying risk factors, the possible risk of exposure during an extended margin period of risk of either 10 or 20 days depending on the complexity and liquidity of reference assets. KBC FP uses a PFE percentile of 99% as the internal risk measure to check limit utilisation.

Credit risk mitigation

Credit risk mitigation entails the use of techniques to lower credit risk and hence capital needs, e.g., regulatory capital.

Netting

At the end of December 2010, KBC did not engage in on-balance-sheet-netting (i.e. the offsetting of balance-sheet products such as loans and deposits).
Close-out netting, on the other hand, is applied in order to manage the counterparty risk arising from derivative transactions. For netting to apply, such transactions need to be documented under ISDA-92 or ISDA-2002 Master Agreements. In addition, nettability rules have been established for all relevant jurisdictions and all relevant products, based on legal opinions published by the ISDA. Accordingly, close-out netting is only applied if legal effectiveness and enforceability is assured.

Based on figures for the end of December 2010, the netting impact on derivative exposure amounted to 12.4 billion euros. Intra-group netting is not included in this figure.

Collateral in repo transactions

KBC engages in the following types of repo transaction:

- *Reverse repos and 'buy and sell-back' transactions:* These transactions are considered deposits made by KBC, with KBC lending cash against securities, which are the credit risk mitigant, until the cash is repaid. The difference between reverse repos and buy and sell-backs is technical and relates to the way coupon payments are handled during the transaction.
  The securities underlying the reverse repo transactions are almost solely government securities (99% of the 8.0 billion euros), with the underlying issuers of the remaining securities being mainly banks and corporate entities. In order to conclude such transactions, a standard General Master Repurchase Agreement (GMRA) contract needs to be concluded with the counterparty, and legal certainty must exist for all relevant jurisdictions. Transactions also need to be compliant with KBC's repo policies for all relevant entities.

- *Repos and 'sell and buy-back' transactions:* These transactions are considered funding, as KBC receives cash in exchange for securities provided as collateral until the cash is repaid. Here too, the difference between repos and sell and buy-backs is a technical one.

- *Tri-party repo transactions:* These transactions are a specific type of reverse repo, where KBC would lend cash and would receive securities as collateral but, unlike regular reverse repos, the collateral is managed by a third party and more types of collateral can be used as stipulated in the tri-party repo contracts. Exposure to these at both reporting dates was zero

In millions of EUR – 31-12-2009

	Exposure [EAD]	Covered exposure [EaD]	Covered exposure [%]
Reverse repos/'buy and sell-back'[1]	15 268	11 172	73.2%[3]
Repos/'sell and buy-back'[2]	22 958	22 219	96.8%
Total	38 226	33 392	87.4%

In millions of EUR – 31-12-2010[4]

In millions of EUR – 31-12-2010[4]

	Exposure [EAD]	Covered exposure [EaD]	Covered exposure [%]
Reverse repos/'buy and sell-back'[1]	12 233	8 040	66%[3]
Repos/'sell and buy-back'[2]	23 274	23 110	99%
Total	35 507	31 150	88%

1. The covered exposure is lower than the exposure, as the security amount is corrected for regulatory haircuts and mismatches.
2. The exposure of repo transactions, which is based on the market value of the securities in the transaction, is higher than the coverage by cash (covered exposure), which is also due to the notion of haircuts. These haircuts are added to the securities leg of the transaction.
3. This low percentage is due to transactions at ČSOB Czech Republic where the reverse repo counterparty and the counterparty of the securities is the same, namely the Czech National Bank (CNB). Therefore the collateral is not eligible for capital purposes, and thus not included in the coverage percentage. There is however no capital impact since the CNB carries a zero PD rating.
4. KBL EPB's (not included in the 2010 figures) gross exposure to repo-like transactions amounts to 5.5 billion euros of which 3 billion for reverse repos and 2.5 billion for repos. The covered exposure amounts to 5.3 billion euros.

Other collateral

This section covers credit risk mitigation by means of collateral provided to cover the counterparty risk arising from derivative transactions and the lending portfolio. The tables show the EAD covered broken down into different portfolios and different types of credit risk mitigation.

Counterparty risk arising from derivative transactions (excluding repo-like transactions)

With regard to collateral for counterparty risk arising from derivative transactions (other than repos which are covered above), a collateral management policy is in place. Financial collateral is only taken into account if the assets concerned are considered eligible risk-mitigants for regulatory capital calculations. This implies, among other things, that legal comfort must have been obtained regarding the ownership of the collateral for all relevant jurisdictions.

Of the total counterparty risk exposure after netting and before collateral, 12.9% (1 407 million out of 10 867 million euros) was classified as collateralised at the end of 2010. A breakdown of covered exposure values by exposure classes and type of collateral is provided in the table below. At the end of 2010, both debt securities and cash collateral were taken into account for credit risk mitigation of counterparty risk exposure. In this respect, it is noted that according to the applicable policy, equity collateral is not eligible.

In millions of EUR – 31-12-2009

Covered exposure [1,2] [EaD]	LGD % applied under IRB Foundation	Sovereigns	Institutions	Corporates	SME Corporates	Total
Cash	0%	0	1 147	500	0	1 647
Debt securities	0%	0	0	0	0	0
Total		0	1 147	500	0	1 647

In millions of EUR – 31-12-2010[3]

Covered exposure [1,2] [EaD]	LGD % applied under IRB Foundation	Sovereigns	Institutions	Corporates	SME Corporates	Total
Cash	0%	0	924	440	0	1.364
Debt securities	0%	0	43	0	0	43
Total		0	967	440	0	1.407

1. Covered EAD is the EAD amount (after netting) on which a reduced LGD percentage is applied due to collateralisation.
2. The exposure only relates to the covered counterparty risk arising from derivative transactions.
3. Impact of KBL EPB (not included in the 2010 figures) is immaterial.

Lending portfolio

The retail segment is not included in the exposure classes in the table below, as it is irrelevant in a collateral context of exposure subject to the IRB approach, because retail is handled through the IRB Advanced approach and collateral is included in LGD modelling (See 'IRB Quality analysis').
Collateral applying to lending exposure subject to the Standardised approach have a direct effect by lowering the EAD, which in turn has a direct effect on RWA and on capital. Since, LGD is irrelevant for these exposures, the collateral is not included in the table and only the total aggregate collateralised EAD is given.

Of the non-retail lending EAD, 6.9% (7.8 billion euros of 112.9 billion euros) was classified as collateralised at the end of 2010 implying that a lower LGD percentage is applied to this portion of exposure in the capital calculations. The impacted exposure is to be interpreted as the total collateralised[2] EAD to which an LGD percentage of 0%, 30%, 35% or 40% has been applied in the capital requirement calculations (compared to an LGD of 45% as used for un-collateralised amounts). The exact percentages depend on the type of collateral concerned as indicated in the table below.
It is clear that credit risk mitigation is only applied when the necessary policies and procedures are in place. Only the collateral meeting the eligibility criteria and minimum requirements (as imposed by the CRD) to qualify for credit risk mitigation has been included in the figures. Hence, bearing in mind that the figures refer to collateralised EAD as described in the previous paragraph, the effective amount of collateral obtained in KBC is much higher than the figure taken into account for risk mitigation purposes. Real estate collateral obtained for KBC's commercial real estate financing activities is not taken into account for credit risk mitigation purposes, for instance. It does not meet the conditions for credit risk mitigation, since the impact is already partially reflected in the PD rating under the IRB approach.

[2] After the application of haircuts, mismatch corrections and collateralisation floors

The table below gives the total EAD covered by eligible financial and physical collateral for each exposure class.

In millions of EUR – 31-12-2009

Covered IRB lending exposure [EAD][1]	LGD applied under IRB Foundation[2]	Sovereign	Institutions	Corporates	SME Corporates	Total
Cash	0%	0	2	317	125	444
Debt securities	0%	0	0	35	24	60
Equity collateral	0%	0	0	192	83	276
Total financial collateral		1	2	545	233	780
Real estate[3]	30%	33	0	2 191	2 868	5 093
Receivables	35%	0	0	1 257	1 310	2 568
Lease collateral	35%	0	0	0	0	0
Other physical collateral	40%	0	0	329	332	661
Total physical collateral		34	0	3 778	4 510	8 322
General total		34	2	4 322	4 743	9 102

In millions of EUR – 31-12-2010[4]

Covered IRB lending exposure [EAD][1]	LGD applied under IRB Foundation[2]	Sovereign	Institutions	Corporates	SME Corporates	Total
Cash	0%	1	6	322	164	493
Debt securities	0%	0	0	58	22	80
Equity collateral	0%	1	0	154	79	234
Total financial collateral		2	6	534	265	807
Real estate[3]	30%	17	9	1 987	3 151	5 164
Receivables	35%	0	0	587	287	874
Lease collateral	35%	0	0	0	0	0
Other physical collateral	40%	74	1	418	476	970
Total physical collateral		91	10	2 992	3 914	7 008
General total		93	16	3 526	4 179	7 815

1 Covered EAD is the EAD amount subject to a reduced LGD percentage due to collateralisation.

2 The LGD percentages are those applied in accordance with Belgian regulations.

3 Including real estate leasing.

4 Impact of KBL EPB (not included in the 2010 figures) is immaterial.

The table shows that the bulk of the collateralised amounts relates to physical collateral (7.0 billion euros or 6.2% of the total non-retail lending EAD), while financial collateral, which has a bigger impact on capital as it attracts a LGD of 0%, is limited to 0.8 billion (0.7% of the total non-retail EAD). Furthermore, as financial collateral is predominantly cash collateral and non-cash financial collateral is amply diversified, issuer concentration risk in respect of financial collateral is negligible.

Where physical collateral is concerned, the concentrations shown in the table are in line with expectations, as most collateral is held for the 'Corporates' and 'SME Corporates' asset classes (and not 'Sovereign' and 'Institutions'). The focus on real estate collateral in these asset classes reflects the preference for this type of asset when collateral is called for.

Collateralised amounts in the lending portfolio subject to the Standardised approach came to 0.2 billion euros of financial collateral and 0.8 billion euros of physical collateral.

Unfunded credit protection

Unfunded credit protection is provided mainly through guarantees and – to a lesser extent – credit derivatives entered into for hedging purposes. For guarantees, the impacted exposure (i.e. amounts receiving a better rating through PD substitution, resulting in lower capital requirements) amounted to 6.4 billion euros at the end of 2010, or 4.7% of total non-retail lending EAD (135.7 billion euros). For credit derivatives, this impact is limited, as they only mitigate credit risk for an amount of 43 million euros.

In millions of EUR – 31-12-2009

Covered exposure [EAD][1,2,3]	Sovereign	Institutions	Corporates	SME Corporates	Total
Credit derivatives	0	0	96	0	96
Guarantees	1 381	914	3 443	204	5 942
Total	1 381	914	3 539	204	6 037

In millions of EUR – 31-12-2010[4]

Covered exposure [EAD][1,2,3]	Sovereign	Institutions	Corporates	SME Corporates	Total
Credit derivatives	0	0	43	0	43
Guarantees	2 029	727	3 349	268	6 373
Total	2 029	727	3 391	268	6 416

1 Covered exposure is the EAD amount after netting covered by guarantees or credit derivatives and thus subject to substitution.

2 The breakdown refers to the exposure classes before substitution is applied.
3 The scope of the table includes the Standardised and the IRB approach.
4 Impact of KBL EPB (not included in the 2010 figures) is immaterial.

The main types of guarantors and providers of protection through credit derivatives are government entities and large financial institutions such as banks, investment banks and insurance companies.

Internal modelling

The credit risk models developed by KBC over the years to support decisions in the credit process include Probability of Default models (PD), Loss Given Default models (LGD) and Exposure At Default models (EAD) models, plus application and behavioural scorecards for specific portfolios (retail and SME).

These models are used in the credit process for:

- defining the delegation level for credit approval (e.g., PD models);
- accepting credit transactions (e.g., application scorecards);
- setting limits (e.g., EL limits);
- pricing credit transactions (predominantly through the use of the RAROC concept);
- monitoring the risk of a (client) portfolio (Risk Signals Databases);
- calculating the internal economic capital;
- calculating the regulatory capital;
- input for other credit risk models (e.g., behavioural scores as pooling criteria for the retail portfolio).

Probability of Default models

Probability of Default (PD) is the likelihood that an obligor will default on its obligations within a one-year time horizon, with default being defined in accordance with Basel II rules. The PD is calculated for each client or for a portfolio of transactions with similar attributes (pools in retail portfolios).

There are several approaches to estimating PDs (from purely objective to more subjective methods); however, all have four steps in common:

Step 1: The segment for which a model will be built is defined (segmentation of the portfolio). It is important that a good balance be struck between the homogeneity of the segment, the exposure, the number of clients and the number of default events. Having too many models will lead to additional operational risks in the credit process, smaller and less reliable data samples and high maintenance costs. On the other hand, the predictability of the models will go down if the segments are less homogeneous. Once the segment has been defined, the data sample on which the model development will be based can be created. This usually requires some 'cleansing' of the available data (for instance, handling missing values and outliers). KBC has built its rating models mainly on internal data.

Step 2: This entails ranking the clients in the targeted segment according to their creditworthiness. Depending on the amount of data available and its characteristics (subjective or objective), specific techniques are used in order to create a ranking model.

- Statistical default/non-default models based on objective inputs: Rankings are derived purely mechanically with no subjective input, using regression techniques. At KBC, this method is only used in the retail segment where objective data is plentiful (e.g., behavioural information).
- Statistical default/non-default models based on objective and subjective input: These are very similar to the purely objective models, but also use subjective input entered by a credit adviser (for instance management quality). At KBC, this method is used to rank large Western European corporate customers, for example.
- Statistical expert-based models: Rankings are based on quantitative and qualitative input, but due to the small number of observed default events, regression is applied to predict expert assessments of the creditworthiness of the clients, rather than their default/non-default behaviour. At KBC, this method is used to rank borrowers in the 'Commercial real estate and site financing' segment, for example.
- Generic flexible rating tool: This is a template that is used by 'graders' to justify and document the given rating class. In this template, the most relevant risk indicators are given a score and ranked in order of importance as a basis for a final rating.

Step 3: The ranking score is calibrated to a probability of default.

Step 4: The probability of default is mapped to a rating class. There is a unique rating scale at KBC for all segments, the so-called KBC Masterscale.

Once all the steps have been taken and the model built and implemented, the quality of the PD models developed is measured by:

- Statistical analysis: variable distributions (means, standard deviations), rating distributions, statistical powers of variables and (sub)models.
- The number of overrulings: if users frequently overrule the output of a model, this indicates that the model might be improved.
- The soundness of model implementation and policies, more specifically as regards system access, system security, integrity of data input, etc.
- The available documentation (user manual, technical reports, etc.).

Loss Given Default models

Loss Given Default (LGD) is a measure of the loss that a bank would suffer if an obligor defaults. It can be expressed as an amount or as a percentage of the expected amount outstanding at the time of default (EAD).

In general, there are many ways of modelling the LGD, such as:

- Market LGD: this is observed from market prices of defaulted bonds or marketable loans soon after the actual default event.
- Workout LGD: this is determined by the sum of cashflows resulting from the workout and/or collections process, discounted to the time of default and expressed as a percentage of the estimated exposure at default.

The LGD models currently used at KBC are all workout LGDs. The models developed are (methodologically) based on historical recovery rates and cure rates[3] per collateral type or per pool (segmentation-based approach).

A major challenge posed by the Basel II regulations is the 'downturn requirement'. The underlying principle is that the LGD is correlated to the PD, and loss rates will be higher in a year with many defaults. This effect has been demonstrated in a number of studies. However, as these studies almost exclusively used market LGD, they are not necessarily relevant for workout LGD

One explanation for the difference in cyclicality between market LGD and workout LGD is the fact that workout LGD is based on a recovery process that can take several years. In most cases, the workout period will thus include periods of both upturn and downturn economic conditions. Market LGD is based entirely on information one month after default. In downturn economic conditions, the market will be hit by a large supply of defaulted bonds, depressing prices. The classic market mechanism based on supply and demand may prove to be a stronger driver for the 'downturn' recovery rates than the macroeconomic conditions that led to the higher number of defaults.

Data collected from the current credit crisis will help KBC Group to model downturn LGD based on its own portfolios and workout processes.

[3] The cure rate is the percentage of defaulted clients returning to a non-default state.

Exposure At Default (EAD) models

KBC uses historical information that is available on exposures of defaulted counterparties to model EAD. The EAD model is used to estimate the amount that is expected to be outstanding when a counterparty defaults in the course of the next year.

Measuring EAD tends to be less complicated and generally boils down to clearly defining certain components (discount rate, moment of default and moment of reference) and gathering the appropriate data. In most cases, EAD equals the nominal amount of the facility, but for certain facilities (e.g., those with undrawn commitments) it includes an estimate of future drawings prior to default.

Pooling models

A pool is a set of exposures that share the same attributes (characteristics).

Pooling can be based on continuous estimates of PD, LGD and EAD or on other relevant characteristics.

- If pooling is based on continuous estimates of PD, LGD and EAD the pooling merely consists of aggregating the continuous estimates into PD, LGD and EAD bands. The added value of pooling is that exposure can be processed on an aggregate basis, which enhances calculation performance.
- If pooling is based on (other) criteria, loans are aggregated into pools based on these criteria. Since criteria need not be continuous (for example, whether or not there is a current account, which only has two categories) the resulting PD, LGD and EAD estimates are not necessarily on a continuous scale.

Group-wide framework for dealing with model uncertainty

While KBC makes extensive use of modelling to steer its business processes, it aims to do so in a cautious manner. In particular, it recognises that no value or risk model provides a perfect prediction of future outcomes. Explicit measures for dealing with model risk are therefore imposed. The potential shortcomings of credit risk models are grouped into three categories, each of which is evaluated using a fixed group-wide assessment.

- Known deficiencies are shortcomings for which the size of the error is known in some way. An example is a model implementation where the average model PD differs from the calibration target. For known deficiencies, a correction is applied to the outcome of the model in order to arrive at a best estimate.
- Avoidable uncertainties concern measurements that are known to be uncertain and rectifiable, but for which the size and even the sign of the error is not known. Examples are an uncertainty triggered by a late model review or not timely reassessed PDs. For avoidable uncertainties, capital penalties are imposed as incentives for corrective actions.
- Unavoidable uncertainties are similar to avoidable uncertainties, except that here the uncertainty is inherent and hence not rectifiable. An example is a new credit portfolio for which no relevant historic data can be found. To raise awareness, estimates of potential errors are made for unavoidable uncertainties.

The estimated overall level of uncertainty (avoidable + unavoidable) is clearly communicated to any stakeholders that use the model outputs.

This framework was adopted from the second quarter of 2010 on, in replacement of a similar one that was in place from the beginning of 2009 on.

Overview of credit risk models

The table shows information on some of the most relevant PD models used for capital calculations subject to the IRB Foundation approach. The scope of the tables excludes all pooled retail exposure.

PD models used under the IRB Foundation approach[1]	Exposure granted [gross EAD] In billions of EUR	Central Tendency[2]	Historical default rate[3]	Average Model PD (excl. overrulings)[4]
PD models for government and public sector segments				
(Worldwide) model for central governments	51.7	0.70%	0.38%	0.69%
PD models for corporate and institutional segments				
Asia-Pacific corporates	1.2	1.55%	1.98%	1.60%
US corporates	3.0	1.60%	1.64%	1.60%
Western-European corporates	28.8	1.51%	1.54%	1.51%
Czech corporates	6.4	2.10%	1.97%	1.25%
Large Czech household cooperatives	0.4	0.26%	0.00%	0.28%
Small Czech household Cooperatives	0.5	0.34%	0.00%	0.31%
(Worldwide) model for banks				
o/w Developed	17.6	0.19%	0.14%	0.32%
o/w Others	2.0	1.13%	1.13%	1.59%
(Worldwide) model for project finance	6.9	1.54%	1.47%	1.36%
(Worldwide) model for management buy outs	2.2	2.70%	3.10%	2.70%
PD models for SME segments				
models for Belgian professionals				
o/w liberal professions	*0.3*	*0.58%*	*0.47%*	*0.55%*
o/w self-employed professionals	*1.7*	*1.47%*	*1.62%*	*1.61%*
o/w private persons	*0.6*	*1.29%*	*1.34%*	*1.42%*
Belgian farmers	0.9	1.80%	1.79%	1.44%
Czech Municipalities	0.2	0.26%	0.06%	0.19%

1 Non exhaustive list of models used under the IRB Foundation approach, and excluding all (pooling) models used in the IRB advanced approach.
2 The central tendency is the average through-the-cycle default probability of a segment.
3 The default rate is the observed number of defaulted obligors during a certain time period as a percentage of total non-defaulted obligors at the beginning of the period (this result is scaled to a one-year period).
4 The average model PD is the mean PD of all obligors rated according to the model. The value at the time of the latest review is shown.

Credit risk related to KBC Insurance

Notwithstanding the fact that KBC Insurance is not subject to Basel II capital requirements, it holds financial instruments that attract a credit risk. This risk stems primarily from the investment portfolio (i.e. issuers of debt instruments).

Credit risk also arises due to insurance or reinsurance contracts concluded mainly by KBC Insurance. In some cases, however, other entities are also involved.

Credit risk in the investment portfolio of KBC Insurance

Guidelines for the purpose of controlling this credit risk within the investment portfolio are issued by the GRCOC. There are standards, for instance, that stipulate what percentage of the portfolio has to be invested in securities issued by governments of OECD countries, as well as standards that require issuers to have a certain minimum rating, and so on. The table provides an overview of the total investment portfolio of the group's insurance entities according to the market value of these instruments.

Bonds and other fixed-income securities are treated in-house under the credit risk framework. As regards their regulatory treatment, they are currently subject to the Solvency I directive.

Another significant portion of the assets on KBC Insurance's balance sheet are loans and advances to banks, which are in fact mostly deposits at KBC banking entities.

As regards the possible credit risk attached to (unit-linked) investment contracts, it is important to note that these represent the asset side of Class-23 products. Since the latter are completely balanced on the liability side, and any risk is also borne by customers investing in them, this product is not subject to a credit or any other financial risk.

Shares and other variable yield securities at KBC Insurance are not treated under the credit risk framework. The risk related to these instruments is measured and monitored as a market risk in non-trading activities, namely as 'equity risk' in the VAR. It should be noted that the equities in the banking book, which are subject to Basel II capital treatment for credit risk, are also included in this VAR measurement. For more detailed information, please refer to the section on 'market risk (non-trading)'.

Investment portfolio of KBC group insurance entities
(in millions of EUR, market value)[1]

Per balance sheet item	31-12-2009	31-12-2010[5]
Securities	22 242	23 396
Bonds and other fixed-income securities	20 746	21 832
Held to maturity	3 517	3 493
Available for sale	17 019	18 131
At fair value through profit or loss (FIFV & HFT)	149	136
As loans and receivables	62	72
Shares and other variable-yield securities	1 463	1 534
Available for sale	1 461	1 531
At fair value through profit or loss (FIFV & HFT)	2	3
Other	33	30
Loans and advances to customers	203	285
Loans and advances to banks	2 898	3 155
Property and equipment and investment property	523	566
Investments in associated companies	23	18
Other	103	13
Investment contracts, unit-linked[2]	7 957	7 329
Total	33 949	34 761
Details for bonds and other fixed-income securities		
By rating[3, 4]		
AA- and higher	68%	69%
A- and higher	94%	95%
BBB- and higher	100%	100%
By sector[3]		
Governments	62%	66%
Financial	20%	18%
Other	18%	16%
Total	100%	100%
By currency[3]		
Euro	92%	92%
Other European currencies	8%	8%
US dollar	0%	0%
Total	100%	100%
By remaining tenor[3]		
Not more than 1 year	4%	7%
Between 1 and 3 years	19%	22%
Between 3 and 5 years	24%	20%
Between 5 and 10 years	34%	34%
More than 10 years	18%	16%
Total	100%	100%

1 The total carrying value amounted to 34 408 million euros at December 2010 and to 33 598 million euros at December 2009.
2 Representing the assets side of unit-linked (class 23) products and completely balanced on the liabilities side. No credit risk involved for KBC Insurance.
3 Excluding investments for unit-linked life insurance. In certain cases, based on extrapolations and estimates.
4 External rating scale.
5 Excluding VITIS Life. At 31 December 2010, VITIS Life's investment portfolio amounted to 2.3 billion euros.

Credit risk due to insurance or reinsurance contracts

KBC is also exposed to a credit risk in respect of (re)insurance companies, since they could default on their commitments under (re)insurance contracts concluded with KBC. This particular type of credit risk is measured by means of a nominal approach (the maximum loss) and expected loss, among other techniques. Name concentration limits apply. PD – and by extension – expected loss is calculated using internal or external ratings. The exposure at default is determined by adding up the net loss reserves and the premiums, and the loss given default percentage is fixed at 50%.

Credit exposure to (re)insurance companies by risk class, in exposure at default (EAD) and Expected Loss (EL) In millions of EUR	EAD 2009	EL 2009	EAD 2010	EL 2010
AAA up to and including A-	353	0.07	423	0.07
BBB+ up to and including BB-	111	0.16	137	0.13
Below BB-	0	0.00	0	0.00
Unrated	16	0.35	15	0.34
Total	479	0.59	576	0.54

Structured credit products

This section deals with KBC's structured credit activities as per year-end 2010. These activities relate to Asset-Backed Securities (ABS) and Collateralised Debt Obligations (CDOs), which are defined as follows:

- *ABS* are bonds or notes backed by loans or accounts receivables originated by providers of credit, such as banks and credit card companies. Typically, the originator of the loans or accounts receivables transfers the credit risk to a trust, which pools these assets and repackages them as securities. These securities are then underwritten by brokerage firms, which offer them to the public.

- *CDOs* are a type of asset-backed security and a structured finance product in which a distinct legal entity, a Special Purpose Vehicle (SPV), issues bonds or notes against an investment in an underlying asset pool. Pools may differ with regard to the nature of their underlying assets and can be collateralised either by a portfolio of bonds, loans and other debt obligations, or be backed by synthetic credit exposures through use of credit derivatives and credit-linked notes.

  The claims issued against the collateral pool of assets are prioritised in order of seniority by creating different tranches of debt securities, including one or more investment grade classes and an equity/first loss tranche. Senior claims are insulated from default risk to the extent that the more junior tranches absorb credit losses first. As a result, each tranche has a different priority of payment of interest and/or principal and may thus have a different rating.

KBC was active in the field of structured credits both as an originator and an investor. Since mid 2007, KBC tightened its strategy (see 'Strategy and processes' below) As an originator, KBC also takes on other roles such as sponsor, when it provides liquidity support to the related SPVs. KBC also invested in structured credit products. These investments appear on KBC's balance sheet.

Apart from briefly describing the procedures and defining the scope, this disclosure provides more insight into:

- structured credit programmes where KBC acts as the originator;
- KBC's investments in structured credit products as per year-end 2010, together with information on the credit quality of the securities, an amortisation schedule of the investments, a view on the quality of the underlying collateral, a discussion on valuation and accounting principles, a view on the results of stress tests;
- the capital charges corresponding to the structured credit exposures.

Strategy and processes

Strict governance procedures apply to KBC's structured credit activities, meaning that appropriate decision authority and business processes are in place for all decisions related to structured credit. In view of the turbulent financial markets and especially the structured credit products market, KBC has tightened its strategy since mid-2007.

As regards investment activities, procedures and processes are to a large extent based on the existing framework for granting credit and making investments, but additionally take into account specific risks and features related to these products.

In mid-2007, after spreads had widened and the ratings of subprime ABS were downgraded on a large scale, KBC decided to implement a moratorium on ABS/CDO investments. At that time, only very few exceptions were granted for prime European ABS.

In mid-2008, KBC further tightened the investment conditions and no new investments in RMBS/CMBS were allowed by either entity. It was also decided that KBC Financial Products (KBC FP), a 100% subsidiary of KBC Bank, would not originate any new deals related to its structured credit business.

Since then, KBC's strategy has not changed.

Scope of structured credit activities

All KBC group banking and insurance entities (incl. KBL) that engage in structured credit activities are covered in this disclosure.

The CDO structure 'Aldersgate' matured on 7 January 2011. As the risks embedded in this CDO matured halfway December 2010 the impact was already included in 2010. This resulted in a reduction of 2.2 billion euros of the notional exposure in the structured credit portfolio, and is not included in the 2010 disclosures of this section. Some linked ABS hedges, with a total value of 251 million euros were still on the books. Indications are given if these are included or excluded in the tables on 'Other ABS exposure' below.

Structured credit programmes for which KBC acts as originator

Under this heading, attention is paid to the structured credit programmes in which KBC entities played an originating role. These structured credit operations can be broken down into the following categories:

- structured credit whose underlying assets arise directly from KBC's credit-granting activities
- structured credit involving third-party assets with no sponsoring role for KBC

Structured credit whose underlying assets arise directly from KBC's credit-granting activities

The main objective of such structured credit is to optimise the balance sheet and to provide additional sources of bank funding. The following structured credit programmes fall under this heading:

Structured credit programmes whose underlying assets arise directly from KBC's credit-granting activities

In millions of EUR – 31-12-2010

Programme	Role	Type of underlying exposure	Nominal amount of the underlying
Home Loan Invest 2007	Originator	Mortgage loans	3 874
Home Loan Invest 2008	Originator	Mortgage loans	2 778
Home Loan Invest 2009	Originator	Mortgage loans	5 398
Phoenix 2 Funding 2008	Originator	Mortgage loans	6 733
Phoenix 3 Funding 2008	Originator	Mortgage loans	2 870
Phoenix 4 Funding 2009	Originator	Mortgage loans	800

Home Loan Invest 2007

Home Loan Invest 2007 is a 'Residential Mortgage-Backed Securities' (RMBS) issue where KBC Bank acts as the originator. An SPV acquired a pool of Belgian residential mortgages granted by KBC and raised funds through the issuance of notes (Class A and Class B Notes, rated 'AAA' and 'Aaa' by Fitch and Moody's, respectively) and KBC's subscription to a subordinated loan of 376 million euros. The notes are eligible as collateral for the European Central Bank (ECB), and thus provide KBC Bank with a liquidity buffer. The portfolio of mortgages comprises 86414 loans totalling 3 874 million euros. Since KBC holds the first loss piece in the form of the subordinated loan, the Basel II securitisation framework does not apply to this structured credit programme, as an insufficient amount of the risk incurred has been transferred. Assets are held as regular assets on the balance sheet of KBC Bank and treated accordingly for capital adequacy calculation purposes.

Home Loan Invest 2008

Home Loan Invest 2008, which is similar to Home Loan Invest 2007, was set up in November 2008. A portfolio of 2 778 million euros' worth of Belgian mortgage loans has been securitised. KBC Bank holds the subordinated loan of 279 million euros and notes worth 2 370 million euros, which implies that the Basel II securitisation framework does not apply, as here too an insufficient amount of the risk incurred has been transferred. These notes are also eligible as collateral for the ECB, and thus provide KBC Bank with a liquidity buffer.

Home Loan Invest 2009

In April 2009 KBC Bank set up its third securitisation transaction Home Loan Invest 2009 securitised a portfolio of 6 667 million euro worth of Belgian mortgage and set a reserve aside of 60 million euro on account. KBC Bank holds the subordinated loan of 727 million euro. The SPV issued notes in the amount of 6 000 million euro. At issuance, approximately 350 million euro worth of notes were placed with external investors, while the rest were retained by KBC Bank. The notes are eligible as collateral for the ECB and thus provide an added liquidity buffer for KBC Bank. The Basel II securitisation framework does not apply, as here too an insufficient amount of the risk incurred has been transferred. Unlike the previous Home Loan Invest transactions, this issue amortises over the tenor of the transaction. As of 31 December 2010, the outstanding notes amounted to 5 398 million euro. The subordinated loan amount remained unchanged.

Phoenix Funding 2

On 16 June 2008, a programme called Phoenix Funding 2 was set up as a source of contingent funding. The SPV has a remaining underlying pool of residential mortgages amounting to 6 733 million euros, originated by KBC Bank Ireland[4] (which is a fully owned subsidiary of KBC Bank). KBC Bank Ireland has retained all of the notes, which implies that the Basel II securitisation framework does not apply, as an insufficient amount of the risk incurred has been transferred. The notes are divided into two classes, i.e. 95% in class A (Moody's 'Aa2' rating) and 5% in class B (Moody's 'A1' rating), maturing in 2050. Following a change in the ECB-requirements a second rating has been put in place for the class A notes as of February 2011 : 'A'-rating by Fitch. A liquidity facility has been provided to the vehicle equalling 3.4% of the outstanding amount of notes. The Class A notes are eligible for placement with the ECB, thus providing KBC Bank Ireland with a liquidity buffer.

Phoenix Funding 3

Phoenix Funding 3, which is similar to Phoenix Funding 2, was set up in November 2008. The SPV has a remaining underlying pool of residential mortgages originated by KBC Bank Ireland worth 2 870 million euros. KBC Bank Ireland has retained all of the notes, which implies that the Basel II securitisation framework does not apply, as an insufficient amount of the risk incurred has been transferred. The notes are split into two classes, i.e. 95% in class A (Moody's 'Aa2' rating) and 5% in class B (the class B notes are not rated), maturing in 2050. Following a change in the ECB-requirements a second rating has been put in place for the class A notes as of February 2011 : 'A'-rating by Fitch. A liquidity facility has been provided to the vehicle equalling 3.4% of the outstanding amount of notes. The class A notes are eligible for placement with the ECB, thus providing KBC Bank Ireland with a liquidity buffer.

Phoenix Funding 4

Phoenix Funding 4 was set up on 4 August 2009. The SPV has a remaining underlying pool of residential mortgages originated by KBC Bank Ireland plc worth 800 million euros. KBC Bank Ireland plc has retained all of the notes. The notes are split in two classes, i.e. 88% in class A (Moody's 'Aa2' rating) and 12% in class B (the class B notes are not rated), maturing in 2046. Following a change in the ECB-requirements a second rating has been put in place for the class A notes as of February 2011 : 'A'-rating by Fitch. The class A notes of Phoenix Funding 4 are eligible for placement with the ECB.

Structured credit involving third-party assets with no sponsoring role for KBC

The purpose of this business line was to generate fee income for KBC as an originator of structured credit. The credit risk related to the underlying assets is transferred to investors. The following existing structured credit programmes fall under this heading:

Structured credit programmes involving third-party assets with no sponsoring role for KBC

In millions of EUR – 31-12-2010

Programme	Roles	Type of underlying exposure	Nominal amount of the underlying
KBCFP CDO deals with ABS	Originator	Corporate reference names and/or ABS	22 837
KBCFP CDO deals without ABS	Originator	Corporate reference names	3 700

[4] In 2009 KBC Homeloans merged with KBC Bank Ireland.

KBC FP has structured synthetic Collateralised Debt Obligation (CDO) deals. These CDOs relate to a pool of reference entities that are selected and monitored by KBC FP. The underlying pools generally consist of either corporate reference names (on average 88%) and ABS (on average 12%, part of which entails exposure to subprime loans), or are made up entirely of corporate reference names.

The CDOs structured by KBC FP are managed CDOs, whereby the manager has the option to conclude substitutions in the underlying asset portfolios of the CDOs. There were no such substitutions in 2010.

The capital structure of a CDO deal comprises several tranches, each representing a certain credit risk profile. These tranches are, in increasing order of seniority:

- the equity pieces, which are always held on the books of KBC and are fully provisioned as of origination date;
- a number of classes of (credit-linked) notes which have obtained external ratings;
- the super senior portion of the CDO deal structure, which is partly hedged and partly unhedged (further information below).

KBC's structured credit position (where KBC acts as investor)

Under this heading, information is provided on KBC group structured credit investments booked in both the banking and trading portfolios and covering hedged and unhedged CDOs, and other ABS exposure. Firstly, an overview is given of the overall exposure, including more details on the hedge counterparties, followed by an overview of the credit quality of the securities, an amortisation schedule and details on the credit quality of the underlying assets of the securities. Lastly, a discussion of the valuation and accounting principles, and stress tests is given.

Overview

In millions of EUR

KBC investments in structured credit products (CDOs and other ABS)	31-12-2009	31-12-2010[4]
Total nominal amount		
o/w hedged CDO exposure	14 830	14 857
o/w unhedged CDO exposure [1]	9 752	7 679
o/w other ABS[2]	5 177	4 678
Cumulative value markdowns (mid 2007 to date)[3]	-6 790	-6 345
o/w value markdowns	-5 426	-5 163
o/w other financial impact	-1 364	-1 182

1 The approximate two billion EUR decrease emanates mainly from unwinding of CDOs, effect of principal losses and pay-downs which are offset by an increase in notional amounts following out-of-court settlements with clients.
2 Year-on-year decrease due mainly to sales of ABS and amortisation; 2010 figure includes 251 million euros worth of ABS hedges of Aldersgate.
3 Excluding the fee paid for the Guarantee Agreement with the Belgian State (incl. Aldersgate).
4 Excluding Aldersgate.

Hedged CDO exposure

In millions of EUR – 31-12-2010

Programme	Type	Nominal amount of the underlying hedged	Mark-to-Model value of hedge protection received
MBIA	Monoline Insurer	14 416	1 688
Channel	Credit Derivatives Products Company	441	2
Total		14 857	
Details on MBIA insurance coverage			
- Total insured amount (notional amount of the super senior swap)			14 416
- Fair value of insurance coverage received (modelled replacement value, after taking the Guarantee Agreement[1] into account)			*1 688*
- Credit value adjustment of counterparty risk MBIA			*-1 182*
(in % of fair value of insurance coverage received[2])			*70%*

1 The MBIA-insured amount is included in the Guarantee Agreement with the Belgian State - see 'Additional information' section of the 2010 annual report (www.kbc.com).
2 Account Taken of translation differences accrued over time.

The super senior portions of CDOs originated by KBC FP are mostly hedged through credit insurers via swap contracts. A relatively limited portion of this insurance was bought from Channel and the bulk from MBIA, a US monoline insurer.
In February 2009, MBIA announced a restructuring plan, which included a spin-off of valuable assets, provoking a steep decline in its creditworthiness. The increase of the market value of the underlying swap in combination with the increased counterparty risk, resulted in significant additional negative value adjustments at KBC. Moreover, the remaining risk related to MBIA's insurance coverage is to a large extent mitigated as it is included in the scope of the Guarantee Agreement that was agreed with the Belgian State on 14 May 2009 (see 'Additional information' section in the 2010 annual report – www.kbc.com).

KBC has not granted any straightforward credit facilities to the above credit insurers, but is exposed to (i) reinsurance cover received for CDOs and (ii) credit enhancement received for liquidity facilities granted by KBC to public finance and healthcare sector counterparties. The underlying public finance counterparties of the liquidity facilities carry high ratings.

In addition, there is also indirect corporate credit exposure to credit insurers within the collateral pool of the CDOs held, which is reflected in the overall valuation of the CDO exposure (fair value approach, as described below).

Unhedged KBC group investment in structured credit, 31-12-2010

This heading relates to the CDOs which KBC bought as investments and which are not 'insured' by credit protection from MBIA or any other external credit insurer (i.e. the 'unhedged CDO exposure' in the table) and other ABS in portfolio ('other ABS' in the table).

The total nominal amount outstanding in the unhedged portfolio dropped by 2.2 billion euro's due to the maturing of 'Aldersgate'.

Part of the risks attached to unhedged KBC group investments in CDOs are mitigated, due to the fact that the unhedged super senior CDO tranches are fully included in the Asset Protection Plan concluded with the Belgian State (see 'Additional information' section in the 2010 annual report – www.kbc.com).

Unhedged CDO-exposure and other ABS
Amounts in million of EUR - 31/12/2010

Total nominal amount unhedged CDO-exposure	7 679
Impact of initial w rite-dow n of junior and equity pieces, settled credit events and prepayments	-1 275
Total nominal amount , net	6 404
o/w super senior tranches (included in the Guarantee Agreement w ith the Belgian State - see above)	3 593
o/w non super senior tranches	2 811
Cumulative market value adjustments	-4 185
Total nominal amount other ABS-exposure*	4 678
Cumulative market value adjustments	-978

* Amount includes 251 million EUR w orth of currently retained hedges from Aldersgate

Also in 2010, KBC concluded several out-of-court settlement agreements with clients in Belgium, Slovakia and Hungary, who invested in CDOs issues by KBC FP.

Credit quality of securities held, 31-12-2010

An overview of the quality of the notes and super senior swaps held at year-end 2010 is shown in the table below.

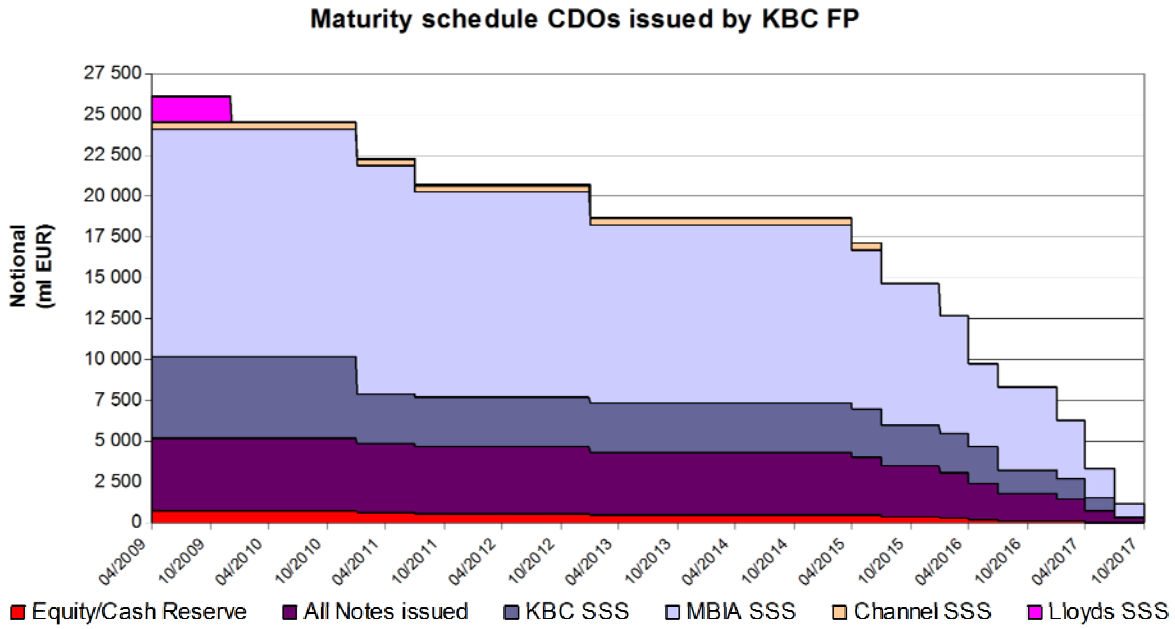
Credit quality of securities held – based on Moody's ratings
Amounts at nominal value (in millions of EUR) – 31-12-2010

	Super Senior (SS)	Aaa	Aa	A	Baa	<Baa3	Unrated	Total
Hedged CDO exposure	14 857[1]	-	-	-	-	-	-	14 857
Unhedged CDOs	3 593 [2]	-	65	-	27	2 647	73	6 404
Other ABS	-	2 682	711	259	88	687	-	4 427
Total 2010[3]	18 450	2 682	776	259	115	3 334	73	25 688
Total 2009	20 324	3 403	936	220	110	3 365	128	28 984

1 Positions hedged by MBIA and Channel.
2 All unhedged positions in the scope of the Guarantee Agreement signed with the Belgian State (see 'Additional information' section in the 2010 annual report – www.kbc.com).
3. Figures are net of equity and junior CDO pieces, settled credit events, prepayments and retained ABS hedges for Aldersgate

Amortisation schedule of the hedged and unhedged CDO portfolio

The following table shows how the CDOs originated by KBC FP amortise over the next few years. These figures exclude two CDOs in run-off, which means that their repayments are in progress.



A notional amount of 1.6 billion EUR will reach its expected maturity date in July 2011 (2.2 billion EUR already matured in January 2011). By end 2017, all CDOs issued by KBC FP (excl the CDOs in run off) are expected to have matured.

Overview of the underlying collateral of the securities held, 31-12-2010

The next tables provide a breakdown of the underlying collateral of the CDO portfolio (both hedged and unhedged) and the other ABS portfolio . They contain more detailed information on KBCs subprime exposure, on the quality of the underlying collateral and on the breakdown of corporate reference names according to sector and region. The figures are net of provisions for equity and junior CDO pieces, settled credit events, prepayments and retained ABS hedges.

Hedged Portfolio

Credit quality of underlying collateral of CDO held – based on Moody's ratings
in millions of EUR - 31.12.2010

		Aaa	Aa	A	Baa	Ba	B	Caa	<Caa3	NR	Total
Corporates		**7**	**427**	**1 963**	**5 178**	**3 084**	**1 415**	**419**	**248**	**385**	**13 126**
Sector	Real Estate	-	-	68	1 334	397	267	48	-	35	2 149
	Banking	-	158	585	417	121	95	91	-	64	1 531
	Finance	4	52	242	118	347	195	-	115	123	1 196
	Insurance	-	100	260	359	3	168	84	-	-	974
	Monoline	-	104	-	69	86	-	-	120	33	412
	Telecom	-	2	138	249	67	7	-	-	-	463
	Publishing	-	-	21	80	421	104	46	-	4	675
	Retail Stores	-	-	29	212	296	62	4	-	-	604
	Utilities	-	3	105	310	23	1	7	-	-	449
	Automobile	-	-	45	211	156	87	-	-	-	500
	Electronics	-	-	34	78	158	31	50	-	35	386
	Oil & Gas	3	1	36	308	104	-	-	-	-	453
	Other	-	7	400	1 433	903	400	89	13	91	3 335
Region	US	7	272	683	2 641	1 921	967	273	211	140	7 114
	EU	-	145	428	1 284	670	306	55	-	62	2 951
	ASIA	-	4	516	476	338	37	91	-	159	1 622
	LATIN AMERICA	-	4	73	87	8	39	-	-	-	211
	OTHER	-	3	263	690	146	66	-	37	23	1 228
CMBS		**1**	**2**	**-**	**-**	**-**	**10**	**-**	**-**	**-**	**13**
RMBS		**9**	**39**	**21**	**12**	**40**	**98**	**262**	**744**	**113**	**1 340**
Origin	PRIME	-	-	-	-	-	-	-	-	-	-
	ALT-A	-	*1*	-	*1*	-	*19*	*38*	*295*	*27*	*381*
	Alt-A (<2005 vintage)	-	1	-	1	-	-	3	1	-	7
	Alt-A (2005-2008 vintage)	-	-	-	-	-	19	35	294	27	375
	SUBPRIME	*9*	*38*	*21*	*11*	*40*	*80*	*224*	*449*	*86*	*958*
	Subprime (<2005 vintage)	-	16	18	11	22	38	31	27	5	168
	Subprime (2005-2008 vintage)	9	22	3	0	18	41	193	422	82	790
region	US	9	39	21	12	40	98	262	744	113	1 340
OTHER ABS		**4**	**22**	**10**	**28**	**18**	**7**	**2**	**-**	**31**	**121**
CDO		**-**	**1**	**8**	**4**	**-**	**16**	**44**	**141**	**42**	**257**
Total		**21**	**492**	**2 001**	**5 222**	**3 142**	**1 547**	**728**	**1 134**	**571**	**14 857**

'Full look through approach', which means that the subordination of the notes held is not taken into account.

Unhedged Portfolio

Credit quality of underlying collateral of CDO held – based on Moody's ratings
in million of EUR - 31.12.2010

		Aaa	Aa	A	Baa	Ba	B	Caa	<Caa3	NR	Total
Corporates		**3**	**184**	**846**	**2 232**	**1 329**	**610**	**181**	**107**	**166**	**5 658**
Sector	Real Estate	-	-	29	575	171	115	21	-	15	926
	Banking	-	68	252	180	52	41	39	-	28	660
	Finance	-	43	112	155	1	72	36	-	-	420
	Insurance	-	45	-	30	37	-	-	52	14	178
	Monoline	2	23	104	51	150	84	-	49	53	516
	Telecom	-	1	60	107	29	3	-	-	-	200
	Publishing	-	-	9	34	181	45	20	-	2	291
	Retail Stores	-	-	12	91	128	27	2	-	-	260
	Utilities	-	1	45	134	10	0	3	-	-	194
	Automobile	-	-	20	91	67	37	-	-	-	215
	Electronics	-	-	15	34	68	13	22	-	15	166
	Oil & Gas	1	0	16	133	45	-	-	-	-	195
	Other	-	3	172	618	389	172	38	6	39	1 438
Region	US	3	117	294	1 138	828	417	118	91	60	3 067
	EU	-	62	184	554	289	132	24	-	27	1 272
	ASIA	-	2	223	205	146	16	39	-	69	699
	LATIN AMERICA	-	2	31	38	4	17	-	-	-	91
	OTHER	-	1	113	297	63	28	-	16	10	529
CMBS		**0**	**1**	**-**	**-**	**-**	**4**	**-**	**-**	**-**	**6**
RMBS		**4**	**17**	**9**	**5**	**17**	**42**	**113**	**321**	**49**	**578**
Origin	PRIME	-	-	-	-	-	-	-	-	-	-
	ALT-A	-	*0*	-	*1*	-	*8*	*16*	*127*	*12*	*164*
	Alt-A (<2005 vintage)	-	0	-	1	-	-	1	0	-	3
	Alt-A (2005-2008 vintage)	-	-	-	-	-	8	15	127	12	162
	SUBPRIME	*4*	*17*	*9*	*5*	*17*	*34*	*97*	*193*	*37*	*413*
	Subprime (<2005 vintage)	-	7	8	5	9	17	13	12	2	72
	Subprime (2005-2008 vintage)	4	10	1	0	8	18	83	182	35	341
Region	US	4	17	9	5	17	42	113	321	49	578
OTHER ABS		**2**	**9**	**4**	**12**	**8**	**3**	**1**	**-**	**13**	**52**
CDO		**-**	**0**	**3**	**2**	**-**	**7**	**19**	**61**	**18**	**111**
Total		**9**	**212**	**863**	**2 251**	**1 354**	**667**	**314**	**489**	**246**	**6 404**

'Full look through approach', which means that the subordination of the notes held is not taken into account.

Rating and type breakdown of ABS held

Moody's ratings - amounts at nominal value - in millions of EUR - 31.12.2010

			Aaa	Aa	A	Baa	Ba	B	Caa	<=Caa3	NR	Total
CMBS			**31**	**15**	**22**	**24**	**-**	**-**	**22**	**-**	**-**	**115**
RMBS			**2 201**	**310**	**88**	**48**	**15**	**59**	**345**	**238**	**-**	**3 305**
Origin	PRIME		2 154	308	74	32	-	0	10	-	-	2 578
		Prime (<2005 vintage)	1 177	173	1	24	-	0	-	-	-	1 376
		Prime (2005-2008 vintage)	977	134	73	8	-	-	10	-	-	1 203
	ALT-A		6	-	14	-	15	35	320	52	-	442
		Alt-A (<2005 vintage)	6	-	14	-	-	-	-	-	-	21
		Alt-A (2005-2008 vintage)	-	-	-	-	15	35	320	52	-	422
	SUBPRIME		40	3	-	16	-	24	15	186	-	284
		Subprime (<2005 vintage)	21	3	-	4	-	1	-	-	-	30
		Subprime (2005-2008 vintage)	19	-	-	12	-	23	15	186	-	254
Region		US	323	3	15	16	15	59	345	238	-	1 014
		ES	628	197	34	-	-	-	-	-	-	859
		PT	321	25	-	-	-	-	-	-	-	346
		IT	438	5	-	-	-	-	-	-	-	443
		NL	379	20	-	-	-	-	-	-	-	399
		UK	25	44	-	-	-	-	-	-	-	69
		OTHER	87	15	40	32	-	-	-	-	-	174
OTHER ABS			**450**	**385**	**149**	**15**	**-**	**-**	**4**	**5**	**-**	**1 008**
Type	CLO		126	329	102	-	-	-	-	-	-	557
	Leases		45	45	10	6	-	-	-	-	-	106
	SME loans		53	-	34	-	-	-	-	-	-	87
	Consumer Loans		28	-	1	-	-	-	-	-	-	29
	Auto Loans/Leases		65	11	-	-	-	-	-	-	-	76
	other		134	-	1	9	-	-	4	5	-	153
Total			**2 682**	**711**	**259**	**88**	**15**	**59**	**370**	**243**	**-**	**4 427**

Valuation and accounting principles

Multiple valuation techniques are used to determine the market value of the CDO/ABS portfolio.

For CDOs, KBC applies a level-3 valuation technique.The Gaussian Copula model models the distribution of default times of the underlying corporate and ABS names in the reference portfolios of the CDO transactions. The asset default trigger in the model is derived from the credit default swap spreads in the market. The correlation between the default times is modelled through Gaussian Copulas[5] and can as such be simulated. By discounting the cash flows resulting from the default time curves on the underlying assets, a value for a specific CDO tranche is determined. The model also ensures that the inner tranches are valued in line with the market, through the calibration with CDX and iTraxx credit spread indices.

For the valuation of the non-super senior positions, the fundamental value (see below) of the positions is also taken into account.

Apart from the initial write-down on junior and equity CDO pieces, the total impact of the financial crisis on the value of the investments in structured credit products between mid-2007 and the end of 2010 amounted to 7.8 billion euros (see table below for more detailed information).

It should be noted that value adjustments to KBC's CDOs are accounted for via profit or loss, since the group's CDOs are largely of a synthetic nature (i.e. the underlying assets are derivative products such as credit default swaps on corporate names).

Details on the impact of the financial crisis
In millions of EUR – pre-tax

	Total up to 31-12-2010
Value markdowns	-5 163
o/w on CDOs (through P/L)	-4.185
o/w on CDOs (through Equity)	-
o/w on ABS (through P/L)	-452
o/w on ABS (through Equity)	- 526
Other financial impact	-2 694
o/w CDO-related monoline counterparty risk	-1 182
o/w other impact on CDO*	-1 495
o/w other on ABS	-
Total impact of financial crisis	-7 857
o/w through P/L	-7 331
o/w through Equity	-526

* Fee paid for the Guarantee Agreement with the Belgian State.

[5] A Gaussian Copula is a dependency structure, which in this case indicates how default events are inter-related.

Stress-test results for KBC group investments in structured credits, 31-12-2010

Two sorts of stress tests have been conducted on the (hedged and unhedged) portfolio of investments in CDOs originated by KBC FP, namely (i) stress tests with an effect on credit default and (ii) stress tests with an impact on P/L. The first type of test determines the (credit) loss in the case of defaults and losses in the assets underlying the CDOs. The second type shows the (market) loss when the main parameters in the valuation of the CDOs originated by KBC FP are stressed.

Stress tests with an effect on credit default

Since mid-2008, KBC has used the concept of 'fundamental value' for the CDOs issued by KBC FP. This aims to estimate how (expected) credit events – when claimed, verified and settled – would affect the principal amounts of the CDO tranches, according to the waterfall structure (reversed seniority). It serves as a reasonable prediction of the redemption value of the CDOs originated by KBC FP at or around the respective expected maturity dates. The calculation of the fundamental value (referred to as the *fundamental value scenario* in the table below) is based on ABS credit events actually claimed and expected losses on ABS, and a 14% loss in the underlying corporate portfolio (which also includes credit events actually claimed and expected cumulative losses).

In addition, a further stressed fundamental analysis was performed under the following test assumptions:

Stress scenario 1: ABS credit events actually claimed and expected losses on ABS, and a 16% loss in the underlying corporate portfolio (which also includes credit events actually claimed and expected cumulative losses).

Stress scenario 2: ABS credit events actually claimed and expected losses on ABS, and a 25% loss in the underlying corporate portfolio (which also includes credit events actually claimed and expected cumulative losses).

The results of these scenarios are summarised in the table[1, 2, 3].

Stress-test results on credit default	Notional	Estimated loss	Estimated loss as % of notional
Fundamental value scenario			
Unhedged portfolio	5 967	3 357	56.3 %
Hedged portfolio	14 415	922	6.4 %
Stress scenario 1			
Unhedged Portfolio	5 967	3 521	59.0 %
Hedged portfolio	14 415	1 391	9.6 %
Stress scenario 2			
Unhedged Scenario	5 967	3 907	65.5 %
Hedged Scenario	14 415	2 547	17.7 %

1 Excluding CDOs in run-off, which explains the different nominal value in previous tables, and excluding junior and equity CDO pieces, where the initial write-down had already been recognised through P/L when the CDOs were issued.
2 Account taken of the Guarantee Agreement with the Belgian State.
3 Nominal value unhedged portfolio excl. Aldersgate (maturity date = 7 January 2011), equity and junior pieces

Stress tests with effect on P/L

KBC has calculated the impact of two stress test scenarios in terms of changes in credit spreads (an increase or decrease by 10%, 20% and 50%, respectively) on the hedged and unhedged portfolio of CDOs originated by KBC FP, excluding the CDOs in run-off (nominal value in scope of 22.3 billion euros, > 90% of total investments in CDOs).

The calculations take into account the impact of the Guarantee Agreement signed with the Belgian State, which reduces the volatility of the super senior positions in scope on P/L. Als the provisioning rate of 70% for MBIA has been taken into account.

Stress test result on the market sensitivity of CDOs

In millions of EUR – 31-12-2010 (pre-tax)

	Market valuation sensitivity	Stress-test result
Test assumptions	Credit spreads in December x 1.10	-138
	Credit spreads in December x 1.20	-269
	Credit spreads in December x 1.50	-617

Test assumptions	Credit spreads in December x 0.90	154
	Credit spreads in December x 0.80	315
	Credit spreads in December x 0.50	871

Structured credit exposure - capital charges

Regulatory capital for credit risk is held for all banking book positions in structured credit exposures. Positions in the trading book are incorporated into the capital requirements for market risk (trading) as measured using the VAR models.

Under Basel II, different approaches are available to determine the required capital for credit risk. The treatment used for the different structured credit programmes is described throughout this report. The investment positions are dealt with under the Rating-Based Approach (RBA), with the exception of KBL EPB, CSOB SR and K&H which report under the Basel II Standardised Approach.

As regards the investments in structured credit, the risk weightings applied for regulatory capital calculations are linked directly to the external rating of the structured credit products invested in. Since these risk weightings rise sharply when ratings fall, downgrades of the structured credit invested in have a serious impact on the capital charge. The exposure amount to which the risk weights are applied, depends on the IFRS classification.

Regulatory capital only has to be held by banking entities. Insurance entities are not required to hold it, but this will change when Solvency II regulation is implemented.

Details on capital charges for structured credit products

In millions of EUR – 31-12-2010

Programme	Invested amount	Size of liquidity facility/credit enhancements	Exposure (EAD) by risk weight class				RWA 2010
			6 - 18%	20 - 650%	1250%	Total	
KBC as Sponsor	13	30					52
Quasar[4]	13	30					52
KBC as Investor	9 584	0	2 775	826	965	4 566	9 665
KBC Bank[2, 3]	6 050	0	2 775	309	963	4 047	9 511
ČSOB CZ	9	0	0	0	0	0	0
CSOB SR	20		0	0	0	0	1
K&H	111	0	0	0	0	0	0
KBC USA branche	281	0	*[1]	*[1]	*[1]	*[1]	*[1]
KBC FP	2 523	0	*[1]	*[1]	*[1]	*[1]	*[1]
KBL	591	0	0	517	2	519	153
Total KBC banking entities	9 597	30	2 775	826	965	4 566	9 717
Total KBC insurance entities	2 774	0	not applicable				0
Total KBC Group	12 371	30	2 775	826	965	4 566	9 717

1 indicates that capital charges cannot be reported separately as they are incorporated into the capital requirements for market risk as measured using the VAR models.
2 The transfer of assets of Atomium to KBC Bank was fully completed during 2010.
3 KBC Bank includes KBC Credit Investments and KBC Asset Management.
4 Quasar is an SPV set up to invest in pools of receivables. During 2010 this was almost completely wound down.

Market risk management (non-trading)

The process of managing KBC's structural exposure to market risks (including interest rate risk, equity risk, real estate risk, foreign exchange risk and inflation risk) is also known as Asset/Liability Management (ALM).

'Structural exposure' encompasses all exposure inherent in the commercial activity of KBC or the long-term positions held by the group (banking and insurance). Trading activities are consequently not included. Structural exposure can also be described as a combination of:

- mismatches in the banking activities linked to the branch network's acquisition of working funds and the use of those funds (via lending, among other things);
- mismatches in the insurance activities between liabilities in the non-life and life businesses and the cover for these liabilities present in the investment portfolios held for this purpose;
- the risks associated with holding an investment portfolio for the purpose of reinvesting shareholders' equity;
- the structural currency exposure stemming from the activities abroad (investments in foreign currency, results posted at branches or subsidiaries abroad, exchange risk linked to the currency mismatch between the insurer's liabilities and its investments).

Strategy and processes

A team in the Group Value and Risk Management Directorate provides support to the GRCOC and helps to develop ALM. Similar teams exist at the different Business Units. Risk management responsibilities for the life insurance business are also included in the scope of ALM.

The ALM strategy is co-ordinated by the newly created Group Treasury function and implemented locally by front-office units. In the past this was done by a central investment function.

The main building blocks of KBC's ALM framework are:

- a focus on 'economic value' as the cornerstone of ALM policy, with attention also being paid to criteria such as income, solvency and liquidity;
- the use of a uniform ALM measurement methodology for banking and insurance activities based on 'fair value models' that forecast the value of a product group under different market scenarios and that are translated into replicating portfolios (combinations of market instruments that allow the relevant product groups to be hedged with the lowest risk);
- the use of a Value-at-Risk (VAR) measurement method for the various categories of risk throughout the group for risk budgeting and limit-setting purposes. This VAR measures the maximum loss that might be sustained over a one-year time horizon with a certain confidence level as a result of movements in interest rates and other fluctuations in market risk factors. Some risk parameters (i.e. inflation estimates, real-estate-risk estimates and correlations linked to these risk categories) are based on expert opinion;
- the definition of an ALM VAR limit at group level and the breakdown of this limit into various types of risk and entities;
- the use of VAR, which is calculated using fair value models for non-maturing products, taking into account different embedded options and guarantees in the portfolio;
- VAR is supplemented by other risk measurement methods such as Basis-Point-Value (BPV), notional amounts, etc.

KBC group non-trading market risk, by risk category (VAR 99%, 1-year time horizon, marginal contribution of various risk types to VAR) - (in billions of EUR)[1]	31-12-2009	31-12-2010[3]
Interest rate risk	0.85	0.90
Equity risk	0.84	0.57
Real estate risk	0.14	0.10
Other risks[2]	0.08	0.11
Total diversified VAR (group)	1.91	1.68

1 Excluding a number of small group companies. The mentioned VAR does not yet capture following (material) risks: corporate credit spread, sovereign spread and cyclical prepayment options embedded in mortgage loans.
2 Foreign exchange risk and inflation risk.
3 Excluding KBL EPB and VITIS Life. The impact of both entities on the group's ALM VAR is 90 million euros due to their equity portfolios.

Scope of non-trading market risk disclosures

The ALM framework is applicable to all material KBC group entities that are subject to non-trading market risks. In practice, this means all entities of the KBC group with the exception of entities that only conduct trading activities. In banking entities with both trading and other activities, the balance sheet is split into a trading book and a banking book, with ALM only dealing with the risks incurred in the banking book.

Equity risk and interest rate risk account for the lion's share of the total risk and will thus be discussed in more detail. However, real estate risk, inflation risk and foreign exchange risk are also briefly addressed below.

Interest rate risk

Interest rate risk for the banking activities

All the commercial production activity of the bank (credit, deposits, etc.) is actively managed in a risk-neutral way. There is no active interest rate risk-taking in funding or investing client-driven production. Active interest rate risk-taking is organised in separate positions for which a separate profit/loss account is kept that can be set off against the economic capital required for the ALM risks taken.

KBC Bank's non-trading interest rate positions are managed via a system of market-oriented internal pricing for products with a fixed maturity date (dated products) and via a replicating portfolio technique for products without a fixed maturity date (undated products; e.g., current and savings accounts). For the latter, a benchmark maturity mix and a core amount are established and reviewed on a dynamic basis in order to incorporate them into the internal risk-measurement system. The fair value model for saving accounts is based on a volume formula and a tariff formula. The volume formula is used to calculate the outstanding volume of the non-maturing instruments based on market-drivers (current volume, current interest rate and spread between market rate and tariff rate). The tariff formula is used to calculate the tariff rate given the outstanding volume.

The bank's capital and reserves are invested in fixed assets, strategic shareholdings and government bonds. The bank may also take interest rate positions with a view to acquiring interest income.

To measure interest rate risks, KBC uses two main techniques: Basis-Point-Value (BPV) and Value-at-Risk (VAR) (see above). The BPV measures the extent to which the economic value of the portfolio would change if interest rates were to rise by 10 basis points across the entire curve (negative figures indicate a decrease in the value of the portfolio). Other techniques such as gap analysis, duration approach, sensitivity analysis and stress-testing (both from an economic value perspective and from an income perspective) are also used.

The table below shows how the bank's exposure to interest rate risk developed over the course of 2009 and 2010.

BPV of the ALM book, banking activities* (in millions of EUR)	
Average, 1Q 2009	-89
Average, 2Q 2009	-94
Average, 3Q 2009	-85
Average, 4Q 2009	-67
31-12-2009	-62
Maximum in 2009	-98
Minimum in 2009	-62
Average, 1Q 2010	-63
Average, 2Q 2010	-68
Average, 3Q 2010	-69
Average, 4Q 2010	-62
31-12-2010	-55
Maximum in 2010	-69
Minimum in 2010	-55

* KBL EPB is excluded from the 2010 figures. Including KBL EPB would lead to an overall BPV for the banking activities of 57 million euros at year-end 2010.

In line with the Basel II guidelines, a 2% stress test is carried out at regular intervals. It sets off the total interest rate risk in the banking book (given a 2% parallel shift in interest rates) against total capital and reserves. For the banking book at KBC group level (excluding KBL EPB), this risk came to 4.48% of total capital and reserves, at year-end 2010 (well below the 20% threshold, where a bank is considered an 'outlier bank' and which can lead to a higher regulatory capital charge).

The following table shows the interest sensitivity gap of the ALM banking book. In order to determine the sensitivity gap, the carrying value of assets (positive amount) and liabilities (negative amount) is broken down according to either the contractual repricing date or the maturity date, whichever is earlier, so as to obtain the length of time for which interest rates are fixed. Derivative financial instruments, which are used mainly to reduce exposure to interest rate movements, are included on the basis of their notional amount and repricing date.

The interest sensitivity gap shows the overall long position of KBC Group in interest rate risk. Overall, assets reprice on a longer term than liabilities, meaning that KBC's interest income benefits from a normal yield curve. The economic value of KBC Group is predominantly sensitive to movements at the long end of the yield curve, benefiting from a decrease in LT yield.

Interest sensitivity gap of the ALM book (including derivatives), banking activities[1,]
(in millions of EUR)

	≤ 1 month	1–3 months	3–12 months	1–5 years	5–10 years	> 10 years
31-12-2009	1 363	7 884	-3 629	1 590	5 874	3 275
31-12-2010[2]	-5 116	-558	626	1 513	5 226	3 852
	-140	55	88	528	140	18

1 Excluding a number of small group companies.
2 KBL EPB is excluded from the 2010 figures. However, these figures are provided separately below:

The interest sensitivity gap shows the overall long position of the KBC group in interest rate risk. Overall, assets re-price on a longer term than liabilities, which means that KBC's net interest income benefits from a normal yield curve. The economic value of the KBC group is predominantly sensitive to movements at the long-term end of the yield curve.

Interest rate risk for the insurance activities

Where the group's insurance activities are concerned, the fixed-income investments for the non-life reserves are invested with the aim of matching the projected pay-out patterns for claims, based on extensive actuarial analysis.

The non-unit-linked life activities (class 21) combine a guaranteed interest rate with a discretionary participation feature (DPF) fixed by the insurer. The main risks to which the insurer is exposed as a result of such activities are a low-interest-rate risk (the risk that return on investments will drop below the guaranteed level) and a risk that the investment return will not be sufficient to give customers a competitive profit-sharing rate. The risk of low interest rates is managed via a cashflow-matching policy, which is applied to that portion of the life insurance portfolios covered by fixed-income securities. The lapse risk (risk of changing policy surrender distributions) and the expected profit-sharing policies are managed with a mixed investment portfolio of fixed-income investments and equities.

Unit-linked life insurance investments (class 23) are not dealt with here, since this activity does not entail any market risk.

The table summarises the exposure to interest rate risk in KBC's life insurance activities. The life insurance assets and liabilities relating to business offering guaranteed rates are grouped according to the expected timing of cashflows.

Expected cashflows (not discounted), life insurance activities[1]
(in millions of EUR)

	0–5 years	5–10 years	10–15 years	15–20 years	> 20 years	Total
31-12-2009						
Fixed-income assets backing liabilities, guaranteed component	11 447	7 154	2 313	1 605	1 243	23 763
Liabilities, guaranteed component	9 229	4 982	1 876	1 549	2 306	19 942
Difference in expected cashflows	2 218	2 172	437	57	-1 063	3 821
Mean duration of assets						5.38 years
Mean duration of liabilities						5.94 years
31-12-2010[2]						
Fixed-income assets backing liabilities, guaranteed component	12 353	7 245	2 250	1 504	1 074	24 425
Liabilities, guaranteed component	9 814	6 287	2 140	1 723	2 560	22 524
Difference in expected cashflows	2 539	958	109	-219	-1 487	1 901
Mean duration of assets						5.40 years
Mean duration of liabilities						6.36 years

1 Excluding a number of small group companies.
2 Excluding VITIS Life. This entity has 573 million euros in fixed-income assets backing 508 million euros' worth of guaranteed liabilities.

As mentioned above, the main interest rate risk for the insurer is a downside one. KBC adheres to a policy that takes into account the possible negative consequences of a sustained decline in interest rates, and has built up sizeable supplementary reserves, primarily for products that are most susceptible to interest rate risk. For instance, in Belgium (which accounts for the bulk of the life insurance reserves), technical provisions for products with a guaranteed rate of interest of 4.75% are calculated at a discount rate of 4%. In addition, supplementary provisions have been accumulated under a 'flashing lights' system since 2000. This system requires KBC Insurance and Fidea to set aside extra provisions if the guaranteed interest rate on a contract exceeds the 'flashing light' threshold by more than 0.1% (this threshold is equal to 80% of the average interest rate over the past five years on ten-year government bonds). By the end of 2010, KBC had obtained an exemption of 80% for the further build-up of this reserve after having proven that the current available reserves are sufficient to cover the potential loss of economic value due to a decrease in interest rates.

Breakdown of the reserves for non-unit-linked life insurance by guaranteed interest rate, insurance activities[1]	31-12-2009	31-12-2010[3]
5.00% and higher[2]	3%	3%
More than 4.25% up to and including 4.99%	12%	11%
More than 3.50% up to and including 4.25%	17%	7%
More than 3.00% up to and including 3.50%	31%	33%
More than 2.50% up to and including 3.00%	25%	22%
2.50% and lower	9%	19%
0.00%	4%	5%
Total	100%	100%

1 Excluding a number of small group companies.
2 Contracts in Central and Eastern Europe.
3 Excluding VITIS Life. This entity accounts for 2.5% of total nominal exposure (68% of which is in the 'more than 2.50% up to and including 3.00%' category).

The various group companies conduct 'Liability Adequacy Tests' (LAT) that meet local and IFRS requirements. Calculations are made using prospective methods (cashflow projections that take account of lapse rates and a discount rate that is set for each insurance entity based on local macroeconomic conditions and regulations), and extra market-value margins are built in to deal with the factor of uncertainty in a number of parameters. Since no deficiencies were recorded by year-end 2010, there was no need for a deficiency reserve to be set aside within the KBC group.

Aggregate interest rate risk for KBC Group

The figures below show the impact of a 10 basis points parallel upward shift of yield curves by the end of 2009 on KBC Group, split up by currency.

Interest Rate Risk - BPV in thousands of EUR – 31-12-2009

	Overall	EUR	CHF	USD	GBP	CZK	HUF	PLN	other
Bank	-62.260	-52.709	-451	182	84	-7.992	545	-1.284	-634
Insurance	-7.959	-7.191	-11	-24	-5	-279	-215	-27	-206
KBC Group[2]	-65.836	-55.518	-462	158	79	-8.271	330	-1.311	-840

Interest Rate Risk - BPV in thousands of EUR – 31-12-2010[1]

	Overall	EUR	CHF	USD	GBP	CZK	HUF	PLN	other
Bank	-54.801	-38.046	55	1.209	43	-12.174	-1.365	-1.723	-2.800
Insurance	-5.498	-4.058	0	-9	2	227	-90	-1.344	-226
KBC Group[2]	-53.979	-35.784	55	1.200	45	-11.947	-1.455	-3.067	-3.026

1 KBL EPB (Bank) and Vitis Life (Insurance) are excluded from 2010 figures. KBL epb reports a BPV of EUR 2,15 mln, where 79% of the IRR is in EUR. Vitis Life will gain EUR 0.19 mln in economic value when the interest rate fall by 10bp. Almost everything is BPV in EUR.
2 KBC Pension Fund is only added to the KBC Group figure.

The group-wide sensitivity of IFRS-based net profit to interest rate movements is reported on a regular basis and at the same time for both the banking and the insurance activities. The table illustrates the impact on net profit of a 1% increase and a 1% decrease in the yield curve, given the positions at the reporting date.

Impact on net profit (IFRS) of an increase/decrease in the yield curve for the KBC group[1]
In millions of EUR

	Increase by 1%[3]		Decrease by 1%[2, 3]	
	2009	20010	2008	2009
Insurance	-8	-5	8	5
Banking	-110	-56	171	89
Total KBC Group	-118	-61	179	95

1 Excluding a number of small group companies.
2 Full market value, regardless of accounting classification or impairment rules.
3 Excluding KBL EPB and VITIS Life. A 1% increase in the yield curve would have a very limited impact on the net profit of KBL EPB and VITIS Life (-0.65 million euros). The impact on the market value of KBL EPB and VITIS Life would be a negative 23 million euros.

Equity risk

The equity risk profile depends largely on the core activity (banking or insurance) of the group company. Insurance companies traditionally keep relatively large equity portfolios, since equity can be used as a hedge for the discretionary participation feature (DPF) of insurance liabilities (especially profit-sharing in the Belgian market). Apart from the insurance entities, smaller equity portfolios are also held by other group entities (e.g., KBC Bank, KBL EPB, KBC Asset Management and KBC Private Equity).

Accounting techniques and the impairment procedure for equity are described in Note 1b of the Consolidated financial statements. Each quarter, an impairment committee meets to determine whether impairment charges need to be recognised, with the decision it takes being based on a set of coherent indicators.

Equity risk is monitored using a VAR technique (99% one-sided confidence interval, one-year time horizon), with a limit being set for the total equity exposure of the group's ALM activities. Please note that the equity positions of the banking entities are also incorporated into the Basel II pillar 1 calculation for credit risk.

The tables below present more information on total non-trading equity exposures at KBC. All minority shareholdings are treated as equity exposures (e.g., the participation in Nova Ljubljanska banka). The first table breaks down the total equity exposure into listed and unlisted components, while the second provides an overview of concentration according to sector.

The table provides an overview of the total equity portfolio of the KBC group.

Equity portfolio of the KBC group[1] (in billions of EUR)	Banking activities		Insurance activities		Group	
	31-12-2009	31-12-2010[2]	31-12-2009	31-12-2010[2]	31-12-2009	31-12-2010[2]
Total equity exposure	1.3	1.1	1.3	1.4	2.6	2.6
of which unlisted	0.6	0.5	0.1	0.1	0.7	0.6

1 Excluding a number of small group companies.
2 Excluding KBL EPB and VITIS Life . KBL EPB has an equity portfolio of 0.28 billion euros, 52% of which is invested in unlisted equities. The entire portfolio of VITIS Life (45 million euros) is invested in listed equities.

The table provides an overview of the total equity portfolio of the KBC group, broken down by sector.

Equity portfolio of the KBC group[1, 2] (breakdown by sector, in %)	Banking activities		Insurance activities		Group	
	31-12-2009	31-12-2010[3]	31-12-2009	31-12-2010[3]	31-12-2009	31-12-2010[3]
Financial	17%	46%	26%	21%	23%	32%
Consumer cyclical	8%	7%	8%	20%	8%	15%
Consumer non-cyclical	22%	15%	17%	8%	19%	11%
Industrial	8%	5%	8%	10%	8%	8%
Basic materials	5%	8%	8%	9%	7%	8%
Energy	8%	5%	9%	8%	9%	7%
Communication	4%	2%	6%	6%	5%	4%
Utilities	4%	4%	5%	5%	5%	4%
Other	24%	8%	12%	13%	17%	11%

1 Excluding a number of small group companies.
2 A number of unlisted participations (the most material one being Nova Ljubljanska banka) were included in the scope of reporting since 2010, which accounts for the significant year-on-year increase for the 'Financial' sector (under 'Banking activities').
3 Excluding KBL EPB and VITIS Life.

The table provides an overview of the sensitivity of income and economic value to fluctuations in the equity markets. The figures include the sensitivity of unlisted equity in the different portfolios.

Impact of a 12.5% drop in equity prices[1] (in millions of EUR)	Impact on net profit (IFRS)		Impact on value	
	2009	2010[2]	2009	2010[2]
Insurance activities	-3	-13	-120	-100
Banking activities	-29	-27	-165	-142
Total	-33	-40	-285	-242

1 Excluding a number of small group companies.
2 Excluding KBL EPB and VITIS Life. A 12.5% drop in equity prices would lead to an economic loss of 35 million euros and 5.6 million euros for KBL EPB and VITIS Life, respectively. According to KBC's impairment rules, approximately 1 million euros of these losses would appear in the income statement.

The table provides an overview of the realised and unrealised gains on the equity portfolio.

Non-trading equity exposure[1] - (in millions of EUR)

	31-12-2009		31-12-2010[3]	
	Net realised gains (in income statement)	Net unrealised gains on year-end exposure (in equity)	Net realised gains (in income statement)	Net unrealised gains on year-end exposure (in equity)
KBC group[2]	95	387	64	377
Banking entities	34	121	21	91
Insurance entities	58	293	45	338

1 Excluding a number of small group companies.
2 The total figure includes gains from some equity positions directly attributable to the KBC group. Gains from joint participations involving the banking and insurance entities of the KBC group have been eliminated, since these participations are consolidated on group level.
3 KBL EPB and VITIS Life have been excluded from the KBC group figure. For these entities, net realised gains amount to 9 million euros (recognised in the income statement) and the losses on year-end exposure come to 98 million euros (recognised in equity).

Real estate risk

A limited real estate investment portfolio is held by the group's real estate businesses with a view to realising capital gains over the long term. KBC Insurance also holds a diversified real estate portfolio, which is held as an investment for non-life reserves and long-term life activities. The real estate exposure is viewed as a long-term hedge against inflation risks and as a way of optimising the risk/return profile of these portfolios.

The table provides an overview of the sensitivity of economic value to fluctuations in the property markets.

Impact of a 12.5% drop in real estate prices[1]
(in millions of EUR)

	Impact on value	
	2009	2010[2]
Bank portfolios	-93	-80
Insurance portfolios	-21	-30
Total	-114	-110

1 Excluding a number of small group companies.
2 Excluding KBL EPB (VITIS Life does not carry any material real estate risk).

Inflation risk

KBC's exposure to inflation is primarily secondary in nature, i.e. via changes in interest rates. This risk is monitored, limited and hedged in line with the policy for managing interest rate risk (see above). The direct exposure of KBC to the inflation risk is limited and mainly arises from contractual payments that are linked to wage inflation, e.g., in the non-life insurance business in Central-Europe and in the pension fund for own employees. This direct inflation risk is monitored using the ALM VAR technique (see above), with a limit being set on the total exposure to 'other risks' for KBC group.

Foreign exchange risk

KBC pursues a prudent policy as regards its structural currency exposure, essentially seeking to avoid currency risk. Foreign exchange exposures in the ALM books of banking entities with a trading book are transferred to the trading book where they are managed within the allocated trading limits. The foreign exchange exposure of banking entities without a trading book, of the insurance entities and of other entities has to be hedged, if material. Equity holdings in non-euro currencies that are part of the investment portfolio do not need to be hedged. Participating interests in foreign currency are in principle funded by borrowing an amount in the relevant currency equal to the value of the net assets excluding goodwill.

Market risk management (trading)

Market risk is defined as the potential negative deviation from the expected economic value of a financial instrument caused by fluctuations in market prices, i.e. interest rates, exchange rates and equity or commodity prices. Market risk also covers the risk of price fluctuations in negotiable securities as a result of credit risk, country risk and liquidity risk.

This section focuses on the trading positions. The interest rate risk, foreign exchange risk, equity risk, etc. of the non-trading positions in the banking book and of the insurer's positions are addressed in this document in the section on 'market risk management (non-trading)'.

Strategy and processes

The objective of market risk management (trading) is to measure and report the market risk of the aggregate trading position at group level, taking into account the main risk factors and specific risk.

KBC is exposed to market risk via the trading books of the dealing rooms in Western Europe, Central and Eastern Europe, the United States and Asia. The traditional dealing rooms, with the dealing room in Brussels accounting for the lion's share of the limits and risks, focus on trading in interest rate instruments, and activity on the forex markets has traditionally been limited. The dealing rooms abroad focus primarily on providing customer service in money and capital market products, on funding local bank activities and engage in limited trading for own account in local niches.

KBC continued to divest trading activities in its specialised subsidiaries in 2010 (viz. KBC Financial Products and KBC Peel Hunt). KBC Peel Hunt was sold through a management buy-out, while the following KBC Financial Products business lines were sold during the year: Insurance Derivatives, Japanese Cash Equity, Convertible Bonds, Asian Equity Derivatives and US Reverse Mortgages. The Exotic Equity Derivatives business has been almost completely hedged away or allowed to mature. KBC Financial Products has continued to wind down its remaining business lines, including the Fund Derivatives and Credit Derivatives businesses.

Scope of disclosures on market risk capital requirements and VAR model disclosures

As market risk exposure arises from the trading books in the dealing rooms of the banking entities, the scope relating to market risk capital requirements across trading portfolios covers all the group's banking entities.

As regards disclosures on the VAR model, the scope is confined to KBC FP and KBC's Global Treasury activities, which encompass both the linear and non-linear exposure of the traditional dealing rooms. KBC FP and Global Treasury easily account for the largest part of the Value at Risk (VAR) within the KBC group.

VAR model and characteristics

The VAR method is the principal tool for managing and monitoring market risk exposures in the trading book. Accordingly, VAR is the primary building block of KBC's market risk management framework and regulatory capital calculations.

VAR is defined as an estimate of the amount of economic value that might be lost on a given portfolio due to market risk over a defined holding period, with a given confidence level. The measurement only takes account of the market risk of the current portfolio and does not attempt to capture possible losses due to further trading or hedging, counterparty default or operational losses.

KBC has chosen the Historical VAR (HVAR) approach to generate VAR calculations. KBC's current VAR methodology is based on a 10-day holding period and a 99% one-sided confidence level, with historical data going back 500 working days. The 99% quantile estimator equals the fifth worst loss (1% of 500 scenarios).

KBC captures the entire distribution of losses for its market risk limit framework. The VAR computation is euro-based. In compliance with the BIS (Bank for International Settlements) requirement, KBC uses the 99% confidence level for the calculation of regulatory capital.

The 1-day horizon is calculated for back-testing purposes.

KBC uses the full revaluation method for calculating P/L figures arising in the series of historical simulations for the VAR calculation on a daily basis. The portfolio(s) upon which HVAR is calculated is(are) also revalued under successive shocked scenarios (500 scenarios), with each outcome being compared to the base scenario.

KBC's global treasury activities (referred to as 'KBC Bank' in the table below) and KBC FP account for the largest part of (trading risk) HVAR exposure within KBC group. Their respective quarterly average HVAR outcomes in 2010, compared with 2009, are displayed in the table below.

The HVAR for KBC FP comprises all trading business lines. Business lines and exposures that are more illiquid and have more of a credit character, such as the fund derivatives business, falls outside the scope of HVAR. The fund derivatives business is considered to be a legacy activity (i.e. no new activity) and is monitored on the basis of Key Performance Indicators, for example on the evolution of the strike and redemptions.

Market risk (VAR, 1-day holding period) (in millions of EUR)	KBC Bank[1, 2]	KBC Financial Products[3]
Average, 1Q 2009	10	14
Average, 2Q 2009	8	15
Average, 3Q 2009	6	9
Average, 4Q 2009	6	10
31-12-2009	5	11
Maximum in 2009	13	21
Minimum in 2009	5	6
Average, 1Q 2010	6	9
Average, 2Q 2010	8	9
Average, 3Q 2010	6	8
Average, 4Q 2010	5	8
31-12-2010	4	7
Maximum in 2010	15	13
Minimum in 2010	4	6

1 Excluding 'specific interest rate risk' (measured using other techniques) and swap basis risk.
2 Integrated HVAR (KBL EPB included in 2009, but excluded in 2010). As KBL EPB is active mainly in client facilitation services, and not in proprietary trading, it makes only a slightly contribution to the HVAR for KBC Bank.
3 Excluding the Avebury CDO and Fund Derivatives business line.

To complement the HVAR calculations, which serve as a primary risk measurement tool, Group Value and Risk Management (GVRM) monitors concentrations in a single currency or in equity positions by means of (secondary) FX concentration limits or (secondary) equity concentration limits.

Regulatory acceptance of the VAR model and capital charges for market risk

The 'Approved Internal Model' (i.e. the VAR model accepted by the regulator), which serves as the input for regulatory capital calculations, covers KBC Bank, its branches and CBC. The Belgian regulator (CBFA) prescribes the use of a 10-day VAR with a 99% confidence level for internal model-based regulatory capital requirements.

Both KBC Bank and KBC Financial Products have been authorised by the Belgian regulator to use their respective VAR models to calculate regulatory capital requirements for part of their trading activities. ČSOB (Czech Republic) has also received approval from the local regulator to use its VAR model for capital requirement purposes.

The resulting capital requirements for trading risk at year-end 2009 and year-end 2010 are shown in the table below. The regulatory trading risk capital requirements of local KBC entities that did not receive approval from their respective regulator to use an internal model for capital calculations are measured according to the Standardised approach. The Standardised approach sets out general and specific risk weightings per type of market risk (interest risk, equity risk, FX risk and commodity risk)

In millions of EUR

BASEL II – 31-12-2009	Interest risk[1]	Equity risk[2]	FX risk[3]	Commodity risk	Total
KBC Bank consolidated	212	127	59	4	402
KBL EPB	18	9	12	0	39
BASEL II – 31-12-2010					
KBC Bank consolidated	186	37	37	2	261
KBL EPB	14	0	11	0	26

1. The decrease in capital requirements for interest rate risk are mainly attributed to reduced trading activity and the gradual exclusion of crisis scenarios.
2. The decrease in capital requirements for equity risk is mainly due to reduced capital requirements for Insurance Derivatives at KBC FP and Peel Hunt, since both were sold during 2010..
3. More refined calculations of FX exposure that is subject to the standardised method at KBC Bank together with the gradual exclusion of crisis scenarios where the main contributors to the decrease in FX capital requirements.

Stress testing

As the VAR model cannot encompass all potential extreme events, the VAR calculations are supplemented by stress tests. The VAR model captures potential losses under normal market conditions, where stress tests reflect the impact of exceptional circumstances and events with a low degree of probability.

For Global Treasury, hypothetical (portfolio-dependent and portfolio-independent) scenarios for interest rate (IR), exchange rate (FX), equity (EQ) positions and credit spreads are used. Portfolio-independent stress tests examine the impact of a number of predefined events that simulate changes in the main risk factors, independent of the portfolio position. As for portfolio-dependent stress tests, the major risk factors that influence the value of the position are shifted.

Besides hypothetical stress tests, historical stress tests are carried out that use a number of historical scenarios, going back as far as 1987.

For KBC Financial Products, 3D stress tests, which are simultaneous shifts in spot, volatility and credit spreads, are run on a daily basis. Historical and generic hypothetical stress tests are run on a weekly basis. Stress tests on the CDO portfolio are performed on a quarterly basis. CDO stress tests are performed by stressing the correlation and the level of the credit spreads. Further stress tests are conducted by simulating losses in the underlying collateral pool, based on the current level of the credit spreads.

For business lines that are not included in the HVAR calculations, capital requirements are determined on the basis of the Standardised credit risk regulation. The risk management of the risk drivers of these business lines is performed through scenario and stress analyses.

Back testing

Back testing plays a crucial role in assessing the quality and accuracy of the VAR model, as it compares model-generated risk measures to daily P/L figures. The purpose of the back test is to examine the VAR's ability to predict losses at a given confidence level.

The back-testing process consists of three steps. Firstly, a 'no action P/L' is generated. This is the P/L that the portfolio produces if all positions remain unchanged, but the market data changes to the next day's data. This revenue excludes non-trading components such as commissions and fees, and estimated revenues from intraday trading. Secondly, the 'no action P/L' is compared with the VAR calculated (99%, one-day holding period). The last step entails reporting negative exceptions to the TRPG and GRCOC, where the negative P/L result exceeds the one-day VAR. These negative exceptions are also referred to as outliers. The number of (negative) outliers, reported during an observation period of four quarters, impacts the multiplier used for capital requirement calculations.

Validation and reconciliation

VAR implementation is validated by an independent validation entity. In order to guarantee the quality of transaction data used in the risk calculation engine, a daily reconciliation process has been set up. The transaction data generated by the source system are reconciled with the data used in the risk calculation engine.

Furthermore, the VAR method is reviewed and subjected to a validation exercise by the KBC Risk Validation Unit at least once a year. In addition, the VAR model is audited on a regular basis.

Operational risk management and other non-financial risks

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Operational risks include the risk of fraud, and legal, compliance and tax risks. This definition is similar to the one given in the Basel II Capital Accord and the Capital Requirements Directive.

The impact of incidents on the group's reputation is taken into consideration when establishing vulnerability to operational risk incidents.

For a description of business risk, reputation risk and business continuity management, see heading 'Other non-financial risks' at the end of this section.

Information on legal disputes can be found in Note 36 of the 'Consolidated financial statements' section in the 2010 annual report (see www.kbc.com).

Strategy and processes

KBC has a single, global framework for managing operational risk across the entire group. It consists of a uniform operational risk language embedded in group-wide key controls, one methodology, one set of centrally developed ICT applications, and centralised and decentralised reporting.

The development and implementation of this framework is supported by an extensive operational risk governance model. Covering all entities of the group, the framework was redesigned in 2010 and will gradually be implemented in 2011-2012.

Scope of operational risk management

KBC Group's OPR Framework covers all entities in which KBC, directly or indirectly, holds at least 50% of the shares or in respect of which it has the power *de jure* or *de facto* to exercise a decisive influence on the appointment of the majority of its directors or managers.

Information is presented below on operational risk governance, the tools used to manage operational and other non-financial risks and the capital charges for them.

Operational risk governance

The main precept of operational risk management is that ultimate responsibility for managing operational risk lies with business' line management, which receives support from local operational risk managers, and is supervised by local independent risk functions.

The Group Risk Management Committee (GRMC) advises the Group Executive Committee on the group-wide framework for managing operational risks, and the Group Risk and Capital Oversight Committee (GRCOC) oversees the main operational risks.

Besides these group committees, there are a variety of risk committees at business-unit level and at various group companies. They keep close track of the practical implementation of the operational risk management framework and also take concrete measures either directly or via line management. All departments that are involved in one way or another in managing operational risks can gain access to the risk committees whenever they feel it is necessary.

The Group Value and Risk Management Directorate is primarily responsible for defining the operational risk management framework for the entire group. This framework is submitted to the GRMC and the Group Executive Committee for approval. The directorate is also responsible for overseeing the practical implementation by line management of this framework. In addition, it supervises the quality of the risk management process, analyses the main risk data and reports to the GRCOC.

The Group Value and Risk Management Directorate creates an environment where risk specialists (in various areas, including information risk management, business continuity and disaster recovery, compliance, anti-fraud, legal and tax matters) can work together (setting priorities, using the same language and tools, uniform reporting, etc.). It is assisted by the local value and risk management units, which are likewise independent of the business.

Toolbox for the management of operational risks

KBC uses a number of building blocks for managing operational risks, which cover all aspects of operational risk management. These are:

- *The Loss Event Database*. All operational losses of 1 000 euros or more have been recorded in a central database since 2004. This database includes all legal claims filed against group companies. Consolidated loss reports are regularly submitted to the GRCOC, the Executive Committee and the Audit, Risk and Compliance Committee.
- *Risk Scans (bottom-up and top-down)*. These *self-assessments* focus on actual (= residual) key operational risks at critical points in the process/organisation that are not properly mitigated, and on new or emerging operational risks that are relevant at (sub)group level
- *Group Key Controls*. Around 25 Group Standards have been developed into Group Key Controls to ensure that key operational risks are managed uniformly throughout the group. Each group entity has to translate these key controls into specific procedures that are adapted to the local situation. The various risk committees monitor the proper implementation of the controls and may allow exceptions to be made (subject to the observance of a strict waiver procedure). Adherence to Group Key Controls is subject to reviews by Group Value and Risk Mangement and Internal Audit.
- *Case-Study Assessments*. These are used to test the effectiveness of the protection afforded by existing controls against major operational risks that have actually occurred elsewhere in the financial sector. One such assessment was used to test the internal controls for preventing and identifying rogue trading practices.
- *Key Risk Indicators*. These help monitor the exposure to certain operational risks and track the existence and effectiveness of the internal controls.

Operational risk capital charge

KBC uses the Standard Approach to calculate operational risk capital under Basel II. Operational risk capital for KBC Bank at the consolidated level totalled 860 million euros at the end of 2010 (this figure excludes KBL EPB, which contributes approximately 72 million euros to the total operational risk capital of KBC group).

Other non-financial risks

Business risk

Business risk is the potential negative deviation from the expected economic value arising from changes in the macroeconomic environment, the financial services industry and/or the market for products and services, as well as from inadequacies relating to business resources that impact on business potential.

Risk factors that are taken into consideration include macroeconomic conditions, changes to the law or regulations, competitor actions, changes in distribution channels or distribution models, changed customer needs, human resources issues and ICT resources. Business risk is assessed on the basis of structured risk scans.

KBC reserves a pillar 2 capital charge specifically for business risk. Business risk capital is based on the operating expenses for the various KBC group entities. The portion of operating expenses to be set aside as economic capital for business risk depends on the level of risk attached to the activities of each entity, as determined on the basis of quantitative and qualitative assessments of activities across KBC group entities.

Reputation risk

This is the risk arising from the negative perception on the part of customers, counterparties, shareholders, investors, debt-holders, market analysts, other relevant parties or regulators that can adversely affect a financial institution's ability to maintain existing, or establish new business relationships and continued access to sources of funding (for instance, through the interbank or securitisation markets). Reputation risk is a secondary or derivative risk since it is mostly connected to and will materialise together with another risk.

The pro-active and re-active management of reputation risk is the responsibilty of the business, supported by many specialist units (e.g., the Press Office, Investor Relations). A dedicated knowledge centre for reputation risk management is being established to further develop the current framework for managing this type of risk across the group.

Under the pillar 2 approach to capital adequacy, the impact of reputation risk on the current business is covered in the first place by the capital charge for primary risks (such as credit or operational risk, etc.). It is also covered by the capital reserved for business risk.

Business Continuity Management (BCM)

The Risk Centre of Excellence for Non-financial Risks is responsible for developing a group-wide framework to ensure the continuity of operations. This framework is submitted to the Group Risk Management Committee and the Executive Committee for approval. Via the local value and risk management units, the risk centre of excellence is also responsible for overseeing the practical implementation of this framework by line management. In addition, it supervises the quality of the risk management process, analyses the main risk data and reports to the GRCOC.

A business continuity report, detailing developments in BCM methodology, the BCM readiness of the various group entities and containing an overview of the major incidents, is submitted each year to the Group Risk, Audit and Compliance Committee.

Insurance risk management

Insurance risk is the potential negative deviation from the expected value (of a particular relevant stochastic variable e.g. economic profit or value variable) due to the uncertain frequency or severity of insured losses. This type of risk stems from uncertainty regarding how often insured losses will occur and how extensive they will be. All these risks are kept under control, thanks to (i) appropriate acceptance, pricing, claims reserving, reinsurance and claims settlement policies of line management, and (ii) to independent insurance risk management.

Strategy and processes

The management of insurance risk is founded on the principle that primary responsibility for risk control lies with line management, and that the entities responsible for value and risk management should operate independently of line management. The mission of the Insurance Risk Centre of Excellence in the Group Value and Risk Management Directorate (GVRM) is primarily to develop a group-wide framework for managing insurance risks. The insurance companies have local value and risk management entities that report to their local Chief Risk Officer. At group level, the Insurance Risk Centre of Excellence is responsible for providing support and acting as trusted adviser for local implementation and organisation processes and for the functional direction of the insurance risk management process of these subsidiary entities (assuming an oversight role through 'relationship management').

When organising insurance risk management, special attention needs to be paid to the role of the appointed or certifying actuary, who is expected to be independent of the business. Since risk management responsibilities overlap those of the appointed or certifying actuary to a considerable extent, this actuary is generally (but not always) employed in (local) risk management units.

Scope of insurance risk management

Following entities are in scope: KBC Insurance Belgium, Fidea, Maatschappij voor Brandherverzekering, Sepia, Assurisk, Warta, K&H Insurance, ČSOB Pojišťovna CZ, ČSOB Poisťovňa SK, DZI.

Insurance risk classification

Part of the risk identification process consists of reliably classifying all insurance risks that may be triggered by (re)insurance contracts.
Firstly, all insurance cover provided by (re)insurance companies is classified according to a standardised (European) line of business classification. Traditionally, at the top level, the insurance risks inherent in the life insurance business can be separated from those which are related to the non-life insurance business. Both categories are then further broken down.
Moreover, from a risk identification point of view, a further breakdown for both categories is usually made between catastrophe (accumulation) risks and non-catastrophe risks. This results in four main categories, viz. 'Non-life non-catastrophe risks', 'Life non-catastrophe risks', 'Non-life catastrophe risks' and 'Life catastrophe risks'.

Non-life non-catastrophe risks are split up into three further types of risk:

- The premium risk – the risk that the premium that will be earned next year will not be enough to cover all liabilities resulting from claims in this portfolio, due for instance to the fact that the number of claims will be higher than expected (frequency problem) or the severity of the claims will be higher than expected (severity problem).
- The reserve risk – the risk that the liabilities stemming from claims that have occurred in the past, but have still to be finally settled, will turn out to be more expensive than expected.
- Cost-related risk – the risk that the cost assumptions used in pricing or valuation of insurance liabilities with respect to acquisition costs, administration costs or internal settlement costs, turn out to be too optimistic.

Life non-catastrophe risks are split up into four further types of risk:

- Mortality risk – the risk that the mortality rates used in pricing will turn out to be too low, i.e. people die earlier than expected. This can be a market phenomenon (e.g., the increase in life expectancy is smaller than the one used in pricing) or a specific portfolio problem (e.g., anti-selection, which means the insurer has a lot of bad risks in his portfolio).

- Longevity risk – the opposite of mortality risk, this is the risk that the mortality rates used in pricing life investment products turn out to be too high, i.e. people live longer than expected.
- Health risk – the risk that the part of the premium charged to cover hospitalisation or disability claims is not sufficient, due to a higher number of claims or more expensive claims than expected.
- Expense risk – the risk that the assumptions about acquisition costs and administration costs turn out to be too optimistic (e.g., due to a higher lapse rate in the portfolio).

For the *catastrophe risks*, a distinction is made between natural catastrophes (e.g., wind storms, floods, earthquakes) and man-made catastrophes (e.g., terrorist attacks like 9/11). Not only the non-life, but also the life insurance business can be exposed to catastrophes, such as the pandemic threat of bird flu or accidental events.

Insurance risk measurement

KBC develops models gradually, from the bottom up, for all material group-wide insurance liabilities, i.e. (i) future claims that will occur over a predefined time horizon, as well as the claims settlement pattern, (ii) the future settlement of claims (whether already reported to the insurer or not) that have occurred in the past but have not yet been fully settled, and (iii) the impact of the reinsurance programme on these claims. These models are used to steer the group's insurance entities towards creating more shareholder value by means of applications to calculate economic capital, support decisions on reinsurance, calculate the *ex post* profitability of specific sub-portfolios and set off economic capital requirements against the relevant return in pricing insurance policies.

Insurance risk management has developed an internal model for the group-wide exposure to natural hazards. This model measures most material natural catastrophe risks for all group insurance and reinsurance companies, with account being taken of outward reinsurance (external and intra group). Work is currently being carried out to develop internal models for measuring (non-natural catastrophe) insurance risks. The internally developed models and frameworks follow the Risk Measurement Framework and are validated within this scope by the independent validation unit.

Best estimate valuations of insurance liabilities

As part of its current mission to independently monitor insurance risks, the Insurance Risk Centre of Excellence periodically requires from local entities to carry out in-depth studies (on annual basis in non-life, on quarterly basis in life) as to adequacy of accounting technical provisions. They confirm that there is a high degree of probability that the booked technical provisions at subsidiary level are adequate. These liability adequacy tests are performed per business line at subsidiary level and the overall adequacy is assessed at subsidiary level for all business lines combined.
The techniques used to perform these best estimate valuations will become the foundation of future group-wide insurance liabilities' valuation frameworks to be used within IFRS 4/2 and Solvency 2. Liability adequacy tests will only remain required as long as IFRS4/1 remains in force.

Technical provisions and loss triangles, non-life business

The table shows claims settlement figures in the non-life business over the past few years and includes KBC Insurance NV, Fidea, ČSOB Pojišťovna (Czech Republic), ČSOB Poist'ovňa (Slovak Republic, from financial year 2008), DZI Insurance (from financial year 2008), K&H Insurance, Secura (up to and including financial year 2009), Assurisk (from financial year 2005) and WARTA (from financial year 2004). All provisions for claims to be paid at the close of 2010 have been included. The claims-settlement figures incorporate all amounts that can be allocated to individual claims, including the Incurred But Not Reported (IBNR) and Incurred But Not Enough Reserved (IBNER) provisions, and the external handling expenses for settling claims, but do not include internal claims settlement expenses and provisions for amounts expected to be recovered. The figures included are before reinsurance and have not been adjusted to eliminate intercompany amounts.

The first row in the table shows the total claims burden (claims paid plus provisions) for the claims that occurred during a particular year, as estimated at the end of the year of occurrence. The following rows indicate the situation at the end of the subsequent calendar years. The amounts were restated to reflect exchange rates at year-end 2010.

Loss triangles, KBC Insurance - In millions of EUR

	Year of occurrence									
	2001	2002	2003	2004[1]	2005[2]	2006	2007	2008[3]	2009	2010
Estimate at the end of the year of occurrence	816	933	774	1 080	1 110	1 194	1 267	1 400	1 480	1 477
1 year later	759	820	796	982	1 014	1 083	1 174	1 345	1 185	-
2 years later	709	830	763	938	978	1 055	1 132	1 180	–	-
3 years later	729	824	743	924	977	1 041	1 000	–	–	-
4 years later	721	814	727	915	958	906	–	–	–	-
5 years later	709	799	699	910	871	–	–	–	–	-
6 years later	715	793	691	851	–	–	–	–	–	-
7 years later	711	787	652	–	–	–	–	–	–	-
8 years later	713	755	–	–	–	–	–	–	–	-
9 years later	674	-	-	-	-	-	-	-	-	-
Current estimate	674	755	652	851	871	906	1 000	1 180	1 185	1 477
Cumulative payments	-590	-667	-565	-735	-729	-747	-791	-912	-801	-626
Current provisions	84	88	86	116	142	160	208	268	384	851

1 From the 2004 financial year, WARTA's figures have been included. If this company had not been taken into account, the following amounts would have been arrived at for financial year 2004 (amount and year of occurrence): 695 for 2001; 780 for 2002; and 690 for 2003.
2 From the 2005 financial year, Assurisk's figures have been included. If these figures had not been taken into account, the following amounts would have been arrived at for financial year 2005 (amount and year of occurrence): 715 for 2001; 816 for 2002; 761 for 2003; and 953 for 2004.
3 From the 2008 financial year, the figures for ČSOB Poist'ovňa (Slovak Republic) and DZI Insurance (Bulgaria) have been included. If these figures had not been taken into account, the following amounts would have been arrived at for financial year 2008 (amount and year of occurrence): 710 for 2001; 791 for 2002; 696 for 2003; 912 for 2004; 960 for 2005; 1 039 for 2006 and 1 132 for 2007.

Stress testing & scenario analysis

The sensitivity of the actual technical insurance results to extreme events has been tested in the past, for instance, under the International Monetary Fund's 'Financial Sector Assessment Program'. It is currently subject to the EIOPA's uniform stress tests for insurance companies. Scenarios are used to estimate, for example, the impact, on a gross and net of reinsurance basis, of claims that are twice as large as the ones generated by the most significant natural disaster of the last 20 years (the Daria wind storm of 1990), of a non-life loss ratio equalling 150% of the worst loss ratio of the past 10 years, of upward and downward shocks of 20% to the lapse rates of life contracts, etc.

KBC's internal natural catastrophe models are able to estimate the anticipated claim costs, should natural catastrophes that have been observed in the past occur again today. Moreover, they can determine the expected impact on bottom-line economic profit of natural catastrophe events, which are expected to occur on average only once within a given time frame (e.g., 100 or 250 years).

The potential impact of stressed scenarios relating to terrorist attacks and pandemics are calculated and reported on an annual basis.
For the life insurance business, a sensitivity analysis is typically performed within the framework of the annual calculation of the embedded value. The results for three types of sensitivity to insurance risk are reported, viz. 'mortality rate: plus and minus 5%', 'lapses: plus and minus 10%', 'expenses: plus and minus 10%'.

Other stress testing exercises may be performed on an ad-hoc basis.

Insurance risk mitigation

The insurance portfolios are protected against the impact of serious claims or the accumulation of losses (due, for instance, to a concentration of insured risks) by means of reinsurance. These reinsurance programmes are divided up into three main groups: property insurance, liability insurance and personal insurance, which are re-evaluated and renegotiated every year.

Most of the reinsurance contracts are concluded on a non-proportional basis, which provides cover against the impact of serious claims or loss events. The independent insurance risk management function is also responsible for advising on the restructuring of the reinsurance programmes, especially with a view to creating shareholder value. This approach has resulted in optimising the retention of the KBC group particularly in respect of its exposure to natural catastrophe risk.

Further information on the insurance activities of the group can be found under Notes 9, 10, 11 and 35 in the 'Consolidated financial statements' section of the 2010 annual report of KBC Group. A breakdown by business unit of earned premiums and technical charges is provided in the notes dealing with segment reporting.

Glossary

ABS (Asset Backed Securities)

ABS are bonds or notes backed by loans or accounts receivables originated by providers of credit such as banks and credit card companies. Typically, the originator of the loans or accounts receivables transfers the credit risk to a trust, which pools these assets and repackages them as securities. These securities are then underwritten by brokerage firms, which offer them to the public.

Add-On

Basel-II-defined factor to reflect the potential future increase in exposure stemming from derivatives transactions.

ALM (Asset and Liability Management)

The ongoing process of formulating, implementing, monitoring and revising strategies for on-balance-sheet as well as on off-balance-sheet items, in order to achieve an organisation's financial objectives, given the organisation's risk tolerance and other constraints.

Alt-A

A classification of mortgages considered riskier than prime, but less risky than subprime. As a result of the subprime crisis, Alt-A mortgages came under particular scrutiny.

Asset class

A classification of credit exposures according to the Capital Requirements Directive – IRB approach. The main classes are Sovereigns, Institutions, Corporates, SME Corporates and Retail. Classification depends on the type of obligor, the total annual sales of the obligor, the type of product and the exposure value.

Banking book

KBC's banking book is defined as all positions in the KBC Bank group that are not in the trading book. A trading book consists of positions in financial instruments and commodities held either with trading intent or in order to hedge other elements of the trading book. To be eligible for trading book capital treatment, financial instruments must either be free of any covenants restricting their tradability or be able to be hedged completely. In addition, positions should be frequently and accurately valued, and the portfolio actively managed.

Beta factor

The capital charge for a business line in the context of operational risk is approximated by multiplying the gross income of that business line with the beta (ß) factor. Thus the ß factor serves as a proxy for the industry-wide relationship between the operational risk loss experience for a given business line and the aggregate level of gross income of that business line.

BIS (Bank for International Settlements)

The Bank for International Settlements (BIS) is an international organisation that fosters cooperation towards monetary and financial stability and serves as a bank for central banks. It is the world's oldest international financial institution and remains to this day the principal centre for international central bank cooperation. (Website BIS: www.bis.org).

BPV (Basis Point Value)

The measure that reflects the change in the net present value of interest rate positions, due to an upward parallel shift of 10 basis points (i.e. 0.10%) in the zero coupon curve.

Business risk

Business risk is the potential negative deviation from the expected economic value arising from changes in the macroeconomic environment, the financial services industry and/or the market for products and services, as well as from inadequacies relating to business resources that impact future business potential.

CAD ratio

Total eligible capital / Risk-weighted assets (the result must be at least 8% according to the Basel regulations)

CDO (Collateralised Debt Obligation)

CDOs are a type of asset-backed security and a structured finance product in which a distinct legal entity, a special purpose vehicle (SPV), issues bonds or notes against an investment in an underlying asset pool. Pools may differ with regard to the nature of their underlying assets and can be collateralised either by a portfolio of bonds, loans and other debt obligations, or be backed by synthetic credit exposures through use of credit derivatives and credit-linked notes.

The claims issued against the collateral pool of assets are prioritised in order of seniority by creating different tranches of debt securities, including one or more investment grade classes and an equity/first loss tranche. Senior claims are insulated from default risk to the extent that the more junior tranches absorb credit losses first. As a result, each tranche has a different priority of payment of interest and/or principal and may thus have a different rating.

CDS (Credit Default Swap)

A privately negotiated bilateral agreement where one party (the protection-buyer or risk-shedder) pays a premium to another party (the protection-seller or risk-taker) in order to secure protection against any losses that may be incurred through exposure to a reference entity or investment as a result of an unforeseen development (or 'credit event').

CEBS (Committee of European Banking Supervisors)

This committee was succeeded by the EBA (European Banking Authority).

Central Tendency

Average through-the-cycle default probability of a segment.

CLO (Collateralised Loan Obligation)

CDO holding only loans as underlying assets.

CP (Commercial Paper)

Unsecured short-term promissory notes which generally have maturities of less than 270 days.

CRD (Capital Requirements Directive)

European Union-specific interpretation of the general Basel II regulations. The CRD is in its turn translated into national legislation and regulation of the EU countries.

Credit risk

Credit risk is the potential negative deviation from the expected value of a financial instrument due to non-payment or non-performance of a borrower (of a loan), an issuer (of a debt instrument), a guarantor or re-insurer, or a counterparty (in a professional transaction), due to that party's insolvency or lack of willingness to pay or perform, or to events or measures taken by the political or monetary authorities of a particular country (the latter is also referred to as country risk).

Cure rate

Rate of clients who default and revert subsequently to ‘non-default’ status.

Downturn LGD

LGD in an economic downturn. The underlying idea in the Basel regulation is that LGD is correlated to PD and loss rates will be higher in a year with many defaults.

DPF (Discretionary Participation Feature)

Part of the annual profit that is attributed to the policyholders of an insurance contract.

EAD (Exposure At Default)

The amount expected to be outstanding if and when an obligor defaults. At the time of default, it is equal to the actual amount outstanding, and therefore is no longer an expectation.

EBA (European Banking Authority)

Committee comprised of high level representatives from the banking supervisory authorities and central banks of the European Union. It gives advice to the European Commission on banking policy issues and promotes cooperation and convergence of supervisory practice across the European Union. The Committee will also foster and review common implementation and consistent application of Community legislation.

ECAP (Economic Capital)

KBC Economic Capital (ECap) is defined as the unexpected loss in the fair value of the KBC group (= difference between the expected and worst case fair value). It is the minimum amount of capital that has to be available in order to protect the KBC group against economic insolvency.

EL (Expected Loss)

The expected value of losses due to default over a specified horizon. EL is typically calculated by multiplying the Probability of Default (a percentage) by the Exposure At Default (an amount) and Loss Given Default (a percentage). It is always considered 'an expectation' due to the 'Probability of Default' factor.

Fair value

The amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction. Market-consistent value or fair value is based on relative pricing or the ‘no arbitrage' argument.

GMRA (General Master Repurchase Agreement)

Standardised contract used when entering into (reverse) repo-like transactions.

GRCOC (Group Risk and Capital Oversight Committee)

Overarching and integrated risk committee at KBC group level that o.a. monitors the integrated risk profile, proposes to the Group Exco mitigating measures when the risk profile exceeds the limits of the risk appetite.

GRMC (Group Risk Management Committee)

Overarching and integrated risk committee at KBC group level that o.a. monitors and ensures the adequacy of risk and capital governance, manages and supervises model frameworks and their implementation.

GVRM (Group Value and Risk Management)

Directorate at KBC group level who's mission it is to independently of the line and in keeping with advanced industry standards to create a Group-wide framework for value, risk and capital management, monitor the implementation of this framework, and provide assistance to the line on the use of value and risk management instruments and techniques.

Haircuts

The difference between the market value of a security and its collateral value. Haircuts are taken in order to account for a possible decline in the market value of a collateralising security upon liquidation.

HVAR (Historical Value At Risk)

Historical Value-at-Risk estimates the maximum amount of money that can be lost on a given portfolio due to adverse market movements over a defined holding period, with a given confidence level and using real historical market performance data.

ICAAP (Internal Capital Adequacy Assessment Process)

The internal process a bank should have in place for assessing its overall capital adequacy in relation to its risk profile, as well as its strategy for maintaining adequate capital levels in the future.

Insurance Risk

Insurance risks stem from uncertainty regarding how often insured losses will occur and how extensive they will be.

Interest rate risk

The potential negative deviation from the expected net asset value of the trading book or the financial investment book due to changes in the level or in the volatility of interest rates.

IRB (Internal Ratings-Based)

An approach defined in the Capital Requirements Directive to calculate the credit-risk-related capital requirements, where a financial institution uses its own models to perform the calculation. There are two possibilities: the IRB Foundation or the IRB Advanced approach. When applying the IRB Foundation approach, internal estimates of the Probability of Default are used to calculate minimum requirements, while the IRB Advanced methodology also takes into account the internal estimates of Exposure At Default and Loss Given Default.

ISDA Master Agreements

Standardised contracts developed by the ISDA (International Swaps and Derivatives Association) used to document bilateral professional transactions. The presence of such contracts also allows professional exposures between the contracting parties to be netted.

LAPA (Liquidity Asset Purchase Agreement)

An agreement to purchase an asset on a firm commitment basis when requested.

Lapse risk

Lapse risk is the risk that the policy holder will end his policy before the maturity date. In modern universal life business where regular premium payments are used, the lapse risk includes the risk of dormancy. Dormancy occurs when policyholders pay less or stop paying premiums on an existing contract.

LGD (Loss Given Default)

The loss a bank expects to experience if an obligor defaults, taking into account the eligible collateral and guarantees provided for the exposure. It can be expressed as an amount or as a percentage of the EAD (Exposure At Default). At the time of default, the loss experienced is a loss of the actual amount outstanding, thus no longer an expectation.

Liquidity risk

The potential that an organisation will be unable to meet its obligations as they fall due because of the inability to liquidate assets or obtain adequate funding (liability liquidity risk) or the risk that it cannot easily unwind or offset specific exposures without significantly lowering market prices because of inadequate market depth or market disruptions (asset liquidity risk).

Market risk

Market risk is the potential negative deviation from the expected economic value of a financial instrument caused by fluctuations in market prices, i.e. interest rates, exchange rates and equity or commodity prices.

Market value

The cost that would be incurred or the gain that would be realised if an outstanding contract was replaced at current market prices (also called replacement value).

Mark-to-Market

The act of assigning a market value to an asset

MVA (Market Value Adjustment)

IFRS-inspired adjustments or reserves recognised on positions at fair value. MVAs cover close-out costs, adjustments for less liquid positions or markets, counterparty exposure resulting from OTC derivatives, model-linked valuation adjustments, operation-related costs, as well as transaction-specific adjustments.

Netting

An agreed offsetting of positions or obligations by trading partners or participants to an agreement. Netting reduces the number of individual positions or obligations subject to an agreement to a single obligation or position.

ODR (Observed Default Rate)

The observed default rate is the observed number of defaulted obligors during a certain time period as a percentage of the total non-defaulted obligors at the beginning of the period.

Operational Risk

The potential negative deviation from the expected economic value of the organisation resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal, IT and tax risk.

OTC (Over The Counter)

An over-the-counter contract is a bilateral contract where two parties agree on how a particular trade or agreement is to be settled in the future. It is usually a direct contract between a (an investment) bank and its clients. It contrasts with exchange trading.

PD (Probability of Default)

The probability that an obligor will default within a one-year horizon.

PIT PD (Point-In-Time PD)

PD reflecting the expected default rate in the next year, based on current economic conditions, in contrast to Through-the-cycle PD.

RAROC

A measure, expressed as a percentage, used to reflect the profitability of transactions and/or financial instruments, account taken of the risk involved in these transactions and/or financial instruments. Roughly speaking, it equals the 'expected profits minus the expected losses' divided by the capital invested.

RBA (Ratings-Based Approach)

Basel II approach for calculating the risk-weighted assets applied to securitisation exposures that are externally rated, or where a rating can be inferred.

RMBS (Residential Mortgage-Backed Security)

A type of structured credit product whose underlying assets are residential debt such as mortgages, home-equity loans and subprime mortgages.

RWA (Risk-Weighted Asset)

An exposure weighted according to the 'riskiness' of the asset concerned. 'Riskiness' depends on factors such as the probability of default by the obligor, the amount of collateral or guarantees and the maturity of the exposure.

SFA (Supervisory Formula Approach)

Basel II approach used to calculate the risk-weighted assets of a structured credit product based on a formula defined in the Basel II securitisation framework.

SPV (Special Purpose Vehicle)

A Special Purpose Vehicle in the context of this document is any distinct entity created to achieve (a) narrow and well-defined objective(s). SPVs may be created by the KBC group, managed by the KBC group, created by third parties for the account of the KBC group or managed by third parties for the account of the KBC group.

SSS (Super Senior Swap)

In the so-called unfunded portion of a synthetic CDO, the risk embedded in a portfolio of assets (as opposed to the assets themselves) is transferred directly to a 'super-senior counterparty' via a super-senior CDS. In this instance, the CDO acts as the protection-buyer, by agreeing to pay a premium to the counterparty (the protection-seller) in return for a commitment from the counterparty to pay compensation to the CDO in the event of any defaults in the reference portfolio. It is the best part in terms of subordination.

Trading book

The trading book consists of positions in financial instruments and commodities held either with trading intent or in order to hedge other elements of the trading book. Positions held for trading intent are those held intentionally for resale in the short term and/or with the intent of benefiting from actual or expected price movements in the short term or to lock in arbitrage profits.

TTC PD (Through-The-Cycle PD)

PD reflecting the one-year expected default rate averaged out over a longer period, in contrast to Point-in-time PD.

VAR (Value At Risk)

The unexpected loss in the fair value of the Group (= difference between the expected and worst case fair value), with a certain confidence level and a certain time horizon